

Why Loyalty Programs Fail

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Summary. Successful loyalty programs prompt desirable customer behaviors, keep people engaged, and generate a high ROI.... [more](#)

High-performing customer loyalty programs, while complicated to operate, have proven to be well worth the effort. Several successful airline loyalty programs have a higher valuation than the underlying airline. A recent Bain & Company and ROI Rocket survey of nearly 870 US consumers found that 63% of respondents said they make buying decisions based on loyalty programs they participate in. And since very small businesses resemble consumers in many aspects, loyalty programs have begun to spread in business-to-business markets, such as AB InBev's program for small- and medium-sized food and beverage retailers.

However, for every successful program, there are a dozen others running at high cost, spurring unprofitable member behaviors, and generating a low return on investment (ROI). Indeed, there's a wide variation in Net Promoter Score (a key metric of advocacy) among programs.

Where Programs Go Wrong

Mediocre, underperforming customer-loyalty programs tend to suffer from a combination of three problems:

Failure to get the economics right

Operating costs for a major program can run in the tens of millions of dollars and create balance sheet liabilities in the billions. Poorly designed programs bear those costs yet limp along with outdated assumptions and rules, touting trinkets and incentivizing consumers in the wrong ways. Some grocery and drug store chains, for instance, offer discounts for goods that people would buy anyway, lowering their profit margin. At one North American chain, up to 25% of milk purchases in a given week after a chain-wide promotional discount would have been purchased at full price during the following weeks.

Coordination and organizational issues can further erode the economics, particularly with coalition programs that have a network of seemingly unrelated partners. Plenti, a U.S. rewards program run by American Express with roughly a dozen corporate participants, lasted only three years in part because the group never settled on a common value for points that would appeal to consumers. The different point systems among participating companies were difficult for consumers to navigate.

Poor understanding of customer behavior

A lack of insights about individual customers limits a company's ability to target and personalize offerings. Too many programs don't align around the behaviors they want to incentivize – whether that consists of more transactions, cross-shopping, repeat trips, or something else. When one of the largest retailers

in Asia analyzed its customer base, it found that many consumers originally classified as low value (by average monthly spending and number of trips) were in fact high value (based on gross margin per item), and thus deserved more benefits than they received.

Sometimes the company simply does not have enough data to build useful profiles. One restaurant chain had millions of active members in its loyalty program, but for some time only about one-quarter of them shared contact information, which made it impossible to personalize offers. The chain then set about fixing the registration problem.

More distraction, little differentiation, low engagement

The proliferation of insurgent brands, mobile apps, content, and experiences has intensified the battle for share of mind and wallet. In particular, the rise of digital media has reduced attention spans. Young consumers are especially prone to turn to social media for product recommendations and shopping.

It's not just digital media bombarding consumers, but also the growing number of loyalty programs. Among U.S. consumers who joined any loyalty program, they participate in 12 on average, our survey found. With that volume, it's no wonder that many consumers find little reason to engage in some programs beyond acquiring discounts.

In industries with high-priced goods such as home furnishings, the rewards often are almost meaningless relative to the value of the item. Worse, programs may be virtually invisible to customers, as the company accrues points liabilities without engendering additional loyalty, as is the case with some drug-store chains.

A Template for Program Redesign

Given these trends, many of today's programs no longer generate desirable behaviors or profitable growth. Yet the executives that run them may feel trapped, worried that in the war for market

share, shelf space, and consumer attention they cannot risk pulling back on their programs. Or they might want to change a program, but they're not sure how to proceed.

Creating a modern, sustainable loyalty program entails several steps that depart from how most current programs operate.

Draw an accurate profile of customers.

Redesigning a loyalty program starts with attaining a deep understanding of their preferences and behavior. The best customer profiles prioritize high-quality, actionable customer information over sheer volume of information. Companies should mine digital exhaust from website visits and e-commerce, combining that first-party data with demographic and behavioral attributes, in order to offer highly personalized features to program members.

Returning to the large retailer in Asia that had misclassified its customer base, the company reclassified loyalty program tiers and took a targeted approach with promotional campaigns, to stimulate cross-category buying. Category spending rose three-fold for snacks and eight-fold for health and beauty products, with the overall basket size for consumers who redeemed promotions increasing between 75% and 225%.

Know what those customers value.

What attributes of the offering and experience matter most to program members? Personalization is the key. Some members would prefer to trade off discounts for more meaningful redemptions. One entertainment company found that 80% of customers value early access to virtual and live events over traditional points-based rewards. Some sports fans relish exclusive access to coaching sessions or curated statistics. Video gamers often want to show off their skills and achievements to other gamers.

Many consumers simply want more convenience. When a survey by Salesforce asked people what would encourage more frequent use of loyalty programs, many were interested in features that reduced friction, such as ease of tracking and simpler terms.

Once a company has hypotheses about what each consumer segment really cares about, the hypotheses can be validated with in-market experimentation. The advent of artificial intelligence can streamline the process because AI tools tests propositions with synthetic audiences based on the digital behavior of real consumers.

Devise a compelling hook.

Most successful programs rely on one or more hooks to attract customers and keep them engaged. At Amazon Prime, the core hook remains free shipping (often within a day or two), though Prime has branched out to include a full-fledged ecosystem of offerings that has attracted more than 230 million subscribers, each spending an average \$1,400 annually, versus \$600 for non-Prime members.

Here again, in-market experimentation will validate which options do and don't resonate with program members. The most promising will merit a large-scale test.

Let the games begin.

Gaming has become the fastest-growing form of entertainment among younger generations. US 13-to-24-year-olds now spend almost as much time with video games as with social media or streaming video, a recent Bain survey found, so that gamification plays an increasingly important role in successful loyalty programs. When consumers have the chance to win, achieve, and gain a bit more value through games, many become promoters who fuel the marketing engine.

Sephora's Beauty Insider targets enthusiasts across makeup and skin care, with tiers structured to incentivize consumers to move up to the next tier. Prizes, in exchange for points, drop in the Rewards Bazaar for only a short time before they run out. In North America, the 17 million members of Beauty Insider now account for 80% of company sales, as the program has significantly boosted cross-selling and upselling of Sephora's product lines.

Some companies have taken gamification to gamers' turf. Louis Vuitton partnered with Riot Games on the League of Legends World Championship in 2019, designing the carrying case for the trophy and later introducing skins for digital avatars with an equivalent line of real clothing to be sold alongside the tournament.

Build community.

The best communities form organically around a favorite team or activity. People with shared interests often want to learn, swap tips, or compete with others.

At the extreme, program members can become authentic ambassadors for the business. That's the case with construction toy maker LEGO Group. The company runs LEGO Ideas, a global open innovation community where fans can submit their own ideas for new LEGO sets, vote for other members' ideas, participate in challenges, and engage in other mini-build activities. A few of their ideas will be turned into commercial sets, with the original designer receiving 1% of the royalties.

Consider an ecosystem with partners.

It may make sense for a program to partner with specialist firms. While the ecosystem should be broad enough to bring relevance and optionality to consumers, the selection of partners needs to fit with the originating brand and appeal to consumers' priorities and passions. These can include a mix of aspirational experiences with more basic rewards. The Hyatt hotel chain's loyalty program, for instance, is partnering with fitness company Peloton to outfit

Hyatt properties with Peloton equipment and provide access to Peloton classes on guestroom TVs. The two companies hope to tap guests' penchant for self-improvement and wellness on top of the functional desire to save money.

Some partner programs go broad. Qantas Loyalty, a tiered, points-based frequent flyer system, has an integrated offering of products and services through more than 700 partners across dozens of industries including travel, retail, utilities, financial services, and health, augmented by Qantas' consumer businesses in insurance, wine, and more. In 2023, the program added \$2.2 billion revenue, with a 21% operating margin.

Typically, though, the greatest value stems from a handful of deep partnerships with tight integration across the customer's experience in search, purchase, and use. Consider Delta Air Lines' co-branded line of American Express credit cards. The exclusive relationship dates to 1996, and has steadily increased in profitable growth. The amount of money consumers charge to these cards approaches 1% of US gross domestic product and is now worth almost \$7 billion annually to Delta, nearly double what it was worth just a few years ago.

Invest, Test, Scale Up

The economics of a redesigned loyalty program can be compelling, through traditional measures of higher retention, share of wallet, and direct sales, along with newer metrics such as in-app transactions, revenues from a pay-to-participate program, or data-sharing arrangements between partners. In a few cases, the programs have migrated from a company's marketing group to integrate with its commercial organization, in recognition of their potential to spur revenue growth.

To be sure, a successful program requires up-front investment. How much investment will depend on whether a company scales up quickly with a free program and adds paid tiers, or starts by building subscription revenues to make the program generate positive ROI faster.

Early days tend to be the costliest. It can take a couple of years to move from zero to 25 million members, but then reaching 50 million can take half that time. Recent programs in the beauty and food industries have attracted 20 million members in less than 12 months. Once social media feedback, marketing investments, and benefits scale up, programs often flourish.

Program leaders should start with the basics of identifying the most valuable customers, gleaning what they value most, and determining how a program can stimulate the appropriate behaviors at a reasonable cost. Technologies can help nurture the right kinds of engagement. Traditional AI helps to personalize and communicate program features at key moments that matter. Generative AI now refines that personalization based on questions that customers ask and other unstructured data. And non-fungible tokens can enhance the emotional value of a transaction, as when a sports fan downloads an NFT of the ticket for an important game to share later with family and friends.

Companies that first nail down the basics, then test and learn as they go, will raise the odds of eventually generating a strong ROI from their loyalty program, activating consumers to promote the brand.

Editor's Note: This article was updated on September 25, 2024 to correctly attribute the source of the survey data to Bain & Company and ROI Rocket.

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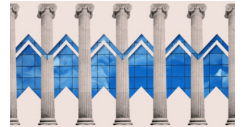
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