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Is it time to rethink loyalty programs?

Drive market share with new strategies for success

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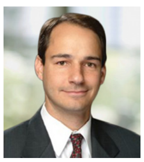

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Sam is a Principal in KPMG Digital and Mobile Solutions and is responsible for bringing together digital solutions for customers in consumer markets across multiple disciplines, competencies, and capabilities within KPMG. With over 25 years of experience, Sam has implemented solutions involving business transformation to thrive in a digital world, customer experience, data and analytics, mobile commerce, Internet of Things, and mobile device infrastructures. Sam specializes in helping customers drive business value using digital and disruptive technologies that include but not limited to digital transformation, creating nontraditional revenue generation models, intelligent supply chain, and channel enablement.

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Todd brings more than 15 years of experience developing solutions for some of the world's most iconic brands using data, analytics, and technology to cultivate enduring, valuable relationships with customers. He is a recognized specialist in the digital marketing world, having worked with senior marketing and technology leaders to design, build, and implement customer-centric initiatives—market entry, data sourcing, data management environments, data-driven creative services and experience design, product development, customer acquisition and retention, and analytics advisory services—that are the key growth drivers for all major brands that are organizing around the customer.

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Paving a new path to growth with loyalty

Millennials, showrooming, and ever-changing technology platforms all lead to a landscape where U.S. retailers find themselves in a low-growth world. Annual growth rates in retail sales appear stuck under 3 percent—well below the 5 percent+ levels that used to be common.[1] Cost-cutting can be part of the response, but retailers cannot prosper unless they keep winning and satisfying customers.

Customer loyalty is a proven way to not just sustain market share, but to grow it. In most mature brands, over 85 percent of *growth* comes from their most loyal customers.[1] People who are already enthusiastic about buying a particular brand are a prime market for that brand's new products. After all, who is more likely to buy a new breakfast cereal or moisturizing cream than consumers who already prefer other food and skincare products from the same brands?

Most retail executives know they have to focus on customer loyalty as they transform their companies to face new technologies, customer behavior, and competitors. But few companies are actually taking action. In KPMG's 2016 Global Consumer Executive Top of Mind survey, 90 percent of respondents said they are worried about customer loyalty, but only 24 percent said building and sustaining customer loyalty was in fact a top ten priority.

That disconnect leaves room for opportunity—and for many companies, optimizing loyalty programs can provide a way forward. KPMG recently conducted a survey of 700 consumers to understand how they currently view loyalty programs and where the opportunities exist for improvement. The results show that loyalty programs are still a major influencer on consumer purchase decisions and can be a useful tool for growth, but they must be kept current.

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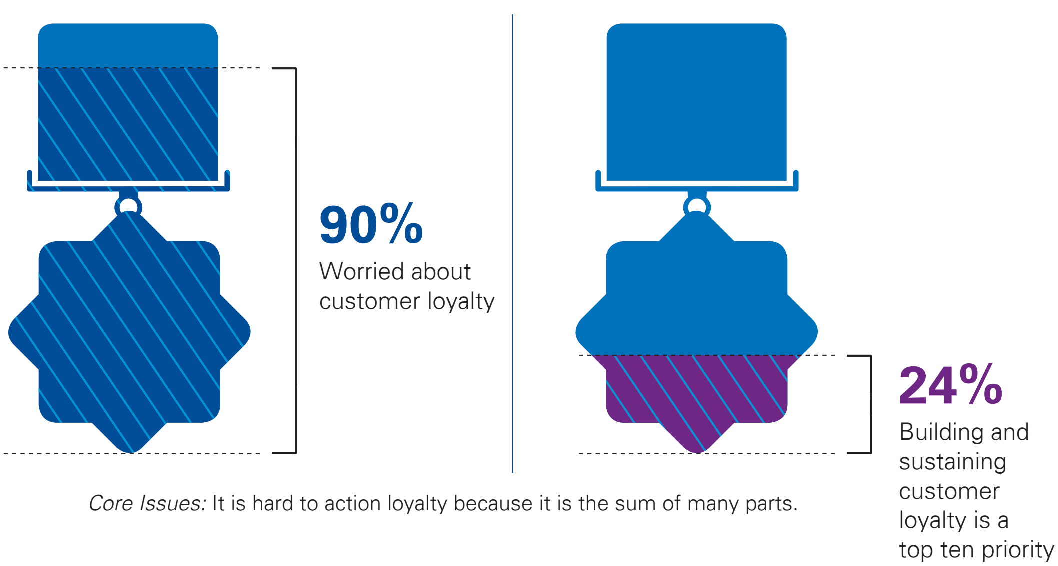


Core Issues: It is hard to action loyalty because it is the sum of many parts.

[1] Trading Economics United States Retail Sales YOY 1993-2016

Make it worth the effort

With cheap capital, low barriers to entry, and new technologies offering new business models, new players are rapidly entering the traditional retail space. Meanwhile, technology has empowered customers with immediate access to more choices and increasingly personalized services than ever before, and they are demanding the same options and experience from every kind of retailer. Digital consumers are increasingly controlling the narrative about the brands they consume through social media platforms and referrals to friends. The old patterns of consumer behavior, advertising effectiveness, and the customer value chain no longer hold true in the current marketplace.

Yet, loyalty programs still appeal to consumers and can still drove market share. Two-thirds of customers in a recent KPMG survey[2] admitted to making a special trip in the last six months to shop at a store in order to earn an award in a loyalty program. Three-quarters of respondents revealed they would give "rave reviews" to at least one of the loyalty programs in which they participate. And 60 percent said they would shop at a store with slightly higher prices in order to earn a loyalty program award.

The costs can be significant. Investments in loyalty programs can reach as much as 5 percent of sales. That means that for a program to be worth the money, it has to reach the right customers, reach them effectively, be disciplined about spending, and have the right financial model.

2/3	**of customers in a recent KPMG survey admit making a special trip in the last six months to shop at a store in order to earn an award in a loyalty program.**
3/4	**of respondents reveal they would give "rave reviews" to at least one of the loyalty programs in which they participate.**
60%	**said they would shop at a store with slightly higher prices in order to earn a loyalty program award.**

[2] Survey executed by MFour Research. See methodology on page 12.

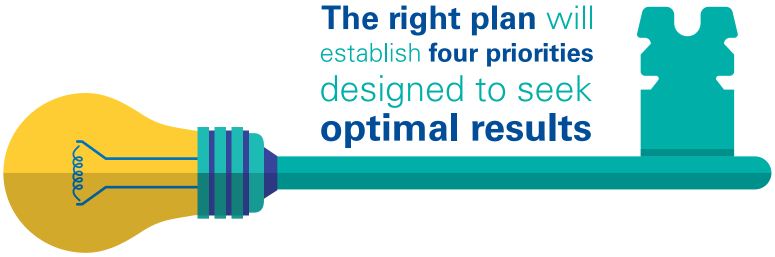
How is your loyalty program performing?

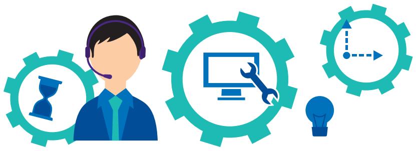
Many companies have loyalty programs. Only a few are optimized to take advantage of today's market and to evolve for tomorrow's consumer. In a fast-paced, increasingly digital marketplace, last year's leader may be this year's laggard. Here are a few questions to determine if a company's loyalty program needs an update or refresh:

- ☐ Are customers enthusiastic about the program?
- ☐ Is it easy for customers to use the program across multiple channels?
- ☐ How much sales growth and customer retention is due to the program?
- ☐ How many customers are "points obsessed"? Does the program treat them differently?
- ☐ Is the financial return on the program satisfactory?
- ☐ Is your program able to answer the above five questions with quantifiable data?
- ☐ Has the program been updated in the last three to five years?
- ☐ Do you regularly hear stories of how the program is changing customer behavior?
- ☐ Does the program have a plan for meeting the needs of the next generation of loyalty?

Many companies may find that the answers to these questions are either "no" or "we don't know." These companies will want to consider a plan to renew part or all of their loyalty programs.

Achieve results with an action plan





1 Start with the core customer experience

A good loyalty program will multiply the impact of a good customer experience; it will not compensate for a bad one. Companies need the right metrics to measure the customer experience in a multichannel retail marketplace, and they need to make that experience the starting point for strategy. The loyalty program, as part of that experience, also needs metrics, including Key Performance Indicators (KPIs).

2 Leverage data effectively

What separates a good loyalty program from a great one? The way it uses the customer data it acquires. Ask yourself: What are my company's most critical business processes? (Pricing or product development are examples.) Then ask: Am I using customer data from our loyalty program in these processes? If the answer is no, your company is missing tremendous opportunities to drive value across the entire business.

3 Keep it new and interesting

The core program has to be consistent, but consumers like novelty. With the right approach to testing and personalization, a loyalty program can frequently introduce new and different benefits that excite customers at a reasonable cost. At the same time, the right analysis will identify benefits that are not popular or profitable. Why not sweep out the dead weight while you win attention with new ideas?

4 Design a business model first

It is often cheaper **not** to worry about the budget at first. Instead, first identify the right program to offer the customer experience you need. Then create a business model that matches your business's financial profile. This approach permits greater creativity in funding and benefit models.

In the next section, we will look at some ideas for a profitable business model.

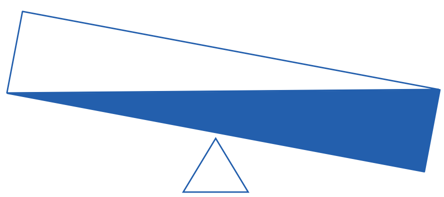
Get the numbers right

How can a loyalty program's business model be affordable and sustainable, while still appealing to customers? Every program is different, but these guidelines will work for most:

- ✓ **Find the right irrationality point.** The best programs generate the most perceived value for customers while costing the least. Companies must have insight into what their customers find valuable—it is not always the largest amount of savings. A good loyalty program's customers will take "irrational" actions to achieve certain benefits. Consider the results in our survey, which revealed that 50 percent of customers said that they would do "almost anything" to earn more rewards in at least one loyalty program.
- ✓ **Make your currency flexible.** As market and consumer preferences change, your loyalty program has to change too, so it can reward customers for new behaviors. To prepare for these inevitable changes, it is best to design a currency that can change too.
- ✓ **Be surprising.** In our study, over 80 percent of loyalty program customers said they prefer surprise deals or gifts to information on sales, special privileges, time-saving opportunities, or other traditional program benefits. A program that offers frequent surprises will likely see a spike in sales and can be less generous with other benefits. Free gifts do not produce points liabilities and can be tailored to individual customers.

74%

of consumers will go out of their way to shop at a store where they earn loyalty points



More than half

of consumers would "do almost anything" to earn more loyalty points

80%

of consumers get excited to find a new way to earn loyalty points

- ✓ **Build partnerships.** It is often possible to develop a partnership to make a loyalty program more affordable. Cobranded credit cards and working with suppliers to reduce costs for products or funding are just two among many partnership options.

  These guidelines will help you define the right program and put a business model in place. The next step is to optimize operations.

Avoid the pitfalls

Even the most appealing and cost-effective programs will not work if operations are not smooth and safe. Here are some areas where problems can emerge unless managers prepare:

Execute on core operations. The wrong program can do more harm than good so it is important that you deliver what you offer. Thirty-eight percent of consumers in our survey reported having problems with a loyalty program over the previous six months. Redeeming points caused the most common problems. Obviously, a program will create the opposite of loyalty if customers feel that they are being treated unfairly. Frustrated consumers often lead to frustrated employees, potentially creating a vicious cycle.

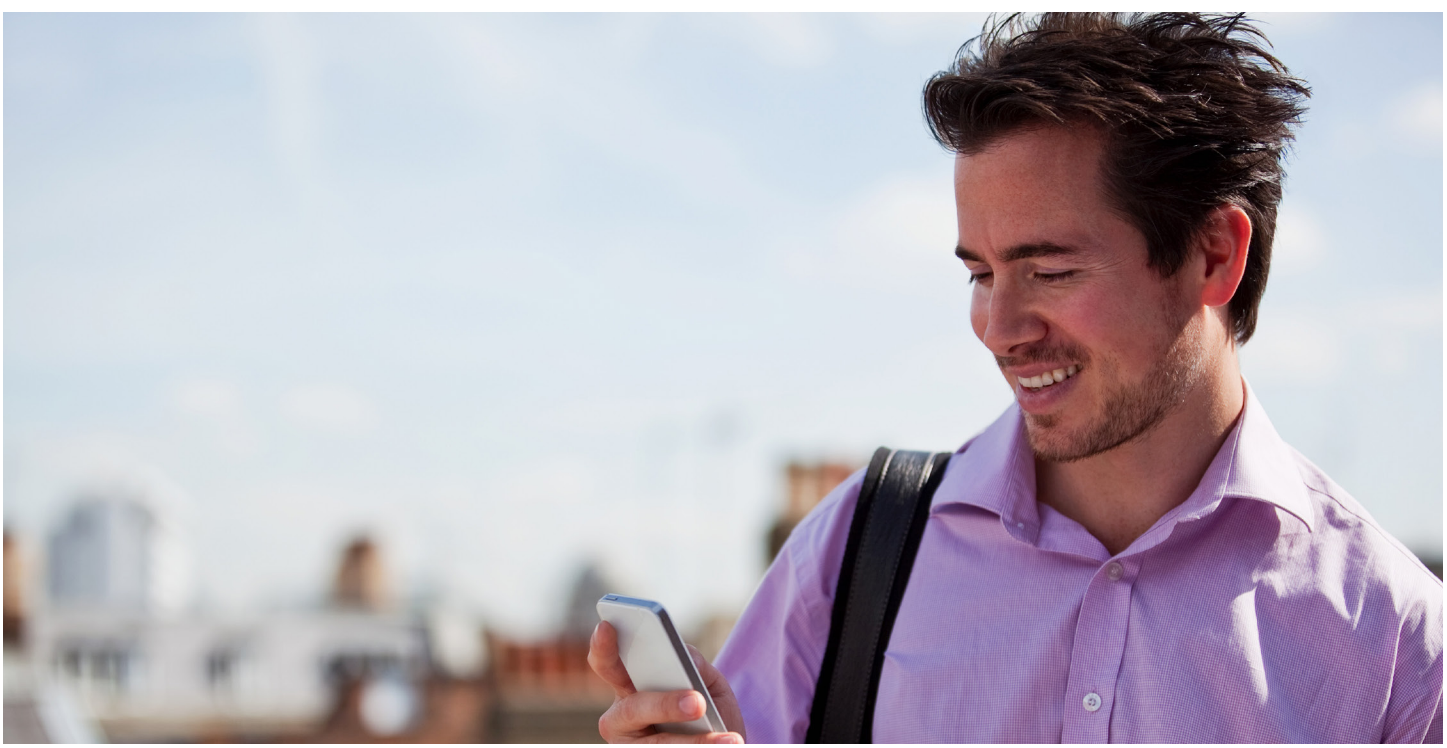
38%

of consumers reported a problem with a loyalty program in the last 6 months

Most common issues:

1. **Redeeming a reward**
2. **Understanding how much of a reward was earned**
3. **Getting credit for a purchase**
4. **Accurate points balance**

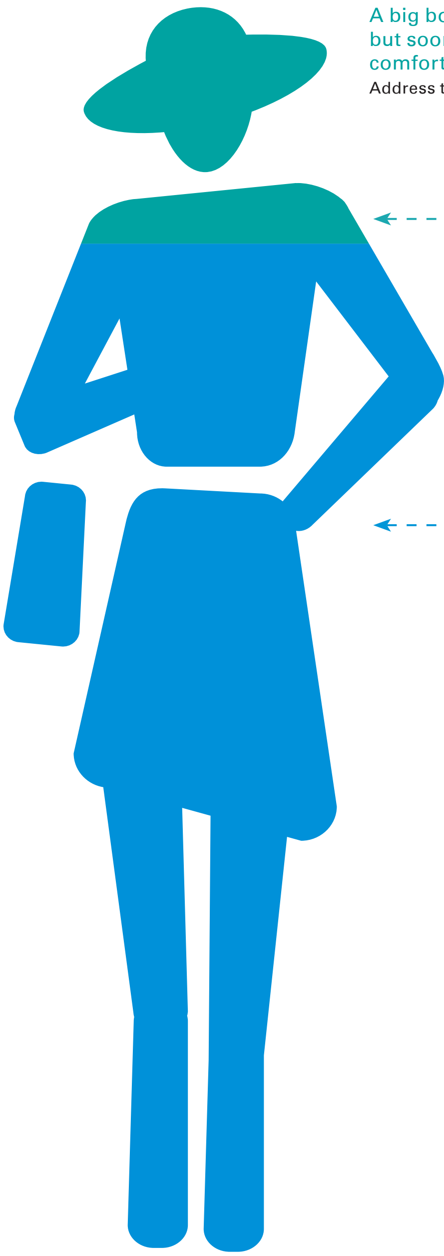
Calculate correctly. It is often hard to estimate the cost of promises you have made to customers. Companies need the right data and the right tools to analyze it. Loyalty programs also need to forecast how external factors—including the economy and competitors' programs—will influence customers' redemption patterns. Programs also should not change benefits and conditions without a firm estimate of the impact on points liability.



Ensure cybersecurity. Cybersecurity isn't just an IT issue. In our survey, 19 percent of consumers said they would never return to a brand that has been hacked, even if the brand fixed the security breach. Of those who said they would eventually return, 33 percent said they would wait at least three months. Suspicion is already rampant: 53 percent of respondents said that they are not happy that brands are storing personal information. Every loyalty program needs to know possible cybersecurity issues, develop a prevention plan, and prepare to detect and respond should a violation occur.

A big box retailer is hacked, compromising your personal information, but soon thereafter addresses the security flaws. Would you still feel comfortable to continue shopping at that store?

Address the flaws; allay the fears.



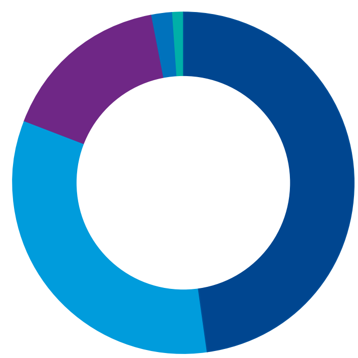
19% No

81%[a] Yes

[a] 62% $25,000 to $34,000

If yes, how long would it take for you to feel comfortable buying from that retailer, online or in-store?

Losses can mount from slow-to-return customers.



- 48% Immediately
- 33% Three months
- 16% Six months
- 2% 12 months
- 1% More than 12 months

What factors would most likely contribute to you not shopping there again?

- 68%[a] Lack of a solid plan to prevent future attacks
- 54%[b] Retailer's refusal to cover losses
- 53%[c] Lack of timely acknowledgement/ response
- 51% Informed by the press before being informed by the retailer

[a] 77% Boomers
[b] 71% Less than $25,000; 65% no college degree
[c] 63% Male; 44% Female

Realize millennials are loyal too

Just like their parents and grandparents, millennials like loyalty programs. Over 90 percent belong to at least one loyalty program, according to our survey. More than half belong to more than one in a single category. It is important for companies to design loyalty programs to match their particular consumers' preferences, not those of an entire demographic. But millennials' expectations and behavior do give several guidelines for developing the next generation of loyalty programs.

They like to earn experiences. This well-known consumption pattern for millennials applies to loyalty programs too. In fact, millennials are more likely than older counterparts to join programs associated with food delivery, restaurants, education, health, diet, and exercise.

They like earning points. Millennials are less likely than their older counterparts to purchase a product or check in at a location just to earn points. They are more likely to engage in loyalty programs whose mechanics for earning points are linked to an experience: games or charitable donations/activities are examples.

To engage and retain millennials, loyalty programs should leverage whatever experiential components they currently have and consider adding new ones. Easy places to begin are games and expanded mobile services. More advanced strategies connect with customers' passions. For example, a major sports clothing and accessories company built a fitness platform that provides daily engagement with customers and data about product use. Loyalty programs that lack an experiential dimension need to act now, or risk losing a major demographic.

90%

of Millenials surveyed belong to at least on loyalty program

Millenials are more likely to participate in programs at:

— Department stores
— Grocery stores
— Restaurants
— Food delivery
— Grocery stores
— Entertainment
— Gym and healthcare

…And less likely to participate in programs in:

— Travel
— Big box retail
— Drug or convenience stores
— Credit cards

Seize the benefits of a relevant loyalty program

Loyalty programs are one of the best and most affordable paths to sustainable growth, if they are well-designed. But too many companies have merely tinkered with their traditional programs that were established years ago when consumer expectations and the competitive environment were much different. Many do not even have the tools to measure exactly how their loyalty programs are currently performing, especially in such key areas as the effective use of consumer data.

The first step for any company is to get a clear assessment of how customers view your brand and your loyalty program and of how well that program is currently working. With that analysis in hand, strategies to reinvigorate the program for your customers and your bottom line may be easy to find.

By following a proven method of driving customer engagement to gain customer loyalty, companies can seize opportunities to strengthen relationships with their customers, build their brands amid increasing competition, and drive market growth.

About KPMG

KPMG Strategy (Consumer Markets)

Things are changing faster and in far greater ways than ever before. Ever more empowered consumers, disruptive technology players, regulatory changes, and a focus on health and wellness are forcing today's consumer markets organizations to take a whole new look at their businesses.

KPMG understands that creating higher-performing organizations and delivering transformational change must be founded on continuous innovation and relentless customer focus to win in the marketplace.

Research methodology

This report is based on a KPMG survey, executed by MFour Research, of 700 consumers evenly split between those under 35 and over 35 and between male and female.

Additional KPMG proprietary research was referenced in this document, including the 2016 CEO Outlook survey, 2016 Consumer Loss Barometer survey, and KPMG's 2016 Nunwood Customer Experience survey.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