THE FUTURE OF CUSTOMER LOYALTY
BUILDING A NEXT-GENERATION REWARD PROGRAMME
THE FUTURE OF CUSTOMER LOYALTY

In a world of new technology and high customer expectations, standard customer loyalty schemes based on transactional rewards will soon be recognised for what they really are: undifferentiated, underutilised, loss-makers.

Usually, retailers justify the cost of their loyalty programme by the data it yields: data which can be used to inform business decisions, sold to suppliers, and used to develop targeted campaigns. But on closer inspection these additional benefits often do not materialise nor justify the investment in the scheme. Our analysis shows that a transaction-based loyalty scheme – where the customer is rewarded with a 1% return of the value of their shop – can cost a $10BN retailer $30–60MM in reduced margin every year. Add to this the considerable cost of running the programme, and these costs will likely never be recouped with the gains made by utilising the data from the scheme.

Even if your scheme isn’t analogous to the one shown in Exhibit 1, we still think the best loyalty programmes in retail can be better and, indeed, need to improve fast.

In the first half of this article, we articulate the case for change and, in the second part, we explain what retailers need to be thinking about when it comes to customer loyalty programmes.

PART 1: THE CASE FOR CHANGE

1. **New competitors are disrupting the market** and challenging the status quo
2. **Customer expectations are changing**, and they want different things from their loyalty scheme
3. **The right technology used in the right way** can help meet customer needs in a new and innovative way

PART 2: GETTING IT RIGHT IN THE REAL WORLD

1. **A future-flexible approach to technology**, with the retailer owning the overall loyalty ecosystem but not necessarily every specific component within it
2. **A start-up mindset** to enable long-term investment in the loyalty proposition
PART 1: THE CASE FOR CHANGE

1. NEW COMPETITORS ARE DISRUPTING THE MARKET

The pressure comes from the need for traditional retailers to find new ways to stay close to their customers in a world where disruptive new entrants are trying to own the customer relationships that retailers once took for granted. Retailers face an assault on their status as the owner of the customer. Be it online pure-play retail competitors, manufacturers selling direct to consumers, or payment providers and digital wallets, many businesses are now trying to develop direct customer relationships. If they do not respond, retailers will find that over time their customer loyalty decreases as other players join the party.

So reinventing loyalty is not some passing trend; it is fundamental to continued survival and future success.

Exhibit 1: The economics of a typical loyalty programme

Loyalty scheme cash profit input at a $10bn retailer
Loyalty scheme gives 1% return on spend as points

<table>
<thead>
<tr>
<th>VOLUME UPLIFT DUE TO SCHEME (%)</th>
<th>-$13MM</th>
<th>-$6MM</th>
<th>$2MM</th>
<th>$9MM</th>
<th>$16MM</th>
<th>$23MM</th>
</tr>
</thead>
<tbody>
<tr>
<td>3.0</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2.5</td>
<td>-$23MM</td>
<td>-$15MM</td>
<td>-$8MM</td>
<td>-$1MM</td>
<td>$7MM</td>
<td>$14MM</td>
</tr>
<tr>
<td>2.0</td>
<td>-$32MM</td>
<td>-$25MM</td>
<td>-$18MM</td>
<td>-$10MM</td>
<td>-$3MM</td>
<td>$4MM</td>
</tr>
<tr>
<td>1.5</td>
<td>-$42MM</td>
<td>-$34MM</td>
<td>-$27MM</td>
<td>-$20MM</td>
<td>-$13MM</td>
<td>-$6MM</td>
</tr>
<tr>
<td>1.0</td>
<td>-$51MM</td>
<td>-$44MM</td>
<td>-$37MM</td>
<td>-$30MM</td>
<td>-$23MM</td>
<td>-$15MM</td>
</tr>
<tr>
<td>0.5</td>
<td>-$60MM</td>
<td>-$53MM</td>
<td>-$46MM</td>
<td>-$39MM</td>
<td>-$33MM</td>
<td>-$25MM</td>
</tr>
</tbody>
</table>

Awarded points going unspent (%)

Most likely outcome is a $27–60MM loss
2. CUSTOMER EXPECTATIONS ARE CHANGING

It’s not just that customers want more rewards; it’s that they want a different kind of relationship with the businesses they choose to interact with. As such, loyalty schemes are changing from transaction-based exchanges between a retailer and a customer to an ongoing relationship with the customer at the centre (Exhibit 2). Our sister firm Lippincott, specialising in brand and design, studies these trends in depth in the report *Welcome to the Human Era: The new model for building trusted connections, and what brands need to do about it.*

**Exhibit 2: Characteristics of loyalty programmes, past and present**

<table>
<thead>
<tr>
<th></th>
<th>OLD WORLD REWARDS</th>
<th>NEW WORLD AFFINITY</th>
</tr>
</thead>
<tbody>
<tr>
<td>Foundation</td>
<td>Formulaic deal</td>
<td>Relationship and belonging</td>
</tr>
<tr>
<td>Assessment</td>
<td>Transparent criteria, with no discretion</td>
<td>Role for serendipity and judgement</td>
</tr>
<tr>
<td>Time horizon</td>
<td>Present and future</td>
<td>Recognition of the past</td>
</tr>
<tr>
<td>Programme language</td>
<td>Points, statements, terms and conditions</td>
<td>Symbols of belonging (without overstepping the mark)</td>
</tr>
<tr>
<td>Identification</td>
<td>Plastic card</td>
<td>Crosses all channels and platforms</td>
</tr>
<tr>
<td>Customer benefits</td>
<td>Economic</td>
<td>Broader</td>
</tr>
<tr>
<td>Feeling</td>
<td>Entitlement</td>
<td>Appreciation</td>
</tr>
</tbody>
</table>

Many companies are starting to update how their loyalty schemes provide shared benefits with customers. Some of the most important trends we would pick out include:

- Increasing use of exclusive promotions and a move away from points
- Non-monetary rewards and symbols of belonging, such as free coffee at UK grocer Waitrose, or childcare and frozen yoghurt at Ikea
- Charity-based rewards and points, such as Kroger’s community awards in the US or Pets at Home animal charity scheme in the UK
- Services to improve the shopping experience, such as Neiman Marcus’ shopping app that incorporates shopping, blogging, events, and loyalty points management
- Broader lifestyle applications, such as Walgreens’ Steps programme.

In these examples, customers are happy to give the retailer access to their data, not because they are getting points in return, but because they are being rewarded or helped in other ways.

Once this virtuous cycle is started, it can be very powerful – customers are prepared to allow more detailed use of their data and more intimate analysis of their habits so long as they are getting useful products and services in return. For the retailer, this extension of brand permission and increase in the number of customer touch points will boost customer loyalty today and can be monetised in the future (as it increases the range of commercial opportunities in the retailer–customer relationship). Interestingly, many traditional retailers are some of the most trusted brands in their home market, giving them more opportunity to drive this virtuous cycle than many other companies, such as financial services firms or internet giants.
3. THE RIGHT TECHNOLOGY USED IN THE RIGHT WAY

Technological advances are rapidly changing the loyalty playing field. In the old world, customers would typically have a plastic card scanned on payment, then rewards would be received as coupons or offers through the post and by email.

In recent years, smartphones and other new technologies have transformed this playing field. Customers are always connected and the online and physical worlds are being merged, with customers expecting seamless integration across channels.

Real time or time-limited offers are becoming much more common, for example fashion shoe retailer Meat Pack in Guatemala has GPS embedded into its app and tracks when users enter competitors’ stores. At certain times during its “Hijack” campaign, this triggered a promotional discount for Meat Pack, which started at 99% and decreased every second until the customer entered a Meat Pack store. The discount and subsequent purchase were then automatically shared on Facebook, sending the app viral.

There is much more two-way communication with customers, for example social media is now a key channel for customers to complain and they expect their issue to be resolved via the same channel. Additionally, customers are more in control of how they interact with loyalty services; they can choose to share Facebook data to access a discount or enter a competition.

Online services are being brought in store. For example, there are apps to help customers navigate and find products as well as smartphone technology to accelerate self-scan and payment.

Underpinning much of this technology are more sophisticated analytics on much bigger datasets. These, along with rapid iterative app development, are becoming important new capabilities for retail IT teams.
PART 2: GETTING IT RIGHT IN THE REAL WORLD

In reality, an exceptional, original, and effective loyalty scheme is much easier to describe than it is to deliver. But, it can be done. One example is Balance Rewards by US health and beauty retailer Walgreens. The scheme is built around unique, non-purchase rewards and creates additional value for both customer and retailer. In Exhibit 3, we summarise how loyalty programmes like the one at Walgreens operate.

Exhibit 3: Loyalty programme from a customer’s perspective

CUSTOMER VIEW

HOW TO MEET THE CUSTOMER NEED

- Provide relevant rewards for the customer to choose from
- Perform big data analyses using multiple sources of data to provide rewards based on consumer behaviour and life cycle, with a focus on cross-selling and retention
- Deliver multichannel loyalty with consumer insights and a loyalty programme that goes across all sales channels, including in stores, brands, and online
- Enable the customer to manage rewards in one place, for example by bundling miles, points, or rewards into a single app or website
- Replace loyalty cards with apps
- Push product updates to the customer
- Distribute benefits and coupons direct to a mobile device
- Be flexible to adapt to new consumer technology (phones, tablets, glasses, watches...)
- Give rewards based on the customer sharing more information about themselves, for example interacting on social media
- Make offers made based on geolocation and customer activity or microsegment
- Reward customers with more personalised offers when they share their likes and dislikes
- Introduce a user-friendly platform to change and settings that control contact information, preferences, and so on
Today, some retailers are making successful changes to their loyalty programme while others are not. Although no two situations are identical, we would pick out two themes that separate the leaders from the laggards:

1. **A future-flexible approach to technology**, with the retailer owning the overall loyalty ecosystem but not necessarily every specific component within it
2. **A start-up mindset** (and often organisational structure) that enables long-term investment in the loyalty proposition.

### 1. A FUTURE-FLEXIBLE APPROACH TO TECHNOLOGY

Twenty years ago, the first retail loyalty schemes relied on expensive in-house systems and technology and were very inflexible in how they operated. Back then, the only alternative to this model was partnering with third-party providers such as Aimia, based in Canada, and Payback, in Germany, but such a move essentially ceded control of much of the loyalty programme and data.

Today, flexibility is the watchword. The cost of the technology required to run a loyalty scheme is much less than it once was and there are a plethora of specialist providers offering solutions to each different area in the loyalty ecosystem. This gives retailers many options for how to set up the loyalty programme: either in-house or outsourced, or a mix, each covering a different aspect of the programme.

**CONTROL THE LOYALTY ECOSYSTEM BUT NOT EVERY COMPONENT**

Our view is that retailers’ interests are best served if they take control of the overall loyalty ecosystem – rather than outsource it to a single provider – but are comfortable partnering with a number of specialist vendors where they add powerful or differentiated capabilities. Taking a leaf out of Apple’s book and applying this “designed in California” mindset allows retailers to maintain control of their loyalty scheme without having to develop internal capabilities in every single area of activity.

**BE FUTURE FLEXIBLE, NOT FUTURE PROOF**

Given that customer expectations and technologies are changing rapidly, it is tempting to try to future proof the loyalty ecosystem: by thinking ahead and designing solutions for every eventuality. This is unlikely to be able to address the as-yet unknown challenges and opportunities ahead. Far better is to design a future-flexible loyalty ecosystem, which allows for new components to be plugged in within a modular architecture.

**DELIVER EXCELLENCE IN CUSTOMER ANALYTICS AND ITERATIVE DEVELOPMENT**

Long-term, competitive differentiation will come from better customer analytics – underpinning more innovative products and services for consumers – as well as improved decision making in the core business.

Linked to this, the fast and continuous development of customer services and apps is an important capability: customers expect the products they use to improve rapidly.
2. A START-UP MINDSET

It’s a simple fact that an effective loyalty programme and the IT that enables it require investment. Most retailers keep tight control on such expenditures and need clear business case justification for investments.

This mindset, though, can be an issue in the loyalty arena. For example, a new menu management app for a food retailer might cost $5MM to develop and launch. Although supported by a strong hypothesis that it would improve customer loyalty and “stickiness” over time, the direct sales benefit of such an app might be difficult to quantify. Understandably, this makes it difficult to raise support for the large initial investment.

In contrast, by using a start-up mindset, the proposition around this app could look quite different. For example, by assigning a $50 value to each customer who downloads the app, you create a way of assessing the app’s cost–benefit, which is much more tangible. Here, it would take 100,000 downloads to cover the app development costs (a small number relative to the millions who shop at large grocers) and would build a much more appealing business case.

We would encourage retailers to think about their loyalty products in this way and develop new KPIs to measure them accordingly. Doing so will enable them to make – and justify – the investments needed to make the loyalty schemes successful.

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Exhibit 4: The future of loyalty looks very different from the past

<table>
<thead>
<tr>
<th>Core proposition</th>
<th>15–20 YEARS AGO</th>
<th>TODAY</th>
<th>THE FUTURE</th>
</tr>
</thead>
<tbody>
<tr>
<td>Points in return for data</td>
<td>• Points in return for data</td>
<td>• Points</td>
<td>• Wider variety of methods of recognition</td>
</tr>
<tr>
<td>Vouchers</td>
<td>• Vouchers</td>
<td>• Points plus bespoke offers and rewards (For example, Waitrose in the UK offering loyalty card holders a free coffee on each visit)</td>
<td>• More emotional content</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Purpose and focus</th>
<th>15–20 YEARS AGO</th>
<th>TODAY</th>
<th>THE FUTURE</th>
</tr>
</thead>
<tbody>
<tr>
<td>Observing customer behaviour from a distance</td>
<td>• Observing customer behaviour from a distance</td>
<td>• Understanding behaviour and feelings closely</td>
<td>• More personal</td>
</tr>
<tr>
<td>Capturing data and segmenting</td>
<td>• Capturing data and segmenting</td>
<td>• Building a 1:1 relationship</td>
<td>• More frequent</td>
</tr>
<tr>
<td>Sending things infrequently</td>
<td>• Sending things infrequently</td>
<td>• Frequent, two-way contact</td>
<td>• More directly beneficial to the individual</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Who is involved</th>
<th>15–20 YEARS AGO</th>
<th>TODAY</th>
<th>THE FUTURE</th>
</tr>
</thead>
<tbody>
<tr>
<td>Only a few or the largest retailers</td>
<td>• Only a few or the largest retailers</td>
<td>• Many retailers of all sizes and sectors</td>
<td>• Almost every retailer</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Customer interaction</th>
<th>15–20 YEARS AGO</th>
<th>TODAY</th>
<th>THE FUTURE</th>
</tr>
</thead>
<tbody>
<tr>
<td>Swiping card at till</td>
<td>• Swiping card at till</td>
<td>• Multiple ways to interact and capture data</td>
<td>• Anywhere, anytime, and on any platform</td>
</tr>
<tr>
<td>Mailing paper statements</td>
<td>• Mailing paper statements</td>
<td>• Move to online (for example, email updates)</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Nature of ecosystem</th>
<th>15–20 YEARS AGO</th>
<th>TODAY</th>
<th>THE FUTURE</th>
</tr>
</thead>
<tbody>
<tr>
<td>Invented and built largely in-house</td>
<td>• Invented and built largely in-house</td>
<td>• Established loyalty providers</td>
<td>• Retailer-controlled third-party ecosystems</td>
</tr>
<tr>
<td>Large one-stop-shop loyalty providers</td>
<td>• Large one-stop-shop loyalty providers</td>
<td>• Multiple specialist “component” providers</td>
<td>• Flexible, continuously changing architecture</td>
</tr>
<tr>
<td>Lower entry or development costs</td>
<td>• Lower entry or development costs</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
CONCLUDING REMARKS

The leaders in customer loyalty are moving away from transactional points-based schemes towards more varied, flexible customer engagement systems (Exhibit 4). Technology is at the heart of this change. Retailers must ensure their schemes are set up in a way to support and enable the technology innovations they will need to deliver the loyalty programmes of the future. In the new world, many retailers will require new KPIs to assess the returns they make in their loyalty programmes to make long-term investments possible.

For retailers who succeed, an improved loyalty scheme can deliver significantly better customer engagement and stickiness. It can also act as a defence against disruptive new entrants trying to get between retailers and their customers.
THE NEW IT HORIZON
HOW THREE YEARS FROM NOW CHANGES EVERYTHING YOU DO TODAY
From our discussions with retail CIOs, they concur but are uncertain as to how to make the move without breaking either the business or their organisation. This report addresses these challenges.

WELCOME TO THE HUMAN ERA
THE NEW MODEL FOR BUILDING TRUSTED CONNECTIONS, AND WHAT BRANDS NEED TO DO ABOUT IT
In this report, our goal is to define what being a Human Era company means, and who is doing it well. Building from a large data set of over 800 companies, we examine the leaders and define the behaviours of companies — both big and small — that are able to break through in this new environment and build trusted, authentic connections.

STRATEGIES TO SURVIVE
KEEPING CUSTOMERS AND GROWING PROFIT THROUGH THE NEXT DECADE OF UPHEAVAL IN RETAIL
This article discusses the changing retail landscape in more detail, and suggests some ways retailers can meet the challenges it presents.
ABOUT OLIVER WYMAN

Oliver Wyman is a global leader in management consulting that combines deep industry knowledge with specialised expertise in strategy, operations, risk management, and organisation transformation.

In the Retail practice, we draw on unrivalled customer and strategic insight and state-of-the-art analytical techniques to deliver better results for our clients. We understand what it takes to win in retail: an obsession with serving the customer, constant dedication to better execution, and a relentless drive to improve capabilities. We believe our hands-on approach to making change happen is truly unique – and over the last 20 years, we’ve built our business by helping retailers build theirs.

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