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Show Me the Loyalty

Affinity programs are meant to create a stronger bond with customers. But how effective are they at improving customer fidelity and profits?

By Christopher Caggiano

I'm no psychic, but I can probably guess what's in your wallet. Chances are it's stuffed with loyalty cards from this airline and that hotel, not to mention a handful of point-accruing credit cards. And your key chain probably has a few hanging versions of the same—video store tag, gas station "quick pass," grocery store card. You probably belong to more loyalty groups than you can count.

Do you really think your customers are any different? It's hard to expect your affinity program to inspire loyalty when all of its members carry your competitors' cards as well.

Face it: Loyalty programs have reached the saturation stage. The first-mover advantage gained by the pioneers in this field is long past. Now as common as kudzu, affinity programs have lost their distinction and, as a result, much of their value.

"They're a necessity, like clean sheets and Internet access," says Martha Rogers, founding partner of the Peppers & Rogers Group. "If they don't reward the development of a learning relationship between the company and the customer, they wind up being a crummy deal for the company, and they don't always add much value for the customers either."

At best, any improvements to these programs only raise the bar incrementally for your competitors. At worst, programs are often founded upon spurious reasoning and don't yet have any measurable impact on customer loyalty, contends Frederick Reichheld, a fellow at Bain & Co. and author of Loyalty Rules. "They're just promotional gimmicks and bribes to motivate short-term customer behavior," he says.

The trouble is that loyalty programs are a cinch to launch but a bear to manage. "You're dealing with consumer behavior, and behavior changes by definition," says Michael Capizzi, vice president of Frequency Marketing, a loyalty marketing provider.

"So you have to keep programs fresh. They need to follow an evolutionary path, or they wither away."

Challenge though they may be to execute, effective loyalty programs can have a significant impact on the bottom line. A Bain study shows that improving customer retention by as little as 5 percent can yield an increase in customer net-present value (cash in minus cash out) by 35 percent to 90 percent. With so much value at stake, marketing chiefs across all industries would do well to re-examine the effectiveness of their loyalty programs.

"I think we'll see a radical shift as people come to recognize that most programs to date haven't been terribly effective," says Reichheld. "But I hope they don't throw the baby out with the bathwater. Loyalty remains fundamentally important to companies. I see great potential for breakout thinking."

It's the Data, Stupid

The remarkable thing about affinity programs, however, is that so few companies have taken full advantage of the data they're collecting—to boost sales, to increase retention, to improve the value of their customer relationships. "When I talk to people about programs, I usually roll my eyes about how much money they are leaving on the table," says Reichheld.

Most large enterprises have implemented sophisticated methods for recording customer data, but only a select few utilize that information to grow the programs in innovative ways, says Capizzi. These more evolved programs, he adds, "are making tremendous use of the data to go after specific behavioral change."

The best example of nurturing behavioral change may be American Express, which runs what is now the largest credit card loyalty program. Launched in 1991 as Membership Miles (primarily as a way for cardholders to accrue points that could be applied to airline frequent-flier programs), the program evolved significantly as AmEx expanded its partnerships, first with hotel chains and vacation providers, later with a broad range of consumer goods companies. Now under the Membership Rewards banner, the program features more than 140 partner companies and includes redemption choices that range from spa treatments and adventure travel to charitable donations.

"The genius of AmEx is how they got people to use the card at gas stations, supermarkets and hardware stores by doubling the points people get at those places," says Capizzi. "So it becomes their preferred method of payment. That's why AmEx is the leader."

The key is learning what drives customers' spending habits and then evolving the program to suit those preferences, according to American Express spokesman Channing Barringer. "We've found that our customers love using points as currency," Barringer says. "They're accruing banks of points and using them on expenses they would normally charge—everything from movie tickets and flat-screen televisions to RV rentals in New Zealand.

"Understanding how our customers want to spend points helps us strengthen the program, which in turn helps drive spending on American Express cards," adds

Barringer. And drive it does: Average card-based spending by Rewards members is more than four times that of nonparticipants.

Information culled from members can also tell you when an affinity program isn't working. In June 2003, Harrah's Entertainment implemented a major overhaul of its Total Rewards program after discovering "a number of pain points," says David Norton, the casino owner's senior vice president of relationship marketing. These included what he calls "challenging service interactions" at Total Rewards kiosks in the casinos, arising typically when program participants (who accrue points based on their gambling activity) realized they couldn't bank those points and use them during future stays.

"You had to use it or lose it," says Norton, "which meant more rewards for us than for them." Norton once saw a patron redeeming points for a dozen bottles of water at the coffee shop on the way out the door because those points would be worthless in subsequent visits. Customers also were vexed that the points they earned at one Harrah's location held no currency at another.

Norton's team realized the casino was neglecting the bulk of its customer base: the low rollers. "We had a lot of success with the VIP guests, but we were struggling in the retail segment," he says. Those customers, he explains, could not accrue enough points in one day to purchase something they perceived as valuable. So the company revamped Total Rewards to make customers' points both bankable and portable. In just over a year, the percentage of total revenue coming from Total Rewards customers has risen from 72 percent to more than 75 percent. What's more, participant satisfaction scores are at an all-time high—about 20 percent higher than before the relaunch.

A Measure of Greatness

Beyond usage and share of wallet, companies often overlook what Reichheld considers the single best measure of customer loyalty: whether customers come back for more and bring their friends with them. What percentage of your customers are enthusiastic advocates of your business? How likely are they to recommend you to a friend or colleague? "If they rate you nine or 10 on that scale, we call them 'promoters,'" he says. "Then we subtract the ones who answer zero to six, who are 'detractors.' Net promoter scores for most companies are abysmal, which means they're failing miserably at building loyal customers."

The management team for Hilton Hotels' Honors Worldwide program employs discrete-choice analysis methods to determine what its members really want. The assumption is that people are more likely to choose your company over your competitors' (and recommend your company to their friends) if you offer them something they truly value. "If you ask customers what they want, they will tell you they want everything," says Adam Burke, senior vice president and managing director of Hilton HHonors Worldwide. "So the key is finding a way to figure out what they value."

The "brand blind" research, conducted by a third party, asks consumers to review different iterations of a program and choose the one they prefer. A first pass might ask them to select one arrangement out of four that differ on certain elements, such as free room upgrades or complimentary breakfasts. Multiple passes unearth patterns of preference, which additional analysis can help categorize into the items that consumers value the most. "When they're forced to choose, they're unconsciously trading off what they want," says Burke. "So we really get a sense of what they value."

This information helps the HHonors program management group make critical decisions about resource deployment. For instance, recent research indicated that the program's core members wanted to maintain their ability to "Double Dip"—a program benefit that enables guests to earn both HHonors points and airline frequent-flier miles during a hotel stay—but that some members were looking for more flexibility. Some preferred to earn miles on a variable basis; others wanted the option to decide trip-by-trip whether to use the Double Dip option.

So the management team instituted three accrual options: 10 points per dollar and 500 miles per stay, 10 points per dollar and 1 mile per dollar, or 15 points per dollar and no miles. This last option is typically selected by guests at the highest level of the program, customers who tend to have plenty of frequent-flier miles and who prefer to earn more of the hotel currency. Members can change their earning profile online as often as they like.

In the works is a plan to expand this ˆ la carte style to the program's other benefits. Upper-tier members typically receive a "welcome amenity," usually in the form of an upgraded accommodation or food and beverages waiting for them in their room. But if someone prefers to receive extra points instead, they'll soon be able to specify that in their online profile. "Rather than us dictating what they're going to receive," Burke says, "they can specify it themselves."

All Aboard

Too often, when a company launches a loyalty program, the commitment to it begins—and ends—in the marketing department. For programs to work, adherents say, the entire company needs to find religion. Too many programs fail because they don't have support from top management or the frontline employees who are closest to the customers.

A loyalty program "is not just an add-on promotion," says Brian Woolf, president of Retail Strategy Center in Greenville, S.C., and author of Loyalty Marketing: The Second Act. "It's a strategic decision... analogous to a company in the food industry moving from high-level retail to everyday low prices. It's a fundamental change in the way you operate."

As Staples kicked off an initiative to refocus on its traditional small-business customers, the marketing team realized it needed to reassess the Staples Business Rewards program to ensure that it was aligned with the new strategy. Previously, store personnel had not been actively signing up customers; marketing took the lead in initiating most enrollment activities through direct-mail or telemarketing campaigns.

Rachel Trueblood, Staples' vice president of small-business marketing, used the relaunch of the Business Rewards program as an opportunity to bring everyone on board. The company spearheaded a training initiative to educate the staff in its 1,100 stores about small-business customers—particularly what their needs are and how to spot them by their purchase patterns and shopping habits. Trueblood also instituted weekly and monthly reports to measure how stores are faring in the program, using metrics such as enrollment activity, average sales per enrolled customer, program sales as a percentage of store sales and so forth.

Without disclosing specific numbers, Trueblood says program enrollment has tripled since the relaunch in 2002, that customers are more active participants in terms of both earning and redeeming rewards, and that retention rates for Business Rewards customers have improved significantly compared with nonmembers. The program, she says, "is one of our best marketing vehicles in terms of return on investment."

Norton of Harrah's agrees that loyalty programs are worthless without frontline buy-in. "You can have the best strategy in the world, but if employees can't deliver on it, it's all for naught," he says. So when the company launched its Total Rewards 2 program, Norton and his staff went on the road to Harrah's 32,000 frontline employees across the United States. Each of Harrah's 25 properties features a Total Rewards Center that handles all onsite inquiries and transactions related to the program.

"The property manages these centers, but the staff functionally reports to us," says Norton. Frontline staffers have access to customers' account balances and can issue rewards based on that information. They can view a customer's account history and tier in order to customize their communications. Norton says the management team is in the process of launching a program in which the company can send messages to customers while they're playing at the slot machines (offers of show tickets or complimentary food, or simply a birthday greeting), all based on historical and real-time information gathered through the Total Rewards program.

The Difference Makers

For most consumers, the initial attraction of loyalty programs is the free stuff. But companies often find that once they start segmenting members, expectations tend to vary with the level of participation. Specifically, lower-level participants care more about the tangible benefits: free services or merchandise, discounts, coupons, rebates and so forth. The higher the tier, the more customers are likely to prize the soft benefits—expedited check-in and checkout, upgrades, a private lounge for travelers and the like. It is within this group that companies can build the strongest bonds.

These softer items often don't add significant incremental costs to the program, but done right they can add exponential amounts of loyalty. "The hard stuff appeals to the head," says Reichheld. "The soft stuff has to do with emotion. Customers want to know that you know who they are, that you value and listen to them. That side of loyalty has largely been ignored."

As Harrah's was exploring ways to make its retail customers more profitable, it didn't want to overlook its VIPs. So Norton and his team created a separate line of marketing materials for the casino's upper-tier patrons. While the company didn't make any changes to its VIP services, Norton felt it was important to reinforce the numerous privileges the company afforded its Diamond-level members: a nicely appointed private lounge, a separate check-in service, expedited jackpot payouts and first dibs on tickets for special events.

One popular perk is a separate line for the seafood buffet at the company's Rio All-Suites Hotel & Casino. "The wait can be 45 minutes to an hour," says Norton. "These gamers don't have a lot of time. So it's a mutual benefit. They want to spend their time playing, and it's in our best interest to make sure that happens."

However, soft benefits don't carry the same weight in all industries. "From our research, we've found that the soft benefits don't resonate as much with our customers," says Staples' Trueblood. So Staples focuses on the more tangible elements: those that save customers either time or money when they shop. Benefits for such critical office products as ink or paper are effective, as are sweepstakes featuring gift cards and offers of free delivery. That doesn't mean even the most utilitarian of companies can't work on the warm fuzzies. Regardless of their business, all companies need to focus on more than just copying the latest program iteration from their competitors, contends Hilton's Burke. "When you add something that anyone else can do, all you wind up doing is escalating costs," he says.

One of the most effective soft benefits, Burke says, is providing your best customers with a chance to kvetch. "The biggest problem is the one you don't know about," he says. HHonors management receives monthly reports from the company's various customer-contact centers, aggregating the issues that occur most frequently. The team also regularly monitors the online chat forums, where consumers gather to discuss hotel rewards programs, for any salient chatter.

"People loyal to the program actually have a higher incidence of problem reporting, and they expect you to fix it because they want to continue doing business with you," Burke says. "If they have a positive outcome from an initially negative situation, it's a far greater loyalty experience. Once you have that, they pay far less attention to competing messages."

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