Maritz MOTIVATION

THE INSIDER'S GUIDE TO CUSTOMER LOYALTY

In this insider's guide you'll learn:

- Why a loyalty program is your most valuable marketing investment

- Design criteria for effective loyalty programs

- How to measure loyalty program success

- How to select the right loyalty partner

- Critical financial considerations

" Any marketer who sets out to earn customer loyalty quickly learns that it can be an elusive goal. Loyalty is tricky. It can be hard to define, difficult to earn and oh so easy to lose.

That's why we created this guide. To help you master the basics of loyalty more quickly. And to help you avoid the pitfalls that all too easily can trip you up on the path to launching your loyalty program.

We'll also be sharing some of the insider secrets we've learned over 30 years of building, managing and advising some of the largest and most complex loyalty programs in the world."

MEET YOUR EXPERTS

Barry Kirk
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ENGAGEMENT AND LOYALTY

DEFINITIONS:

LOY·AL·TY

both a behavioral and an attitudinal tendency to favor one brand or company over all its competitors.

EN·GAGE·MENT

the cumulative impact of member interactions across a defined and predictable lifecycle. Loyalty is about relationships, not response rates, so engagement is measured over time and across touchpoints, not just based on a single campaign.

LOY·AL·TY PRO·GRAM

a focused marketing initiative to identify, retain and nurture your most valuable customers with the highest potential for growth. This initiative typically includes providing unique recognition, rewards and targeted communications designed specifically for those customers.

FAST FACTS:

PROFITABILITY
+25%

CUSTOMER CHURN
-5%

Reducing customer churn by just 5% can increase customer profitability by 25%

IT COSTS
5x to 10x more
to aquire a new customer than to keep an exisiting one

INSIDER TIP

Once you have mastered these basic definitions, we want to get you thinking about the loyalty experience. LX allows marketers to optimize relationships with the best, high-potential customers and even your pre-loyal customers

— Cheryle Frenzel

CUSTOMER INSIGHTS:

from the 2018 Maritz + Wise Marketer loyalty landscape study

78% of consumers agree they are likely to purchase more often from a company when they're active in its loyalty program.

47% of consumers cite rewards and status benefits as the primary drivers for joining a brand's loyalty program.

45% of consumers cite the opportunity to "earn rewards" as a primary driver for purchasing from a brand in the first place.

For most brands, this makes a loyalty program your most valuable marketing investment.

DO YOU REALLY NEED A LOYALTY PROGRAM?

Determining whether a loyalty program should be part of your marketing strategy largely depends on what challenges you are trying to address and what resources you have to devote to a program. While a loyalty initiative can address a wide range of business challenges, it is not a panacea. Understanding which challenges are not a good target for your program is as critical to your success as knowing which issues a program can solve.

A LOYALTY PROGRAM IS THE RIGHT STRATEGY IF YOU WANT TO:

- Identify and track active customers
- Increase the lifetime value of your customer base
- Increase purchase recency/frequency rate for your existing customers
- Improve customer retention and reduce churn
- Improve best customer satisfaction
- Incent customer advocacy/referrals

A LOYALTY PROGRAM WILL NOT EFFECTIVELY ADDRESS:

- Product quality issues
- Customer service issues
- Non-competitive pricing issues
- Extreme changes in the marketplace
- Product delivery or availability issues
- Employee morale issues

DO YOU HAVE THE RIGHT COMPONENTS IN PLACE TO SUPPORT A LOYALTY INITIATIVE?

- Your products/services have repeat purchasability

- You have readily accessible customer behavioral data

- You have metrics to identify active vs. inactive customers

- You have the ability to market directly to the consumers of your products/services

- You have executive support for the importance of a retention strategy

INSIDER TIP

As you work within your company to build support for a loyalty program, it's critical to educate your peers and executives from the start that loyalty takes time. Most programs do well to break even in year two, and then begin to show profitability in year three. Be sure to remind your stakeholders that loyalty is about building relationships, not response rates.

– Evan Snively

WHO SHOULD BE THE TARGET OF YOUR PROGRAM?

Loyalty programs are narrow by design. Your program will be most successful if it is focused on a subset of customers that represent high current value or high potential value. For most companies, a successful program targets 40% or less of their customers.

Establishing a **value-based segmentation** scheme will be key to this approach. Value metrics can vary, but most companies start with some combination of spend, frequency, recency and number of products/services used.

INSIDER TIP

Good Loyalty programs drive revenue, but great ones show you which customer you should reinvest.

As you develop your Loyalty program and the marketing strategy to go with it, you'll be able to determine the value each customer represents to your business. Focus your budget on high value customers, and you'll get the best return on your investment.

— JR Slubowski

VALUE-BASED SEGMENTATION MODEL

An evaluation of your customer base and the potential it holds.
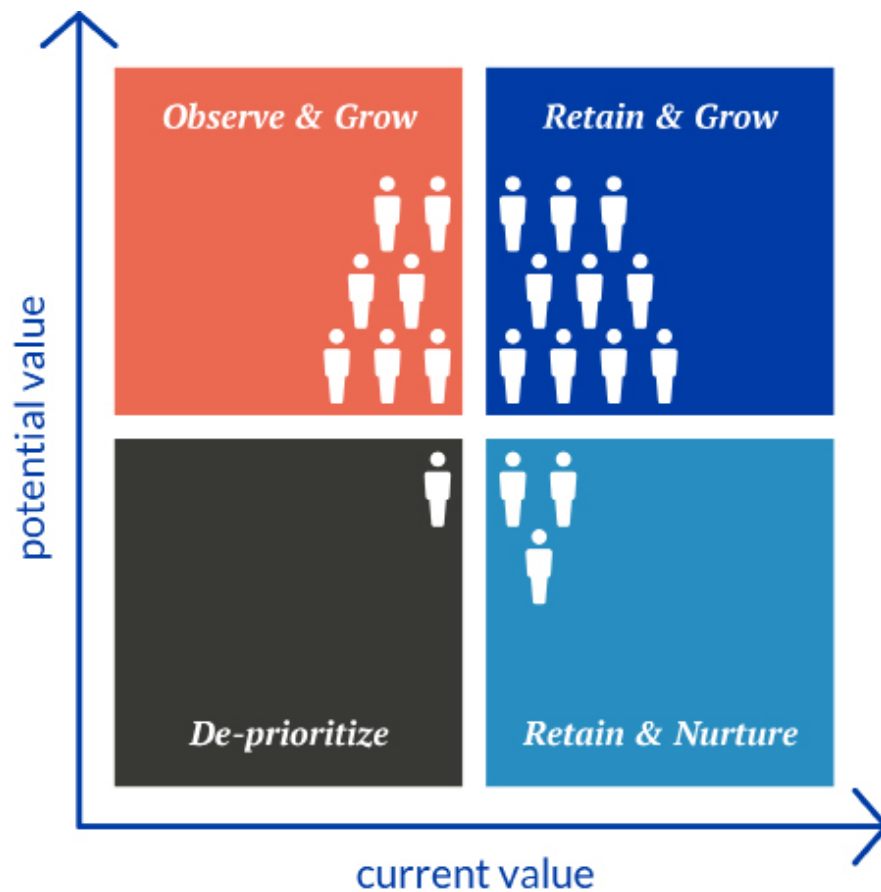
The chart above reflects the behavior patterns that your customers follow, and evaluates those patterns on the basis of their value to your business. For each segment, you should establish specific marketing strategies driven by a value-based segmentation using decision science.

For instance, some customers will purchase your product once as a gift, but they are not likely to return or make additional purchases for themselves. These customers, while appreciated, are not going to build your business. As a result, 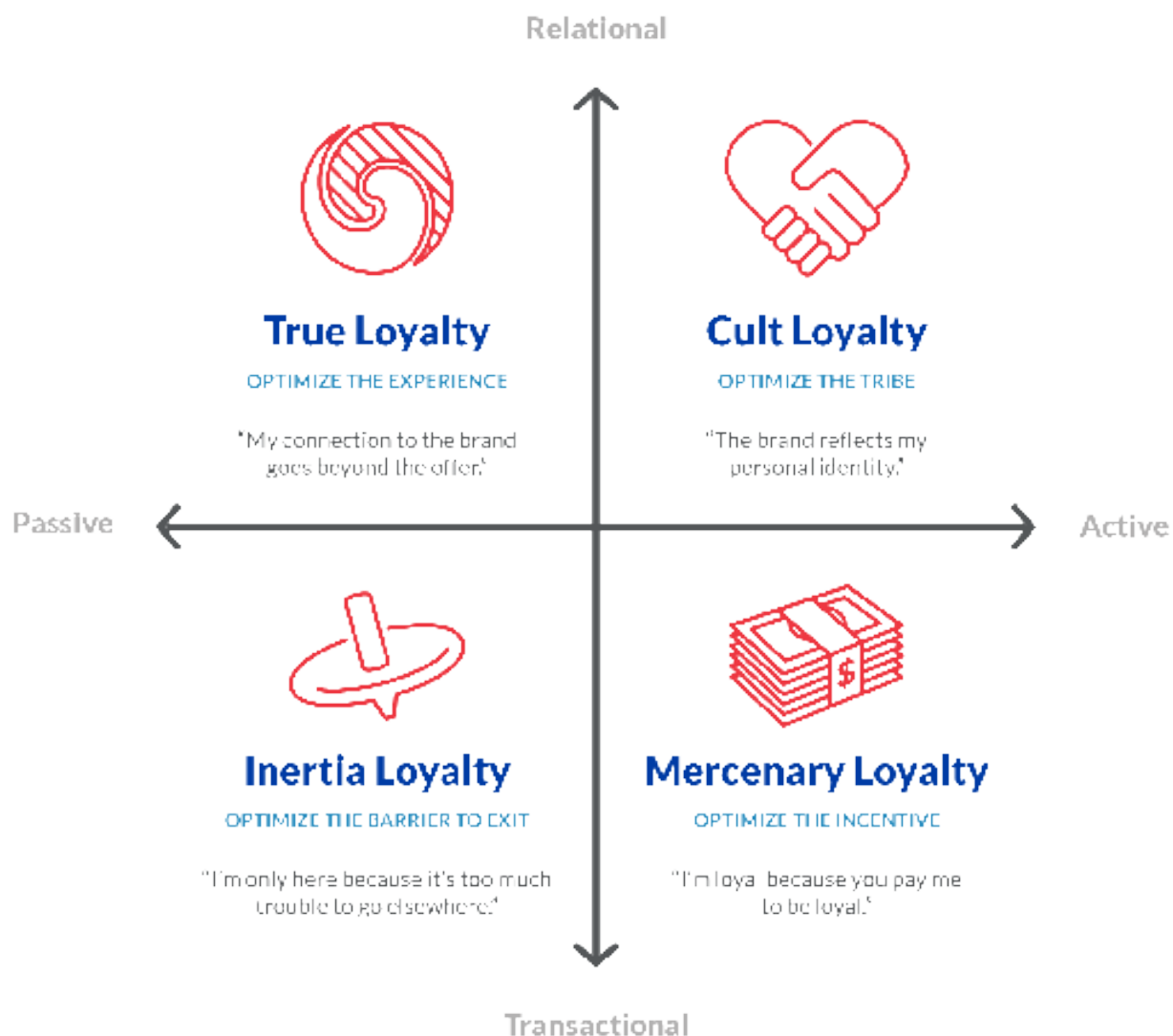they are of low overall value and should not be the target of your marketing communications. For all intents and purposes, they can be ignored.

At the other side of the chart, you'll find a customer who is of high current value and high potential value. Not only do they purchase your product for themselves, they're going to keep purchasing it, they'll purchase it as a gift, and they'll recommend it to everyone they meet. These customers hold the highest value to their business, and should be the primary target of your retention and engagement strategies.

WHAT KIND OF LOYALTY ARE YOU WANTING TO BUILD?

The Maritz Multi-Loyalty Framework outlines four types of customer loyalty based on the behaviors and engagement of both program members and program brands.

This framework shows the relationship between the degree to which a program is transaction-based or relationship-driven, and the level of passive or active engagement of program members.

Relational

True Loyalty
OPTIMIZE THE EXPERIENCE

"My connection to the brand goes beyond the offer."

Cult Loyalty
OPTIMIZE THE TRIBE

"The brand reflects my personal identity."

Passive ← → Active

Inertia Loyalty
OPTIMIZE THE BARRIER TO EXIT

"I'm only here because it's too much trouble to go elsewhere."

Mercenary Loyalty
OPTIMIZE THE INCENTIVE

"I'm loyal because you pay me to be loyal."

Transactional

CULT LOYALTY

Members personally identify with the purpose and values of the brand and actively seek to connect socially to fellow brand loyalists.

TRUE LOYALTY

Focus is on the entire loyalty experience being engaging, not just the redemption. "Earn" behaviors share equal focus with "burn" behaviors through an engagement strategy that includes a refined member lifecycle, segmentation, a data-driven communications cadence, meaningful personalization and surprise-and-delight.

MERCENARY LOYALTY

Primarily focuses on customers being rewarded monetarily for purchase behaviors. Retention is primarily driven via a "hidden" rebate offered to the member in terms of points redeemable for rewards and status.

INERTIA LOYALTY

Focuses on "barriers to exit" and is the answer to the question, "How do I best trap my customer into an ongoing interaction with my brand?" Brand stickiness is often engendered through subscriptions and contracts, particularly those that auto-renew on a periodic basis.

The winning brands are those that integrate the best elements of Cult, True and Mercenary Loyalty together into a Multi-Loyalty strategy. They will combine diverse elements of those three types of loyalty into an experience that activates deep engagement and connects members through shared identity with the brand and with one another. This is the optimal approach for maximizing the benefits of the Multi-Loyalty Framework.

PROGRAM DESIGN FUNDAMENTALS

Loyalty programs are complex. They ultimately can involve a sophisticated and intricate mix of multiple strategies, tactics and audiences. But you don't have to start there. The best strategy when launching a new program is to keep it simple. You should aim for designing a program that is easy to understand and to execute at launch — with a specific plan to add to program sophistication over the first 24 months post-launch — and should include these four basic components:

CURRENCY

Program currency is what members earn for their spend and engagement behaviors (points, miles, stars, credits, etc). Currency is also what your members will use to redeem for rewards. Your program design should include an "earn-burn structure" which establishes how members earn, how much they can earn and at what earning level they will be eligible to redeem.

REWARDS

Rewards are the most powerful motivator of member behavior and should be aligned to your brand and your customers' interests. A robust rewards mix generally offers a combination of merchandise, gift cards, e-gifts and travel at a range of values.

COMMUNICATIONS

Member communications are critical to maintaining engagement. The best programs use a mix of standard and segmented messaging and a combination of channels (email, direct mail, text messaging, mobile and web).

GAME MECHANICS

Game mechanics offer an additional engagement layer to your program beyond simply recognizing spend behaviors. Mechanics commonly found in loyalty programs include tiers/levels, challenges/missions, badges, progress bars, surprise-and-delight, auctions and virtual rewards.

THE THREE MOST COMMON LOYALTY PROGRAM STRUCTURES

An "earn-and-burn" structure is key to most successful programs. It provides the "mercenary hook" critical to attracting new members and maintaining the attention of legacy members. There are a wide variety of approaches to building earn-and-burn into your program, but the three most common structures include:

POINTS & REWARDS

Seen in the majority of loyalty programs, this structure enables members to earn a currency for spend behaviors. That currency can then be redeemed at some later date for a pre-established catalog of reward items. This model optimizes the dynamics of anticipation and delayed gratification to drive engagement.

CASH-BACK

This model focuses on rewarding members with a cash refund that usually represents a standard percentage of their brand spend. It is common with this form of program to enable auto-redemption where rewards are issued with no redemption action required by the member.

OFFER–BASED

Most common in the retail space, this program structure primarily focuses on providing members with an array of special offers and discounts on products and services. These offers are generally richer than those provided to non-members, and/or may give members early access to special deals.

CORE LOYALTY PROGRAM DESIGN CRITERIA

The most critical design criteria for your loyalty program is that it be structured to meet the specific needs and behavior of your customers. However, experience with many programs across multiple market verticals has shown us that some design criteria have applications across almost all successful loyalty programs, including:

1 High perceived value of program currency

No matter what your "points" are worth in terms of actual dollars, members must perceive those points as offering a true value reflective of the their relationship with your brand and worthy of their active engagement in the program.

2 High perceived value of reward options

Points alone do not create a compelling value proposition. What those points can be redeemed for is just as critical. A strong reward mix will include a variety of options at different point values, without offering so much choice that it overwhelms your program members.

3 A compelling "earn velocity"

According to Maritz's own research, 40% of consumers cite "benefits took too long to earn" as the primary reason for quitting a loyalty program. Well-designed loyalty programs ensure that the effort required by members to hit redemption thresholds is competitive with other programs in your space and linked to reasonable expectations for member spend.

4 A personalized, segmented user experience

A common mistake of newer loyalty programs is the temptation to cut corners by creating a single experience for all members. Remember, program members are offering you access to their behavioral data in return for a different kind of customer experience. The more segmented and targeted you can make that experience – taking into account their demographics, interests and needs – the more likely you are to engage them over the long term.

SUCCESS MEASUREMENT

A customer loyalty program is like any other marketing initiative – it is measured by evaluating quantifiable financial metrics against the investment required to design, launch and operate the program. The most common financial metrics include:

ROI

Return on Investment is a calculation of the program's cost against actual or predicted impact on driving incremental profitability through shifting member behavior.

CLV

Customer Lifetime Value is a prediction of the net profit attributed to the entire future relationship with a customer. Customer Lifetime Value is a particularly appropriate metric for a loyalty initiative, since the goal is to develop a long-term relationship with your best customers.

RFM

Recency, Frequency, Monetary Value is a scoring technique often used to calculate or estimate member value and retention.

However, there's more to measurement than just your financial metrics. Loyalty programs offer a number of useful new behaviors which, when tracked and analyzed, can act as powerful proxies for customer loyalty and as predictors of program profitability.

These new metrics include:

- Enrollment rates
- Point accrual rates
- Redemption rates
- Member churn
- Member campaign engagement
- Member referral

Ultimately, your program success metrics should be driven by your company's strategic goals and by the maturity of your program. The key is to be sure that you have a measurement plan in place and that you are scoring your program against those measures, at minimum, on a quarterly basis.

INSIDER TIP

As your program matures, one of the strongest temptations you will face is the inclination to shift your measurement focus from program profitability to program cost. In many companies this shows up in an inordinate preoccupation with reducing cost per point (CPP) versus driving member engagement. **Resist this temptation**.

Staying focused on your program as a profit driver will put you in a stronger position to grow the program and show its true value to the company.

— *Cheryle Frenzel*

PROGRAM FINANCIALS

Since you're contemplating launching a loyalty program for the first time, brace yourself: you'll be encountering a lot of new financial terms. Loyalty marketing has its own language – terms like "point liability," "cost per point" and "breakage"– and it's going to be important for you to understand them.

The financial aspects surrounding a new loyalty program are predominately associated with point liability. This refers to a "holding" account for earned points that are outstanding and expected to be redeemed. Points reserved within the liability account are converted into a dollar amount and reside on the organization's balance sheet.

Think of point liability as an obligation or a debt owed on the part of a company, because that's exactly what it is. It represents a payout, in points, that is owed to members and will be demanded at some point in the future through redemption.

INSIDER TIP

A point expiration policy will help you estimate breakage. Most program members prefer their points never expire, but there are financial and engagement advantages to having an official point expiration policy. It helps you determine a better estimate of breakage – knowing that there is a time when points no longer exist. It lowers program expense and gives you more budget dollars for other marketing initiatives. And it gives your members a reason to stay active and use their points for redemption, one of the most powerful drivers of ongoing engagement in a loyalty program.

– JR Slubowski

1

Rewards expense is incurred when points are issued.

While the actual cash flows out when the points are redeemed and you pay for a reward, your marketing budget is impacted at the time points are issued. This is different from most marketing strategies that are short-term in nature and where expenses are normally incurred at the same time as cash flow.

2

In the healthiest of programs, nearly one third of all points will go unredeemed.

This is "breakage," referring to the points that are never expected to be redeemed, either due to expiration or member forfeitures. Expected breakage is normally estimated up front and is technically never put into your point liability. This also means it should never hit your expense line.

3

Typically, your program's ROI will break even in the second year.

A point expiration policy will help you estimate breakage. Most program members prefer their points never expire, but there are financial and engagement advantages to having an official point expiration policy. It helps you determine a better estimate of breakage — knowing that there is a time when points no longer exist. It lowers program expense and gives you more budget dollars for other marketing initiatives. And it gives your members a reason to stay active and use their points for redemption, one of the most powerful drivers of ongoing engagement in a loyalty program.

Finally, don't let all these financial concepts take your attention off of creating a compelling loyalty program for your members. Your program needs to be financially sustainable, but it also needs the proper investment required to build an experience that is worthy of your customers' valuable time and dollars.

HOW TO SELECT THE RIGHT LOYALTY PARTNER

After you've determined that now is the time for you to develop a loyalty program for your customers, the next thing to do is select the right loyalty partner.

Your new loyalty partner will be acting as an extension of your brand. Similar to any consumer loyalty program, you should expect and plan for this relationship to be along-term one. Most loyalty partner contracts are written for 3-5 year terms and typically continue on longer.

Even to the most seasoned marketer, the process of researching and selecting a loyalty partner may seem like a daunting task. Contributing to this challenge is the tendency for many start-ups and novice loyalty providers to vastly overstate the simplicity of launching a new program and understate the expertise needed to do it well.

So, how can you cut through the clutter and find the "right" loyalty partner for your brand? Here are a few things to consider:

1 You may not know what you don't know.

It's hard for many marketers to own up to this one, but it's true. Loyalty marketing is an ever-evolving, industry that is largely unknown to most marketing professionals. A good loyalty partner will confidently help you:

- Determine what type of loyalty you want from your customers

- Provide assistance in designing a loyalty program (i.e. earn/burn rules, tiers, etc.)

- Provide support in establishing loyalty-specific customer segmentation models

- Be able to provide insights on the financial commitment and likely return on a loyalty program using well-established financial models

- Assist in keeping members engaged with your brand from onboarding forward so that your program will deliver optimal results.

2 What type of loyalty partner do you need?

Most loyalty partners fall within one of the following two groups:

- **Limited Service Provider** (LSP) – generally provides one primary service related to launching or managing a loyalty initiative. Most commonly these are either loyalty platform providers, loyalty design/analytics consultants, call center providers or rewards fulfillment providers.

- **Full Service Provider** (FSP) – provides all or most of the standard components of the loyalty service value chain, including: Program Design, Program Analytics/Research, Creative Services, Loyalty Technology, Program Management, Rewards Fulfillment.

3 What's the difference?

- LSP's generally have services and expertise in one specific area related to a loyalty program. They are typically enlisted for more mature programs where there is already a network of suppliers in place and where you need to integrate discrete offerings to fill gaps.

- The FSP's provide a comprehensive solution from start to finish and/or "plug 'n play" for specific loyalty services as needed. Even though you may not require all of these services immediately, FSP's are able to step in and assist clients at all levels of program maturity and across all service needs. FSP's are generally more attractive to new program initiatives, or for struggling programs looking for a reboot.

"Investing in loyalty makes sense.

Engaged and loyal customers will deliver you more incremental profit. They'll be significantly more resistant to competitive offers. And they'll be a source of referral to acquire new customers who look just like them.

If you do loyalty well.

The trick to doing it well is recognizing that loyalty is a different animal from any other type of marketing. It requires a focus on just the right customers, with just the right strategy and intention, and a clear understanding of tested and proven loyalty financial models.

Master those components and you'll see your loyalty program become a critical performer in achieving your goals for brand preference, growth and market share."

— Barry Kirk

ABOUT MARITZ

At Maritz we help you build loyal relationships with your customers by delivering full-service loyalty solutions, including:

- Program design and strategy informed by loyalty industry expertise, best practices and deep insight into the science of human motivation

- A foundation of analytics and research that provides actionable insights into profitable customer behavior

- A world-class reward experience that is unique for each customer

- Flexible, state-of-the-art technology and creative services that bring your loyalty strategy to life

Our full-service loyalty solution consists of the following components
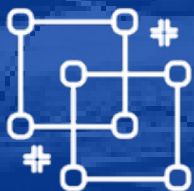
STRATEGY & PROGRAM DESIGN

ANALYTICS & RESEARCH

REWARD STRATEGY & FULFILLMENT

CREATIVE STRATEGY

TECHNOLOGY & IMPLEMENTATION

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