Loyalty programs abound, but most of them don't accomplish much. If you want yours to perform, here are the five mistakes to avoid.

Your Loyalty Program Is Betraying You

by Joseph C. Nunes and Xavier Drèze

What is more rare than undying loyalty? Apparently, an undying loyalty program. In the past few years, we've seen companies of all kinds killing off the programs they'd designed to inspire greater fidelity in the ranks of customers. Subway, the restaurant chain, got rid of its Sub Club cards, which allowed diners to earn a free sandwich after purchasing eight. In Australia, Coles supermarkets phased out a program that rewarded owners of the company's stock with merchandise discounts ranging from 3% to 7.5%. Online phenomenon eBay quietly pulled the plug on its Anything Points program for U.S. customers. Target missed the mark, it seems, with its innovative approach involving "smart" credit cards. American Airlines and America Online jettisoned their joint customer-loyalty program. The list goes on. Even as loyalty programs are launched left and right, many are being scuttled, and not with a sense of mission accomplished.

How can this be? In many cases, these programs are created by highly competent marketers in otherwise successful businesses. It is now well recognized that an old customer retained is worth more than a new customer won. The concept of rewarding frequent buyers

ALISON SEIFFER

has been around to tinker with at least since the days of the Green Stamp. What could be so hard about a simple loyalty program?

After researching that question in various ways over the past several years, we've learned that there are many aspects of loyalty programs that are hard to get right. The challenges start with clarifying business goals, given that loyalty programs can produce a variety of benefits. They continue with engineering the economics of reward structure and creating incentives good enough to change behavior but not so generous that they erode margins. Not least, there are puzzles of consumer psychology to sort out, which can make two rewards of equal value inspire very different levels of purchasing.

Our research suggests that there are patterns in what the successful loyalty programs get right and in how the others fail. In this article, we share what we have learned conducting our own studies and observing programs in practice. Together, our findings constitute a tool kit for designing something rare indeed: a program that won't do you wrong.

What Can a Loyalty Program Reasonably Do?

Creating a successful loyalty program starts with defining what should be gained from the effort. Only with clear business goals can one design the appropriate mechanisms and judge whether they are operating effectively. So let's take note, first of all, of what a loyalty program cannot do. It cannot, in any true sense, create loyalty. "Loyalty" means faithfulness. It means unswerving devotion. If you are loyal to something – a concept, a person, a product – you are not a fair-weather friend. You stick with it even when doing so runs counter to your interests. But surely this is not something to be expected in any commercial setting; it's scarce enough in love and war.

We don't raise this semantic issue facetiously or with a sense of outrage. Rather, our point is that euphemisms, especially ones as broadly adopted as "customer loyalty," don't make the work of management easier. They muddy the waters and throw marketing efforts off course.

To clarify things, then, let's explore the five goals loyalty programs really can serve.

Keep customers from defecting. In some cases, loyalty programs create what marketers call barriers to exit. That is, they make it hard for customers to switch to new vendors. This is a critical goal in situations where customers typically use only one supplier, as with mobile phone service or home heating oil. Given the high stakes of a customer's lifetime value, the focus is on keeping accounts from falling into enemy hands.

Take, for example, this reward to Sprint's long-distance phone customers: For every dollar they spend with Sprint, they earn an airline mile redeemable with any of five different airlines. Sprint rival AT&T does not offer such a plan. Consequently, all else being equal, a member of any of those five airlines' frequent-flier programs would rather have Sprint as a long-distance carrier. A customer might stick with Sprint even if she became temporarily dissatisfied with the service, because the mileage benefit accrues over time. If she left and later came back, she would have to start accruing miles all over again. This is what's known as lock-in – the customer's equivalent of an employee's "golden handcuffs."

Win greater share of wallet. For goods and services a customer typically buys from more than one seller, a loyalty program can encourage the consolidation of purchases. This applies to air travel, groceries, credit, food and drink, gasoline – all purchases made frequently and in small amounts. The key is to give the customer a reason to steer more of that business into one seller's hands.

Awarding points for purchases is the most common way of doing this. For example, Amazon.com offers a Visa card that rewards shoppers with a point, worth a penny, for every dollar they spend (three points if the dollar goes toward an Amazon purchase), distributed in the form of a $25 Amazon gift certificate when 2,500 points are accumulated. A shopper who might otherwise alternate among stores now has a reason to favor Amazon. Indeed, even if another seller offers a similar program, there is an incentive to consolidate in one place because certificates are issued once a threshold of points has been reached. Many such programs exist in the credit industry, and for good reason: In 2004, the 185 million credit card holders in America each carried an average of four cards. Of course, points programs are used far beyond the world of credit cards. Retail stores and hotels, for instance, also use them – witness Best Buy's Reward Zone program and Starwood's Preferred Guest program, a favorite of business travelers.

If we had any doubts about how effectively a program could increase share of wallet, they were dispelled by Arizona retailer ABCO's success in capturing more of its customers' purchases of baby goods. The Baby Club we helped launch rewarded members with Baby Bucks for purchases; 100 Baby Bucks could be exchanged for a $10 voucher. Within six months, we observed a substantial uptick in the number of transactions involving baby products and in the average number of baby products per transaction, adding up to a 25% net increase in baby product sales. This increase did not occur because there was a sudden baby boom. It was purely the result of parents' driving past competitors to consolidate their baby-related purchases at ABCO.

Of course, the Baby Club was able to achieve such results because it was the first program of its kind in the area. For most companies in competitive markets, that's at best an ephemeral advantage. But even where there are competing programs, it is possible to prevail with the right reward structure. Specifically, your program should feature what economists call a convex reward structure, whereby greater levels of expenditure earn proportionately greater rewards. Homebase, the UK do-it-yourself retailer, has arrived at a two-tiered system that seems to work: Customers save 2% on purchases as soon as they become members of the Spend & Save program. Once they've spent £400, they save 10% on the rest of their purchases that year. Consider the incentive that creates for a homeowner who spends about £800 per year on DIY supplies. If he splits his purchases evenly between Homebase and one of its competitors (spending £400 at each outlet), he receives £8 back from each retailer (assuming that the competitor has a similar program), for a total of £16 in savings. But if he spends the entire £800 at Homebase, he receives £48 back.

Prompt customers to make additional purchases. We've been describing situations where competing for a customer's purchases is a zero-sum game. The expectation is that the customer will buy just so much and no more, and the objective is to capture the largest portion of that amount. But a loyalty program needn't set its sights so low; it can also create incremental demand, spurring purchases that would not otherwise be made.

This is a common effect of multitiered loyalty programs (those with, say, Silver, Gold, and Platinum levels), where each tier brings additional benefits. Customers who are on the cusp of attaining the next status level – or in danger of slipping to a lower one – will often spend more in order to secure the higher ground. To cite one of the most extreme examples we've seen: A friend of ours in Los Angeles found himself 3,000 miles short of United Air Lines' Premier Executive status with just a few weeks remaining in 2005. He took the least expensive qualifying flight, to the frigid destination of Buffalo, New York, where he stayed less than 24 hours before returning.

Even when status levels are not part of a program, a valued reward can lead consumers to accelerate their purchases, and that can add up to increased overall consumption. Working with a chain of car washes on the West Coast, we observed that a loyalty program offering a free wash after eight purchases led drivers to wash their cars more often as they got closer and closer to earning the reward. This same effect has been observed by other researchers studying coffee shop purchases, and it would no doubt apply to small luxuries like tanning and spa sessions, as well. The common thread is that these are goods and services for which consumption is flexible and can be increased easily. A service station might therefore create a reward program for oil changes and see overall sales rise; using it for snow tire changeovers probably would not work out as well.

Yield insight into customer behavior and preferences. A benefit of loyalty programs that has gained prominence in the past decade is their ability to provide useful data about customers. The data can both produce insights about general buying behavior and allow the seller to target promotions to individual customers. Tesco, the UK grocery store chain, is often cited for its expertise in using the data collected from its Clubcard members. Cardholders receive a quarterly mailing with offers so carefully customized that Clive Humby, one of Clubcard's architects, told *Promo* magazine in 2004 that Tesco prints about 4 million variations for each mailing. As data collection and maintenance become easier and cheaper, we are witnessing a proliferation of companies offering to provide marketing insights based on loyalty program data.

Yet one must be careful not to overstate the benefits of collecting consumer purchase data. Initiatives like Tesco's require a dedicated staff of analysts and substantial investments in data management and augmentation. And even then, a company's customer data, taken in isolation, may not yield many novel insights. We were reminded of this when we worked with Twentieth Century Fox Home Entertainment. Few would suspect that online purchasers of X-Men movies would be prime targets for 1930s-era Shirley Temple movies. But indeed, we discovered that action film fans with kids were especially receptive to pitches for the young actress's movies. How could Fox Home Entertainment determine which of its customers had children? Only by combining its own data with information purchased from third-party provider Equifax. The point is, it isn't sufficient to collect loyalty program data and expect that effective marketing moves will spontaneously suggest themselves; one must have a marketing objective in mind and then seek the data.

If food, beverage, fuel, insurance, and other expenses are factored in, a 25,000-mile reward costs less than $15, on average, to fulfill.

Turn a profit. Some loyalty programs can even function as profit centers. Consider American Airlines' AAdvantage program. Even as the airline racks up billions of dollars in debt, the AAdvantage program turns a tidy profit selling miles to other businesses to use as rewards for their customers. AAdvantage clients range from huge concerns like Citibank to small businesses like Ariake, a sushi restaurant in Los Angeles. Consumers of Kellogg's breakfast cereals get thanked with American Airlines miles; so do subscribers to *USA Today*. Together, U.S.-based airlines sell nearly $2 billion worth of miles to more than 22,000 businesses.

This may seem like a loyalty program's crowning achievement, a gambit available only to the long established and mature. In fact, it was the function

Joseph C. Nunes *(jnunes@marshall.usc.edu) is an associate professor of marketing at the University of Southern California's Marshall School of Business in Los Angeles.* ***Xavier Drèze*** *(xdreze@wharton.upenn.edu) is an assistant professor of marketing at the University of Pennsylvania's Wharton School in Philadelphia.*

of the earliest broad-based program, S&H Green Stamps. Thomas Sperry (the "S" in "S&H") did not create Green Stamps in 1896 to reward customers of a business S&H owned. The system was conceived as an independent business that would sell stamps to merchants, along with the books to paste them in. S&H's only direct trade with consumers was through redemption centers where people exchanged their stamps for merchandise.

Today, any company with a broad customer base and excess capacity could consider leveraging its loyalty program in the same way. Marriott has done so with its Rewards program, enabling customers to collect points for a future hotel stay by shopping at Target, the Gap, Lands' End, Macy's, or Best Buy. But of course, these types of ventures, while generating additional revenues, also involve all the complexity of running stand-alone businesses. A critical concern is arriving at the right price per reward point. In the airline business, for example, the average mile sells for about two cents, although it goes for significantly less to high-volume customers like Citibank. This means the airline sells the right to 25,000 miles for about $500 in incremental revenue. In most businesses, economics like this would be disastrous, but airlines are able to keep the true incremental costs quite low. They can limit the availability of qualifying seats, and they count on a certain portion of miles going unredeemed. If food, beverage, fuel, reservations processing, liability insurance, and other miscellaneous expenses are factored in, the 25,000-mile reward actually costs less than $15, on average, to fulfill.

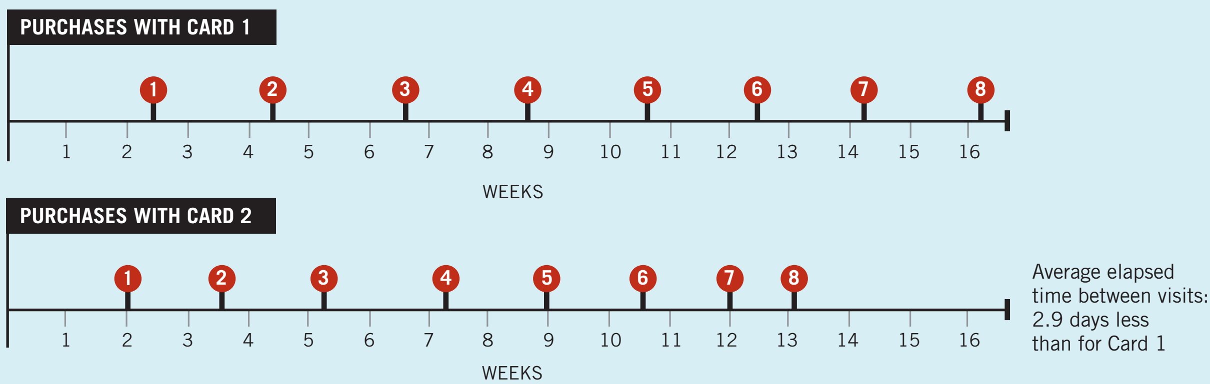
We've outlined five benefits a company can gain from a loyalty program, and the corollary should be clear: Any given program must be designed to serve specific goals, and priorities must be set among them. It's unreasonable to expect to design a program that equally pursues several distinct objectives. Rather, it makes sense to focus on a couple and design the optimal program to serve them. (If additional benefits can then be layered onto that design, fine–but only if that can be done without compromising performance in the key areas.) The unfortunate reality,

The Effect of a Jump Start

In April 2004, we staged an experiment in a car wash business in Los Angeles. The business distributed 300 stampable cards that promised a free car wash after eight paid visits. The cards, however, took two forms. Card 1 was a straightforward buy-eight-get-one offer. Card 2 presented itself as a buy-ten-get-one offer, but customers were told that, as a special promotion, they were being given the first two stamps free. Essentially, then, the economics of the two programs were identical. The question was whether those two stamps, by framing the quest as one that had been undertaken rather than one not yet begun, would have an effect on sales.

The "endowed progress effect," as we termed it, turned out to be substantial. First, total redemptions were higher. While only 19% of the customers with Card 1 stuck with the program and claimed the prize, 34% of Card 2 customers did so. Card 2 customers also came back at a faster rate, as reflected in the diagrams below (which represent only the customers who got all their stamps and earned the free wash). As this comparison shows, the average elapsed time between visits was less for Card 2 than for Card 1. Finally, under both programs, purchasing accelerated: The time between visits became shorter and shorter as the customer got closer to the payoff. But note that the rate of acceleration was greater with Card 2. The time between visits compressed more along the way.

For details on this study, see our article "The Endowed Progress Effect: How Unwarranted Advancement Increases Effort" in the March 2006 issue of the *Journal of Consumer Research*.



however, is that many loyalty programs seem to have no distinct targets squarely in their sights.

The Levers of Loyalty

On the face of it, designing a loyalty program is a straightforward exercise. It must be attractive to customers and not too expensive. Both sides of that equation, however, are easier said than done. Our study of programs in practice suggests that several components are especially important and difficult to design well.

Divisibility of rewards. First, there is a careful balance to strike in what we would term "divisibility," or the number of discrete reward-redemption opportunities a program provides. A program that allows members to redeem points in clusters of 5,000 is twice as divisible as one that allows people to redeem points only in clusters of 10,000. Managers and their customers often diverge in their preferences on this matter. Customers prefer highly divisible programs because they provide many exchange opportunities and thus reduce award waste. They see a low-divisibility program as having such a high threshold for rewards that it deters them from ever embarking on the quest. By contrast, managers don't like offering highly divisible programs because they are not effective at creating consumer lock-in. If one can redeem 5,000 points, why strive to accumulate 10,000? As always is the case when the desires of companies and those of consumers collide, a compromise must be struck. The right level of divisibility will factor in the expected yearly program usage and the amount of company differentiation. Our research shows, for example, that in a grocery store setting (high usage, low differentiation), a \$50 reward for every \$500 spent engenders greater customer loyalty than either a \$10 reward for every \$100 spent or a \$100 reward for every \$1,000 spent (too much and too little divisibility, respectively).

Sense of momentum. Research has proven that the further along members are in a loyalty program, the more they use it. By contrast, at the outset of their membership, their involvement is irresolute. Because they have not yet made any progress, the rewards seem far away. Worse, they have little sense of how easy it will be to achieve the goals. Rather than lose a customer's interest right out of the gate, the best designed programs provide what we've termed "endowed progress," a little push to get things moving. We learned how effective endowed progress can be when we staged a field experiment at a metropolitan car wash. (See the exhibit "The Effect of a Jump Start" for details.)

Let us quickly offer a caveat, however. Customers must see the endowment as earned or warranted by their behavior, or the tactic will have little effect. Indeed, if it smacks of cynicism, it may produce a negative one. Even if the endowed progress is simply cast as a signing bonus for new program members, it should give them a sense of established momentum.

Nature of rewards. Research about the compensation of professional salespeople has shown that they respond more dramatically to performance incentives that promise pleasure (like luxe vacations and, in decades past, fur coats) than to purely utilitarian incentives (like cash bonuses). In the same way, consumers love to be given a treat they would not splurge on with their own money. And so the most successful loyalty programs often feature less functional and more pleasure-providing rewards. When Maritz Loyalty Marketing, which operates loyalty programs for various merchants, analyzed the reward redemptions for its clients in 2005, it found that American consumers preferred the latest electronics (televisions, video games, stereos, DVD players) to household goods (appliances, furniture, art) by a factor of almost two to one. But the benefit of offering nonutilitarian rewards is not simply that they get people excited about the program. In experiencing the reward, people come to have pleasant associations with the brand. Note what happened with Nectar, a UK-based reward program that serves customers of various retail outlets. Its members collected more points (in other words, spent more at program-affiliated stores) during the month immediately following a point redemption than during other months – and the effect was even greater when the points were redeemed for a hedonic reward such as theme park admission.

American Express Incentive Services is well aware of this element in its program design. It divides rewards into two types: sticky and slippery. Sticky rewards stick in the recipient's mind, reinforcing the relationship with the program provider, while slippery rewards are mundane and tend to slip from memory. Which do you think is stickier: the utilitarian reward that's quickly assimilated into the recipient's daily life, or the reward that breaks the routine and may even confer bragging rights? Hoping for stickier rewards, American Express has launched its IN:CHICAGO and IN:LA specialty cards, which allow members in Chicago or Los Angeles to earn "special dining, drinking, and entertainment rewards at some of the city's best spots."

Expansion of relationship. Sometimes, the only effect of a buy-ten-get-one-free program is to give away a product unnecessarily. After all, a customer who likes a product enough to buy it ten times could probably be expected to purchase it again. By making the 11th time free, the company effectively gives the habitual buyer a quantity discount. (Subway's Sub Club used to do exactly this.) More valuable to a company is a program that expands the consumer's repertoire of purchases. For example, instead of giving an 11th cup free, a coffee shop might make the tenth a larger size or throw in a free pastry. As well as being a more hedonic reward, the sample might introduce the consumer to a new product and induce higher future sales. This is one reason airlines are happy to fill empty seats in business or first class with members spending frequent-flier miles for an upgrade. It gives the traveler the taste of a better experience that he might find difficult to live without in the future. In fact, Subway's current plans are to offer franchises a new reward program, featuring a magnetic card that will allow customers to trade points for cookies and other extras.

Combined-currency flexibility. A program in which consumers never redeem points would be very inexpensive to offer. However, it would be of little interest to members. To be attractive, a program must lead to redemption; that's when the benefits really become the most salient to the consumer. The key for managers is to make the redemption as inexpensive as possible to the company. In our research, we have found that if companies allow program members to redeem their points in combination with hard currency, it lowers the psychological cost to consumers. In other words, it can increase the perceived benefit to the consumer without undue cost to the company.

For example, we found that consumers would rather buy a flight with $250 and a copayment of 5,000 frequent-flier miles than with a straight payment of either $300 or 30,000 miles. Small amounts of miles seem trivial to the consumer, as they make most mileage rewards seem too far away. Thus, being able to spend these alternative currencies in smaller amounts (accompanied by cash) is more appealing than spending lots of precious miles on a cheap flight. An expensive flight, however, is another story. (See the exhibit "The Case for Currency Combinations.") More simply put, companies stand to gain incremental sales when they're flexible in how they allow customers to combine currencies.

Mistakes to Avoid

We've been reviewing the finer points of loyalty program design – the elements that, when carefully managed, separate the best programs from mediocre or bad ones. It's easy to come away from such research with the strong sense that the devil is in the details. But in truth, when we reflect on the programs that were outright failures, we see that the issues were not all that nuanced. Loyalty programs typically founder on some simple mistakes. Allow us to offer five basic pieces of advice.

Don't create a new commodity. If your program is tantamount to discounting, then you are only paying people to buy and, paradoxically, creating greater disloyalty. You will inevitably be drawn into the equivalent of a price war, with tit-for-tat competitive moves basically yielding parity and lower profitability all around. Just consider the attempt last August by United Air Lines to poach fliers worried about a mechanics' strike at Northwest Airlines. In an e-mail promotion, United targeted customers in certain midwestern cities with an offer of double miles. Northwest responded by matching the offer for flights taken before early October.

The typical grocery store loyalty program does not reward loyal behavior; it rewards card ownership.

In mid-October, United announced it would award double miles for travel until mid-December. All of this had the opposite effect of what either side wanted – it encouraged price shopping.

It's worth noting that the same thing killed the Green Stamp. Stores began trying to outdo one another by offering double stamps, then triple stamps, and ultimately quadruple stamps, inflating the value of the average stamp to about eight cents on the dollar. Shoppers were happy to go wherever they could collect the most stamps. What had begun as a mechanism for rewarding loyal customers devolved into clumsily concealed price promotions administered by third-party stamp providers. Eventually, stores had had enough and began touting the benefit of lower prices with no stamps attached.

The thought of offering double miles, points, or credits to steal share in the short term is compelling. Almost all loyalty programs, from Best Western's Gold Crown Club to Hilton's HHonors, and from American Express Rewards to Visa Extras, have at one time or another upped the amount of the alternative currency they offer in exchange for sales. But managers must use their loyalty programs for more than a direct payment mechanism for purchases, which is simply not sustainable in the long term.

Don't reward the disloyal. Probably the most familiar example of a program that rewards the unfaithful is the typical grocery store card. Beyond their data-gathering purpose, these cards are meant to attract customers by giving members-only discounts on promotion items. Card-carrying shoppers get the advantages of coupons without having to clip them. Because no store charges for membership, though, shoppers quickly accumulate as many cards as there are local grocers. This type of program does not reward loyal behavior; it rewards card ownership. And sometimes it doesn't even do that, because helpful cashiers are often happy to swipe a dummy card for customers who have forgotten or never signed up for their own.

The Case for Currency Combinations

Some points-based loyalty programs allow customers to combine points with cash to pay for purchases. For instance, a Net SAAver fare advertised on American Airlines' Web site allowed fliers to purchase any ticket normally priced at $189 either for $189 or for $39 plus 16,000 miles.

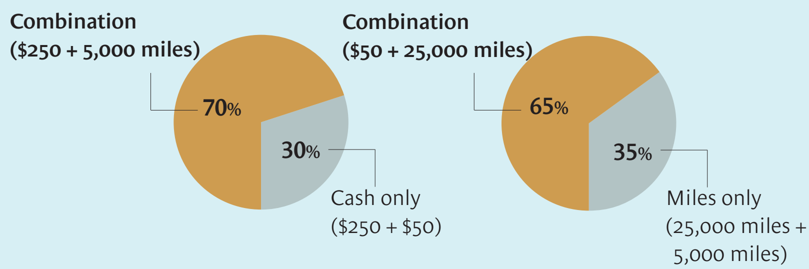
To discover how consumers respond to such combined-currency prices, we asked airline travelers who had experience with miles programs to look at a hypothetical set of pricing options. We presented two scenarios, asking some participants to consider a low-cost flight and others to consider a high-cost flight. For each case, respondents were asked to choose among payment options of all miles, all cash, or a combination of the two. Our respondents in the low-cost scenario could pay for a $300 flight ($250 plus a $50 surcharge for expedited booking) with cash or with 30,000 miles or with a combination of, say, $250 and 5,000 miles. Respondents in the high-cost scenario could pay for a $1,000 flight and a $50 surcharge with $1,050 or with 105,000 miles or with a combination of money and miles.

In pure economic terms, all the options cost the same. But as the charts show, preferences ended up varying based on the cost of the flight. For the low-cost flight, people preferred a combined-currency payment. For the high-cost flight, people preferred a single-currency transaction. In our article "Using Combined-Currency Prices to Lower Consumers' Perceived Cost" (*Journal of Marketing Research,* February 2004), we model the marginal values being placed on miles by consumers and suggest how merchants can optimize their pricing accordingly. For here, it is sufficient to say that consumers do prefer combined-currency pricing under some conditions, and a program with the flexibility to offer it will be more successful than one without that flexibility.

Low-Cost Scenario

A flight worth $250, with a $50 surcharge.

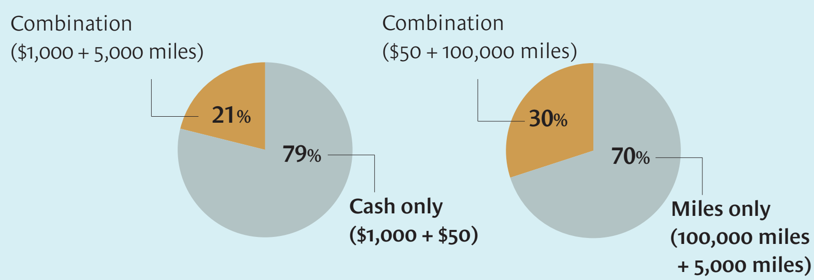
How would you prefer to pay?



High-Cost Scenario

A flight worth $1,000, with a $50 surcharge.

How would you prefer to pay?



Therefore, managers must ensure that their loyalty programs are incentive compatible, designed so it is in customers' best interests to be loyal. A program should reward the use of the card over time rather than on a given purchase occasion, and it should discriminate between more and less loyal customers in the size of its rewards. For example, at the women's clothing chain Chico's, customers become Passport members after spending $500, entitling them to discounts and targeted communications.

Don't reward volume over profitability. Gauging loyalty solely on the basis of such rudimentary measures as purchase quantity can be very misleading. Instead, Harrah's Entertainment, for instance, tracks the types of gambling that people do and focuses on its most profitable customers. Its loyalty program recognizes, for example, that roulette wheels have a different house take than slot machines. Thus, when a customer calls to book a night at one of its properties, Harrah's is able to generate a spot price for the room based on customer profitability as well as availability. Profitable customers might stay for free while others might be charged hundreds of dollars for the same room or even be told that no rooms are available.

Frequent-flier programs are beginning to follow suit. American Airlines revamped its entire AAdvantage system to track members according to their profitability. The program still adheres to the convention of issuing miles to fliers but can use the customer's P&L when making other decisions about the customer relationship.

Keeping track of the profitability of the customers is paramount. Companies reward loyalty because they believe it leads to profits. By tracking profits directly, a company can better target its rewards.

Don't give away the store. There's no reason to cut into profit margins if a customer can be made happy with a costless reward. For example, United Air Lines ranks meal service in its first and business classes based on seniority. A 1K cardholder is asked her choice of entrée before a Premier or Premier Executive cardholder. It costs the airline nothing to bestow this honor, because the numbers and types of meals taken on board do not change. Similarly, Citibank does not answer the customer service calls it receives in the order they are received; rather, wait time is a function of the callers' assets. Many managers refer to this type of preferential treatment as customer recognition. Call it what you like – it effectively rewards the most valuable customers.

Even if managers cannot make customer rewards costless, they can often lower the costs. A classic way to achieve this is to provide coupons rather than straight discounts. Baby Club's 10% discount, for example, was given in the form of Baby Bucks that could be redeemed for $10 vouchers that themselves could be redeemed for groceries at ABCO. When interviewed, club members showed real enthusiasm for the "10% discount" they received. However, when we looked at the liability to the store, we found that the low redemption rate coupled with the profit margin on the sales of the items bought with the coupons reduced the liability from 10% to a mere 1.72%.

Don't promise what you can't deliver. When a loyalty program pledges to reward customers with preferential treatment (shorter lines, expedited delivery, special toll-free numbers), it must ensure that the services provided through these special arrangements are better than the services available to regular customers. This is particularly true when customers can easily compare the two levels of service. While it may be hard to gauge the amount of time others spend waiting on the phone, it is easy to see whether the first-class ticket line moves faster than the regular line. Comparison is especially salient when customers are waiting for their luggage. The premier passenger cannot help but observe how many bags without a bright orange or pink "priority" tag are delivered before he gets his.

To make matters worse, customers do not compare averages with averages; they compare extremes with extremes. That is, they notice the speed of service only when they are not being served promptly. Our research suggests that, on average, airline luggage marked as "priority" tends to come out of the plane faster. Many airlines even have a special container for these bags. Yet we have also found that, frequently, a good number of nonpriority bags are delivered before the last priority bag comes out. If too many nonpriority bags are delivered before priority bags, the premier passenger begins believing that the promise of superior service has been broken. Managers need to ensure that the lower bounds of premium service never look worse than standard service.

Keep the Faith

We began this article with a litany of failures, a sampling of loyalty programs that were dumped for not delivering. In a way, this is the good news, because many other programs that should get canceled continue to limp along.

Yet loyalty programs are ingenious marketing tools when they are designed and executed well. In a wide variety of industry settings, they've proven their ability to reduce churn, increase sales and profitability, and yield the kind of insight that allows a company to provide more valued service to its customers.

Making sure that a company's loyalty program will carry its weight begins with clarifying what the program is expected to do. This requires careful attention to the details of program design, from the value and nature of the rewards to the ways in which they are bestowed and redeemed. Perhaps more than anything, a successful program depends on competent and consistent execution. Even with all of this, true loyalty might be too much to expect, but companies will likely have longer-term relationships with happier customers. And that, to us, sounds like the best kind of competitive advantage.

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