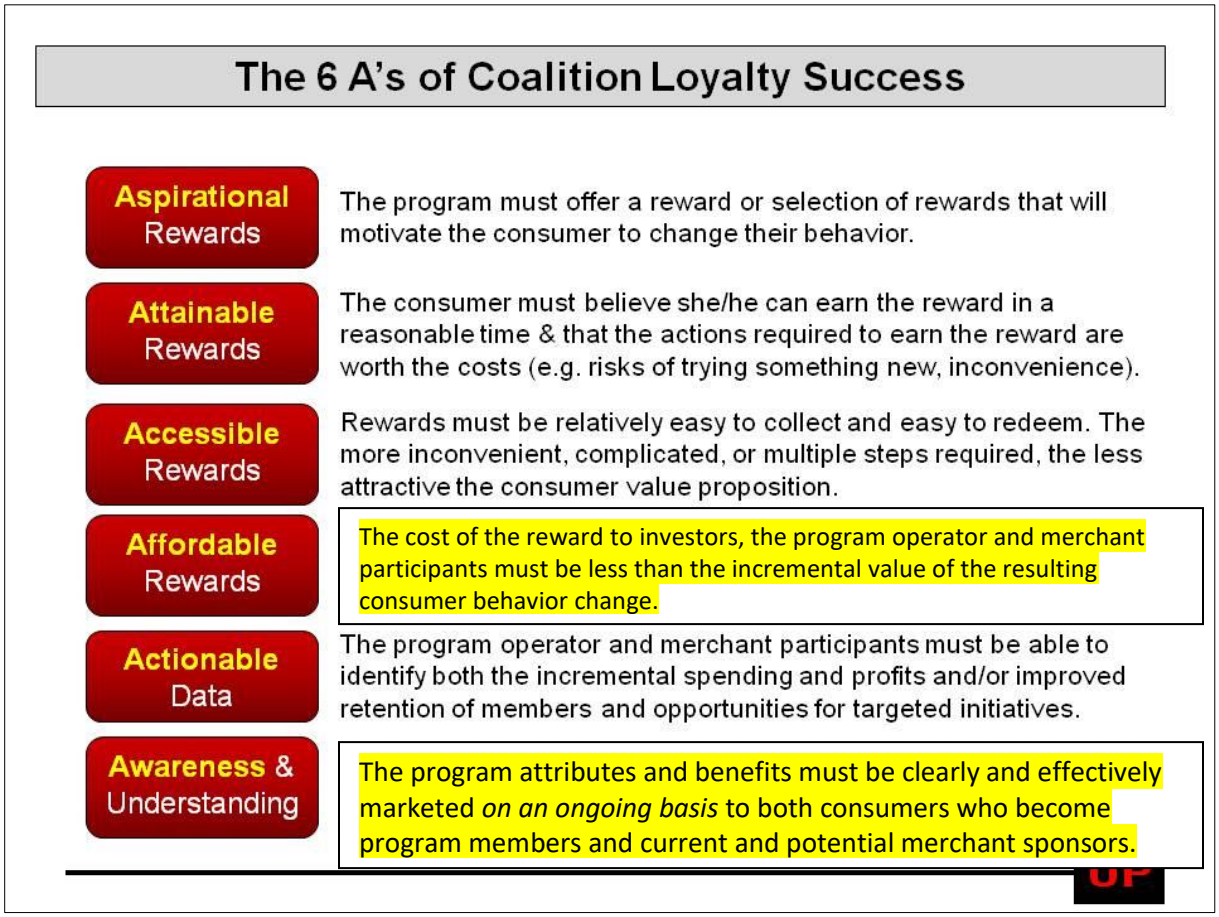
The 6 A's of Coalition Loyalty Success & the Virtuous Cycle of Profitability

Summary: SLI's founders include entrepreneurs and executives who have designed, launched and run many of the most successful coalition loyalty programs around the world. We have also studied other successes and failures and have had the painful personal experiences of being investors or executives in two coalition loyalty programs that were not successful. Before starting Sports Loyalty International. CEO Craig Underwood and Chairman Sir Keith Mills agreed there are six requisite elements of successful program. Rewards must be ***aspirational, attainable****, and* ***accessible*** *or easy to earn and redeem for target consumers and sufficiently* ***affordable*** *to investors, program operators and business partners who pay for the reward to enable a clear and attractive return on their investment. The program must be designed and executed to collect* ***actionable information*** *on participating member's behavior to both prove that the program is delivering an attractive ROI and to identify underperforming segments and new opportunities to use the program's assets to increase the businesses profitability. Finally, participants must be* ***aware*** *of the program's benefits. They must be clearly and effectively marketed at launch and on an ongoing basis to create awareness and understanding of program value to potential and existing members and the businesses paying for the rewards. If these "6 A" elements are present in the program's design and effectively launched and enhanced through rollout and operation, the loyalty business can generate an attractive virtuous cycle of profitability driven by the value created for all stakeholders.*

The 6 A's of Coalition Loyalty Success



All profitable coalition loyalty programs share six common elements in their design, launch, and on-going operations. The most profitable loyalty programs, like the AIR MILES Reward Program in Canada, now part of Alliance Data System's LoyaltyOne division, maximize the effective implementation of all six. Although trade-offs

can be made among the six – as programs that offer extremely high value in some of the areas can still be profitable with less than optimal performance in others – we know of no programs that have been successful, sustainable, and profitable over the long run (e.g. more than five years), who fail to contain all of these elements.

A Most Important Caveat

Before diving into the details of each of the 6 A's, we must share one of our most important believes formed from literally hundreds of years of combined experience by our founders and partners experience running and studying programs in the loyalty space:

A great loyalty program will not compensate for an uncompetitive consumer value proposition.

If your business, product or brand suffers from poor service, product deficiencies and/or pricing that is unaligned with the value provided to target customers vs. the competition, a great loyalty program – either stand alone or coalition – will not compensate. At best, the program will motivate members who have not tried your product or stores to test them, but if they came because of the loyalty rewards, they are unlikely to return if your consumer value proposition is uncompetitive.

We learned this the hard way in the early days of AIR MILES Canada in our grocery category. In Western Canada, we launched with Safeway, the leading grocer, who became and remains an extraordinary program sponsor. In Ontario, AIR MILES Canada's founders – both originally from the US – signed Food City in the wee hours the night before their launch press conference. Although Food City's flagship store was attractive and high quality, the early AIR MILES founders didn't realize that many of its stores were old, tired, and offered poor service, at best, from unmotivated employees. Unfortunately, AIR MILES Founder & CEO Craig Underwood learned this firsthand in an embarrassing moment when Chairman Keith Mills visited Canada shortly after launch. Underwood took Mills on a "store tour" to visit several sponsors and stopped at a Food City that Underwood had not visited before and was clearly *not* a flagship store. Once inside, the nervous Underwood noticed the TV with a built in VCR that was supposed to be playing an AIR MILES promotional video on a nonstop loop during store hours was turned off. He quickly pushed in the tape, anxious to show the company's some of the marketing support the chain was putting behind the program. But within a few minutes of starting, a check-out clerk shouted something like "What's that crap?" And another responded "Oh, it's that AIR MILES video. I am so sick of hearing it." Needless to say, not the company founder's best experience with a Chairman.

The data soon demonstrated in a more powerful way the problem with including a sponsor with a poor or inconsistent consumer experience and/or brand image in a coalition program. We began to test numerous data base driven targeted offers in the early months of the program. Specifically, we identified collectors who were earning miles from Shell and living in the trading area of one of our grocery partners, but had not yet earned miles on their grocery shopping. We ran simultaneous programs in Western Canada for Safeway and in Ontario for Food City. The comparative results were stark and telling. More than 50% of those targeted with bonus offers from their nearest Safeway tried shopping at the store. Then, close to 80% of the non-shoppers who tried Safeway returned for additional visits – demonstrating the initial behavior of new, and highly profitable, loyal customers. The Food City results were nearly opposite. Less than half of those targeted tried their local Food City, reflecting the chain's overall weak brand. More telling was the fact that under 20% of those who shopped at the store once returned for additional visits. Today, over 15 years later, Safeway remains a cornerstone of the AIR MILES Canada program. Food City and AIR MILES did not renew their initial contract and the brand was eventually retired. No Food City stores remain in Ontario. They are a testament to the fact that even a great loyalty program will not compensate for a poor consumer value proposition.

The Details

1. Aspirational rewards: The program must offer a reward or selection of rewards that will motivate the consumer to change their behavior. Our view of what constitutes "aspirational" has changed over time. When we were first selling in and launching Air Miles, we often made fun of programs that offered "bathroom scales" and other consumer appliances as rewards. But a few years into the business, our research demonstrated that a significant percentage of AIR MILES best customers, or Gold Collectors, also held membership in the Canadian mass merchant Zeller's Club Z ("Zed" in Canada) and that many felt "Club Z is more relevant to me." As we reviewed that research, we realized that the definition of an aspirational award was largely individual-centric and we began to expand our rewards, first into other travel related rewards, then entertainment, like movie passes. Eventually, we developed a full (virtual) catalogue of rewards, from electronic merchandise like iPods and flat screen TV's to grocery and other gift certificates from our Sponsors. For some, cash back remains an aspirational reward; for others, saving a few cents per gallon of gas on a few fill-ups per year appear to be highly aspirational. That said, we do not believe that commodity based rewards, cash back or others than can be easily replicated will provide their sponsoring companies a long term sustainable competitive advantage. (For more on this point, see "Ghost Points: The high cost of Ghost Points: Will the short term gains from high perceived value high breakage gas discount and other "loyalty" programs yield long term pain?)

2. Attainable rewards: The consumer must believe she/he can earn the reward in a reasonable time and that the actions required to earn the reward are worth the costs, e.g. risks of trying something new, inconvenience. "Attainability" is a word that those of us in the loyalty business speak about almost as a technical term, and for some of us super nerds it is. But at its core, attainability is a mental calculation or a gut feeling that everyone who continues to participate in a loyalty program operates on. To continue demonstrating the requisite behavior for the time needed to earn the reward, a consumer has to believe *it's a good deal*. Am I going to stay in LA two hours later and take the 12 AM Delta flight instead of the 10 PM American, just for the frequent flyer miles? Am I going to carry a Stop & Shop card and use it every time I shop there to get discounts? Am I going to pay $25 to join the Barnes & Noble program to receive 10% off my purchases for a year? If I believe I am getting *good value* for these behaviors, I will continue to do them – as long as I am reminded of the benefit (see Awareness below). If not, I won't.

   A simple way to think about attainability is "how long does it take to get something I want." One of the major benefits of a coalition program over a stand-alone or single company program is the consumer's ability to accelerate and maximize attainability by consolidating all of their shopping with program sponsors.

   At AIR MILES, based on our initial research and re-enforced by ongoing Collector behavior and feedback, we designed the program so that the average member could earn a free trip in a year and, with the addition of our lower mileage reward options (acronymed LeMRO's), a smaller reward every month. Adding LeMRO's to the program in the mid 90's dramatically improved our attainability for a broad selection of Canadian consumers. One of the most important consumer groups became the front line employee at our Sponsors. A young person pumping gas at Shell, for example, probably wouldn't spend enough in a year on groceries and at other sponsors to earn a free flight, but could earn several movie passes or days skiing with our expanded and more affordable reward options.

   The attainability of programs that offer cash back, usually 1% back, present an interesting question. For some, getting a discount of any value is aspirational and therefore even small amounts back at the time of

purchase or later into an account also represents program attainability. This segment may change over time, partly driven by life stage and partly driven by the economy – particularly the consumer's personal household economics. One thing we believe is that the amount of cash or funds that can be reasonably collected over a year in niche marketed programs must be reasonably significant. For example, saving $20 a year toward a college tuition bill that will likely cost the member over $500,000 doesn't feel like a "good deal." Neither does being able to decrease a $25,000 season ticket to an NFL game by $500. But again, attainability is in the eye of the collector. That said, one thing that cash back does not offer is a reward that is easy to differentiate from competitive offers. Furthermore, putting a dollar in a member's account can be the most expensive reward (see Affordable below).

3. Accessible rewards: Rewards must be relatively easy to both collect and redeem. If access to rewards is inconvenient, feels complicated, or requires multiple steps, the program will be less attractive the consumer and will generate a lower, possibly unprofitable, level of behavior change.

   It is amazing how many programs blow this one. Granted, we don't believe anyone starts out trying to design a program that makes it difficult for consumers to earn rewards. However, in their desire to rush to market – usually for reasons as urgent as a thinning cash flow – many companies end up with unbelievably complicated or burdensome programs. The two best known examples of this are the grocery execution for the 1992 AIR MILES program in the US, and a Dominos Pizza offer in NASCAR's Race Points program. In 1991, the inability to sign grocers as sponsors in the US was augmented by the realization that the then hugely fragmented nature of the retail grocery store industry would make it difficult to sign enough to offer sufficient convenience to the majority of American households. AIR MILES made the decision to offer exclusivity instead to the major consumer packaged goods (CPG) companies – brands like Coke and Kellogg's – as a way to offer miles to collectors. Although Loyalty Management Group executives were able to sign up multiple companies offering great offers on literally hundreds of products, (even in the pre-internet era), the only way for consumers to actually earn points for buying the specific products was to cut out the UPC codes and mail them to LMG. SLI Founder Craig Underwood describes the failure of the U.S. AIR MILES program, in part, by sharing this story:

   Two years after launch, I called my then-70 year old mother to tell her that the US program was shutting down the next day and to reassure her that I still had a good job. The first thing she said was, "Oh my, that must be because of me!" Certain that she was not the cause of the company's demise, but always interested in her thinking, I asked her to explain. She replied, "Because I have a whole drawer full of UPC codes that I have cut out and keep forgetting to mail in." Although my mother was a social worker (and later First Lady) by profession, her business and political instincts were almost always spot on.

   Several years ago, NASCAR developed and launched a Race Points program with the firm Stoneacre. Although some offers were strong and easy to collect, the program suffered from low attainability with no grocer or other major retail sponsors, and with at least one sponsor requiring a baffling level of complexity to earn points. Dominos, a great and nearly ubiquitous brand, was a Race Points sponsor, but required their point collectors to: (1) buy pizza, (2) go to the NASCAR web site, (3) find and click-on the small *Race Points* icon, (4) find the *Sponsors* tab, (5) click on *Dominos*, (6) locate and print a form, (6) find a promotional piece of paper that is taped to the pizza box (probably now in the trash or being destroyed by the customers dog), (7) locate the code on the bottom of the piece of paper, (8) write down the code on the printed form from Step 6, and finally, (8) fax the form to Race Points. The likely consumer reaction: TMTNGTDT (too much trouble, not going to do that).

These are extreme, although quite real, examples. Less extreme would be to require card registration or registration and payment with a specific card. These requirements have worked in many programs, but none are as easy as simply showing the same membership card at the point of sale at every sponsor. Another requirement that will dampen consumer initial and ongoing participation is what we call "two-step programs," where the consumer must collect points in one program (usually an existing single company program) and then transfer them into another program's points before they can be redeemed. This, too, can work and has become far easier with the increasingly interactive capabilities of digital and mobile technology. For example, American Express Membership Rewards collectors can easily transfer their points into Delta's Skymiles or other frequent flyer programs with a few clicks within the Membership Rewards web site, which credits the miles in a few minutes. Although transferring points from one program to another can increase attainability, such a design increases complexity and adds friction that will decrease participation and behavior change, at least to some degree. Again, the more aspirational and attainable the reward, the more hoops an avid collector will jump through to earn the reward.

4. Affordable rewards: In order to generate a positive ROI, the cost of the reward program to investors, program operators, and merchant participants must be less than the incremental value of the concomitant consumer behavior change.

   At the end of the day, nothing else matters if the program is not demonstrably profitable to whoever is paying for the cash back, the points, or other benefits. In most programs this means that the entire system cost of delivering the reward to program members in exchange for their specific shopping behavior must produce a positive ROI, or return on investment. The program must be designed in such a way that the economic benefit of members' behavior change can be shown to be larger than the full cost of implementing the program. The larger the program, the greater the ROI burden on the company executive sponsoring the program and the agencies or program operators helping run it.

   With the growing opportunities for leveraging social, mobile, and interactive digital media to monetize online consumer behavior, the sources of value from reward programs are expanding rapidly. Traditional programs must prove program ROI from a combination of what is usually referred to as lift, shift, and retention. Lift is increased spending from existing customers. Shift is new revenue from customers who switch from a competitor to the participating business or try a new product. Retention is the revenue gained from slowing or eliminating defections to competitors.

   While we use "affordability" as a catchall for program ROI, the actual cost of the reward is an important part of the equation. The greater the difference between the perceived value of the mile or point to the program participant and the cost of redeeming that point to the company or program operator, the easier it will be to demonstrate and prove profitable behavior change. The original AIR MILES Shopping Reward Programme developed by Sir Keith and his colleagues in the late 80's benefited from the ability to access excess seat inventory from British Airways at a fraction of the cost of buying a seat.

   While affordability and ROI are hugely affected by the cost of the reward, the most important part of the equation is not the cost, the investment or the "I," but rather the level and economic impact of the demonstrated behavior change, or the "R" that generates the return on investment. The more aspirational the reward, the faster the attainability, the more accessibility the sponsors, and the greater the ease of collecting points, the greater the behavior change. And most important, if the combination of

the company's, product's, and service's consumer value proposition (including the reward program) do not provide significantly greater value to targeted customers than competitive programs, then the program will not change behavior over time and instead become only an additional cost of doing business. This is what happened to trading stamps in the 60's. Eventually every grocery store and every gas station offered stamps that could be redeemed for exactly the same merchandise in exactly the same amounts. Eventually, since no storeowner or company executive believed the programs were creating profitable behavior change, they all stopped issuing the stamps. We believe the ubiquitous grocery gas discount programs are headed rapidly in the same direction. (For more on this point, see "Ghost Points: The high cost of Ghost Points: Will the short term gains from high perceived value high breakage gas discount and other "loyalty" programs yield long term pain?)

5. Actionable data: The program operator and merchant participants must be able to identify the incremental spending and profits, and/or the improved retention of members and opportunities for communicating targeted, relevant offers.

   At the end of the day, all businesses continue to exist over time if they create value for their customers – the force that actually generates revenue. The same is true in spades for loyalty programs, coalition or other. Those programs that continue to exist and grow, like AIR MILES Canada and Nectar, are clearly providing demonstrable value to their Sponsors. With AIR MILES sales approaching one billion per year, it's safe to assume that some sponsoring companies are paying as much as $100MM per year for their loyalty program. Sponsors would not make this level of investment and AIR MILES would not have grown to anywhere near its current size without the ability to prove that the money Sponsors pay for points, data, insights, and targeted marketing programs increases the profitability of AIR MILES Collectors far in excess of their investment. We use the word investment intentionally. One of AIR MILES greatest competencies is their ability to track collector behavior and to work with Sponsors' CFO's and other leaders to calculate and maximize their return on investment.

   This is only possible if the program is designed and implemented to enable both the program operator and the participating companies to measure behavior change: namely, lift, shift, and retention. Program value can only be maximized for all parties if the loyalty program's information system has the ability to identify the gap between members' potential and current spending at sponsors. A simple example would be the ability to identify a program member with four people in their household, who lives within a few blocks of a sponsoring grocery, but spends less than $50 a week at the grocery. Higher levels of value can be created by understanding other demographic characteristics, responsiveness to offers, reward preferences, etc. This is one of the advantages of a coalition program over a stand-alone or single company program. A coalition program will always have a more robust data set on its members than a single company loyalty program. Coalition programs even have the opportunity to identify changing consumer spending habits over time, e.g. home renovation or an increase in household size (e.g. babie$).

   Regardless of whether the program is stand-alone or coalition, the ability to credibly track the cost and value of incremental behavior change, and increasingly, identify high-potential, underperforming households, must be built into the program design before launch. At a minimum, neglecting this important element will make the program operator's life miserable. More likely, executives within the sponsoring companies who are paying for the program will – and arguably should – kill it.

6. Awareness of benefits: The program attributes and benefits must be clearly and effectively marketed *on an ongoing basis* to both current and potential consumer members and the program's merchant sponsors.

   Although this would seem like a no-brainer, we are continually amazed at the number of loyalty programs that are poorly marketed. Some recover after a poor launch, but many remain so over time. CVS is a rare but excellent example of a company that does a great job of marketing the existence of their programs. Shoppers are asked for their ExtraCare Rewards almost every time they pay at a cashier and 100% of the time by the self-checkout machine. CVS also lets customers use their phone number as a program identifier, a good example of making the program accessible, or easy to collect. Although we never analyzed this, we all believed that one of the primary drivers of AIR MILES' early enrollment and ongoing participation success was the fact that almost all Sponsors' front line employees "ask for the card."

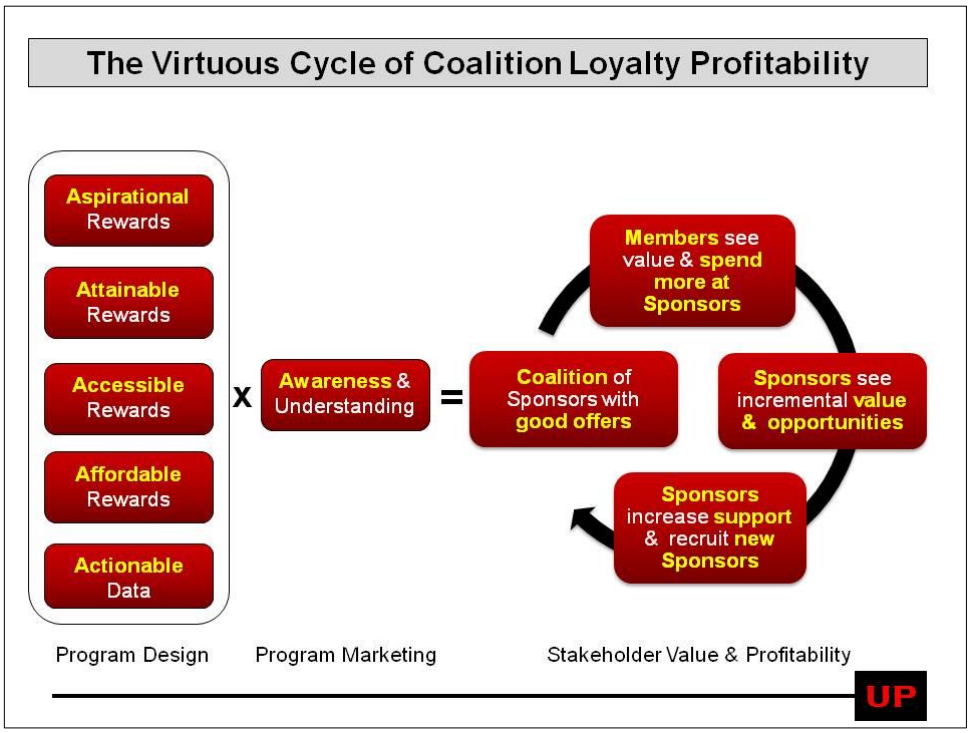
   Another reflection from Founder Craig Underwood:

   While in Canada, I was a member of YPO (Young Presidents Organization) and was fortunate to be in the small group Forum with Don Guloien, now CEO of Manulife. Don showed up at a Forum meeting one night, looked at me and said, "I almost got in a fight because of you today!" Don is a brilliant and passionate Chief Executive, but doesn't exactly strike you as someone who would ever get in a fight. Shocked, I asked him why. He responded, "I'm driving a Suburban and the guy at my local Shell told me I was an idiot for not having an AIR MILES card, given how much we spend on gas." You get the point.

   Creating awareness for the program at launch and on an ongoing basis is critical, but awareness without understanding is actually more damaging than below threshold awareness. AIR MILES founders also learned this lesson the hard way, recalls Underwood:

   We absolutely blew our initial launch marketing for AIR MILES. We created a marketers nightmare: high awareness faced with even higher misunderstanding. Many Canadians thought we were a frequent flyer program (duh!), or a credit card program, or that it would take forever to earn a reward. We knew we had a problem when initial enrollments fell short of our expectation, so we immediately invested in research to understand the problem and rapidly changed our creative to address the problem (this last is now the subject of a business school case study). We learned two lessons. The first was to not get too imaginative with the program message. While our initial creative featured people shopping and then flying through the air, our re-launched marketing focused on sponsor products and services with the tag line "BUY ME, FLY FREE." We learned the value of "two-by-four" marketing. The experience taught us to promote "attainability." We produced a simple chart that showed potential and existing collectors how quickly their miles would accumulate if they shopped at our largest sponsors, as well as what those miles could be redeemed for. The value of a coalition program became immediately clear. It is amazing how many programs fail to use this simple but powerful approach to demonstrating their potential value to customers.

The Virtuous Cycle of Profitability



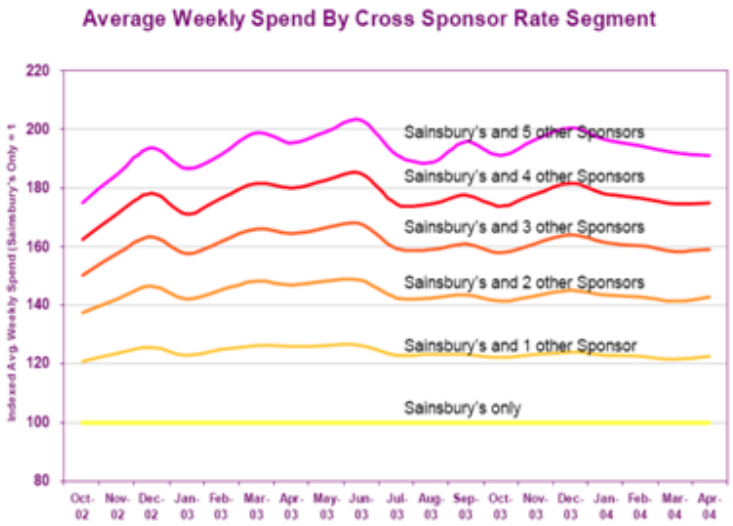
If a loyalty program is designed with rigorous fidelity to the 6 A's at launch and on an ongoing basis, and continuously enhances the program's value proposition in full collaboration with sponsoring companies and reward suppliers, the system can create a virtuous cycle of profitability for all stakeholders. As we stated above, all businesses eventually succeed or fail based on the value they create for their customers, their employees and their investors. One of the reasons we are so passionate about the coalition loyalty model is that the value creation formula is so visible and so linked between collectors, sponsors, and investors.

One of the founding principles of The Loyalty Group was "always put the Collector first." At our core, we believe that loyalty programs must *work* for the customer – the person who joined the program. First, the customer must be getting a reward they value, in a reasonable period of time. Next, this must be in return for actions they believe represent a good deal relative to the value they perceive themselves earning. A program that achieves these two results yields consumers who will not only join, but also continue to exhibit the desired behavior, as long as the combined value proposition of the sponsoring companies' products and services and their loyalty program exceed that of competitors.

In a coalition program, the consumer maximizes program value, or points earned, by consolidating all of their purchases at sponsoring companies. Sponsors in turn benefit when program members buy as much as they can from their respective businesses. Most sponsors will also want program members to buy higher margin products, register for automatic payment, pay their bills on time, and/or exhibit other profit maximizing behavior. All of these behaviors can be rewarded within a well designed and managed database driven coalition loyalty program. The consumers' desire to earn points and the sponsors' desire to maximize share of wallet are completely aligned. This, however, only touches the surface of the value creation story. We found that if Sponsors were seeing a significant ROI on their investment in AIR MILES, and at the same time we were helping them identify opportunities to target underperforming customers, they would actually help us recruit additional sponsors. Derrick Fry, SVP of the Bank of Montreal, flew from Toronto to Calgary with us to attend a dinner with Shell executives who were considering joining the program and then *took the red eye back to work that same evening.*

Both Bill Turner, CMO of Sears Canada, and Jim Brophy, a BMO Vice President, participated in the company's pitch to the Chairman and President of A&P Canada, who soon after agreed to join the program.

While more sponsors in the program increase collector attainability, this, in turn, increases collector loyalty to each individual sponsor. Although this is intuitive, it is backed up by the behavior we saw demonstrated quantitatively in our programs. We began to call this pattern "the multiplier effect." Nectar and their grocery partners at Sainsbury's allowed Harvard Business School to publish the following chart in an HBS Case Study, showing that collectors increased their spending at Sainsbury's as they increased the number of other Sponsors they bought from:



Consumer value creates sponsor value, which increases consumer value, which even further increases sponsor value. But what about the program operator and its investors? They, too, participate in the virtuous cycle. Coalition loyalty is like many businesses, in that they must initially invest in the creation of a customer. In this case, the customer is a program member. The program member is initially a cost and only a *potential asset.* ost of creating or acquiring a program member only *becomes a profitable investment* if the consumer begins to earn points by shopping at sponsors. Depending upon the cost of acquisition and enrollment, the program operator will likely not create a profitable collector if the program member only shops infrequently at one sponsor. If they shop at more than one sponsor, however, the program member becomes marginally profitable and begins to contribute to the fixed costs of running the program. Collector value – and therefore program value – is maximized when members consolidate their spending at as many sponsors as possible. Again, the value creation of all stakeholders – collectors, sponsors, and program owners and operators – is clearly and completely aligned. This explains why coalition loyalty programs, (with a few notable exceptions), either become large and sustainable businesses or fail within a few years of launch.

So if this is the model for program success and investor possibility, how are coalition loyalty and stand-alone programs doing? In aggregate, not well. Colloquy reports that the average US household has joined 18.1 loyalty or shopping reward programs, yet remain active in only 8. In other words, the average American consumer has joined and consequently dropped out of more programs than found them valuable enough to remain active in. From our experience internationally, we know that well designed, launched, and run loyalty programs can maximize value for all stakeholders.