

# Four determinants of loyalty points' effectiveness

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## Executive Summary



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*Japan's loyalty point market has become more competitive than ever. To boost loyalty points' effectiveness as a sales promotion tool, companies must not only have a large number of loyal customers and issue points in sufficient quantities, they must also have ample points of contact with customers and continually roll out effective data-based initiatives.*

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### Growing loyalty point market is becoming increasingly competitive

The environment surrounding loyalty points and mileage rewards (collectively referred to below as loyalty points) has recently been undergoing dramatic change, with companies announcing shared loyalty point initiatives in rapid succession. Most notably, PayPay unveiled plans to enter the shared point market and Sumitomo Mitsui Financial Group (SMFG) and Culture Convenience Club (CCC) announced an agreement to merge SMFG's V-Point loyalty program into CCC's T-Point coalition, Japan's first coalition loyalty program.

The value of loyalty points issued annually by major Japanese companies in 11 industries already exceeds ¥1tn. Loyalty points issuance by private Japanese companies is projected to keep growing to over ¥1.2tn by FY2025.

Additionally, shared loyalty points redeemable across many companies/services are becoming increasingly common. In addition to companies joining coalition loyalty point programs like the aforementioned T-Points, more and more companies, most notably railways, are launching their own shared loyalty point programs exclusive to their own groups. A case in point is JR West's WESTER Points.

Another trend that cannot be overlooked is the growing prevalence of initiatives aimed at improving the point-of-sale customer experience. Whether collecting or redeeming loyalty points, customers usually have had to present a rewards card or app separate from their medium of payment. In recent years, however, new cashless payment media have enabled consumers to collect and redeem points

via their medium of payment without presenting a separate rewards card or app. From a convenience standpoint, such payment media are similar to a house credit card that doubles as a rewards card.

In response to such corporate initiatives, consumer behavior also has been changing. According to NRI's 2022 Questionnaire Survey of 10,000 Consumers (financial edition), shared loyalty point usership continues to grow while loyalty points' degree of influence over point-of-sale purchase decisions has decreased.

One reason for their diminished influence is that loyalty points tend to lose potency as a sales promotion tool because they have been adopted by so many companies and are easy to copy. Another possible reason is that the sheer volume of loyalty point issuance today, including points issued by the government to incentivize use of cashless payment media and enrollment in the national ID number program, may have accustomed consumers to accumulating large point balances and diluted loyalty points' sales-promotion effect in relative terms. If so, this would be a monumental change.

## Four determinants of loyalty points' effectiveness

In light of such, I want to discuss how to boost loyalty points' effectiveness in terms of sales promotion from the standpoint of four factors.

The first factor is how many loyal customers a company has. No matter how outstanding a loyalty program is, it will not be sufficiently effective unless enough customers enroll in it and are they responsive to point rewards. The share of a company's total revenue that comes from loyalty program members (a.k.a. loyal customers), particularly those who respond to point-related promotions, is a key metric for assessing loyalty points' utility as a marketing tool. Sponsors of coalition loyalty programs publicly report their membership numbers (though their respective definitions of "member" differ somewhat). All of them have total members equivalent to more than half of Japan's population. The aforementioned NRI survey found that loyal customers, defined as customers who actively accumulate and redeem loyalty points, account for a relatively hefty 20-40% share of survey respondents who identify as loyalty program members.

The second factor is the scale of incentives (amount of rewards) available to loyalty program members. Loyalty points being incentives with economic value,

the greater the aggregate amount of points available to customers, the more effective the points would be expected to be as an attitudinal change agent. That said, loyalty programs are subject to budget constraints. Companies therefore have to factor cost-effectiveness into their calculus of how much rewards to offer loyal customers.

The third factor is points of contact with customers. If a company lacks sufficient contact with its loyal customers, it would have difficulty inducing them to make their next purchase or take action toward doing so, even if many of them have ample point balances. It is crucial for companies to increase routine communication with loyal customers via, e.g., a smartphone app, either their own or a third party's, instead of limiting communication to the point of sale. By doing so, they can gain visibility into information and behaviors predictive of sales opportunities. Additionally, they should be able to more accurately target specific sales promotions at customers. Scaling up contact with customers is one reason that coalition loyalty program sponsors have been upgrading their points-related smartphone apps.

The fourth factor is analytical, creative and planning capabilities. Through redemption of loyalty points, companies can get a variety of information from many customers or loyalty program members, including non-transactional information. By utilizing such information to increase sales promotions' effectiveness and, in turn, inform all facets of operations, including product development, merchandise sourcing and store siting strategies, companies can transform loyalty points from a tool that merely provides economic benefit into a management strategy tool. Of course, such a transformation is by no means easy to pull off. Requirements to succeed include modification of services to enable serial data utilization (including revision of, e.g., agreements), deployment of new information systems and formation of an organization to execute such tasks (mainly including hiring of analytics staff). Coalition loyalty program sponsors that have taken such steps have to varying degrees started to actively provide marketing tools and various action proposals.

### **Creativity is key to keeping loyalty programs from getting stale**

To maximize loyalty points' effectiveness, companies must continually develop creative solutions across the entire process from deciding what type(s) of points

to offer (proprietary/third-party, single/multiple) to identifying which customers to approach and formulating specific point-redemption initiatives. They must also keep their loyalty programs from getting stale and continue to strengthen each of the four factors discussed above (within tolerable cost constraints).

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