

Using Reward Programs to Create Loyal Customers

By Robin C. Johnston

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Robin C. Johnston
rjohnston@INVICTUSsolutions.com

INVICTUS Solutions Group <http://www.INVICTUSsolutions.com>

Customer reward programs were first introduced by the airlines more than a decade ago. Since then, businesses ranging from bookstores to coffee shops to credit cards have implemented reward programs. Properly implemented reward programs create loyal customers. However, many reward programs simply don't work. The rewards are either ineffective motivators or too costly to be practical. Often reward programs and short-term promotional programs conflict, turning off loyal customers and attracting only less profitable price-switchers. In order to avoid the traps that can sour customer relationships or drain scarce resources, it makes sense to examine the fundamentals of developing a successful customer reward program.

Why Customer Rewards?

A good reward program can serve two functions:

- It allows the business to collect information about its customers.
- Rewarding customer loyalty increases sales and reduces costs by increasing customer share.

In addition to gathering the customer's name and address, a reward program can be used to gather information about the customer's buying habits, typical expenditures and other preferences. This information is used for two purposes. Firstly, it can be used to spot opportunities to increase sales to the individual customer. Secondly, it can be used to develop a marketing campaign to target new customers who share similar demographic or psychographic profiles.

Effective reward programs accelerate the loyalty life cycle, encouraging first- or second-year customers to behave like a company's most profitable tenth-year customers. Although we rarely measure promotion expense on a per-customer basis, it is not uncommon for the cost of acquiring a new customer to exceed \$1000.

What Constitutes a Good Reward Program?

There are several elements to developing a reward program that will effectively build loyalty. A good reward program generally has the following aspects:

1. Customers are told how they will be rewarded.

While customers may appreciate an unexpected thank-you, reward programs work better if you tell the customer up front how much of a thank you they will get. As "Co-opetition" authors Brandenburger and Nalebuff put it:

"If you are planning to say thank you, you should let your customer know in advance so they'll stick

around for it. You don't have to treat your customers as though you're throwing them a surprise birthday party. You might be surprised when they don't show up. Telling them that you have a present waiting down the road doesn't ruin the sentiment"

2. Appropriate rewards.

Say "Thank You" in kind, not cash. For example, an airline could offer \$500 cash as a thank you for being a frequent flyer. This would be a large thank-you, but it is also expensive. Instead the airline offers the frequent flier a free flight to a destination of their choice. The airline uses a seat that would otherwise be unoccupied, so the cost is little more than the in-flight meals and a few peanuts. This modest investment generates significant reward value. Coffee shops apply the same principle with "Coffee Club" cards. A customer purchases 10 cups of coffee and receives one free. The customer may value the reward at a full \$1.79, but the cost to the store is only 40 cents.

A restaurant may choose to offer a free meal as a reward. For the reward to be well received the customer should be able to choose what day and time she wishes to receive the meal. In addition, she should be able to have a free choice of menu items. A free dinner, offered Tuesdays before 6pm, with a limited selection of entrees, is fine for promotional purposes, but it will not encourage customer loyalty.

The following are key attributes of appropriate rewards:

- Cash Value. The customer perceives the reward as having a tangible value.
- Choice. The customer has choice as to which reward they receive.
- Aspirational Value. An exciting reward can make a reward enticing beyond it's strict cash value. A free trip to Hawaii has a higher aspirational value than \$450. A free chocolate cappuccino has a higher aspirational value than a \$1.59.
- Relevance. The reward should be clearly associated with the business. When the reward is 'free' it can encourage customers to try other products and service offered by the business.

3. Best Rewards for The Best Customers.

The well-designed reward program is progressive, offering better rewards as the customers spend more. Coffee Clubs typically offer a free coffee with every tenth cup. In addition, why not offer a free mug with every 100th cup?

4. Consider Timing Carefully.

Don't offer the reward too quickly or too slowly. A reward offered too quickly will be seen as a promotional offer as opposed to a reward. This discourages, rather than encourages loyal behaviour. A reward offered too late will be perceived as either unobtainable or of little value.

Compromises:

Ultimately a good reward program involves tradeoffs. Cash is the reward that offers the customers the greatest choice, but it is not clearly associated with a particular business (except perhaps financial institutions), and the cost is high relative to the perceived value. The key is to exercise judgement and to remember the difference between a reward and a promotional activity.

Robin C. Johnston is Director of INVICTUS Solutions Group in Charlotte, NC. INVICTUS offers marketing and management consulting for first-time entrepreneurs as well as established enterprises. For more information on customer loyalty and reward programs, or for information about our other business services, call Robin at <mailto:rjohnston@INVICTUSsolutions.com>.

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