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The Mother of Invention

The Power of Merchant-Funded Rewards in a Recession

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Executive Summary

If there is truth in Plato's maxim regarding "necessity, who is the mother of our invention," then the coming months should be innovative times for marketers operating in the current economic climate. Faced with plummeting consumer confidence, increased competition, and wary, budget-conscious shoppers, marketers are in desperate need of new strategies to engage and retain customers.

Fortunately, there is hope. The loyalty-marketing industry was born during the dismal recession of the early 1980s, and in the years since, has evolved into a critical tool for marketers to maintain profitable relationships with their best customers. One progressive model for enhancing the loyalty value proposition, merchant-funded rewards, has proven effective in delivering value to consumers, program operators and merchant partners.

This paper explains the challenges, roles and benefits of adding merchant-funded reward solutions to your loyalty-marketing arsenal. Key highlights include:

- Marketing budgets are being scrutinized as a result of recent corporate cutbacks and economic pressure. Consumers are even more value-driven, placing the importance of price above brand or company loyalty. The ballooning number of loyalty programs across all industries means fierce competition for consumer memberships and engagement.

- Merchant-funded rewards programs provide solutions to the many challenges facing today's marketers. In theory, these programs offer wide selection and greater value potential to consumers, while the shared reward funding structure spreads costs and liability among multiple stakeholders.

- Merchant-funded programs are on the rise. But the boom in the sector has not come without considerable growing pains. Establishing an effective merchant-funded solution is a complex task that requires commitment and considerable resources. Half-hearted attempts will result in a limited consumer experience that fails to deliver a modern shopping experience.

- Successful merchant-funded programs will satisfy the needs of members, merchants and program sponsors, creating value and payoff for each party. Merchants gain access to high-value consumers. Members get valuable offers and earn at higher velocity. And sponsors reduce costs while fostering richer customer engagement.

With so many constituents to satisfy, marketers may wonder if developing the ideal merchant-funded program is an impossible task. Don't be discouraged. This paper outlines the new technologies and industry best practices that can help a program realize the full benefits of a merchant-funded loyalty solution.

I. The Role of Loyalty Marketing

Since the launch of the American Airlines *AAdvantage* program in 1981—considered by business historians to be the "big bang" of the loyalty-marketing industry—loyalty marketing has enjoyed a long and storied history as one of the most successful tools available to marketers who seek to build profitable customer relationships. COLLOQUY defines loyalty marketing as the "effort to identify, maintain and increase the yield from best customers through long-term, interactive, value-added relationships." Properly positioned, loyalty marketing is the tactical execution of an *enterprise loyalty* strategy that seeks to use customer data to transform a product/channel-focused organization into a customer-centric one in order to deliver organic, sustainable growth to stakeholders.

Loyalty marketing is symbiotic, rather than parasitic; there must be benefit for both sides, or it won't work. When it functions properly, both the brand and its customers perceive value in cultivating deeper relationships

To build sustainable customer relationships, loyalty marketers follow a three-step process:

- **Identify:** Loyalty marketing seeks to recognize and reward customers based on tracking their individual purchase behavior and projected potential. As customers spend more with you, the benefit you derive from tracking their patronage increases. This tactic allows you to retain your most valuable customers and maximize their spending. But in order to affect profitable customer behavior, you must first identify who those customers are. Armed with this knowledge, you can then introduce initiatives to retain your best customers and increase your share of their overall spend

- **Understand:** Loyalty marketers seek to exchange value for information. The customer loyalty program is a tactical marketing tool that provides both motivation for customers to engage in this value exchange and a forum for productive dialogue between them and the sponsoring brand. This *value exchange* allows you to learn more about your customers' behavior and preferences, and then act on that insight to produce a measurable return on your loyalty-marketing investment. Loyalty marketers typically assess customers according to their value, and then act to retain currently profitable customers and increase the lift from those who show the most potential for future profit. It's a zero-sum game—you deploy these tactics in order to increase your share of a customer's spend at the expense of your competition.

- **Influence:** Once members perceive meaningful benefit from the value exchange, they repeat the desired behavior—they shop more frequently, spend more per visit and tell more people about their experiences with your brand. Relevant dialogue also delivers a sense of relationship and community to customers—especially when you listen and react to what they tell you. By tracking personal attributes and transactional history, you can apply value-added mechanisms that further increase their level of spend. This approach forms the essence of all customer relationships, which COLLOQUY defines as "the voluntary exchange of value for information, with the mutual expectation of gain." Loyalty marketing is symbiotic, rather than parasitic; there must be benefit for both sides, or it won't work. When it functions properly, both the brand and its customers perceive value in cultivating deeper relationships.

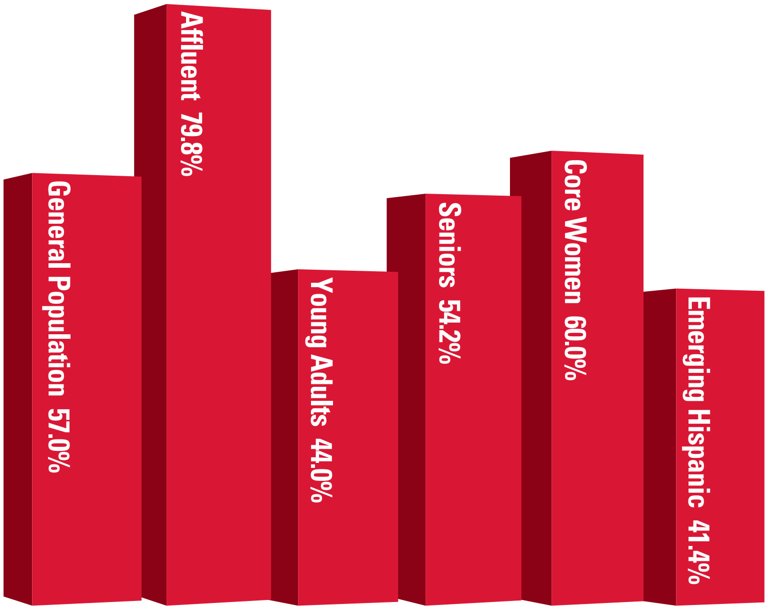
The results of this approach speak for themselves. Companies as varied as Best Buy, Delta Air Lines, Harrah's Entertainment and Tesco have deployed an enterprise loyalty strategy, fueled by loyalty-marketing tactics, to become category leaders.

Properly cultivated, loyalty program members can become your most powerful advocates—COLLOQUY's recent white paper on the intersection of loyalty programs and customer word-of-mouth revealed that nearly 70 percent of active loyalty program members are self-described "champion customers" who will recommend the program sponsor's products or services to others.

Another COLLOQUY study showed that nearly 60 percent of U.S. consumers reported active engagement with at least one loyalty program. While this number does not necessarily mean that all 60 percent are heavy program users, we can assume that recalling engagement signifies in most cases an awareness of the program and often activity important to the customer relationship, such as earning and redeeming benefits, visiting program web sites, and responding to program communications, auctions, surveys and promotions. Furthermore, specific desirable consumer segments such as the affluent and core women reported even higher participation levels, reaching 80 percent.

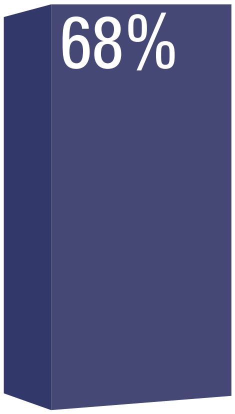
The numbers don't lie. Loyalty marketing remains the marketer's most reliable and measurable way to find brand champions, dialogue with valuable consumers and develop profitable relationships with them.

Exhibit 1
Recalled Loyalty Program Participation Rates by Segment
Percentage of respondents stating they belong to any loyalty program, April 2007



• *Source:* The Difference Engine: A Comparison of Loyalty Marketing Perceptions Among Specific U.S. Consumer Segments, *August 2007*
• *n=500 respondents per segment*

Exhibit 2
The Role of Reward Programs in Generating WOM About the Brand
Percentage of respondents that are brand champions due to reward program



• *Source:* The New Champion Customers: Measuring Word-of-Mouth Activity Among Reward Program Members, *January 2009*
• *Question: Thinking about the Reward Program you belong to . . . Within the next 12 months, how likely are you to recommend the services or products of that company to family/friends/others?*

Challenges for today's loyalty marketers

While loyalty marketing remains the best and most measurable way to build profitable relationships with best customers, challenges both intrinsic and extrinsic to the discipline will place the onus on loyalty marketers to renew and refresh their programs and initiatives while controlling costs. Here's a closer look at a few of the key challenges:

Outside of commodity purchases, consumers need not so much to feel that they're getting the best deal with every purchase, but rather that they're getting consistent economic value across their purchases with your brand.

1. **The global economy exerts pressure on marketers to control costs.**

   On Dec. 1, 2008, the National Bureau of Economic Research officially confirmed that the U.S. economy was in a recession. More than 2.6 million people lost their jobs in 2008, and most economists predict that the employment outlook will get worse in 2009. The specter of "stagflation"—the brutal combination of a declining Gross Domestic Product (GDP) and increasing prices—has reappeared for the first time since the 1970s, with the Consumer Price Index doubling to 5.4 percent in 2008 while the Conference Board's February 2009 U.S. Consumer Confidence Index reached its lowest point (25.0) since the Index began in 1967. The crisis is global: Canadian consumer confidence is likewise mired at a multi-year low, and even the nascent China Consumer Confidence Index (CCCI) dipped to its lowest point in September 2008.

   The natural corporate reaction in such an environment is to cut costs, and marketing budgets are usually the first to feel the effects of the scalpel, if not the hatchet. A recent MarketingProfs survey, for instance, reported that the economy has already forced planning and budgetary changes on 52 percent of marketers; 65 percent are anticipating negative effects. The result is that potentially beneficial loyalty-marketing initiatives may be delayed, if not cut permanently.

2. **Consumers are increasingly value-driven.**

   In this economic environment, all marketers suspect that, in an effort to stretch their dollars, consumers will shop less and base purchase decisions more on price and special deals than on loyalty to a brand or company. Two separate 2008 studies back up this fear: An October 2008 study by AlixPartners found that 60 percent of consumers said they would wait for special deals, discounts, and offers for their holiday shopping. Meanwhile, a SoundBite Communications study found that 7 out of 10 consumers are more focused on deals this year than last.

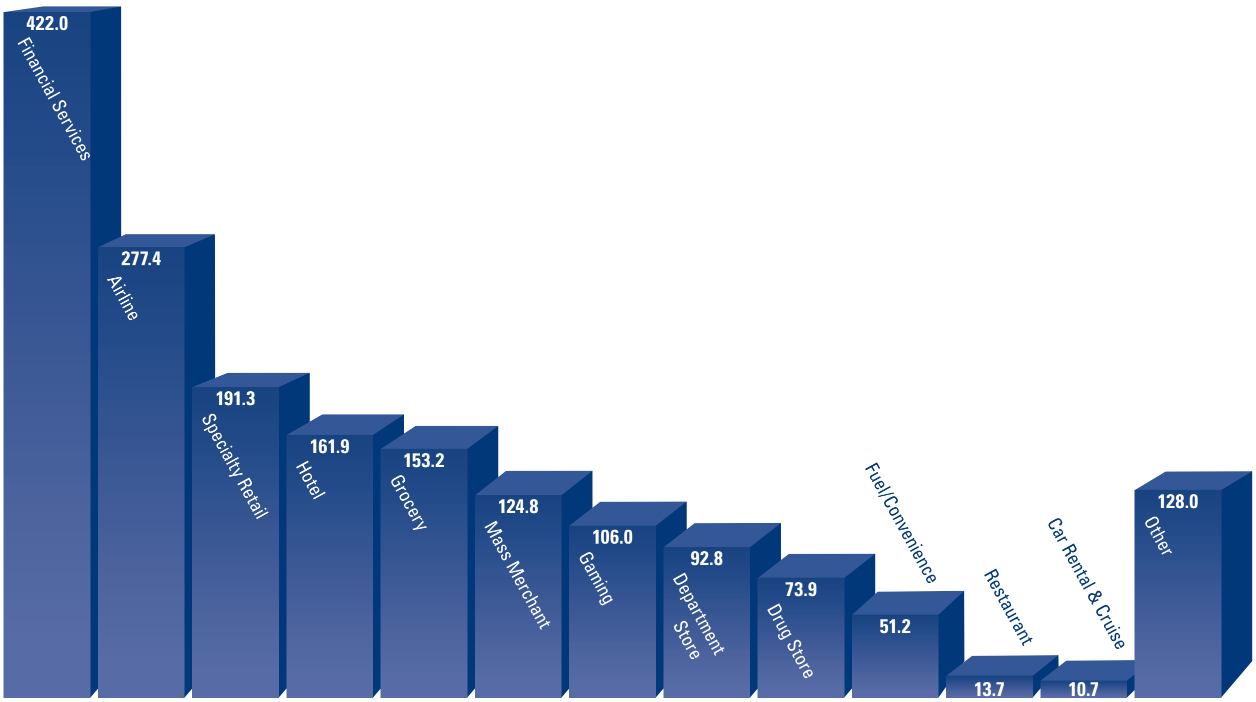
   Even in good times, consumers still demand value. COLLOQUY's June 2008 Retail Loyalty Index revealed that consumers do indeed consider "value for money" a fundamental factor in their shopping loyalty. It's not that consumers at all times and everywhere consider only price when choosing a brand; intent to recommend, store environment, product selection and quality service are equally important drivers of retail loyalty, and consumers in our survey indicated a clear willingness to trade some margin back to the retailer in return for an improved customer experience. Outside of commodity purchases, consumers need not so much to feel that they're getting the best deal with every purchase, but rather that they're getting consistent economic value across their purchases with your brand.

3. **Loyalty programs are now a commodity.**

   COLLOQUY's 2009 Loyalty Census white paper reveals that, from 2006 to 2008, U.S. loyalty program memberships increased from 1.341 billion to 1.807 billion—an adjusted growth rate of nearly 25 percent since our previous Census. This number translates into 14.1 loyalty program memberships per U.S. household. Most of this growth was fueled by the financial services sectors which has now surpassed the airline industry as the single largest category of loyalty program members. But there is a dirty secret hidden among those fat membership roles: the blended average of *active* program participation across all verticals is only 43.8 percent. Several vertical market sectors hover at only 25 percent active membership rates.

What those low activity rates tell us is that, even as the average U.S. household belongs to 12 different loyalty programs, they actively participate in only four of them. In this age of loyalty-marketing ubiquity, conscientious loyalty practitioners must periodically measure program activity rates and drive engagement as a precursor to incremental revenue, retention and loyalty. By regularly injecting life into your loyalty strategy with new offers, partners, and rewards, you create the strategic foundation to support your company's business objectives.

Exhibit 3
U.S. Loyalty Program Memberships by Sector, 2008



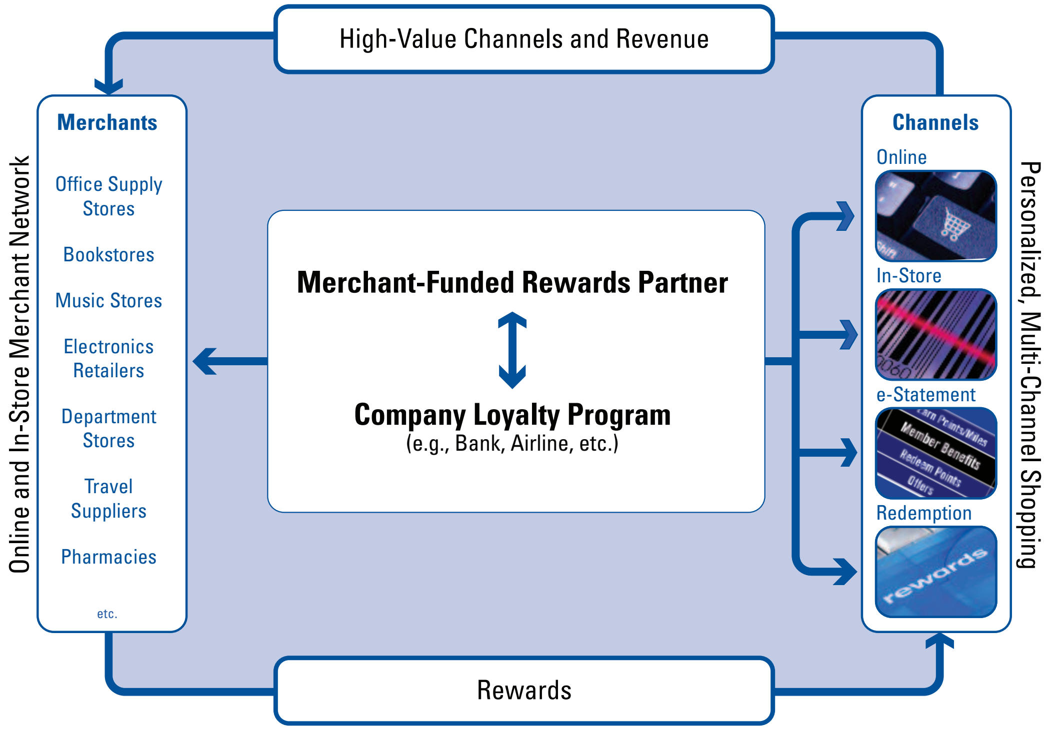
• *Source:* The Big Sort: The 2009 COLLOQUY Loyalty Marketing Census, *April 2009*
• *Numbers expressed in millions*

The opportunity of merchant-funded rewards

Despite the challenges outlined above, loyalty marketers will continue to innovate with new and exciting value propositions that engage consumers and drive their loyalty to sponsoring brands. One such innovative solution has continued to gain traction with both program operators and consumers: merchant-funded rewards. In a recessionary economic environment, merchant-funded rewards programs can provide real value for marketers and consumers alike. Programs fueled by merchant-funded rewards can help loyalty marketers overcome each of these challenges—the shared reward funding structure helps sponsors control program costs and liability, while the increased choice and wide array of participating merchants help differentiate programs and provide additional incentive for value-hungry consumers.

Merchant-funded reward networks typically allow hundreds of merchants in all major shopping categories to join together in a coalition to provide offers to loyalty program members such as rebates, enhanced points or miles earning, coupons, and special offers such as free shipping. Shoppers may shop online, in the bricks-and-mortar store, or via a catalog. Merchants pay a commission of anywhere from a few percent to more than 20 percent for each sale that comes through these programs. For participating merchants, the rewards network provides a channel for customer acquisition and revenue lift—and the more revenue that funnels through the program, the more value they're willing to provide members in the form of commissions and special promotions.

Exhibit 4
Merchant-Funded Loyalty Shopping Solutions
Linkage of merchants, loyalty programs and consumers to power unique, differentiated programs



• *Source: Mall Networks*

The three key constituencies of loyalty programs benefit from merchant-funded rewards in the following ways:

Program members: By shopping through a branded loyalty shopping portal, members can easily compare the best promotions and product prices across merchants and shopping channels. When they decide to make a purchase or take advantage of an offer, they do so directly through the merchant's online site, store or catalog. Every time they shop, consumers earn bonus points, miles, or cash rewards through the program itself as well as benefitting from the special offer. A reward credit cardholder, for example, might earn 1 percent cash-back on all purchases, while at the same time earning an additional 3 to 20 percent cash back from the merchant—and may also take advantage of additional offers, such as free shipping. The opportunity for members to "double dip" by earning standard rewards program benefits along with merchant-funded bonus rewards, special deals, and discounts provides a powerful incentive for members to consolidate their spend with the sponsoring brand.

Merchants: Leading merchant brands who participate as players in merchant-funded rewards solutions enjoy the benefits of participating in a network of merchants and consumers that provide them access to a strong acquisition channel of engaged members who enjoy the opportunity to earn additional value in the program. Merchants also benefit from association with other leading brands in the network, and can even gain access to cross-shopping purchase behavior that can provide them with valuable insights into consumer behavior.

Loyalty program sponsors: For loyalty program sponsors, merchant-funded rewards offer unique advantages. Merchant-funded rewards not only provide a powerful tool for loyalty marketers to differentiate their programs, but also increase member engagement beyond the limits of traditional loyalty programs. Here are a few key benefits:

- *Increased earn velocity:* In most proprietary loyalty programs, the ability to increase engagement and drive earning velocity is limited to the company's own products and services—for example, members of a retailer's loyalty program earn most of their rewards through buying the retailer's merchandise. Merchant-funded rewards networks allow consumers to earn more rewards, faster, at no additional cost to the program sponsor.
- *Increased engagement:* A typical program sponsor captures only a fraction of a consumer's overall spend, which limits the sponsor's opportunity to engage that consumer and build a longer-term, profitable relationship. By incorporating a large set of merchants into the loyalty program with a compelling value proposition and shopping experience, merchant-funded reward solutions allow loyalty program sponsors to leverage a higher percentage of every member's total shopping behavior.
- *Decreased costs:* Merchant-funded loyalty shopping has one additional advantage for loyalty marketers—and in an era of tight marketing budgets, it is arguable the most important benefit. Unlike traditional loyalty programs, which are entirely funded by the program sponsor, merchant-funded networks provide a richer loyalty program for members without additional cost incurred by the sponsor. Merchants who want access to your best customers are willing to pay for the privilege by funding bonus offers, discounts and special deals that provide better rewards for members and a more robust program for the sponsor.

Merchant-funded reward programs thus deliver significant benefits to all constituents. They provide a multi-channel suite of loyalty shopping solutions that enables a network of consumers, sponsors and merchants and drives material impact on key loyalty metrics such as acquisition, spend and profitability. Companies that offer merchant-funded loyalty shopping programs are seeing the results: increased engagement, double-digit spending lift and reduced program costs.

Exhibit 5
Benefits Matrix: Merchant-Funded Rewards

Program Sponsors	• Improved consumer engagement • Re-engagement of lapsed members • Access to wider percentage of shopper spend • Ability to fund richer reward program at lower cost • Improvement in key program metrics • Strategically-aligned merchant partners
Members	• Trust and familiarity from participation of brand-name merchants • Broad range of merchants and shopping categories • Increased earn and burn velocity—earn more rewards faster • Opportunity to double-dip • Access to exclusive bonus offers and special deals • Ability to search and compare offers, products, and prices across merchants easily • Modern shopping experience with highly relevant offers on par with the best retailers • Ability to shop across channels: online, in-store
Merchants	• Access to high-value, segmented consumers • Access to strong acquisition channel • Revenue lift for existing customers • Enhanced or reinforced brand with association with top program sponsors • Clear ROI from ability to track and manage the program results

But what about *return-on-investment*? For loyalty program sponsors, a merchant-funded rewards strategy not only can help drive core loyalty metrics of engagement, retention and profitability, but also can help drive specific industry metrics—for example, card issuers can leverage merchant-funded rewards to help increase card spend, share-of-wallet, activation and retention.

Merchant-funded rewards programs drive these loyalty metrics by tracking member participation, activity and profitable behavior change. For example, merchant-funded programs can help with new customer acquisition efforts by providing a strong value proposition; increase the number of customers who also join the loyalty program; re-activate lapsed members by providing a reason to re-engage; and improve engagement, loyalty, retention, and overall spend by encouraging members to participate as both visitors and shoppers with greater frequency.

> *"The newly launched* SkyMiles *Shopping mall features a jaw-dropping 500 retailers. That's more than twice the number of merchants participating in the other largest networks . . . . This, without a doubt, is the future of mileage malls."*
> *— Blogger Tim Winship*

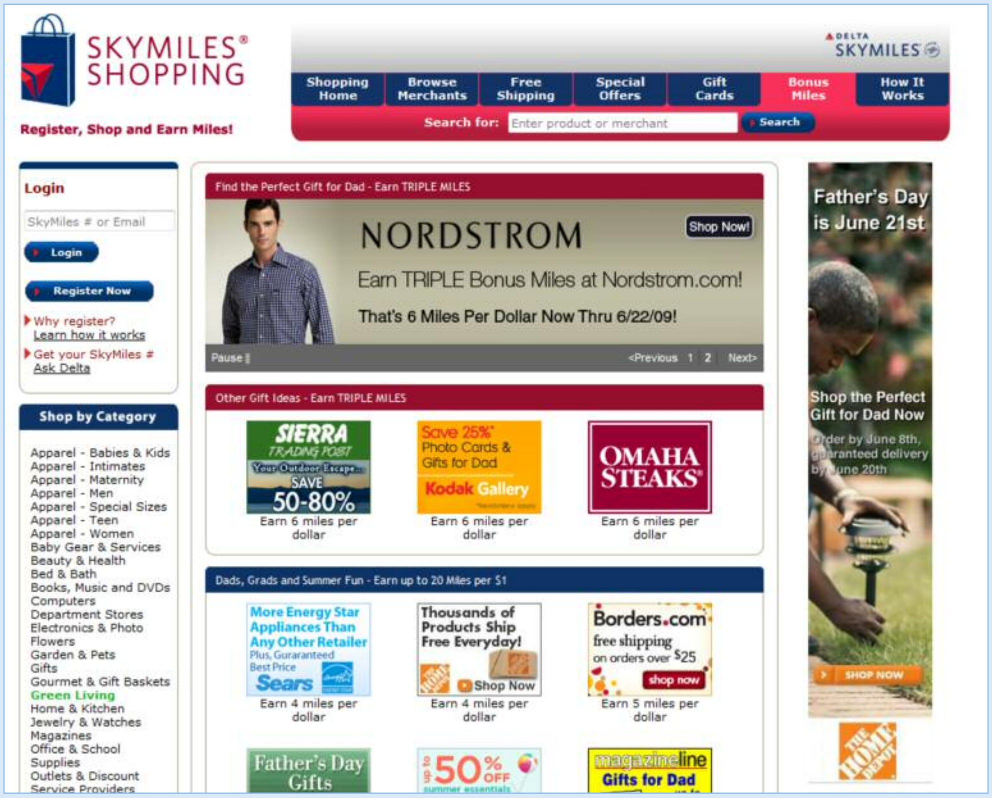
Case Study: The Delta SkyMiles *program*

Delta *SkyMiles*, one of the world's largest and most successful airline loyalty programs, blazed a trail with their 2003 launch of the original *SkyMiles* Shopping program. Like many of the early deployments of legacy merchant-funded rewards solutions, the *SkyMiles* shopping network was limited to about 100 merchants, and the shopping portal consisted largely of links to merchant partner sites and ads that described the miles that members could earn with each merchant partner.

In August 2008, Delta seized the opportunity to drive increased revenue and improved member engagement by re-launching a new and improved *SkyMiles* Shopping program in August 2008. The revamped program offered members even more ways to earn miles, with an expanded merchant network of more than 500 merchants and 20 million products providing an unprecedented array of shopping choices for Delta customers. With such innovative features as comparison shopping, cross-merchant search, personalization, and daily updates of new offers like quadruple miles and free shipping, the revamped portal was designed to meet the tough expectations of today's online shopper.

How did the re-launched portal resonate with *SkyMiles* members? During the first month after the re-launch, the number of members shopping through the portal and the number of transactions on skymilesshopping.com more than doubled over the same period the previous year. This growth rate has continued after launch and far exceeded the historic results from the previous version. In addition, customer engagement metrics have soared.

Blogger Tim Winship, one of the leading authorities on frequent-flyer programs, said of the new portal, "The newly launched *SkyMiles* Shopping mall features a jaw-dropping 500 retailers. That's more than twice the number of merchants participating in the other largest networks. But it isn't just the network's size that impresses. Unlike the other mileage malls, Delta's now boasts a robust search-and-compare feature that adds real value to the shopping experience. This, without a doubt, is the future of mileage malls."



A brief history of loyalty shopping

Loyalty shopping portals and programs are not a recent phenomenon. Early in their history, some of the first airline loyalty programs began to sign partnerships with complementary brands that offered frequent flyers additional ways to earn airline miles. Early partners included co-branded credit card issuers—which opened up earning opportunities across the entire breadth of a member's spending—along with rental car companies, hotel brands and other partners. These partnerships helped build the value of airline miles to the point that the airlines were able to create a lucrative new line of business selling miles to partners. On the part of the airlines, this effort is labor-intensive; in most cases, these partners and offers are managed by internal teams who market them through direct mail and online links.

Early in their history, some of the first airline loyalty programs began to sign partnerships with complementary brands that offered frequent flyers additional ways to earn airline miles.

Outside of the airlines, Discover Financial Services was a pioneer in integrating shopping rewards into their value proposition. In 1986, Discover introduced the popular "cashback" program that rewarded cardholders with a cash rebate based on how much their annual spend on the card. This addition turned the card into a de-facto shopping reward program and remains central to how Discover markets the card. In 2006, Discover launched the ShopDiscover online mall with 20 merchant partners, and has continued to add new merchant partners since launch.

As one of the earliest brands to incorporate an online shopping portal into their value proposition, Discover undertook the challenge to build and manage the full technology infrastructure needed to implement the portal. They also recruited partners to and continue to manage the merchant network itself—an enormous operational challenge that incurs considerable costs. That Discover chose to undertake this challenge speaks to their belief that the shopping portal adds considerable value to their brand. What lessons can marketers draw from these merchant-funded reward pioneers and legacy first-generation vendors? Here are a few:

- Most of the legacy partner shopping portals have failed to evolve, and thus don't generate the same level of enthusiasm on the part of merchants, members, or sponsors as some of today's newer merchant-funded reward programs. These legacy programs are limited in breadth and don't provide the modern shopping experience today's consumers expect.
- Companies who opt to build a merchant-funded solution can expect to devote considerable resources and treasure to the recruitment, integration and management of merchant partners. The complexity of this process is outside the core competencies of most organizations, and requires a dedicated internal team to manage it.
- While many companies would love to replicate Discover's success at implementing a partner shopping program, few have the resources or the level of commitment required to build their own multi-channel loyalty shopping program—and even pioneers like Discover have looked to take advantage of next-generation merchant-funded solutions to enhance their programs.

II. Best Practices for Merchant-Funded Rewards Programs

To construct a successful merchant-funded reward program, loyalty marketers must manage the complex, intersecting needs of the three primary constituencies involved: program members, merchant partners and the program sponsor itself. Many merchant-funded deployments, therefore, vastly underperform against their potential. Consumers see a paucity of offers—a small set of merchant partners made up largely of the usual suspects—and are often subjected to a bad shopping experience. Merchants then don't see any revenue lift, so they drop their offers or leave the program. Loyalty programs spend large sums of money acquiring merchant partners and managing the relationships, but still see limited benefit from the program.

Consumers expect your shopping portal to offer up the same blue-chip merchants with whom they shop regularly. Just as a brick-and-mortar shopping mall is judged by the quality of its anchor stores, so too do strong retail brands anchor your shopping portal and endow it with a sense of quality.

The good news is that new technologies and emerging best practices are available to help program sponsors offer effective, differentiated merchant-funded reward solutions. Merchant affiliate programs, modern multi-channel shopping experiences, and ecommerce, personalization engines, and high-scale transaction tracking platforms are now all within reach.

Even with the next generation of tools available, however, not all programs realize the full benefit of merchant-funded shopping solutions. To fully take advantage of the new merchant-funded solutions available, consider the following best practices:

Extend the breadth of merchants and offers. Stock your merchant network with a breadth of merchants and categories that cover the full range of consumer shopping habits. As in any loyalty program, driving participation and activity in a merchant-funded rewards program requires changing consumer behavior. A program that offers the full breadth of all major shopping categories removes a barrier to behavior change—consumers can count on the merchant-funded program to offer nearly anything a consumer might want to buy.

Most consumers shop with dozens of merchants every year across a variety of product categories. Many failed merchant-funded programs offer only a handful of merchants in a narrow set of product categories, which provides limited choices for consumers and captures only a narrow subset of their shopping behavior. Consumers enjoy the experience of shopping through single-site portals: consider the success of Amazon.com, which offers a broad selection of product categories, as well as the proliferation of comparison-shopping sites, search engines and multi-channel retail department stores and mass merchants such as Wal-Mart. Consumers demand both choice and convenience.

Align with blue-chip brands. In addition to breadth, consumers expect your shopping program to offer up the same blue-chip merchants with whom they shop regularly. Just as a brick-and-mortar shopping mall is judged by the quality of its anchor stores, so too do strong retail brands anchor your shopping program and endow it with a sense of quality. Aligning with strong brands creates a halo effect for your program. In addition, prospective merchant partners will rush to become associated with a high-quality shopping program. Creating, nurturing, and managing relationships with blue-chip merchants is complex, time-consuming, and requires continued investment in the partnership; the best merchant-funded loyalty shopping programs have a demonstrated ability to leverage a large network of merchants in order to offer the best value to their customers.

By the same token, featuring too many unknown, unproven or second-tier merchants in the program can saddle your loyalty program with a negative brand halo. Consumers do associate the experience of shopping with a merchant in the program with the loyalty program sponsor. If you aren't careful, a poor customer experience at a merchant partner may negatively impact program success.

Provide compelling and dynamic value to your members. Merchants are willing to offer exclusive, generous rebates and special promotional offers to your members—provided that you have developed a trusted, strategic partnership with them built on the mutual desire to deliver real value to members. While simple cash-back offers of 1 percent or less might work for credit card issuers, merchant-funded reward programs benefit from large numbers of compelling offers, rebates, and special promotions that drive repeat visits and increase purchases. The most compelling programs feature a variety of merchants delivering strong bonus offers that are refreshed on daily, monthly, and seasonal basis. Many loyalty shopping sites are nothing more than clickable-banner farms featuring offers that don't change for weeks or even months. Don't be one of them.

Best-practice keys to a successful merchant-funded reward program:

- √ ***Broad and deep merchant network***
- √ ***Partnership with blue-chip brands***
- √ ***Real value to members***
- √ ***Committed program marketing***
- √ ***Intuitive multi-channel shopping experience***
- √ ***Effective segmentation***
- √ ***Strategic alignment with partners and members***
- √ ***Continuous measurement and optimization***

Market your program. Without an effective marketing strategy, even the most compelling loyalty shopping program is doomed to wither on the vine. Especially for new programs, a comprehensive tactical marketing plan is essential to build awareness of the program, encourage first-time visitors, and reinforce repeat visits. The best merchant-funded programs leverage existing marketing assets as well as incremental marketing campaigns. The best programs make effective use of marketing tactics such as visible links from the web site home page, new member welcome kits, and allocation of message space on existing communications assets such as email newsletters and direct-mail statements.

Email in particular is one of the most cost-effective means to market your merchant-funded program. New members who opt into the merchant-funded shopping program should receive welcome emails, order confirmations and targeted offers at regular intervals. Loyalty program emails typically enjoy high open rates, and provide excellent opportunities to reinforce your value proposition and create member value through personalization and relevance.

When choosing a merchant-funded rewards vendor, you should ensure that vendor possesses both the technical and marketing expertise to support your efforts. State-of-the-art merchant-funded loyalty programs require multi-channel, segmented, integrated, event-based and time-based marketing campaigns that deliver the right message to the right customer through the right channel—every time.

Create a dynamic, intuitive multi-channel experience. While many loyalty program sponsors attempt to erect sturdy walls between online and in-store, consumers blend their shopping experience across channels in various ways, such as researching products online but then purchasing them in the store. According to Forrester Research, 27 percent of all retail sales now either occur solely online or involve online research prior to the in-store purchase. Loyalty shopping portals must reflect this new multi-channel reality by breaking down internal silos that separate your physical and virtual worlds to provide a fully integrated, multi-channel shopping experience for your customers.

Additionally, the appearance of similar kinds of walls between the "main site" and the "loyalty site" are viewed as disruptive barriers by consumers. Every part of your site should blend into a single shopping experience. Consumers view your entire web site as the single face of your company. When they're forced off the main site, encounter a new log-in gateway, or perceive a change in the site's look and feel, they often abandon ship.

Online retailers understand that their marketing efforts help bring customers to their site—but what happens when those customers experience the moment of truth by purchasing or redeeming for rewards on your site? Will they turn into repeat visitors and repeat shoppers? Today's consumers are conditioned by the highly optimized shopping experiences they enjoy with such best-in-class online retail sites as Amazon, Best Buy, or Borders, and a visitor conversion from browser to purchaser will be predominately based on how their shopping experience compares to the best. Loyalty shopping portals must meet or exceed this high bar—generic, static, and confusing user experiences will guarantee you nothing more than low transaction volume and poor repeat visitor metrics.

Given the importance of the online channel to the customer experience, program sponsors can offer nothing less than a rich, intuitive, virtual experience powered by personalized, relevant content and offers. Consumers also demand effective search and browse capabilities that allow them to quickly locate the right product, offer, or merchant. Many loyalty shopping sites fail at this critical element: some offer only product search; others only on offers or merchants; a few lack any search functionality at all. Whether browsing or searching, consumers must find the experience intuitive and immediately fruitful—or they'll look elsewhere.

Build strong relationships through effective segmentation. The most effective way to build strong multi-channel relationships is through effective segmentation. Consumers expect easy access to the products, offers, and merchants most relevant to them. Across channels, consumers should see personalized offers, merchants, and products based on their shopping history, preferences, and the behavior of other consumers with similar profiles. This personalization must be consistent across channels—whether delivered online, in-store, via e-statements, to the email in-box, or at home via direct mail, all offers must display consistent relevance.

Targeting should include a combination of technologies and services, including: merchandizing analytics to review all offers and suggest optimum targets; business rules driven by member preferences such as preferred merchants and channels; context-driven offers such as those based on page content or search terms; and personalization based on past purchases, pages visited and redemption patterns. Such personalization can be implicit, based on consumer segmentation by history, behavior, and analytics, or explicit, based on user-provided preferences.

While explicit segmentation can provide a useful start, studies have shown that less than 2 percent of users fill out detailed profiles, and few still maintain those profiles to keep them current. Implicit targeting based on customer data, on the other hand, provides immediate value while taking the burden of accurate information off the shoulders of your customers.

Remember: Effective segmentation ensures that your marketing dollars achieve maximum efficiency. Don't squander customer and consumer good will on irrelevant offers.

Ultimately, your goal should be to create a differentiated relationship in which the entire shopping experience—from currency earning rates, offer targeting, messaging and branding elements—is fine-tuned to customer segments based on combinations of transactional behavior, card portfolios, program tier level, or to specific sales channels such as small business. Remember: Effective segmentation ensures that your marketing dollars achieve maximum efficiency. Don't squander customer and consumer good will on irrelevant offers.

In order to engage in all of this segmentation and analysis, your merchant-funded loyalty program will require a technology platform robust enough to handle the complexities and scale of large programs, and flexible enough to enable and enforce business rules that embrace opportunities to improve performance. Most programs cannot adapt to changing business rules or different marketing priorities because of the inherent limitations of their shopping platform. Best-in-class loyalty shopping platforms don't hinder your marketing strategy, segmentation approach or messaging tactics, but rather enable these elements. Can your loyalty shopping platform leverage your existing brand and marketing assets? Does it offer a strong e-marketing capability tightly integrated into the platform? Can it run marketing campaigns and send event-based emails to drive return visits? If not, it may be time to seek a more robust solution.

Seek strategic alignment with your merchant partners. Merchant-funded loyalty shopping works best when the program sponsor, partner merchants and members all find value in the relationship. Maintaining this balance is an exceedingly complex proposition, and many programs die over time because one of these constituencies fails to perceive an equal stake in the relationship. Absent this balance, merchants no longer see the return and either pull out of the program or reduce the quality of their offers. To overcome this danger, seek alignment with your merchant partners on the value of the partnership and your mutual commitment to delivering real value to your customers. A solution provider committed to pay-per-performance pricing, rather than high retainer-based pricing model, can help you strike this balance with your merchant partners.

Most top merchant-funded shopping vendors with a proven track record of driving profitable customer behavior change will operate under a performance marketing model. In a performance marketing model, the bulk of the payment to the merchant-funded rewards vendor is in the form of commission share from shopping. By reducing implementation and fixed operations fees and aligning pay with performance, this model ensures goal alignment between vendor and program sponsor that drives ongoing success.

Measure, analyze, and optimize for continuous improvement. Finally, remember that merchant-funded rewards programs are a means to an end. Merchant-funded programs deliver ROI through increased customer engagement, retention, and profitability. Successful program operators are obsessive about tracking these metrics and driving continuous improvement. It's an old loyalty-marketing mantra: Successful programs must evolve or die. Successful and continuous program improvement relies primarily on the effective use of customer analytics. Analytics drive your merchant and offer strategy, enable customer segmentation and personalization, and establish benchmarks for effective tracking and optimization. Repeat visitors constantly evaluate whether or not they want to return. A program that continuously evolves through updated merchant partnerships, offers, messaging, and features is critical for program stickiness and engagement. Customer analytics provides the roadmap that allows your program to stay fresh relevant. Absent continued investment in analytics and optimization, your program will grow stale, old, and undifferentiated.

III. Conclusion

The current economic crisis is a vise, compacting corporate budgets to fractions of their original size. In the face of adversity, companies are forced to act quickly and creatively, or else falter in the flurry of competition. Value-seeking consumers, also hit hard by the downturn, are armed with more choice than ever—making decisions every day about which merchant to patronize, what channel on which to shop and which loyalty programs they will commit to. Today's consumers no longer merely appreciate a loyalty option as part of the shopping experience—they expect it.

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With loyalty marketing as the central battleground for consumer loyalty and loyalty shopping as the primary weapon, differentiating via an effective merchant-funded loyalty shopping has become the imperative for many companies. Merchant-funded rewards offer the logical model for a successful "time-of-adversity" program because of the win-win-win value proposition. These programs demand commitment and considerable resources, but the payoff can largely outweigh initial investment. Executed correctly, the merchant-funded program can create value for program sponsors, merchants and consumers.

The Authors

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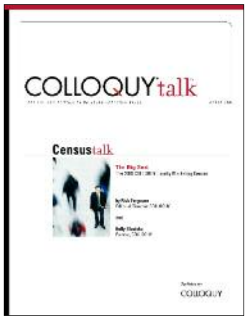

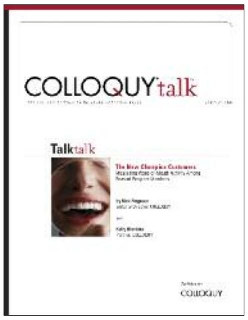

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