

Loyalty programs: what works, what doesn't

By Jarrett Paschel, Ph.D. It really is quite enlightening to head to Wikipedia and look up the various definitions of loyalty. The first entry under loyalty reads: Loyalty, also called allegiance or ...

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It really is quite enlightening to head to Wikipedia and look up the various definitions of loyalty.

The first entry under loyalty reads: Loyalty, also called allegiance or truth, is faithfulness or a devotion to a person or cause.

In the second definition, before discussing weighty topics such as Loyalty and ethics and Loyalty in the Bible, we find Loyalty and Marketing, which is defined as follows:

The practice of providing discounts, prizes, or other incentives to encourage continued patronage of a business. Generally, loyalty programs are considered less expensive to maintain than allowing customer defection or "churn."

Sandwiched somewhere between allegiance or truth and the philosophical foundation to ethics we find the marketer's version of loyalty: "Hey Tommy boy, toss a couple of coupons her way so next time she might think about, uhh, you know, coming back!"

In other words, loyalty programs are thought by many to be the least costly method of trying to get your customers to come back. Perhaps not surprisingly, the least costly methods are often the least effective.

We've been listening to frustrated consumers complain about retail loyalty programs for years, so we were not surprised that our recent research confirmed this position. Looking at the chart we find that 74 percent of consumers somewhat or strongly agree that "retailers need new and better ways of rewarding loyal customers." Moreover, the statements below that received scores above 40 percent, only two of the seven are positive.

Clearly something needs to change.

But what should change? And how?

From our perspective, consumer loyalty strategies in the retail arena should be defined as follows:

A unilateral and selfless acknowledgement of your organization's appreciation for your customer's continued patronage and support with a gift or service of substantive or

meaningful value. Ideally, such gifts should be usable or consumable immediately or in the near-term future—as opposed to a carrot dangling from above.

These gifts or rewards need not be obviously monetary in nature, such as granting your customers access to expedited security lines at airports. But the bottom line is that true loyalty is driven by something beyond regular discounts or reward points (i.e., airline miles). **True loyalty is about making your customer's life better in a meaningful way, however small or large the gesture may be.**

We believe current loyalty programs can be roughly sorted into three categories:

1) Routinized:

These are the expected discounts based on commonly held consumer beliefs regarding the nature of economic transactions. Consumers view this loyalty as an inducement or a “tit for tat” relationship not dissimilar from volume discounts. The rewards here are viewed as almost meaningless. As one consumer observed:

What is the point of the loyalty club card savings when every single wine in the wine department is always on the “club card savings price,” not to mention half of the entire frozen food aisles? It becomes some stupid hassle to go through just to ensure I get the real price. Besides, whenever I forget my card the cashier just swipes hers...

This category is the least successful at driving both loyalty perceptions as well as continued patronage. Honestly, is this as good as we can do as an industry?

Examples: Grocery store loyalty cards, automatic cash back savings (i.e., Discover card's 5 percent program), x percent savings for the use of the retailer's credit card.

2) Incremental/Deferred:

While somewhat effective at driving continued patronage, these programs do not necessarily drive true loyalty. These programs are typically structured around the idea that repeated visits result in gradual accrual of ownership of a meaningful reward of monetary value. The term “gradual accrual of ownership” may sound awkward, but it was not that long ago that frequent flyers would be rewarded with actual tickets that could be traded in the open marketplace.

Yet while these programs might encourage continued patronage over time, they do not drive permanent patronage, as evidenced by the fact that while consumers do collect airline miles—often across a variety of airlines—the vast majority still purchase tickets based on which airline offers the best prices or the most convenient scheduling. Collecting miles is meaningful and fun, but it rarely reminds the consumer of the passion the brand maintains for its customers.

Likewise, what does it mean for consumers when nearly every single airline—as well as most credit cards—award loyalty points?

Examples: Airline miles programs, travel rewards programs, “Every X meal free” cards, etc.

3) Substantive:

Finally we arrive at the most effective loyalty strategies. These are what we term substantive loyalty programs because they drive loyalty via innovative methods of surprise and delight, as well as more general methods of making their customers lives noticeably better.

To be certain, the various airline elite status programs share elements in common with deferred loyalty programs, but here the rewards are different because they improve their customers' quality of life on a regular basis. As opposed to airline miles, which many people collect in the same manner as the now dated S&H Greenstamps, airline status is all about quality of travel—and, by proxy, quality of life. Access to preferred security lines, free upgrades, better customer service, and access to private lounges all encourage more permanent loyalty behaviors. As most seasoned travelers come to understand, you pick one or two airlines and stick with them—even if it means that you are often forced to forego the convenience of a non-stop route.

But the best loyalty programs channel the human desire for **surprise and delight** with gifts of meaning and significance.

Examples: Here we find that the best-in-class examples are not really generalizable or classifiable precisely because of their unique, customized nature. Consider the following example from a consumer we recently interviewed:

Despite the fact that I love to collect my Starwood points, there are a few hotels that I always stay at even though they don't offer reward programs.

One hotel really stands out. Upon checking in, I am often upgraded to a larger room, though to be honest that's not such a big deal...What's really cool is that when I get to my room there's usually a half-bottle of champagne, a box of chocolates and a personal letter of thanks from the hotel's manager, along with an invitation to a complimentary dinner and a couple of drink tickets. Honestly, who would prefer points to this kind of treatment?

Moving away from the travel industry, consider the following scenario: You have become acquainted with the manager of the wine department at your local grocery store. He has helped you pick out wines on numerous occasions. One day he walks up and says, "Hey I've got this great new wine I would love for you to try, it's one of the best Italian wines I've had in ages." While telling you this you watch as he scratches the \$35.99 price tag off and replaces it with one that reads \$3.99...he ends the interaction with a well-timed, "Let me know what you think." After such a display of generosity and the closing remark all but requires one to continue the relationship.

Several best-in-class food retailers begin every month by sending all of their customers on their mailing list a coupon good for something of bona fide value for free. Past examples include lobster legs, a rib eye steak, a large bottle of Tide, and a pie. We'll take the steak any day.

And how about your favorite restaurant for taking clients to dine? Why should it seem improbable that they start every meal—whether you are with clients or without—by serving you a couple of bottles of complimentary champagne?

The Upshot?

All told, the human desire to demonstrate loyalty via the ritual of continued patronage is a near universal feature of all modern economies. Your customers are begging to award you their loyalty—in part because it reduces the effort spent always having to make choices. This makes it all the more puzzling that today's retail landscape remains littered with the dusty remnants of broken loyalty programs. Surely someone can manage to fill this void?

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What do you think? What loyalty programs have you seen that are particularly effective or innovative? Talk about it in the comments!