McKinsey&Company

Chief Marketing & Sales Officer Forum

Loyalty: is it really working for you?

Just because you have a loyalty program doesn't mean its generating value.

December 2011 | by Tariq Shaukat and Phil Auerbach

Everyone values loyalty – presidents, generals, friends. That's no less true for corporations. U.S. companies spend $50 billion a year on loyalty programs alone. And if you get it right, loyalty programs can generate as much as 20 percent of a company's profits.

So you'd think that, given those stakes, companies would have carefully developed loyalty programs. In our experience, however, it's surprisingly rare. In too many cases, companies have built "me too" commodity programs – how many points and rewards programs are you a member of? – that often don't drive value. They are easy to copy and don't take real advantage of the latest capabilities (e.g., social networking) available to consumers today.

In addition, companies often take a "set it and forget it" attitude to programs that don't keep up with the changes in the marketplace. Customer behaviors change, product portfolios change, competitors change – but loyalty programs often just innovate at the margins instead of constantly refocusing on where the opportunity is. Our research into the customer decision journey has shown that keeping customers in a virtuous loyalty loop is critical to spur both brand advocacy and sales.

Executives are shocked when we show them our analysis of U.S. retailers that found those with loyalty programs were posting a 2.28 percent comp sales increase, while those without loyalty programs were posting 4.26 percent gains. Granted, there are many possible reasons for that disparity, but marketing leaders see the big warning sign: Just because you have a loyalty program doesn't mean it's working.

This is true in company after company we've worked with. In a recent visit to a leading travel firm, we discovered that more than one-third of its best customers were not even in its loyalty program. The company was spending money on loyalty, but not investing in all of its most loyal customers.

To succeed today, it is clear to us that companies need to embrace new digital tactics, re-examine old systems, and move beyond just points and rewards.

Creating loyalty programs that work

Well-designed loyalty programs have impact where it matters most – with high-value, high potential, or at-risk customers. To ensure that your program is driving maximum value, we suggest three steps:

1. **Be crystal clear about your objectives:** Programs can drive impact far beyond a narrow definition of "loyalty". What do you want your loyalty program to do? Win new customers? Increase wallet share? Save money? The first step to any loyalty program is concrete objectives. That may sound obvious but, in our experience, most ineffective or value-destroying programs lack this basic discipline. Knowing your goal will help you target the right customers, design the right benefits, and focus on analyzing the right metrics.

2. **Get granular to identify the customers who are really valuable:** How well do you really understand your customers? Successful loyalty programs understand both the profit customers generate and the influence they have more broadly on sales. The real payoff from loyalty programs comes from locking in those customers who drive profitability .

   At one consumer services client, for example, we discovered that less than 1 percent of the customers generated over 10 percent of the company's profit. Standard metrics used in the loyalty program – frequency of purchase, for example – failed to consistently identify these high value customers. As a result, resources were invested in the wrong people and in the wrong places.

3. **Build a program around the customers that generate value:** Loyalty programs are comprised of two "frames," our term for the structure, benefits, and experiences of the program:

   - **Published:** Visible programs promoted to customers and non-customers, such as traditional "points'"and experiential offerings (e.g., access to concert tickets or access past security lines). These published programs are intended to motivate and appeal to a broad audience, generate excitement, and build scale. Often, a broad program is accompanied by segmented offerings that offer rewards to specific segments based on their value and/or potential (think platinum, gold, silver, etc.). They can also be tied to different life stages, attitudes or needs.

   - **Unpublished:** These are rewards or experiences that are generally not visible or known to the average consumer – often invite only. They can be offered to the best customers or to target specific behaviors (high potentials, early tenure customers, etc). Often they will have "surprise and delight" elements. In many cases they are structured programs that are invitation-only. These rewards are meant to convey an exclusive status and are generally most useful in increasing share of wallet of those most profitable customers. Importantly, they are harder for the competition to copy.

   Within the Published frame, it is important to create segmented offerings that tie rewards based on various levels of service and value to the right customer groups based on their value and/or potential (think platinum, gold, silver, etc...). Rewards can also be tied to different life stages, attitudes or needs (e.g., families, beginning of college, etc.).

In one example, a gaming company to use both Published and Unpublished approaches to reward its most valued customers. The customers are encouraged to sign up for the program and identify themselves during play – a highly public and open experience. At the same time, other rewards are delivered to these high value customers through more private pathways such as tracking the customer's gaming patterns and giving more personalized rewards. The combination of Published and Unpublished tactics creates a matrix of loyalty efforts that surrounds the company's most desirable customers. The result was a share of wallet increase by as much as 20 percent and average revenue by up to 25 percent.

One company following this segment-oriented strategy for a Published program is Amazon. It launched its very public Prime program in 2005 as a subscription-based program with an annual fee. These best customers increased their purchases on the site by about 150 percent after they joined, according to Bloomberg BusinessWeek. Amazon has since built on the Prime 'frame' to create two new segment-specific offerings: Amazon Student and Amazon Mom.

A large number of companies are actively raising loyalty to the top of their agenda. While a formal Published "program" is not always the answer, it is important to ensure that loyalty isn't an afterthought. For those with loyalty initiatives, it is equally important to ensure that they don't turn out of sync with consumers, competition, or the market. Otherwise the money you're spending is simply flying out the door. And it's only matter of time until the customers follow.

To learn more, contact us at marketingandsales@mckinsey.com. You can find related insights on our site: http://cmsoforum.mckinsey.com. Please follow us on Twitter @McK_CMSOforum