

# Partner<sup>talk</sup>

PUBLISHED BY LoyaltyOne | COLLOQUY



## An Open Economy

The Evolution of Loyalty in the United States

**Richard Postrel** Founder and Chief Executive Officer, SWIFT EXCHANGE

**Kelly Hlavinka** Managing Partner, COLLOQUY



## An Open Economy

### The Evolution of Loyalty in the United States



In recent years the line between some increasingly common redemption processes and an open exchange of rewards currencies has begun to blur considerably.

#### Introduction

For years, Capital One has been asking, “What’s in your wallet?” Today, the answer is increasingly becoming the rewards currencies earned from credit card, airline, hotel and retail loyalty programs. These points, miles and cash-back rewards are, actually or virtually, sitting in your wallet along with your fives, tens and twenties, all ready and waiting to be spent. The loyalty industry is evolving, and as new technologies drive an exploding mobile and payments market, we may be on the brink of a new era for the loyalty industry—one in which we achieve a true open economy for our promotional rewards currencies.

Yet, many questions remain. Are rewards actually currency? Should they be? And if so, what are the effects on consumers, program operators and merchants?

So *are* rewards the same as money? Merriam-Webster, succinct as ever, defines money as “something generally accepted as a medium of exchange, a measure of value, or a means of payment.” *The Economist* elaborates, telling us that money has three main qualities: as a medium of exchange, as a unit of accounting and as a store of value. That is, it can be used to purchase goods and services, to provide different things a common value, and to hold purchasing power for future use. Central to money’s utility is its universality, which enables the consumer, if she has enough on hand, to buy anything from Butterfingers to BMWs, to invest in a Fortune 500 or a five-person start-up, and to save for that trip to Hawaii or for her child’s college education. The choice is hers.

Historically, the promotional rewards currencies used in loyalty programs (points, miles, cash-back) have shared some, but not all, of the qualities of money. Rewards currencies certainly function as a medium of exchange; consumers earn rewards from program operators in return for patronage and can then exchange them for a variety of goods and services. However, consumers have been limited by restrictions on how, when and where the exchange takes place. In addition, the value of rewards currencies has not always been transparent. And, unlike cash, rewards currencies can’t be hidden in a mattress—because they have terms of use, such as expiration. So while rewards currencies have had some money-like qualities, they have lacked the fungibility and universality that make money the coveted entity it is.

But could that be changing? Rewards may never *completely* match the flexibility and ubiquity of true monetary currency. However, in recent years the line between some increasingly common redemption processes and an open exchange of rewards currencies has begun to blur considerably. In fact, we have marked an accelerating trend in the direction of an open loyalty economy. In this paper, we highlight the growing movement toward this open economy, look at the reasons for its rise, and consider the implications for reward program operators, merchants and consumers.

## Something's Happening Here

The looming open economy for loyalty—the open exchange of rewards currencies—represents the next logical evolutionary leap of the industry. Loyalty's historical timeline began with closed earn/closed burn proprietary programs in which rewards were both earned and burned with one program operator. In fairly quick order, many loyalty programs evolved to include closed earn/open burn options, which allowed redemption for a wider variety of rewards. Next came open earn/open burn programs, in which rewards could be earned by making purchases from multiple companies and redeemed for a wide array of travel, merchandise or experiential rewards. At each incremental step, consumer choices for both earning and redeeming rewards became broader.

In today's environment, consumers have a desire for more utility and interchangeability with their reward currencies. In particular, consumers desire ways to transcend the limitations of traditional redemption mechanisms that require redemption from a pre-selected set of inventory at a specified website. Partly in response to this marketplace demand, we have seen the propagation of rewards currency conversion programs in which members can exchange, transfer, and/or convert their points and miles in one loyalty program into another loyalty program so that redemption can occur outside of one's own location. Additionally, we have seen an increase in the number of rewards currency-plus-cash programs offering consumers the ability to supplement the redemption with cash in order to redeem rewards more quickly and frequently. Most recently, we have seen the emergence of programs enabling consumers to redeem rewards currencies instantly at the point of purchase, as if they were a tender type. These tweaks in loyalty reward delivery, driven by technology and energized by today's highly mobile, tech-savvy consumers, are scratching an itch that may finally be satisfied only by the transformation to a far more open loyalty economy.

### The Open Economy for Loyalty Defined

*The open loyalty economy is a customer-centric marketplace—sparked primarily by technical innovation and mobility—in which loyalty rewards currencies function as a flexible, fungible currency in commerce transactions. In that open economy, consumers will freely exchange and/or combine rewards currencies among programs and within an ever-expanding universe of merchants.*

### Loyalty Currencies are Moving Steadily Toward a True “Open Economy”



Source: SWIFT EXCHANGE and COLLOQUY

In addition to program innovations and ever-expanding technical capabilities, a variety of consumer pain points have also been pushing the industry in this direction, as we pointed out in “The Mix Fix: Rewards Aggregators and the Trend Toward Collaboration,” (February 2012):

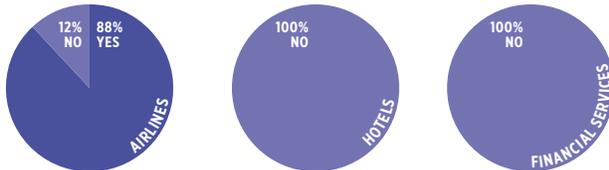
- **Program proliferation.** With more than 18 loyalty memberships per household (Source: 2011 COLLOQUY Loyalty Census), consumers have difficulty managing all the programs to which they belong.
- **Redemption complexity.** Navigating opaque and complex redemption policies, with their attendant details, layers and rules, is a source of frustration for consumers.
- **Insufficient payback.** In any single loyalty program, the rate of earn velocity is often insufficient to return much in the way of value or utility to the consumer.

Seen in the light of all these factors, the movement toward an open loyalty economy begins to have an air of inevitability about it.

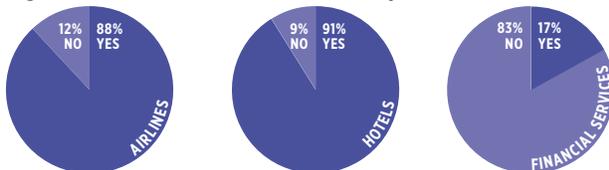
How far away are we? In a sense, the change is already underway, with airlines and hotels at the forefront. Among eight top airline programs, 88 percent allow conversion of miles *out* to at least one other program in a different industry. Of 11 top hotel programs, 91 percent offer that same flexibility. On the question of allowing *incoming* conversion from at least one other program, those same airline and hotel programs stand at 100 percent and 64 percent, respectively. The financial services industry is behind in both of those categories; among 12 top financial services rewards programs studied, 17 percent offer outgoing conversion of rewards to at least one other program in a different industry, and none accept incoming conversion from other programs.

### Rewards currency conversion across airlines, hotels and financial services

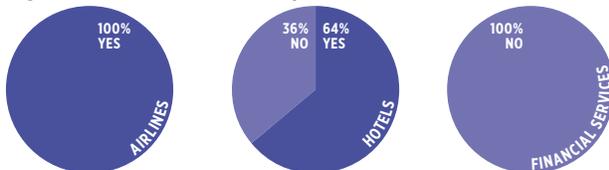
Transfer currency **OUT** of one program into at least one other program within the **SAME** industry



Transfer currency **OUT** of one program into at least one other program within a **DIFFERENT** industry



Transfer currency **INTO** one program from at least one other program within **ANY** industry



Data compiled based on the top eight U.S. airline programs, the top 11 U.S. hotel programs and 12 flagship points and miles proprietary rewards programs operated by the top U.S. credit card issuers. Rewards currency conversions included are enabled through both direct and indirect transfers.

Airlines lead the way, enabling the most significant levels of conversion between programs. Conversion between airlines is typically orchestrated through third parties while conversion between airlines and other industries is more often done through direct connections.

Hotels are not far behind the airlines, but they typically do not allow rewards currency conversion with other hotels. Financial services programs are much more restrictive in this area, but a few programs enable conversion out to other non-financial services programs.

Source: 2012 research, SWIFT EXCHANGE and COLLOQUY

In the matter of rewards currencies as cash, however, financial services are leading the way, with 33 percent of 12 top programs enabling their rewards currencies to be used like cash directly with at least one merchant online. Beyond the points-plus-cash options for travel that have existed for several years, two such alliances offer the ability for in-store shopping with rewards currencies: Citi's *ThankYou* mobile app, which can be used in Best Buy stores, and the Amex-RedLaser partnership, which offers UPC price comparisons and reward redemption through ShopAmex. Programs such as these are leading the way toward fully flexible, mobile, in-lane redemption of rewards currencies.

### Rewards currency as cash most often seen online with financial services programs



#### Financial Services Rewards Currency = Cash Outside of own program virtually

*Approximately one-third of programs evaluated enable their currency to be used like cash directly in the check-out path of at least one merchant online.*

Source: 2012 research, SWIFT EXCHANGE and COLLOQUY

• Data compiled based upon 12 flagship points and miles proprietary rewards programs operated by the top U.S. credit card issuers.

We're clearly seeing a march toward something beyond both points conversion and points-plus-cash. A model that mimics an open economy may be the next logical step.

An open loyalty economy brings ubiquity, flexibility and transferability to consumers, program operators and merchants alike.

### Benefits and Opportunities

In an open loyalty economy, consumers will enjoy the technology-driven ability to freely exchange and/or combine rewards currencies, both among themselves and with program operators, for more efficient use. They will also be able to make point-of-purchase decisions about redeeming points, miles or cash throughout an expansive universe of large and small merchants. An open loyalty economy brings ubiquity, flexibility and transferability to consumers, program operators and merchants alike.

In this vision of the future, consumers will enjoy increased control and empowerment, with:

- Decreased friction in both earning and redeeming
- Increased utility of rewards earned and choice of redemption options
- Increased ease of redemption

Program operators will benefit from:

- Increased customer engagement
- Improved customer experience
- Reduced costs for setup and delivery of rewards
- Recovering the time and resources formerly devoted to managing static rewards catalogs and buying and selling non-core merchandise (for special offers, premiums and other awards)

Merchants that are a primary source for rewards content will benefit from:

- Increased sales and traffic
- Alternative distribution of promotional dollars and/or customer incentive promotions
- Access to \$48 billion in perceived value of new rewards currencies issued each year (Source: 2011 COLLOQUY and SWIFT EXCHANGE, "Buried Treasure: The 2011 Forecast of U.S. Consumer Loyalty Points Value")

## Navigating the Evolution

We are living through what is perhaps the period of greatest change in the loyalty industry, driven by necessity and emerging technologies. And, as with nearly every area of business and culture today, rapid changes and the capabilities afforded by the exponential growth of technology can be liberating, intoxicating and (let's be honest) occasionally overwhelming. As program operators move forward into the era of the open loyalty economy, welcoming the new, dynamic possibilities that innovation and technology provide, it's important to remember the basic fundamentals of any successful loyalty program.

**Maintaining brand integrity** is an essential part of the solution. When rewards currencies become as broadly usable as the dollar bills in your wallet, brand differentiation becomes even more paramount. Ask yourself where each of the individual dollar bills in your wallet came from, and you'll see the potential problem. Program operators need technologically advanced solutions to enable combinability and transferability while maintaining brand presence, recognition and differentiation.

**Encouraging the dream** for consumers is key. Whether the program participant is eagerly anticipating a free flight to Hawaii or a price break on a new set of golf clubs, the dream-nurturing aspect of rewards programs must always be present. This requires that special packages, rewards and incentives continue to function as aspirational goals so that the open loyalty economy does not devolve into a mundane exchange of rewards currencies. Remember, too, that dreams vary: Some may get greater satisfaction from paying off the monthly credit card than from a free flight to Vegas.

**Preserving the perceived value stretch** enables program operators to offer meaningful rewards that keep consumers coming back. Practicing the art and science of loyalty successfully depends on careful maintenance of this perceived value stretch. Deal terms negotiated between program operators and merchants must create a win-win-win value proposition for all, thus avoiding a straight points-for-cash or miles-for-cash exchange that eliminates or reduces the value stretch.

**Controlling costs** will continue to be an important function for reward program operators. In an open loyalty economy, breakage, a current primary cost control, will decrease. However, while a certain amount of breakage is healthy, programs should never rely on breakage as a fundamental cost control. In a fully optimized and efficient open loyalty economy, it is possible to minimize breakage while maintaining and even increasing ROI. But of course, due to its impact on program economics, breakage bears close watching.

With rewards currencies inching closer to the utility and universality of money, reward programs have the opportunity to become powerful customer acquisition and retention tools—precisely the brilliant marketing tools they were once intended to be. And keep in mind that as our economy, and the customers who drive it, become increasingly mobile, customer-centricity means striving to meet today's customers where they are and matching their mobility to provide the utility and choice they demand and expect. As the loyalty industry proceeds along the evolutionary scale—through points and miles conversion and points-plus-cash paradigms and into the realm of the open loyalty economy—it is incumbent on us all to balance the transition and remain firmly focused on customer-centricity. If we do this, rewards as “money” may indeed buy happiness for all.

As program operators move forward into the era of the open loyalty economy, it's important to remember the basic fundamentals of any successful loyalty program.



## An Open Economy

### The Evolution of Loyalty in the United States

#### About the Authors

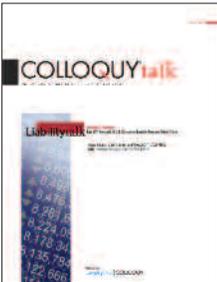


SWIFT EXCHANGE Founder and CEO Richard Postrel sets overall company strategy and oversees intellectual property development with 60 patents issued and pending in payment technology, financial services, information exchange, central server systems and Internet technologies. Previously, Richard designed and built the world's first dynamic foreign exchange system, the first electronic options trading system and the first Internet-based point-of-sale device. He has participated in six American Trade Missions and lectured at seven World Economic Conferences including Geneva, London and Hong Kong. He also brings trading and exchange system expertise, having worked as a differential arbitrage trader for J. Aaron and Co.



As COLLOQUY Managing Partner, Kelly Hlavinka has helped define and carry out COLLOQUY's mission as the voice of the loyalty industry since 1996. Drawing on her 20 years as a loyalty specialist, Kelly develops articles, white papers and educational initiatives that illuminate the many ways to unlock the asset of customer-specific data for her clients. Kelly has shared her expertise with correspondents of *The Wall Street Journal*, *The New York Times*, *USA Today*, *Brandweek*, *BusinessWeek*, *Advertising Age* and *SmartMoney*. In 2003, Kelly launched and managed COLLOQUY's strategic consultancy, working with clients such as Lennar Homes, MGM Mirage, Eddie Bauer, Best Buy, HP and American Express.

#### About SWIFT EXCHANGE and COLLOQUY



As a pioneer in global commerce, SWIFT EXCHANGE has developed a first-of-its-kind loyalty operating system utilizing its patent-protected technology to make points and miles from different reward programs as easy to spend as cash, online or in stores. Reward providers better manage their costs while dramatically increasing collaboration with merchants, systematically. Merchants receive new traffic and tap into the \$48 billion in rewards currency issued each year in the U.S. alone. Founded by CEO Richard Postrel, SWIFT EXCHANGE is owned and operated by Signature Systems LLC. For more information, visit [www.swiftexchange.com](http://www.swiftexchange.com) or call 305-865-7000.

COLLOQUY® comprises a collection of publishing, education and research resources devoted to the global loyalty-marketing industry. COLLOQUY® has served the loyalty-marketing industry since 1990 with more than 40,000 global subscribers to its magazine, and [www.colloquy.com](http://www.colloquy.com) is the most comprehensive loyalty website in the world. COLLOQUY's research division develops consumer and B2B research studies and white papers including industry-specific reports, sizing studies and insights into the drivers of consumer behavior. COLLOQUY also provides educational services through workshops, webinars and speeches at events throughout the world. COLLOQUY magazine subscriptions are available at no cost to qualified persons at [www.colloquy.com](http://www.colloquy.com) or by calling 513.248.9184.

**COLLOQUY** | a LoyaltyOne publication

4445 Lake Forest Dr., Cincinnati OH 45242  
 Telephone: +1.513.248.9184  
 Fax: +1.513.248.9184  
 Email: [info@colloquy.com](mailto:info@colloquy.com)



## NEW TOOLS ANYONE?

A variety of new tools from Swift Exchange now lets customers use rewards in places they're already shopping - online or in stores. More importantly, our tools help reward providers manage costs and increase merchant collaboration through Swift's automated system.

87% of reward providers we surveyed felt challenged to manage costs. 92% want more collaboration. We think 100% are really going to like us. Check out [swiftexchange.com](http://swiftexchange.com) or call (305) 865-7000 x160.

