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# T ransformation of loyalty programs into financial services

Katsumi Tomita

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## Executive Summary



**Katsumi Tomita**

Senior Consultant

ICT & Media Industry  
Consulting Department

*Loyalty programs with financial features have been popping up in recent years, including programs in which point balances accrue interest or earn investment returns and programs that convert loyalty points to cash deposited in brokerage accounts. Such innovative loyalty programs are likely to become increasingly common in pursuit of both customer satisfaction and business expansion.*

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### Loyalty programs becoming more diverse

Merchants' loyalty programs typically award points to customers whenever they make a purchase and allow customers to redeem point balances as partial payment for subsequent purchases. In recent years, loyalty programs have been becoming increasingly diverse, particularly in terms of what happens after points have been awarded. Loyalty points have long been redeemable at varying exchange rates for a variety of rewards, including airline tickets, promotional coupons (exchangeable for merchandise for substantially fewer points than usual) and chances to win prizes in drawings or lotteries. Moreover, we are now seeing a growing number of loyalty programs that incorporate elements of financial services.

Examples of such financial features that have emerged since 2016 include accrual of interest on accumulated point balances (offered by RealWorld), point balances that gain or lose points as a function of a mock investment portfolio's performance (Credit Saison) and redemption of points as partial payment for investment trust purchases (Rakuten and Invast Securities).

With Realworld's loyalty program, members earn monthly interests in the form of additional points with their point balances. With Credit Saison's Eikyufumetsu (never-expiring) point investment service, program members mock-invest points (no assets are actually purchased). Their invested point balances gain or lose points in accord with their investments' performance. Rakuten and Invast Securities' services enable program members to use point balances to actually purchase investment trusts (Invast Securities' service automatically converts credit card point balances to cash and transfers the cash to the cardholder's brokerage account).

## Types of financial services associated with loyalty programs

Financial features of loyalty programs can be broadly classified as interest-bearing point balances and investment features, while the loyalty programs themselves can be classified more granularly.

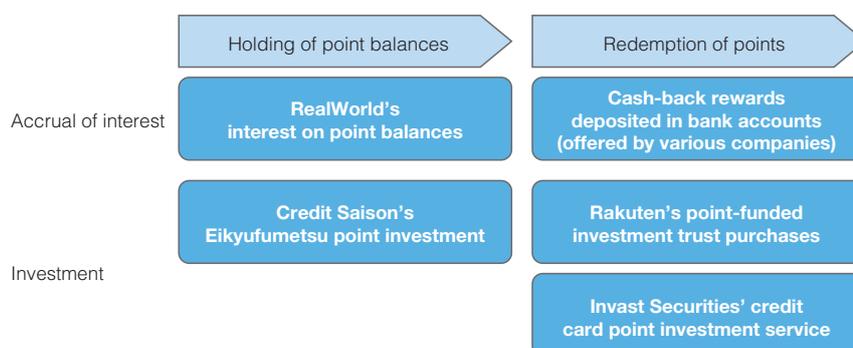
From a loyalty program sponsor's standpoint, loyalty points' lifecycle can be broken down into three major stages: the awarding of points to customers, holding of point balances by customers and redemption of points. Accrual of interest on points and Credit Saison's point investment service pertain to the second stage, during which the interest-bearing or invested points have yet to be spent and customers naturally consider those points to still belong to them. Rakuten and Invast Securities' investment services, by contrast, convert points to cash, which is used to purchase investment trust units. They are thus redemption-stage services. Accordingly, if customers have committed their entire point balances to investment trust purchases through one of these services, they would no longer consider themselves to own those points, except for any new points they may have subsequently earned. Cash-back rewards deposited into the cardholder's bank account are analogous to a redemption-stage interest payment. Cash-back rewards have long been available from various companies.

## Service features reflect providers' business attributes

Differences in loyalty program features often reflect differences in the nature of loyalty program sponsors' respective businesses.

In the case of RealWorld, the company with the interest-bearing loyalty points, customers earn points mainly by purchasing products advertised on their member

### Types of financial services available from loyalty programs



Source: NRI, based on information from company websites

pages on RealWorld's websites and/or registering for and using services (among other means, including playing games). Meanwhile, RealWorld points are mostly redeemed for rewards other than RealWorld's own services, including cash back and other companies' loyalty points. RealWorld therefore faces a substantial risk of its users becoming inactive or canceling their accounts once they have redeemed their entire point balances. The interest it pays on point balances offers customers an incentive to continue holding points and hopefully remain active users (and keep their point balances above a certain level).

Credit Saison likewise focuses on the holding stage of the loyalty-point lifecycle with its Eikyufumetsu points awarded mainly for Saison Card usage. Its mock investment service is targeted primarily at cardholders who continuously accumulate Eikyufumetsu points and are avid investors. Because the service involves only mock investing, it does not require a brokerage account and may appeal even to cardholders hesitant to invest in securities in real life.

Rakuten and Invast Securities' loyalty points are redeemed into customers' brokerage accounts at Rakuten Securities or Invast Securities. The fact that customers are spending their points may appear to jeopardize the companies' ties with the customers, but with the points being converted to cash deposits into in-house brokerage accounts, the point expenditures are actually contributing to growth in Rakuten Securities and Invast Securities' assets under custody.

In sum, loyalty programs' financial features differ among program sponsors as a reflection of differences in the nature of the sponsors' respective businesses and, in turn, the services they are capable of providing.

### **Loyalty programs as a way to improve customer satisfaction and lead business expansion**

The loyalty programs not only increase points' value for customers (i.e., increase customer satisfaction) through investment or accrual of interest, they also incentivize customers to continue accumulating points or adding to their account balances (i.e., they drive growth in the program sponsors' customer assets under custody). Such incentivization distinguishes these innovative loyalty programs from their predecessors.

Unspent point balances and customers' brokerage account balances are destined to eventually be spent in one manner or another. They accordingly have some

bearing on the latent growth potential of the company in question. This growth potential can be amplified by adding payment modalities with a distinctive value proposition, such as e-money and/or cryptocurrencies, to the mix. It is expected that more companies will increasingly deploy loyalty programs in pursuit of both greater customer satisfaction and growth by giving customers the opportunity to increase their point balances through investment or other means while nudging them to ultimately redeem points for the company's (or an affiliated company's) own services or payment media.

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Inquiries to : Business Planning & Financial IT Marketing Department  
Nomura Research Institute, Ltd.  
Otemachi Financial City Grand Cube,  
1-9-2 Otemachi, Chiyoda-ku, Tokyo 100-0004, Japan  
E-mail : kyara@nri.co.jp

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