WHITE PAPER

Loyalty 2.0 - Making Loyalty Pay

October 2023
By Ed Crouch, Christina Flood, Patrick Hadlock, Mike Marcus and Amanda Luther of the Boston Consulting Group, Inc.; and Nancy Bacon, Shawn Conahan and Jordan Glazier of Wildfire Systems

Making Loyalty Pay

Financial Institutions (FIs) and Merchants are struggling to make loyalty economics work in a world with rising consumer expectations and strained loyalty funding sources.

Loyalty programs are a proven way to build a positive brand identity, boost engagement, increase sales, and improve customer satisfaction levels. Growing competition, combined with the rise of digital commerce, has led to an acceleration of rewards platform innovation over the last decade.

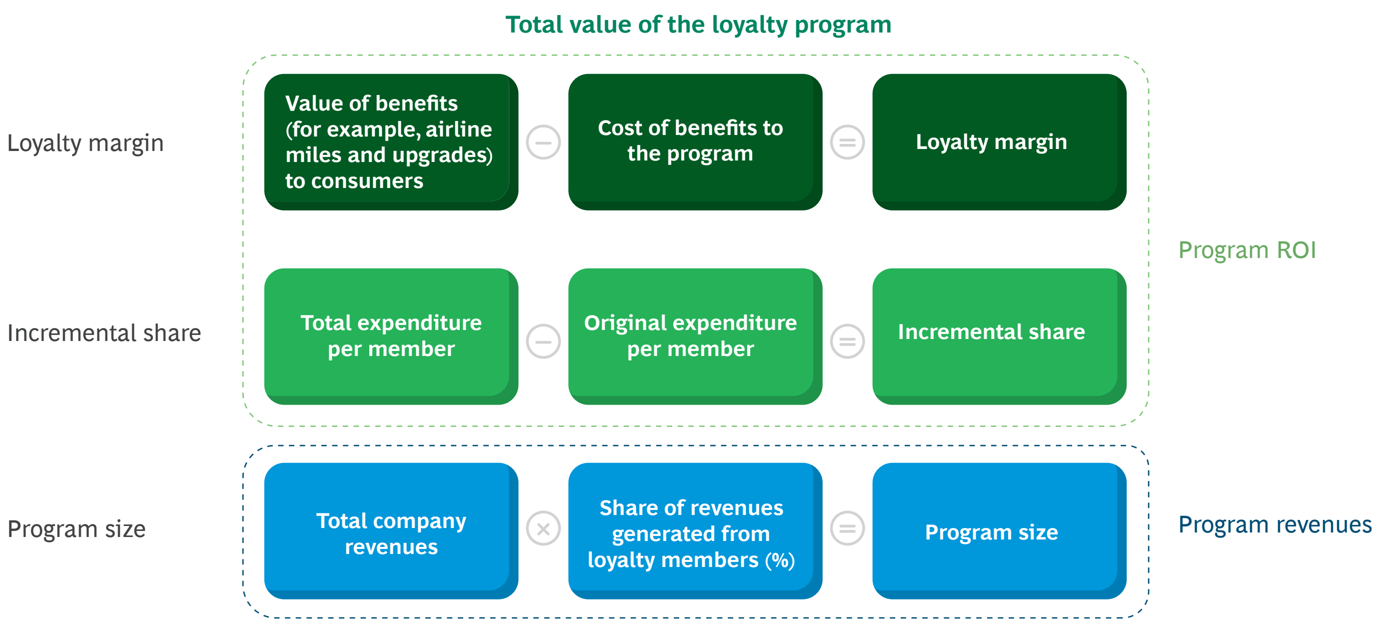
As a result, with both rising consumer expectations and reward costs, funding for the programs has become acutely challenging. This puts Merchants and FIs in a quandary about how to assemble the pieces of the loyalty puzzle to make the economics work for all participants.

The Loyalty Margin

At its core, the value of a loyalty program can be determined using a framework developed by BCG that is based on the loyalty margin.

Any program's value is a function of the loyalty margin—the benefits that the program offers to customers relative to the cost of those benefits to the company—as well as the incremental expenditure share the program generates and the size of the program (BCG, Leveraging the Loyalty Margin: Rewards Programs That Work, April 2014).

Loyalty Economics - How a Rewards Program Creates Value



Source: BCG analysis.

The consumer perspective: Consumers want more rewards, more value, and more personalization.

Based on our work with FIs and Merchants, we see that:

- **Consumers want more value:** 75% of consumers are more interested in earning cash back rewards when they shop because of rising prices and inflation (Wildfire, Shopping in the New Normal, June 2023)

- **Consumers are watching their spending:** Four out of five shoppers are taking on at least one cost-cutting measure like reducing the quantity or quality of the goods they purchase (PYMTS, Consumers Pare Spending on Grocery and Retail Even as Inflation Slows, May 2023)

- **Consumers expect more personalization:** 73% of consumers expect companies to understand their unique needs and expectations, up from 66% in 2020, and over half of consumers (56%) expect offers to always be personalized (Salesforce, “Fifth Edition State of the Connected Customer,” May 2022)

The reality is that many loyalty programs are struggling to keep pace. This raises the question: How can loyalty program economics become more self-sustaining? One potential answer is to find additional funding sources to increase the loyalty margin by driving incremental revenue, which creates an economic win-win-win for all parties.

Here is how it might work.

One major unlock is to have FIs drive retail traffic to Merchants that creates attributable, incremental sales in exchange for payment in the form of an affiliate merchant marketing fee. This attributable, incremental traffic from the FI drives incremental revenue for the Merchant. This can be measured at all levels of the purchase funnel:

- **Top of funnel:** more traffic with improved attribution and higher return on marketing investment (ROMI)
  - 81% of shoppers are more likely to purchase from a store that offers some sort of reward or cashback (Wildfire, Online Shopping Rewards Have Gone Mainstream, October 2022)
- **Mid-funnel:** larger average basket sizes
  - Shoppers who use browser-based shopping extensions for rewards have a 16% higher average order value compared to shoppers who do not use them (Commission Junction case study)
- **Bottom of funnel:** higher sales conversion rates
  - 79% of shoppers are more likely to complete a purchase when they earn cashback rewards (Wildfire, Online Shopping Rewards Have Gone Mainstream, October 2022)
  - Shoppers who use browser-based shopping extensions are 1.6x more likely to make a purchase than those who do not use them (Commission Junction case study)

Getting to the root of the problem – the rising cost of loyalty

Loyalty programs are typically funded by some combination of interchange from the FI and contribution margin from the Merchant. From the **FI perspective, there is greater pressure on the card-based P&L to fund loyalty as interchange is stressed.**

Interchange stress: Value exchange to consumer and Merchant partners are at an all-time high, driven by rising expectations.

Consumers expect more value exchange, due in large part to competition in the card market. The abundance of credit card programs continues to raise the stakes in the loyalty game thereby driving up the costs of creating and maintaining a rewards program:

- **Higher cashback rates** from top FIs (e.g., Chase, Capital One)
- **Higher value proprietary rewards programs** (e.g., Chase Sapphire, Capital One Venture X)
- **Co-brand competition** (e.g., United, Hilton, Marriott, Amazon)

Merchant partners from co-brand and private label cards also expect more contractual value exchange from program revenues to enhance their Merchant P&L.

From the **Merchant perspective, the contribution margin underpinning loyalty programs is under strain due to increasing costs driven by customer acquisition, retention, and fraud costs.**

Customer acquisition has become more difficult and more expensive due to a variety of factors:

- **Aggregators** have become top of mind for beginning a shopping journey and not only compete with brands, but also offer their own loyalty incentives.
- **Proliferation of channels** creates a fragmentation of audiences, making it more difficult for brands to get widespread exposure to drive the desired increase in sales.

This requires direct marketing investment on third-party sites and creating compelling loyalty programs to drive customers to direct channels.

The cost to retain customers continues to rise as well. Consumers engage less but are in more loyalty programs than ever:

- **Loyalty programs are saturated** across industries making it harder to stand out and requiring more investment and innovation in programs:
  - US consumers are enrolled in about 17 loyalty accounts but are active in just seven of them (Bond Brand Loyalty report).

“

Amid growing competition, rising consumer expectations and rewards costs, there is a need to look beyond the current loyalty approach to boost the loyalty margin in a meaningful way.

Finally, **fraud** and **privacy issues** are also driving increased costs:

- The sophistication and prevalence of fraud, including an increase in ad click fraud, is responsible for an estimated $44 billion of lost ad revenue annually. With 40% of digital ad traffic driven by ad-clicking bots, that increases the need for better attribution and identification (Statista/Juniper research).
- Shifting privacy climate, such as **disabling third-party cookies**, is creating demand, and therefore requires additional spend for first-party relationships and attribution.
  – As a result of Google's cookie deprecation, 60% of companies plan to increase spending to place more emphasis on first-party relationships (BCG research, Winterberry Group Identity Outlook 2020).

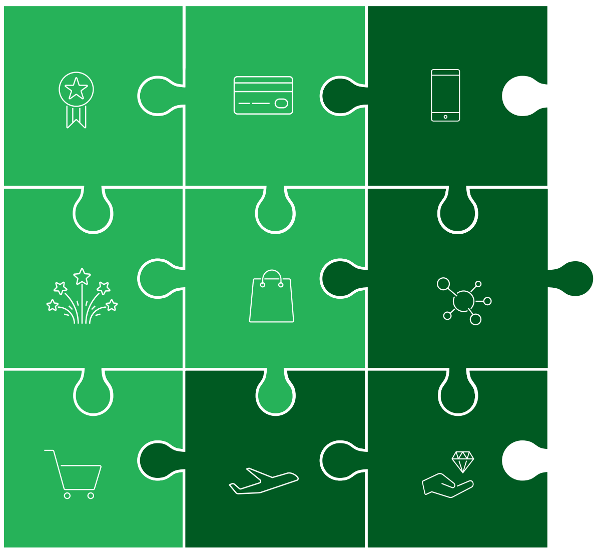
Assembling the puzzle pieces to improve the loyalty margin

There is a need to look beyond the current loyalty approach to boost the loyalty margin in a meaningful way. This means adding new loyalty capabilities to the existing capabilities to drive higher incremental revenue from customers.

Assembling The Loyalty Puzzle Pieces To Drive Incremental Revenue

Traditional Loyalty

- **Loyalty Program**
  Earn & burn, tender preference, and/or tender neutral
- **Loyalty Currency**
  Points, Stars
- **Payment Options**
  BNPL/Installments, Private Label, Co-brand, and Debit
- **Card-linked Offers & Experiences**
  Cardlytics, Chase Dining
- **Shopping Rewards Mall**
  BankAmeriDeals



Loyalty 2.0

- **Browser & App-based Offers**
  Avion Rewards ShopPlus/ Wildfire, Honey/PayPal, and Capital One Shopping
- **Retail Media Network**
  Home Depot
- **Proprietary, Personalized Offers Platform**
  Starbucks
- **Travel Platforms**
  Chase/CX Loyalty, Capital One/Hopper

Traditional Loyalty Programs

Even the best FI-based loyalty programs today have very similar loyalty program design features, siloed capabilities, and disjointed customer journeys. Some of the current puzzle pieces include:

- **Loyalty currency** (e.g., points, stars) to drive usage
- **Earn and burn** that is either tender preference and/or tender neutral
- **Payment options** (e.g., BNPL/installments, private label, co-brand, and debit) for more payment flexibility
- **Card-linked offers and experiences** (e.g., Cardlytics, Chase Dining) for rewards through participating credit cards
- **Shopping rewards mall** (e.g., BankAmeriDeals) for rewards and offers within the FI's website

Adding Loyalty 2.0 Capabilities

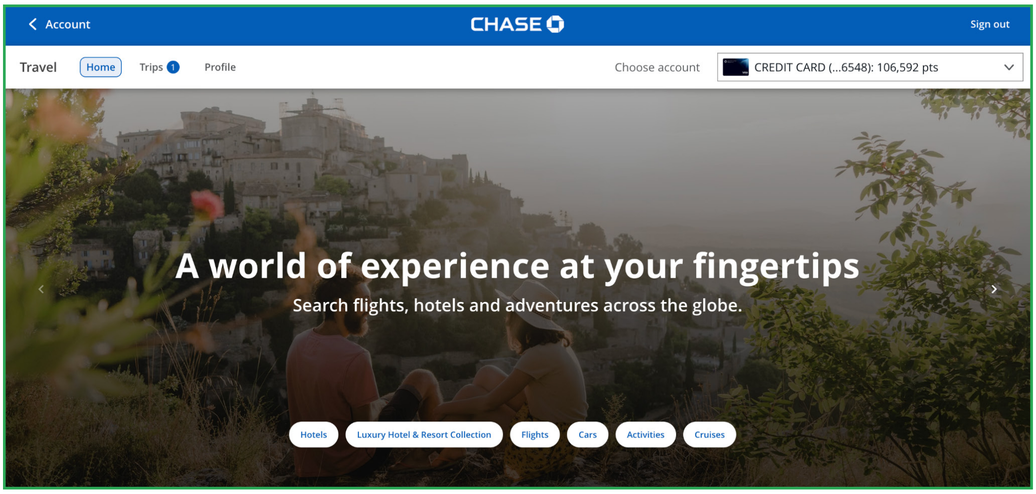
FIs and retailers need to innovate using new **Loyalty 2.0 capabilities**. This will stimulate increased consumer adoption/usage that will drive incremental system economics. When integrated effectively, Loyalty 2.0 capabilities can be additive and transformative by removing the barriers required today to earn or burn the loyalty currency while reimagining shopping journeys via a seamless user interface (UI), user experience (UX), and customer experience (CX). Increased adoption and usage will ultimately drive increased revenue to the Merchant and to the FI.

Based on our collective observations, leading FIs and Merchants are already using these Loyalty 2.0 capabilities to **innovate their programs, create incremental revenue streams, and deepen consumer relationships.**

The best examples today are:

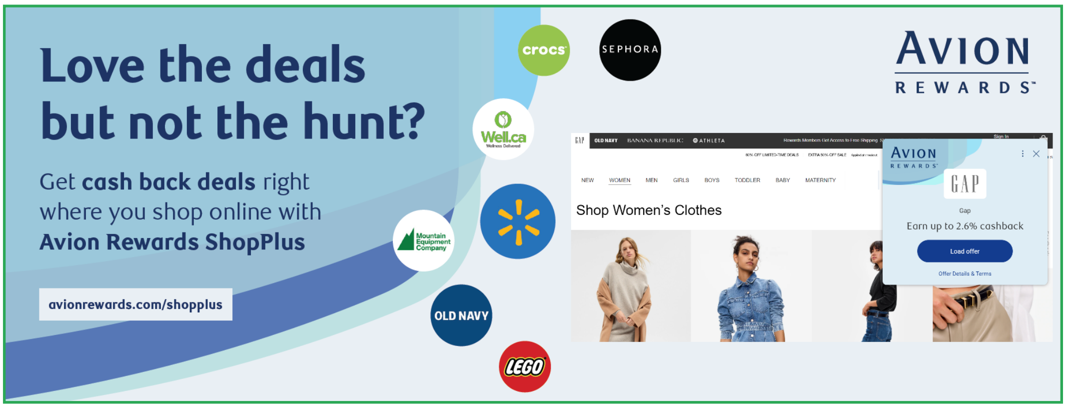
- **Travel platforms:** These platforms integrate travel buying experience and bring unique deals and offers to consumers. Examples include Chase/CX Loyalty, and Capital One/Hopper. Travel platforms create significant incremental commissions funded by travel companies. Chase, for example, projects a $15 billion annual revenue business by 2025 (Chase Investor Day presentation, page 67).

Chase travel:



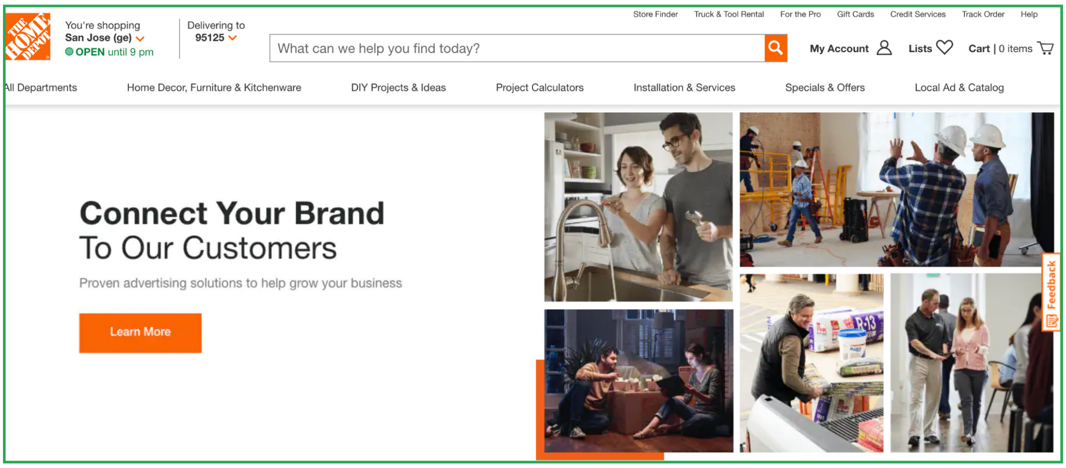
- **Browser and app-based offers:** These platforms integrate and embed deals and offers in the digital shopping experience. Examples include Avion Rewards ShopPlus (a collaboration between RBC's Avion Rewards and Wildfire), Visa VAMS (powered by Wildfire), PayPal/Honey, and Capital One Shopping. Browser-based offers can create significant incremental commerce revenue funded by Merchants. PayPal/Honey, for example, produces $1 billion in annual revenue (industry interviews).

Avion Rewards ShopPlus:



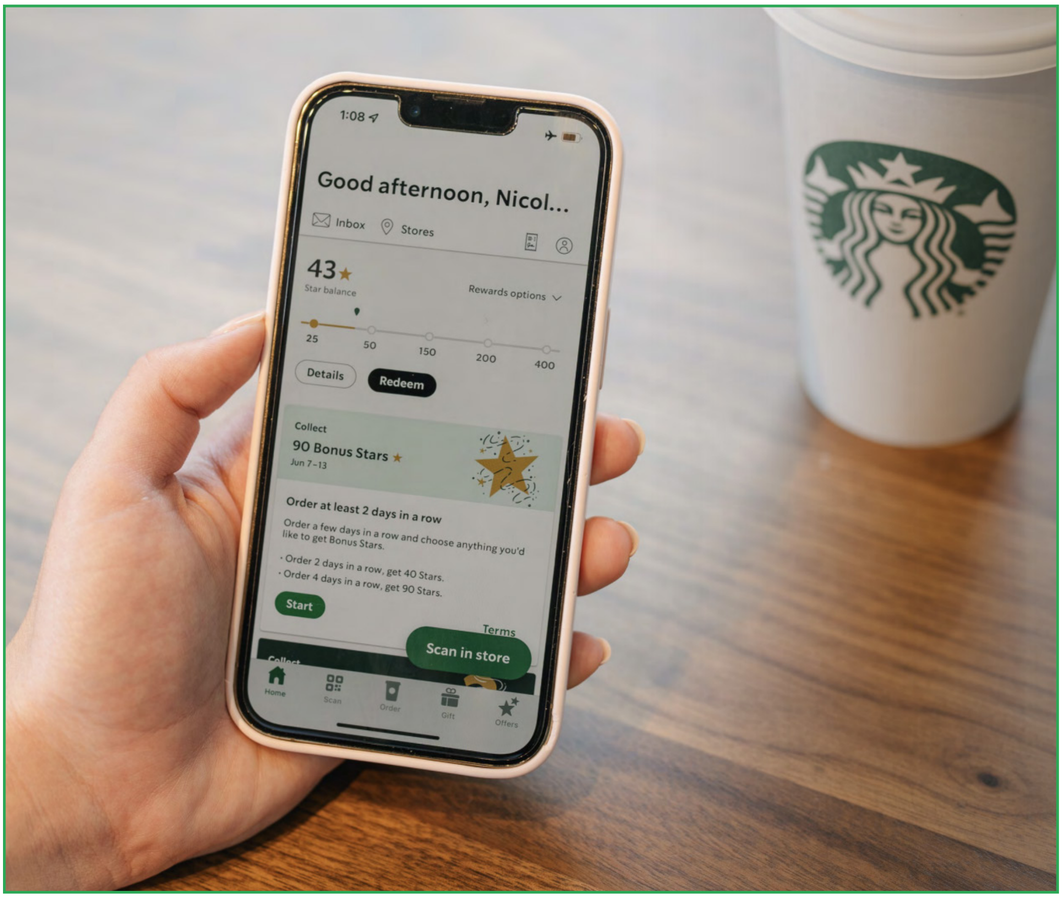
- **Retail media networks:** These networks create an effective advertising program to promote brands and products across channels. This channel could create significant incremental advertising revenue for FIs funded by Merchants. Home Depot's retail media network produces $350 million in revenues (Source: BCG research). Overall, retail media networks are projected to hit $45 billion in annual revenues in 2023 (American Banker, As retailers overhaul the checkout, they find fresh troves of data, January 2023).

Home Depot:



- **Proprietary, personalized offers platforms:** These platforms develop personalized and relevant offers based on consumer data (engagement and purchase history) and have proven effective in creating incremental sales revenue from higher conversion of increased targeting and efficacy of promotions. Starbucks is a great example of a highly effective personalized loyalty ecosystem. For example: 50% of U.S. Starbucks transactions are from Starbucks Rewards Members (Starbucks investor day presentation).

Starbucks:



"The ultimate win-win-win loyalty program creates benefits for the consumer, the Merchant, and the FI. The consumer gets rewarded, the Merchant generates more sales, and the the FI earns revenue from the attributable consumer traffic it generates.

Implications: Getting started

FIs and Merchants can increase the loyalty margin by creating incremental revenue streams from harnessing new Loyalty 2.0 capabilities.

In the short term: FIs and Merchants should **test, learn, and experiment** with the goal of ultimately scaling marketing and technology. For FIs, there are partnership opportunities available to test key Loyalty 2.0 capabilities with partners and white label providers in a variety of categories (Travel Platforms: e.g., Hopper, Expedia, Booking.com; Browser & App Based Offers: e.g., Wildfire).

In the medium term: FIs and Merchants will ultimately need to have **six core capabilities** to assemble/orchestrate all the loyalty puzzle pieces.

As businesses begin to sketch out a new loyalty program or consider upgrading an existing one, they should keep in mind that any successful program needs to achieve simplicity, personalization, and a frictionless customer experience—while keeping program economics sustainable. And even the best-designed program must be supported by high-quality products and delivery if it is to succeed. (BCG, Loyalty Programs Need Next-Generation Design, May 2023)

Six underlying capabilities:

1. **Data and analytics:** To create a successful loyalty program, FIs and Merchants must access high-quality data and have the ability to analyze it effectively. This includes transaction history, engagement (e.g., website browsing activity, email engagement), and supplemental third-party information. Advanced analytics techniques, such as machine learning and artificial intelligence can help companies identify patterns and trends that drive customer behavior, which can help inform their loyalty program's direction, design, and strategy.

2. **Personalization algorithms:** Personalization enables FIs and Merchants to create more relevant and engaging customer communications. Ultimately personalization drives higher quality interactions, increased retention, and higher customer lifetime value. Personalization uses advanced analytics tools to predict the best course of action for each customer, as well as leveraging MarTech to schedule and deploy these communications through multiple channels and touchpoints.

3. **Marketing Technology (MarTech):** MarTech describes a range of software and tools that assist in achieving marketing goals or objectives. In the context of loyalty programs, MarTech is critical to helping FIs and Merchants personalize their communications with customers, manage content, offers/rewards, automate tasks (e.g., issuing rewards), and track performance.

4. **Advertising Technology (AdTech):** AdTech denotes the software and tools used to buy, manage, and analyze digital advertising. AdTech platforms enable FIs and Merchants to reach customers through targeted advertising across a variety of channels, including social media, search engines, and display ads. By leveraging AdTech platforms, FIs and Merchants can drive awareness and engagement with their loyalty programs, ultimately boosting program adoption and participation.

5. **Commerce engine:** FIs and Merchants may need to upgrade their commerce engine to support new loyalty program features. This includes rewards sign-up optimization, redemption, and seamless checkout flows to fully enable omnichannel guest experiences across mobile, web, app, and in-store touchpoints.

6. **People and process:** As we see with many of our clients, there is a 10/20/70 rule - 10% is building the algorithms, 20% is architecting the underlying technology, and 70% is developing the organization and creating the right operating model (BCG GAMMA, Making AI Real for Business). To leverage the full power of Loyalty 2.0, FIs and Merchants need to invest into the people and business processes. Two key elements to achieve this are:

   – Putting the **right talent** in place (e.g., data scientists, data architects, analysts, product managers)

   – Creating an **Agile process and operating model** that enables teams to act quickly on insights. This typically prioritizes speed/flexibility, involves breaking the loyalty plan into phases, and emphasizes continuous collaboration and improvement.

Assembling and orchestrating the Loyalty 2.0 puzzle pieces aligns the new loyalty program with rising consumer expectations and enhances their shopping journey.

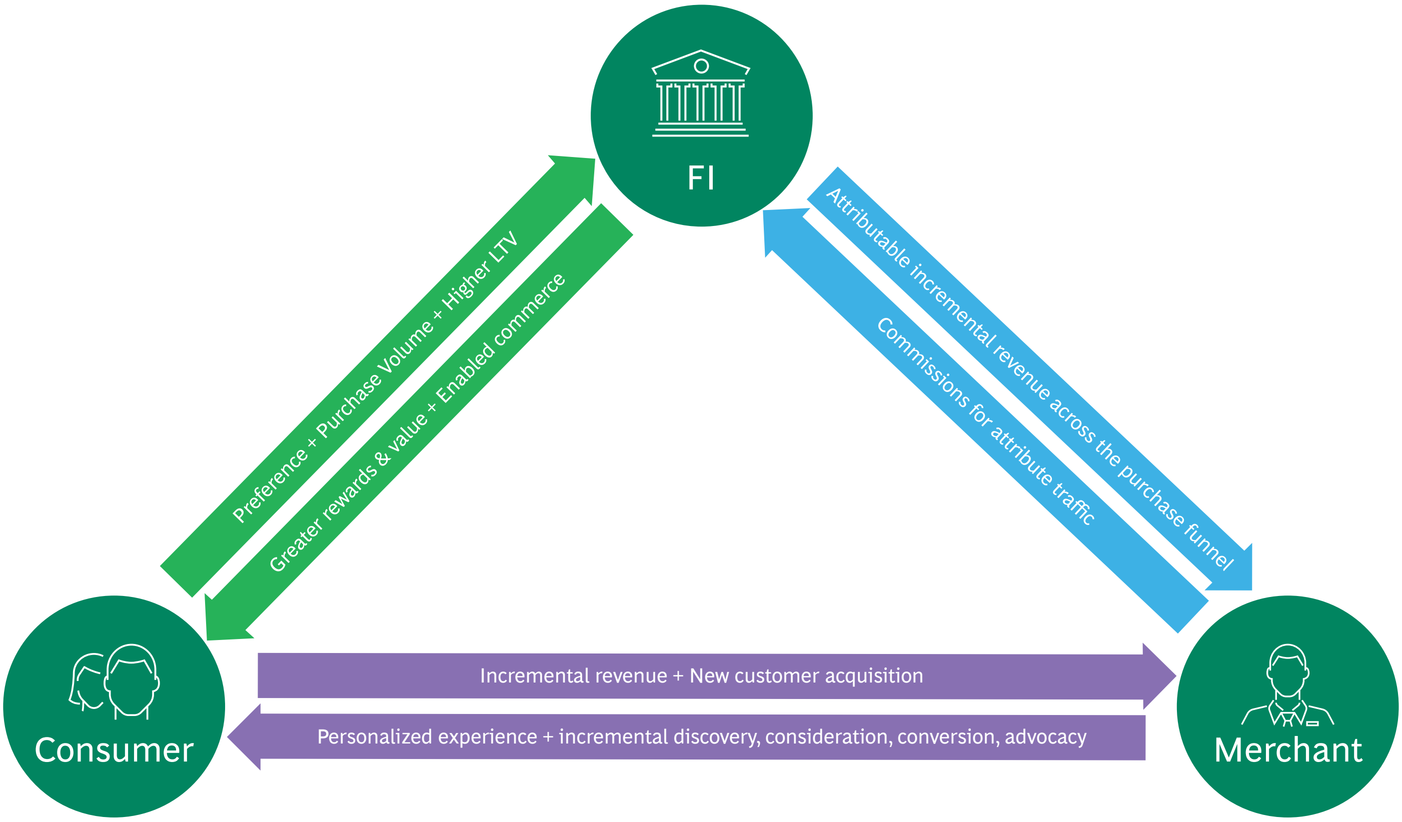
The Win-Win-Win Solution

The ultimate win-win-win loyalty program creates benefits for the consumer, the Merchant, and the FI. **The consumer gets rewarded, the Merchant generates more sales, and the FI earns revenue from the attributable consumer traffic it generates.**

The **user interface** becomes more intuitive by focusing on the consumer needs, preferences, and pain points. The resulting **journey** makes it easy to use and simple for consumers to navigate and interact with the loyalty program. Successful implementation of the **user experience** creates positive interactions with the loyalty program and helps ensure an engaging, relevant, and personalized interaction for consumers.

Finally, as FIs and Merchants integrate the Loyalty 2.0 puzzle pieces into the existing customer journeys and interactions with the brand, they will align the loyalty program with the brand values, messaging, and customer service to ensure that the program enhances the overall **brand promise**.

The Loyalty 2.0 Economic Flywheel



The Loyalty 2.0 puzzle is simple enough to solve if the **incentives are aligned** and **incremental revenue is created:**

- **FIs** can build preference, purchase volume and higher lifetime value (LTV) from the consumer and commissions for attributable traffic from Merchants.
- **Merchants** can receive incremental revenues from the FI's attributable traffic and new customer acquisitions.
- **Consumers** can receive personalized value from Merchants, and greater rewards through enabled commerce from FIs.

In conclusion, there is a puzzle to solve and a roadmap to follow. FIs and Merchants can create an economic flywheel that enhances the loyalty margin, enables more value to be exchanged to the consumer, and prevents a race to the bottom on loyalty costs.

You can make loyalty pay!

About the Authors

BCG

Ed Crouch is a Managing Director and Partner in the Consumer practice at BCG and leads the topic of loyalty globally. You can reach him at crouch.edward@bcg.com

Christina Flood is a Partner in the Financial Institutions practice at BCG. You can reach her at flood.christina@bcg.com

Patrick Hadlock is a Senior Advisor to BCG. You can reach him at hadlock.patrick@bcg.com

Mike Marcus is a Senior Advisor to BCG and a board member at Wildfire Systems. You can reach him at marcus.mike@advisor.bcg.com

Amanda Luther is a Managing Director and Partner in the Consumer practice at BCG. You can reach her at luther.amanda@bcg.com

Wildfire

Nancy Bacon is the VP of Strategy and Customer Success at Wildfire Systems. You can reach her at nancy.bacon@wildfire-corp.com

Shawn Conahan is the Chief Revenue Officer of Wildfire Systems. You can reach him at shawn@wildfire-corp.com

Jordan Glazier is the founder and CEO of Wildfire Systems. You can reach him at jordan@wildfire-corp.com

For Further Contact

If you would like to discuss this report, please contact the authors.

Boston Consulting Group partners with leaders in business and society to tackle their most important challenges and capture their greatest opportunities. BCG was the pioneer in business strategy when it was founded in 1963. Today, we work closely with clients to embrace a transformational approach aimed at benefiting all stakeholders—empowering organizations to grow, build sustainable competitive advantage, and drive positive societal impact.

Our diverse, global teams bring deep industry and functional expertise and a range of perspectives that question the status quo and spark change. BCG delivers solutions through leading-edge management consulting, technology and design, and corporate and digital ventures. We work in a uniquely collaborative model across the firm and throughout all levels of the client organization, fueled by the goal of helping our clients thrive and enabling them to make the world a better place.

MAKING LOYALTY PAY