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THE ART AND SCIENCE OF CHANGING CUSTOMER BEHAVIOR

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The Long Tail of Loyalty

It's more than the latest marketing catch phrase— through diligent application of dialogue marketing, network-building and relevant rewards, smart companies are opening up new vistas in customer retention and lifetime value. COLLOQUY takes a look at life in the Long Tail.

The De-Evolution of Loyalty

HOW TECHNOLOGY DRIVES STRATEGY DECISIONS—AND VICE VERSA

BY JIM KUSCHILL

LOYALTY PROGRAMS HAVE BEEN AROUND LONG ENOUGH— NEARLY 25 YEARS HAVE PASSED SINCE AMERICAN AIRLINES LAUNCHED THE AADVANTAGE PROGRAM—THAT WE'RE STARTING TO SEE THEM ENTER THEIR SECOND AND EVEN THIRD GENERATIONS. TECHNOLOGY EDITOR JIM KUSCHILL HAS KEPT HIS EYE FIXED ON PROGRAM EVOLUTION AND HAS DETERMINED THAT PROGRAMS NOT ONLY EVOLVE, BUT ALSO DE-EVOLVE—AND THAT SUCH DE-EVOLUTION MAY ACTUALLY BE BENEFICIAL.

In the beginning, there was the consumer and the vendor. They knew each other. Marketing couldn't help but be one-to-one. And it was good. Over time, businesses got bigger. People traveled far and wide. Vendors no longer knew the consumer. Marketing had a problem. And it was not so good.

Then on the Sixth Day, Marketing conceived of the Loyalty Program. In exchange for information about you, I'll provide you valuable compensation— in points or miles, perhaps, or maybe in terms of preferred services or other benefits at my establishments. Thus was the proprietary loyalty program born. Marketing smiled and saw that the solution was good— for a time.

Consumers appreciated the loyalty program. But being the fickle creatures they are, they soon grew tired of the limited options available for earning points. Their velocity was too slow, making it hard to achieve meaningful rewards. So Marketing decided that additional ways to earn equity would add excitement to the program. Compatible vendors were contacted and brought into the fold. Thus was the Partner model of loyalty programs born. Marketing smiled and saw that the solution was good. But only for a time.

Consumers appreciated the enhanced earning options. But being fickle creatures still, they soon grew tired of the limited options available for redemption. The available rewards no longer excited them. Marketing then decided that additional ways to burn points would add excitement to the program. Compatible partners were contacted and brought into the fold. Thus was the Player model of loyalty programs born. Marketing smiled and saw that the solution was good— but once again, only for a time.

Each of these strategy changes begat technology changes. What started as a simple exercise grew into a monster technology platform, with inputs and outputs galore. For a time, the technology people were happy to enhance and adjust the system. Marketing smiled and saw that the changes were good. But for how long?

Each time Marketing wanted to implement a bonus, the software platform grew. Each time Marketing wanted to add a tier or a redemption option or a new source of data, the complexity grew. Soon, the people who knew why the software worked the way it did moved to other tasks and other jobs. They left their code behind, but little else.

But the changes kept coming— only they were no longer fun to implement. An addition to one portion of the system broke another portion. Last year's Christmas bonus fired again this year, but nobody immediately new why. It took longer and cost more to add capabilities. The consumer couldn't understand why their balance on the IVR didn't match their balance on the web site, and why neither balance matched what the call center provided. And they wondered why it took weeks for transactions to post to their accounts.

Meanwhile, some very smart Marketing people looked at the costs of running loyalty programs and scratched their heads. They saw two key problems: the earning velocity and the program cost. While the Player model helped earning velocity, it was still fairly low for most participants, which made it hard to keep members happy and involved with the program. These marketers also recognized that loyalty programs were costly to develop and operate, which limited both the vertical markets that could support a program and the richness of value proposition they could provide.

If Marketing could somehow obtain efficiencies across a number of vendors, velocity would increase and costs would go down. And thus the Coalition model of loyalty programs was born.

The Coalition model allowed members to earn a single currency across each program sponsor, thus increasing velocity and reducing costs over a standalone program. What's more, the model increased a sponsor's ability to acquire new customers and more intelligently cross-market to their current ones. Once the coalition obtained traction in the marketplace, the marketing people saw this, and there was much rejoicing.

As with most things in life, the Coalition model represented compromise. Sponsors had to agree on who owned the data generated across the coalition and what could be done with it. Usually, the coalition itself owned the data and controlled its use, not the sponsors. Sponsors also had to agree on who owned the brand, how that brand was marketed, and how the sponsor brands were marketed with it. Finally, the coalition itself needed to make a profit— and that profit had to be factored into the operating costs.

Still, barring fundamental technology changes, the Coalition model has proven sound. But technology evolves, and that evolution raises some interesting questions. Will the compromises inherent in coalitions continue to be good ones?

We are DEVO

Loyalty program costs generally come in three large buckets: awards, communications and operations. Award costs are generally the biggest bucket, as technology evolution has allowed marketers to lower communications and operational costs. Tasks that used to take time and money can now be performed quickly and inexpensively. We no longer have to build everything from scratch— we can license technology and outsource our operations. The available software is robust and generally provides more flexibility than we may ever need.

So marketers must periodically survey the landscape. At some point, might the costs, both tangible and intangible, that accrue to coalition sponsors become greater than the costs of going it alone? Perhaps not for every vendor or vertical— but certainly for some, this will be the case. We may live to see a de-evolution away from the loyalty coalition. Given the cyclical nature of most things, such de-evolution seems inevitable.

Consider the natural evolution of airline loyalty programs as an example. Most frequent-flyer programs began life as proprietary programs, evolved into partner programs and then eventually grew into player programs. The sequence of evolution seems to stop here. We have yet to identify any program, in the airline or any other industry, that has made the transition from a

player program to a coalition— although Air Canada's *Aeroplan* program seems determined to try. Perhaps the value of the proprietary brand has greater perceived value than the coalition brand. While vendors do sometimes sunset their proprietary programs and join coalitions, the hurdles to intrinsic evolution appear too great.

On the flip side of the equation, we have already seen a few instances in which a sponsor left a coalition to launch a proprietary program. Given the changes in technology and their impact on costs, we expect to see more. And doesn't it seem reasonable to believe also that, once propriety programs appear again, they will inevitably evolve once more into Partner and Player models?

As always, this cycle of evolution and de-evolution will be driven largely by technology choices, as determined by strategic decisions. While this form of marketing evolution is perhaps not as inevitable as Darwin, it does happen. Your program will change over time– you'll add and remove tiers, bonuses, communications streams, partners and so on.

You'll also find yourself fighting that other inexorable force: entropy, or the nature of a system to fall apart over time. Code changes hasten entropy, and loyalty programs by their very nature demand changes. The more data silos you have, the more complex your program rules, the more sources and sinks you have for information, the harder it is to keep entropy at bay and to implement the changes you need to evolve your program in the right direction. Whether your program is evolving or de-evolving, you'll want to make sure that you're in control.

Jim Kuschill is the Technology Editor for COLLOQUY. His hair is growing back just fine, thanks.

"Barring fundamental technology changes, the coalition model of loyalty has proven sound. But technology evolves, and that evolution raises some interesting questions. Will the compromises inherent in coalitions continue to be good ones?"