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The Loyalty Trap

2017 | Stephen Shaw

Ever since reward programs first became popular over fifty years ago, marketers have been trapped into thinking that customer loyalty can be bought. But customers today are looking for more than just rewards – they want to be treated honestly and fairly.

She jokingly refers to it as her “hobby”.

Every weekend, before heading out to shop, she scans the grocery and drug store flyers in search of deals. But she’s not looking for ordinary coupons and discounts – she’s searching for Air Miles offers. She is an avid points collector, hooked on earning miles, and loves to play the loyalty game: taking advantage of bonus miles and special promotions, just so she can cash them in for free trips. A typical calculation might go something like this: “Robaxacet Platinum gets me 10 miles for buying two. But that’s still pretty expensive. If I wait for the drug store’s standard deal – spend a total of $50 to get 100 miles – am I further ahead?”

She works diligently at collecting those miles – so diligently in fact that when Air Miles occasionally bungles a transaction by failing to award her the right number of miles, she’s instantly on the phone to them, demanding a correction. Of course, whenever she has to wait longer than necessary “due to unexpected call volume”, which is much of the time, her indignation grows by the minute. Even more bothersome: the ordeal she has to go through to redeem those hard-earned miles. The available inventory of flights is so restrictive she sometimes must surrender more miles than she would like just to get her preferred booking. Yet, in spite of those hurdles, she responds with glee when she hits the 6,000-mile mark and qualifies for the ONYX tier.

This actual profile of an Air Miles Collector helps explain the addictive appeal of reward programs in Canada. There are tens of millions of shoppers just like her, many even more extreme in the lengths they’ll go to maximize their miles and points: registering for every promotion they see; paying for everything on their point-earning card(s); carrying multiple cards so they can switch over the moment they hit the top tier; signing up to get the one-time bonus points and then immediately cancelling the card; “double dipping” by earning miles twice in one purchase; and much more.

The coalition program Air Miles dominates loyalty marketing in Canada with 9 million “collectors”

Catering to these collectors is a wide range of companies, from coalition loyalty programs like Air Miles and Aimia, to rewards aggregators, to mass merchandise retailers such as Canadian Tire and HBC, to the grocers and pharmacies, to airlines and travel credit cards, to booksellers, hotels, cinemas, casinos, restaurants and car rental companies – all investing in loyalty management systems and infrastructure to feed this gaming addiction. The question marketers need to ask themselves: what does any of this have to do with customer loyalty?

Surprise Windfall

The loyalty business, as we know it today, grew out of a simple goal: drive repeat purchase using promotional incentives. If you were a grocery shopper back in the 1960s, for example, you could collect "stamps" based on the amount of your purchase which you collected in a book. When the book was full you could exchange it for catalog merchandise like housewares. For very little effort, budget-minded shoppers could earn a tangible reward, making trading stamp programs extremely popular at the time. As a result, they became the model for frequency marketing.

The appetite for miles turned into an unexpected windfall for the airlines

Canadian Tire introduced its venerable loyalty program in 1958, using a unique form of reward: a pseudo-currency called "Canadian Tire Money". Originally awarded just for fill-ups at its gas stations, the aim of the program was to compete against the standard promotional giveaways of the oil giants without sparking an open price war. The "cash bonus" coupons became so popular that the program was expanded to the retail stores, when they started to be printed on genuine bank note paper, making them feel like real money. A testament to their enduring appeal is the fact that shoppers still love collecting printed "money" even today, despite the successful launch of a card-based digital loyalty program in 2014.

In 1981 American Airlines created the first airline mileage program. It was a frantic response to the fare wars that broke out following industry deregulation when seat prices were being driven down by smaller gadfly competitors. The airline wanted a "barrier to exit" that would inhibit their frequent fliers from switching carriers. The concept took off and soon after the other major airlines were offering programs of their own, including Air Canada which launched Aeroplan in 1984. As the airlines quickly realized, the real value of these programs was not simply filling otherwise empty seats: it was the ability to link booking data to individual passengers. At last they could identify their most valuable fliers, mostly "road warriors" flying on business, ushering in the age of tiered loyalty programs.

The highly popular Green Stamp programs of the 1960s were the original form of frequency marketing.

The other major discovery: the airlines could sell their mileage currency to co-branded credit cards, travel partners and affiliate networks for many times the marginal seat cost. The appetite for miles turned into an unexpected windfall for the airlines, spawning an entire ecosystem of buyers and resellers. Today the sale of miles is a multi-billion-dollar source of ancillary revenue for the airlines with profit margins that would make the drug cartel blush.

The unfettered sale of miles had unforeseen consequences for the airlines

Unforeseen Consequences

In Canada, the Air Miles program was launched in 1992, patterned after a coalition model born in the U.K.. The formula was highly appealing to coalition sponsors: enjoying category exclusivity, they could buy flight rewards for their customers without the onerous expense of operating a "me-too" loyalty program. Linked to fast-earning accumulation opportunities in groceries, gas, and credit cards, the Air Miles loyalty card quickly won a favored spot in most people's wallets, eventually carried by two-thirds of Canadian households. "They came in at a time when it was complicated and difficult to build a loyalty program and they did it right," recalls Steve Allmen, who heads up a Toronto-based loyalty consulting firm called Loyalty & Co.

The unfettered sale of miles had unforeseen consequences for the airlines. All of those "saved" miles became a ballooning liability at a time when the airline industry was being hammered by rising fuel costs and the pesky emergence of no-frill airlines. The major airlines wanted out – but no one was brave enough to go first. Under earnings pressure, they began to limit seat availability, frustrating collectors trying to redeem their points. Instead of feeling positive about their redemption experience, members began to get resentful. Partly in response to souring attitudes, airlines have now started to award points based on dollars spent instead of distance flown, placating the more profitable members.

The promise of a free flight is still prized above all other rewards for its high perceived value

In 2002 a bankrupt Air Canada spun off its Aeroplan program as a separate entity, anxious to offload the points liability while still benefiting from the insatiable market demand for miles. Groupe Aeroplan, as the company was now called, later acquired the U.K.-based coalition program Nectar, and in 2011 renamed itself Aimia. By that point Air Canada had become just one of many reward suppliers, albeit the most indispensable, accounting for 75% of redemptions. The promise of a free flight is still prized above all other rewards for its high perceived value, notwithstanding the redemption hurdles and booking restrictions.

When Air Canada announced in the spring of 2017 that it was repatriating its loyalty program - to the dismay of Aimia stockholders – the decision rocked the industry. The ostensible reason for the take-back: to restore control over the quality of the member experience. A more plausible reason: to regain control over the member transactional data. "Control the data, control the experience, control the consumer, control the brand, generate the revenue," explains Steve Allmen, a former AIMIA executive himself.

TRANSACTIONS	RELATIONSHIPS
Reward Management • Tiered rewards • Card-linked offers • Bonus point offers • Bundled offers • Contextual offers • Affinity offers • Partner offers	**Member Management** • Appreciation events • First-look previews • Concierge services • Personalized content • Badges/honorariums • Experiential rewards • Automatic upgrades
Promotion Management • Downloadable coupons • Daily deals • Instant discounts • Cash back • Location-based offers • Event offers	**Experience Management** • Expedited delivery • Service privileges • Mobile checkout/payment • Alerts/notifications • Product help/tutorials • Relationship pricing

The mix of program elements must include both transactional and loyalty drivers designed to enhance the customer experience.

Synthetic Loyalty

Membership data is invaluable, as the grocery trade found out years ago, embracing a loyalty model first pioneered by the British supermarket giant Tesco in the mid-1990s. Tesco proved through its analytical rigor that its Clubcard database could be a rich source of shopper insight, not only improving the precision of its promotional targeting, but helping to guide assortment planning and category management as well. The grocer saw a significant spending lift by introducing members to new categories – encouraging them to load up on select items – and promoting ancillary purchases.

In the U.S. Kroger's loyalty program is rated the best in the grocery business, with Kroger Plus cardholders accounting for almost all purchases. The healthy growth of the company in a notoriously cut-throat industry is testament to the power of shopper loyalty, especially compared to the current financial woes of Canadian grocers.

Typically, grocery loyalty programs operate as an extension of trade promotions. Grocers cover 30%-50% of program costs through manufacturer trade funds (“Buy 2, Get 1 Free!”). The CPG manufacturers buy loyalty points which are used to target segmented members with bonus offers that can be downloaded to their loyalty cards – certainly a better deal than buying space in weekly flyers, where they are obliged to give all shoppers the same discount, subsidizing already heavy users.

A whole generation of deal-seeking shoppers has been trained to buy on price

The recent merger of Loblaw’s PC Plus with the Shoppers Optimum program takes that personalization capability to a whole new level, creating Canada’s largest transactional consumer database (estimated to be 12 million unique members) for the explicit purpose of growing the shopping basket. Expect to see the “database wars” heat up between Metro, Sobey’s and Loblaw over the next few years, as they battle to lock in shopper loyalty, petrified by the specter of Amazon snatching their customers away.

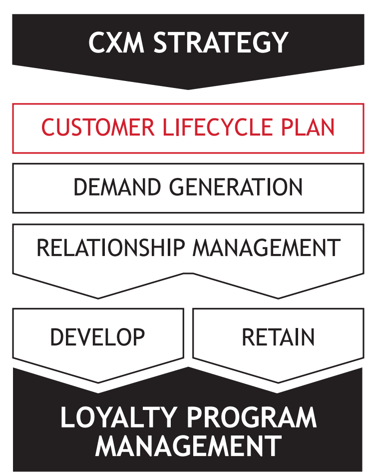
Grocers are not the only ones fixated on point-based rewards – the same mind-set pervades the entire retail trade (which operates half of all loyalty programs). A whole generation of deal-seeking shoppers has been trained to buy on price while off-price and e-commerce retailers have become the first default stop on the buying journey. Cynical shoppers choose to play the loyalty game, knowing their own dollars are being used to seduce them (“Get 5,000 Bonus Points When You Spend $40 or More on Almost Anything in the Store!”).

Collecting points is certainly more fun than clipping coupons, which explains why loyalty program memberships in Canada grew 35% last year, according to one study. Almost every Canadian belongs to at least one program – usually, a half dozen or so in which they are active (seven seems to be the saturation point after which activity tails off). But enrollment figures mask a worrisome trend: active program participation has declined. Few members are very satisfied with their experience – finding it too hard to earn meaningful rewards, too frustrating to deal with customer support, too arduous to redeem their points. And many members are only vaguely aware of their point balance if at all.

The “earn and burn” design reduces the relationship to a contractual deal

Those unredeemed points keep piling up as well, worth as much as $16 billion according to one estimate, much to the exasperation of Canadian loyalty operators. Air Miles alone reported a deferred redemption liability of $245 million in 2016 (although it normally counts on a historical breakage rate of 20%). The urge to reduce that liability led LoyaltyOne, the owner of the program, to bring in a 5-year point expiry policy in 2016, causing an immediate public backlash and forcing the company into a quick retreat. This shortsighted gambit also provoked new government legislation to protect loyalty members from voidance of their points.

But the harshest indictment of reward programs is this: just 15% of the membership population believe those programs improve their brand experience. The “earn and burn” design reduces the relationship to a contractual deal, making customers feel neither valued nor special.



The loyalty program strategy should be connected to a broader customer experience plan which sets out the guiding principles and framework for management of the relationship over time.

It simply creates what's been termed "synthetic loyalty", devoid of emotion. The reward program is just another way for members to save money. The cumulative effect: erosion of brand loyalty and mounting consternation with the stealth devaluation of point values. The member attitude toward most programs can be summed up in one word: "Meh".

"One of the best lines I ever heard", says Steve Allmen, "is you can have the best loyalty program in the world without points, and you can have the best rewards program in the world without loyalty."

A growing trust deficit lies at the heart of the loyalty crisis

The Trust Deficit

Is true brand loyalty even possible in an age when shoppers are more price sensitive than ever, and actively compare prices online and in-store before making a purchase? True loyalty is an emotional state of mind – a feeling of trust in the integrity of the relationship. It means more than simply "give and get": it means "You care"; it means "You understand me"; it means "You make me feel special". Loyalty is an outcome, not a program. But the real payoff is not "word of mouth" or "likelihood to recommend" or "positive reviews" or "willingness to pay a premium" – it is, simply, a belief that the brand is trustworthy.

Observes the renowned 'trust philosopher' Onora O'Neill: "Let me give you a simple commercial example. The shop where I buy my socks says I may take them back, and they don't ask any questions. They take them back and give me the money or give me the pair of socks of the color I wanted. That's super. I trust them because they have made themselves vulnerable to me."

The honesty of the experience is what matters. Being reliable matters. Acting socially responsible matters. But that's the problem: fewer and fewer people trust businesses to do the right thing. A growing trust deficit lies at the heart of the loyalty crisis: to overcome it, to win greater loyalty – true loyalty – companies must be more trustworthy. The word "loyalty" has been tarnished by years of misuse, by avarice, by promotional flimflam.

The goal of a loyalty program should be to create a rewarding experience for customers at every stage of the lifecycle.

A reformation movement is needed – a reinvention of the loyalty model – centered around the customer experience.

The obvious starting point is to think beyond discounts and points. It begins by asking the right strategic questions: How do we show appreciation to our best customers? How do we make the enrollment and onboarding experience special? How do we add value to our everyday interactions with customers? How do we guide our customers unobtrusively toward the right decisions based on shared information? How do we take up causes our customers believe in? How do we inspire them through our actions? How do we build community spirit? How do we show authentic gestures of support? How do we help our customer in ways that align with our brand purpose? Most important of all: How do we make it easier for customers to like us?

A loyalty strategy will start to take shape from the answers to those questions. That strategy should be a sub-set of a broader customer lifecycle plan, with goals tied to both behavioral indicators of loyalty (such as member retention, year-over-year spending growth and brand participation) as well as attitudinal benchmarks (net promoter score being the most obvious example). The loyalty scorecard should include both program health measures and longitudinal indicators of success such as increased commitment and advocacy. Even a 20% bump in member value can make the investment worthwhile, not to mention the goodwill a program creates amongst its repeat customers, provided it offers them something more than simply dollars off their next purchase.

Core Principles

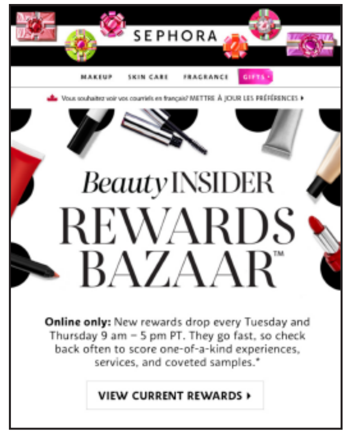
A "next generation" loyalty model must satisfy three distinct time dimensions of the customer experience: "**Point-in-Time**", meaning real-time, mobile-driven interactions; "**Over Time**", meaning the recognition and appreciation of customers over the full relationship lifecycle; and "**All the Time**", meaning the "anywhere, anytime" versatility of the business in supporting the pre-shop, on-premise and post-sale experience.

The exact mix of program elements is, of course, dictated by the loyalty financial model. But certain operating principles are intrinsic to success:

- **Members should be made to feel special**: by offering "behind the scenes" access to events, "front-of-the-line" privileges or invitations to join "advisory panels".
- **Members should feel recognized**: by tailoring communications and offers to individuals based on their relationship history and preferences.
- **Members should feel a sense of belonging**: by making it easy to connect with like-minded members who relish sharing stories and experiences as brand loyalists.
- **Members should have fun**: by "gamifying" the experience through performance incentives and honorariums and by offering rewards for participatory activities.
- **Members should feel truly rewarded for their efforts**: by offering both experiential rewards (unique experiences, unattainable otherwise) and variable currency based on member longevity and value.

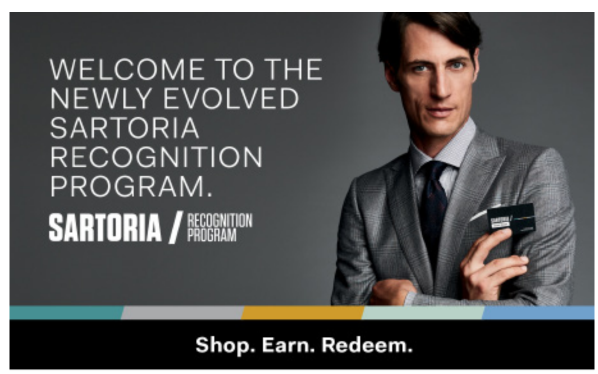
The best programs make customers feel connected to the brand

The best programs today – like Starbuck Rewards, Sephora Beauty Insider, Nike+, MyPanera – incorporate many of these principles and excel at encouraging high levels of engagement. Contests, surveys, mobile apps, social sharing, location-based offers, "daily deal" alerts – all are effective at sustaining interest and participation in the program. But more than that, the best programs make customers feel connected to the brand. They become an integral part of the brand experience, making customers feel valued – important – understood.



The Sephora program has won a devoted fan base with a rich mix of personalization, tiered rewards and exclusive entitlements for VIB members.

Small gestures, made often enough, have a disproportionate impact on customer loyalty. When Harry Rosen reminds a high-value customer of an exclusive advance sale, and makes it easy in the body of the e-mail announcement to book an appointment directly with a personal "clothing consultant", the feeling it evokes is appreciation for the ease and convenience,



The Harry Rosen Sartoria Reward Program offers five status tiers based on total annual spending (the highest is Platinum Elite at $10 thousand and above).

especially when that sales associate responds almost immediately. When Singapore Airlines remembers that special drink a VIP member craves, and has it ready for them on take-off, the passenger feels thrilled to fly with them. When members of "Inspire", the Quebec liquor board program, are notified of limited-run wines and new arrivals which match their taste profile, they are thankful for the courtesy.

The business case for a loyalty program is irrefutable: members will almost always out-spend non-members, due to the regular communication of personalized offers, and show greater affinity for the brand, making them more open to hearing about new products. But the program must be designed to augment the customer experience, not take the place of it. Otherwise customers will become loyal to the program and not the brand (which is the compromise coalition reward sponsors must make). The best loyalty program in the world will never make up for indifferent service or inadequate merchandise.

Marketers need to shift the strategic emphasis of loyalty programs from issuing rewards to designing a rewarding experience. At that point, the lines will blur between the membership experience and how customers experience the brand. Companies will have learned to be loyal to their customers just by treating them honestly and fairly – and those customers will be loyal in return.

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The scale and complexity of managing a reward loyalty program demands a clear business rationalization and dedicated management infrastructure.