THE SECRET TO

POINTS LIABILITY

NAVIGATING LOYALTY PROGRAMS

A joint white paper from TFL and the Incentive Marketing Association

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Introduction

Retaining customers has always been a challenge for businesses, but in today's consumer landscape, companies must also navigate evolving technology and online brand comparisons. But even before consumers could research what product or service to choose, brands looked for creative ways to keep their customers coming back.

One of the solutions that is still prominent in today's market is loyalty programs. While loyalty programs have matured over time, they aren't entirely different; customers are incentivized for most of the same reasons, including their amount of spend, repeat purchases, referrals, birthdays, etc.

Where Betty Crocker's box tops were once one of the most popular loyalty programs among consumers, many rewards programs have evolved with technology, making them more easily accessible and creating more touchpoints.

With more loyalty program innovation from competitors and higher expectations from consumers, brands should ensure they're offering incentives that their customer base will appreciate and remember, like live event tickets. Not only will the right reward offerings help retain customers, but they'll also help companies reduce liabilities.

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Loyalty Program Points

One common format that brands adapt for their loyalty program is a points or miles system. These programs reward customer touchpoints with miles or points in exchange for something else the customer wants. What was once the standard of direct transaction has evolved into more expectations from consumers, and companies need to adapt.

Use AAdvantage as an example; each time an AAdvantage member flies on American Airlines, they receive “miles.” Those can be used for other flights, hotels, car rentals or other upgrades.

> *Younger consumers “want flexible rewards they can use across airlines, hotels and other lifestyle brands,” said Henry Harteveldt, founder of Atmosphere Research. “Loyalty programs needs to evolve to meet these expectations.”*

Companies outside of the travel industry use points too, but the use of points differs. Starbucks lovers, for example, might go get a coffee five or six mornings each week, creating more opportunities to receive points. Travelers, on the other hand, are not as frequent as those coffee drinkers, but they do have a higher cost for the products they’re buying.

Often, these low-frequency/high-cost programs are used by people who have to travel a lot for business – they’ll rack up points from business travel and then use the miles for personal travel when they have the time. During that in-between period, however, the miles sit in their account, resulting in an outstanding cost to the business.

> *Sometimes, the low-frequency/high-cost programs work together with the high-frequency/low-cost programs. Delta, for example, partners with Starbucks, and soon, Uber. People can now buy coffee or book a car and receive SkyMiles in return.*

Points Liability

While loyalty programs are known for what they give consumers, the business has to work its rewards currency into its budget, and that's not just for points that have been given out — there are three stages points go through before presenting a liability to loyalty programs.

Points Issued

Points issued refers to the number of loyalty points (or other currency) a loyalty program has awarded its members.[1]

Points Burned

Points burned include any points that have been removed from an account. This can include if a customer redeemed the points, the points expired, a product was returned or a member was deactivated, among other reasons.

Outstanding Points

Points that are outstanding include points that have been issued but haven't been burned yet.

Outstanding points are what present liabilities to a company.

Loyalty Program Liability

To understand points liability, it's important to understand how the redemption rate and cost per point are calculated. It's the total amount a company should reserve to pay for future reward points, as defined by the U.S. Generally Accepted Accounting Principles (GAAP).

Redemption Rate

Points Redeemed / Points Issued

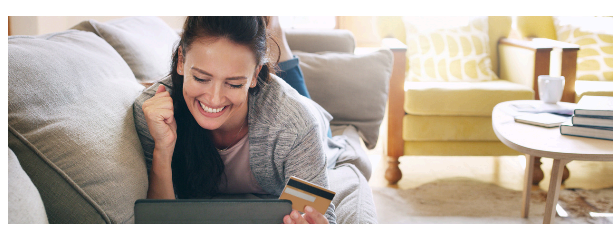
Cost Per Point

Cost of Redemptions / Points Redeemed

To put it in more simple terms, points liability is the cost of the points that have been given out but haven't been used – they can't be marked as burned yet, but it isn't money that the company can use for something else. These outstanding points are a future cost, so they're marked as a liability on companies' balance sheets.

Just because loyalty programs can present a liability doesn't mean the risk outweighs the benefits. According to a study from Accenture, members of loyalty programs drive between **12-18 percent more incremental revenue** than non-members each year.[2]

But members need to remain engaged for brands to reap the benefits.



Meeting Customers Where They're At

Companies need to remain conscious of the risk that loyalty points can have, but there are ways to mitigate that risk. The solution for some brands might be to set an expiration date on points issued, but this runs the risk of making customers feel like they aren't being rewarded genuinely or appreciated for their loyalty.

The solution to making customers feel appreciated and not leaving points unused is better understanding how customers want to be rewarded. When there's a mutual understanding and respect, customers are more likely to redeem their points – and quickly.

"Choice and digital accessibility are essential," said Marina Hodges, senior director of product marketing at Blackhawk Network (BHN). "Don't force consumers to redeem their points in a way that doesn't suit them."

The importance of choice isn't just about types of rewards, it's about how points can be redeemed. Sometimes, a high-value reward might be more expensive than a consumer's point allotment. That's why flexible spending like split tender can resonate with a customer, too.

> *"Loyalty programs are now 43 years old," said Henry Harteveldt, founder of Atmosphere Research. "Like any middle-aged adult, they need a tune-up."*

But choice and accessibility only matter if there are rewards that consumers care about.

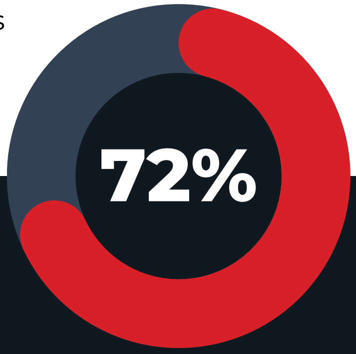
Rewards like gift cards may work to keep some consumers coming back, but having the option to put their points toward more meaningful rewards strengthens the emotional connection consumers have with a brand.

"The best way to drive loyalty is through a memorable experience," said Hodges. "It's not just about accumulating points; it's about being able to use them in meaningful ways."

Research has shown that live events are a type of reward that will get consumers excited to spend their points when their favorite artist comes into town or they want to see their favorite team in action.

In a study by the Harris Poll on behalf of TFL, 64 percent of respondents said if a brand allowed them to use their loyalty points for live event ticket purchases, they would recommend that brand to others, with another 62 percent claiming they would spend more money with that brand.

Consumers want to be rewarded for their loyalty, and they want to feel like the brand genuinely appreciates them and their business. Rewards like live events create a sense of community and connections, and having the flexibility to pay for them how they want — like TFL's private label split tender feature, which allows consumers to pay with points, dollars or both — builds stronger connections between consumers and brands.



What rewards excite consumers? Memories.

According to TFL's survey with the Harris Poll, seven in 10 (72%) respondents agree with the statement: "The memories I have from live events outlast the memories I have from things I have bought."

The Future of Loyalty

Younger generations have different expectations from brands than used to be the norm. These expectations are going to change how loyalty programs operate, and those changes are starting to be adapted by older generations.

As consumers' wants and spend evolve, they want to give their money to brands that don't just offer something in return but add something to their life. Where consumers once felt recognized by mere exchanges, coupons or free meals, today's savvy customer wants their salary to pay for their groceries and rent and other programs to pay for their extracurriculars. They want flexibility, too – from cost to type of payment – so that they're sure to access the reward they wouldn't have otherwise spent money on.

Despite their increasing popularity and importance to keeping customers engaged, loyalty programs present a liability to brands. Rather than taking away points that have been rewarded for repeat purchases, amount spent or other forms of loyalty, brands should give their customers the opportunity to spend their points on something they'll remember for the rest of their lives.

Live events are proven to be beneficial for attendees, and choosing favorable loyalty rewards like events is advantageous to brands as it prompts referrals, spend and frequency.

[1] Loyalty Program Liabilities: Definitions & Recommendations

[2] Members of Customer Loyalty Programs Generate Significantly More Revenue for Retailers Than Do Non-Members, Accenture Research Finds