RE-THINKING REWARDS

It's a curious fact that the public excoriates banks, not card issuers. Of course, apart from the monolines – and there are very few pure ones these days – most card issuers are banks.

But somehow, it's the banks that get the blame.

Which means that, faced with the two closely-linked tasks of rebuilding public trust and increasing profitability, card issuers may just be able to focus a little bit more on the second.

No mean task in itself: since the crisis began, the pressures on profit have been unrelenting.

- Thriftier customers who spend more carefully and worry about the debt they carry
- Regulators bearing down hard on fees
- Squeezed interest margins
- Credit losses

And now comes what may be the biggest bear of them all: unremitting political pressure on interchange.

Look on the bright side: every portfolio has a solid tranche of profitable customers. The challenge is – assuming you can identify them, which is not always a given – how to hold on to them. And what tools you have to hold on to them when interchange in particular is dwindling so fast. Or to put it another way, how cost-effectively to create and maintain customer loyalty.

First things first. Way back when, aspiring marketers learned that successfully managing the Four P's – Product, Price, Promotion and Place – was essential. And, hoary as the concept may seem these digital days, it has a lot going for it, provided you add a fifth P: Personal service. Chasing customer loyalty without these cornerstones in place is a waste of time.

With them, you can reasonably expect to hold on to your profitable customers. But you want them to do more than just stay: you want them to do more of the stuff that makes them profitable. And that change of behaviour is what rewards programmes aim to bring about. Well-run programmes have demonstrated significant increases in spend (frequently associated with higher revolve), declines in attrition, and boosted activity levels.

All very desirable results: but how to achieve them when marketing budgets are tight?

Typically, rewards come in one of two forms: cashback, or goods and services. Each has its strengths and weaknesses:

Cashback		Goods and services	
For	**Against**	**For**	**Against**
Customers get it	Simple to copy	Clever buying creates wide margin between actual cost and perceived value	Requires substantial investment in programme management
Easy to manage	Can lead to competitive race to the bottom	Greater variety of awards, can be customised, tiered	
	No breakage	Easy to refresh	
	Over time, comes to be seen as routine	Has an element of "treat"	
	Difficult to keep fresh	Rewards can range from entry-level to aspirational	
	Some evidence it appeals most to the budget-conscious	Breakage	

Whatever their respective merits, both approaches will become less affordable as interchange dwindles.

In the UK, we are already beginning to see the results: Capital One withdrew its popular Aspire World cashback card earlier this year and Barclaycard has also retired a cashback product. Even American Express, less hard-hit by the rule changes, has imposed minimum spend levels on its Platinum Cashback card[1].

So is there any other source of funding?

Two or three years ago, the great white hope was merchant-funded programmes. At bottom, the idea was that banks would provide a customer communications channel so that merchants could offer discounts. There would be a clear benefit for banks who would get a rewards programme largely paid for by someone else, while merchants would benefit from – what precisely? That was the difficulty: proving to merchants that the incremental sales outweighed the cannibalisation – the cost of offering discounts to customers who would have paid the full price otherwise.

As a result, many programmes struggled: some found it difficult to recruit the marquee merchants necessary to give the programme High Street presence and name recognition. Others got over this hurdle, but haven't been able to retain merchants expensively recruited in Year 1 who saw no clear benefit from continued participation in Year 2. Worse, in many markets, merchants are loudly complaining that through interchange they implicitly fund banks' expensive rewards programmes. Not a great atmosphere in which to make that funding absolutely explicit.

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[1] The new rule applies to Platinum Cashback cards issued prior to August 2009. Amex continues to offer other cashback products

So what's the answer?

Perhaps we need to re-think rewards: traditionally, they relied heavily on breakage. But a new model is available, which virtually ignores breakage and takes its income from delivering measurable value to merchants. This is the approach very successfully developed in Germany by Payback, and now spreading to other markets in Europe. There's a real opportunity here for issuers – especially those with acquiring arms – to harness the power of their databases, and enter into a genuine partnership with their merchants, one which is perhaps for the first time based on a real sense of mutuality.

At least one big beast thinks so: surely that's why American Express bought Payback. Watch this space….

Roy Stephenson
Background

- With more than 20 years of experience in the payment card industry, Roy was previously with American Express, where as VP and General Manager, he launched the highly successful commercial card business in the UK, going on to lead product rollout across EMEA and latterly Latin America/Caribbean.
- As a consultant, Roy works with banking and payment card clients around the world, identifying and advising on best practices in customer marketing and relationship management. He has also undertaken assignments in media, utilities, airlines and retail.
- He has developed and audited coalition and bank loyalty programmes in the UK, Ireland, the Netherlands, Spain, Canada, Dubai, Kuwait, Australia, Singapore, Spain, Israel, Turkey, Saudi Arabia, Brazil, Chile, Venezuela and Mexico.
- Roy has also advised on airline FF programmes, and has been the rewards lead in the MasterCard Advisors pool.
- He speaks fluent Spanish, reasonable French and is the author of *Marketing Planning for Financial Services* (Gower Publishing). He has a B. Com, holds an MA in Management Studies and is a Fellow of the RSA.
- For further background, client list, articles and sample engagements, please visit www.roystephenson.co.uk