

THE NEW LOYALTY ECONOMY:

HOW TO USE DIGITAL WALLET-LINKED REWARDS TO REINVENT LOYALTY PROGRAMS AND BOOST CUSTOMER RETENTION



INTRO

Instant rewards redemption using digital payments is a game-changer for financial institutions. By giving consumers ‘point ubiquity’—the universal ability to make purchases with rewards currencies at the point of sale using digital wallets, card issuers can dramatically increase loyalty-program use, secure ‘top of wallet’ status and attract members of key demographics.

THE FUTURE OF LOYALTY PROGRAMS IS HERE

A paradigm shift is under way in the loyalty rewards market. Improving speed, ease and value over traditional cash-back, statement credit and gift card programs, loyalty points can now be redeemed at the point of sale (POS), and in-app, offering millions of locations and options to reward-savvy consumers. In this new loyalty economy, card issuers can begin to build new customer experiences around this new capability to increase engagement in their rewards programs, build brand loyalty and enable issuers to leverage their loyalty programs for increased usage and growth.

Financial institutions are now facing a new set of challenges in winning ‘top of digital wallet’ positioning, attracting and retaining young demographics, and providing rewards that offer value and ‘stickiness’ for their brand.

At the same time, challenges associated with traditional loyalty rewards programs grow larger. In an increasingly competitive market, issuers are throwing costly incentives, such as cash-back rewards at new originations. The same type of customer you attract with such incentives is also likely to jump at the next tempting offer; creating a race to the bottom. Meanwhile, another set of customers doesn’t even bother redeeming rewards due

to cumbersome redemption processes, creating a \$100 billion liability¹ for financial institutions. According to a Bankrate.com survey, 31 percent of U.S. cardholders have never redeemed their rewards, because of the time, effort, and complexity of tracking points on multiple programs and limits on how points can be used.² The result: financial institutions lose money and customers get no additional value for their ‘loyalty.’

With the right strategic approach, financial institutions can use the trend towards digital payments to strengthen their brands and stay top of wallet. By creating differentiated loyalty reward programs and new experiences, issuers can increase stickiness and spend with existing customers and attract new ones, particularly millennials who prefer to interact with brands via mobile.

Financial institutions can now start creating new customer experiences for redemption, enabling customized loyalty-based redemption offers and messaging, including location-based instant offers. All of these enhancements will encourage frequent redemptions, increased engagement and the ability to improve overall cost per point (CPP) on accrued liability.

THREE FORCES DRIVING CHANGE ACROSS FINANCIAL SERVICES

There are three critical technological and behavioral shifts taking place in the financial services landscape, which institutions can capitalize on to turn loyalty into an actual driver of growth.

1. A Tipping Point in Adoption of Mobile Wallets.

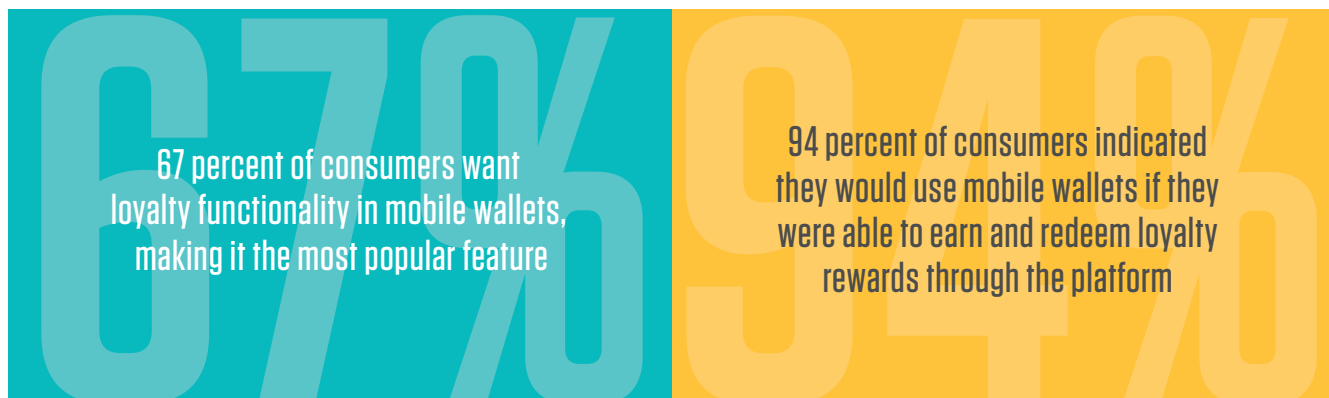
By 2020, 450 million people worldwide are expected to be using mobile payments, according to Juniper Research, which estimates that the volume of in-store contactless payments could reach \$2 trillion, or 15 percent of all POS transactions. Of this \$2 trillion, mobile device providers and platforms such as Apple, Samsung and Google enable 15 percent. By next year, Apple Pay is expected to lead, with half of the 'OEM Pay' users globally (consumers using wallets provided by smartphone original equipment manufacturers).³

It's projected that by 2020, more than half of the U.S. population will give mobile wallets a try. But adoption will depend on engaging customer experiences and additional features, such as instant loyalty redemption options. Indeed, two-thirds of consumers in a recent survey said they want loyalty features in their mobile payments, and 94 percent said they would use a mobile wallet more frequently if they could earn and redeem

loyalty points with every transaction.⁴ Therefore, having an integrated loyalty rewards payment option will be increasingly critical to success.

2. An Increasingly Competitive Loyalty Market

To drive customer acquisition, issuers now offer large sign-up bonuses and generous cash-back rewards, waive first-year annual fees and use other enticements. These tactics bring in new users and promote card usage in the short term, but there are offsetting issues, including high acquisition costs and retention risk. A financial institution's brand is not building loyalty if the customer who signs up for the 2 percent cash-back reward program in January then switches to another card in October when a competing bank dangles a 2.5 percent cash-back program. Consumers who sign up for a card but don't redeem points are among the least sticky. Non-redeemers are 2.3 times as likely to defect as cardholders who had redeemed points in the previous 12 months. Building programs around digital payments, making redemptions easy and routine, and providing enhanced user experiences can help financial institutions attract and retain customers – and turn loyalty into a money maker.



3. Shifting Demographics – Attracting Millennials

Members of the millennial generation, who are entering their peak earning years and in 2019 are expected to become the largest demographic cohort in the U.S., are heavy users of smartphones and early adopters of digital payments. They represent a lucrative target for digital payments-based loyalty programs. Having loyalty programs based on digital payments will soon become table stakes in the competition for these demanding customers.

Millennials also have high expectations, demanding a mutual relationship with companies and brands. Online and offline,

millennials influence the purchases by other consumers, too. What's more, according to research by Blackhawk Network, millennials are much more likely than older consumers to engage with brands they are loyal to and in many more ways. Marketers can consider using branded value solutions such as loyalty points and targeted offers to acquire more loyal members of this generation. For instance, 52 percent of millennials used targeted offers from a brand or store that they are loyal to vs. 43 percent of Gen Xers and 31 percent of Baby Boomers.⁵



THE NEW LOYALTY ECONOMY OPPORTUNITIES

The new model for the ‘loyalty economy’ is coming into focus. Customers expect to be able to use their rewards currencies at the point of purchase and apply rewards to any item, rather than being confined to choices in the issuer’s rewards catalog. This point ubiquity will trigger a huge change in consumer behavior, turning loyalty redemptions into a part of routine shopping experience and driving frequent and ongoing program engagement. Opt-in transaction data can also become part of data-driven, real-time marketing programs, releasing new sources of value, enabling new kinds of customer experiences, increasing engagement, deepening customer relationships and giving issuers new opportunities to secure ‘top of wallet’ status.

New sources of value

In this new loyalty paradigm, rewards currencies interact with merchants, apps, digital wallets and websites creating a new ‘economy’ of opportunities for partnership, messaging, offers, deals, transactions and data. Issuers and retail partners can collaborate on personalized offers based on how many reward points sit in a consumer’s account. American Express, for example, might partner with Best Buy to give 10 percent off when their customers use their American Express points at Best Buy stores, driving new traffic and revenue sources to the chain.

Kroger Pay, a digital payment program recently launched by the giant grocery chain, illustrates some of the possibilities. It combines shopper payment information with loyalty cards and promotions, including digital coupons and personalized offers. Kroger has also introduced a new debit card under its rewards card program that offers discounts on private label products, bonus fuel points and more. The card, along with the Kroger Rewards credit, and prepaid debit cards, offers additional rewards when used through Kroger Pay. Altogether, Kroger Pay and its

store rewards card program enhance loyalty, provide data about those loyal customers’ purchases and responses to marketing, and they’re a stream of revenue in their own right.⁶

Loyalty programs leveraging digital wallet-linked rewards can create value for multiple stakeholders—issuers, consumers, retailers, etc. Consumers can use their points wherever and whenever they want simply and easily, giving them a new everyday payment option and enabling them to stretch budgets and treat themselves to special purchases. Merchants can partner with program sponsors, enabling deeper micro-segmentation and targeting custom consumer offers at the point of sale.

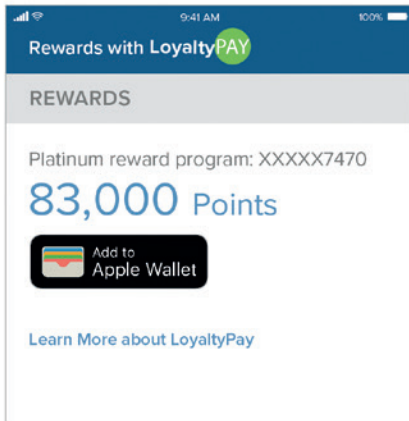
Stronger branding

By offering a new kind of customer experience through digital wallet-linked rewards, card issuers will be able to strengthen brands in new ways and avoid the risk of brand disintermediation. With traditional rewards, the role of bank brands can easily be obscured when consumers redeem points for gift cards, statement credit or cash, for example. At the “golden moment of loyalty,” the time these options are redeemed for memorable, tangible rewards such as TVs, iPads and hotels rooms, the reward program brand is nowhere to be seen.

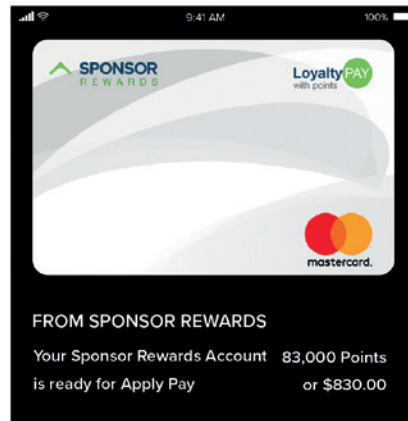
When customers of loyalty programs utilize digital wallet-linked rewards redeem in-store or in-app, they will see unique visual program branding, as well as personalized messaging and real-time views of account and reward balances. As shown below, when loyalty rewards members open their digital wallets, they can see the exact number of points earned and the exact dollar amount available to spend using their loyalty program sponsor’s reward card creating exponential brand impressions over traditional loyalty programs today.



1. Add Rewards Card to Wallet



2. Open Wallet



3. Spend & Redeem



Source: bridge2solutions.com

Digital wallet-linked reward loyalty programs offer a way for financial institutions to get the brand halo effect that comes with redemptions. The moment when customers redeem loyalty points is when they feel the greatest delight with a brand. According to an Elsevier study on reward redemptions, during the post-reward period, the redeemer has enhanced feelings of gratitude, importance, satisfaction or obliged reciprocity with the brand.⁷

Rewards redemption will go from an annual or bi-annual event to part of everyday payments, increasing frequency of contact. Research tells us that customers see a range of benefits from participation in loyalty programs, including saving money and gaining a greater sense of control over their finances. So, brands can attain new value with consumers through association with savings and rewards, and daily contact. Every time a consumer makes a payment with Apple Pay or another wallet, the branding of the associated card issuer will pop up, showing shoppers points they can use and reminding them of the advantages of dealing with that financial institution. Users will perceive the brand as more customer-centric, which should

be extremely positive for driving new business and increasing engagement among existing customers.

Only good things will happen from this. We already know that consumers who repeatedly redeem rewards have higher customer satisfaction and greater loyalty to brands.⁸ And customers who enjoy the ease and flexibility of digital wallet-linked rewards are more likely to help brands through word-of-mouth, by promoting rewards programs through social media, for example.

Form lifetime relationships with the most valued customers

Financial institutions that master the new loyalty model will be well-positioned to attract millennials and other younger consumers, who represent future growth. Bank customers typically form strong and long-lasting relationships with products and brands when they are between 25 and 30.⁹ This period is when consumers begin to advance professionally, form families, and start to amass wealth. If banks want to build lasting relationships with this new generation of customers, they need to

match the digital customer experience users are accustomed to on their smartphones.

Millennials and the rising Gen Z cohort appreciate the convenience and ease of access to loyalty programs and rewards provided through mobile wallets. These consumers are early adopters of mobile payments and generally, like to interact with brands via digital touchpoints. The State of Mobile Wallet Marketing study found that 83 percent of millennials are more likely to use mobile payments if loyalty rewards and discounts are automatically applied.¹⁰

By bundling payments and loyalty, banks can help convince millennials and other target consumers to form lifelong relationships with their institutions.

Foster engagement beyond payments

Consumers are looking for more ways to use their mobile wallets. Linking digital payments to loyalty programs is the top feature consumers say they want, but they also want to use their secure mobile wallets for storing IDs, boarding passes, tickets and personalized alerts. Financial institutions, retailers, and digital wallet providers can create even more value by offering such features to increase consumer engagement.

Another way to increase engagement is to use the mobile wallet to push customized offers, including geo-based promotions. For example, when a retailer detects that a consumer is in the vicinity of one of its stores, it can look up any items the consumer has left in an online shopping cart. Triggering an alert to the shopper that the item is in stock at the nearby store and perhaps a special offer to encourage the shopper to make the store visit. When the shopper pays for the item (and anything else the consumer picks up) with a mobile wallet, loyalty rewards can automatically be added to the customer's account, making the entire shopping and earning process quick, convenient and seamless.

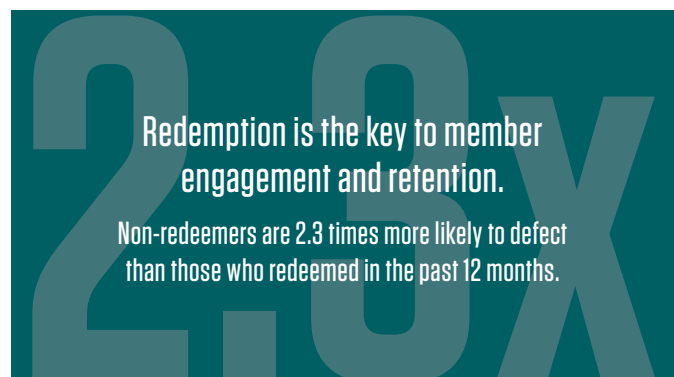
In the online world, where the bar is set high for maintaining engagement, convenience trumps brand loyalty, so creating a seamless user experience is the only way to keep shoppers using

your app. If it's not simple to use, reliable, and fast, users will delete it just as quick as they download it.

Mobile loyalty can be an entry point to grow banking relationships from basic transactions to complex products through a consistent focus on the digital customer experience and the right tools. The more comfortable members become using their mobile devices to execute everyday transactions using the bank's card, the easier it will be to upsell and cross-sell. Using the payment app itself or via other contacts, financial institutions can leverage the loyalty relationship to market mortgages, personal loans, brokerage services, wealth management advisory services and other complex products.

The Reward: Staying top of wallet

As momentum builds for digital payments, more consumers are reaching for phones instead of physical wallets at checkout. This shift in behavior gives financial institutions a fresh opportunity to win the number one position in their mobile wallets – and get their cards to stay there. This is the pathway for card issuers to reap the rewards from their investments in loyalty programs, by making their brands more relevant, more engaging, and omnipresent in the lives of consumers.



PATH TO SUCCESS

Consumers demand that the redemption experience for rewards programs meets their gold standard: the interactions must be as fast and easy as any other electronic transaction. Loyalty program sponsors can rise to the occasion to deliver this best in class experience. After all, it will be valuable for everyone— financial institution sponsor brands (who will benefit from engagement, loyalty and customer satisfaction), consumers (who will finally have true point ubiquity and increased discretionary funds from their rewards currencies), merchants (who will benefit from increased acquisitions and commerce) and digital wallets (who will have their killer app to drive adoption). It will also be beneficial for the financial institutions that become early adopters of digital wallet-linked rewards as they have an additional opportunity to acquire new customers from late adopters and those who lose market relevance by not adopting.

Here are four best practices to help differentiate your rewards solution:

1) Design a new, streamlined redemption process

Point ubiquity – the ability to use reward points like currency anywhere, anytime – promises to eliminate the time-consuming and arduous processes of outdated rewards programs. The challenge for financial institutions is to create redemption experiences that are both easy to use and that reliably trigger emotional attachment to the sponsor’s brand. This requires:

- Presenting a simple design,
- Establishing straightforward policies to earn and use reward currency,
- Delivering a fast, easy and frictionless redemption experience,
- Doing away with old-style rewards such as cash and gift cards
- Creating opportunities for new surprise and delight experiences, relevant messaging and value-based offers and discounts to accompany point redemption

- Providing spontaneous options and instant gratification for redemptions
- Eliminating costs, processes and issues (i.e., paper statements, gift card shipping, lost and stolen cards)

When fast and intuitive redemption experiences are coupled with easy ways to earn more points, consumers will perceive loyalty rewards points as a valued form of currency and budget extender.

Frequent, fast and easy reward point redemptions using mobile wallets will make using the loyalty program sponsor’s brand a daily habit and way of life, placing the brand at the top of wallet and building long-term customer loyalty.

2) Integrate digital payments into existing rewards programs

The promise of making payments anytime, anyplace, anywhere is easy to visualize and, by now, consumers have come to expect it. However, most bank infrastructure remains a complex array of legacy systems that cannot deliver such service levels. While middleware solutions and payment hubs can obscure the limitations of the most archaic back-office environments, banks ultimately will have to commit to a fully digital future.

The digital transformation of any financial institution, upgrading both core and supporting systems, and automating internal processes, is not merely a project for each line of business. It also requires a complete change of mindsets about how to conduct business. Many institutions have made significant progress toward fully digital operations. For those who have not done so, the critical imperative now is to integrate digital and mobile technology into their rewards programs.

The same factors that make these technologies – along with social media – powerful disrupters of the retail experience apply

to loyalty programs. These factors include more comprehensive selection and choice, greater transparency, location-based services, and the integration of friends into the shopping and rewards experience. Think about the ability to send messages to the smartphones of high-value customers known to be nearby, about a limited-time offer they can share with up to four friends.

Security and speed are other important factors. Consumers will not tolerate anything less than secure and instantaneous transactions. From the start, Apple Pay, Samsung Pay, and Android Pay have been far more secure than traditional credit cards because they rely on virtual account numbers and create unique security codes, or tokens, for each transaction.¹¹ Those encrypted tokens are verified by card issuers such as Visa or Mastercard before a transaction is approved. Apple and Samsung Pay also require fingerprint verification.

3) Provide new personalized experiences and value-based offers

Relevant and customized offers for redeeming points can shake things up and create unique experiences and value. Retailer Designer Shoe Warehouse (DSW), for example, needed a way to keep customers engaged with their program and remind them where they stood and what they could earn by spending more at DSW stores. DSW launched marketing campaigns that sent personalized reminders to each loyalty customer. Reminders included how many points customers need to get their next \$10 off certificate, deals they're currently eligible for (i.e., exclusive 2x points on every purchase), and a snapshot of their interactions with the brand, including how long they've been a loyalty member, how many points they've earned, and how much they've saved in the past two years.¹²

What made the campaign so successful was the level of personalization. A loyalty program like DSW's gives the brand

access to tons of customer data. DSW used that to their advantage to build hyper-personalized and relevant offers.

Data also gives financial institutions more ways to improve engagement. Capital One, for example, has been partnering with data and analytics platform Foursquare to use location-based customer data to push offers to shoppers via mobile phone apps when the phones indicate that they are in partner stores. Capital One's Second Look program monitors customers' spending habits, using machine learning to analyze customer spending and create custom alerts (customers can specify the kind of alerts they want to receive).¹³

Using digital data, Capital One is creating positive relationships with its brand that's driving customers to use the app for digital payments, and there's stickiness with the other functionalities like loyalty. We believe this is going to be increasingly important as we move towards cashless stores.

4) Changing consumer behavior

While the adoption of mobile payments is accelerating, financial institutions still need to encourage usage and shape new consumer behaviors. Specifically, they need to find ways to get consumers to use their cards in their mobile wallets. So changing consumer behavior becomes more important than ever, whether the shift is from plastic to mobile, or your payment option as opposed to your competition. American Express, for example, is encouraging corporate cardholders to pay with their smartphones via a partnership with Apple Pay. This one-step checkout capability for entertaining clients or purchasing business items is an important step in providing a seamless, integrated, end-to-end digital experience.¹⁴ American Express has also created offers tied to consumers' Uber activity in the hopes of becoming the default payment method for ride-hailing services.¹⁵

Financial marketers are facing a classic limited-time opportunity. The large financial players are spending money today because changing consumer habits is easier now than in 12-18 months. Now is the time to catch and ride the wave of digital payment acceptance or your financial institution may not make into the mobile wallet.

To break old habits and create new ones, financial institutions should tailor customer communications to emphasize the benefits of digital payments vs. cards. Financial institutions should not send a one-time, channel-specific communication – they should reinforce their messaging over and over again across all channels. Early and often, financial institutions should remind customers of the simplicity, convenience and security.

CONCLUSION

The advent of point ubiquity – the ability to make purchases with reward currencies at the point of sale using digital wallets – and sophisticated data and analytics capabilities offers financial institutions a vast opportunity to connect with customers at a detailed and personalized level like never before. It also creates opportunities for partnerships with merchants, enabling institutions and retailers to add value to customers by collaborating on personalized offers and deals.

As the momentum accelerates and use of digital wallet-linked rewards become universal, digital-forward financial institutions can substantially increase loyalty-program use, attract millennials

and other young customers who represent future growth, strengthen their brands and secure top of wallet status in both the physical and mobile wallets. The opportunity is particularly promising for early adopters of digital wallet-linked rewards, setting the stage to acquire new customers from late and non-adopters, and retain those customers as rewards redemption become part of their everyday payments.

By improving speed, convenience and ease of use for rewards redemption over traditional cash-back, statement credit and gift card programs financial institutions will differentiate rewards programs to thrive in the new loyalty economy.



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ABOUT LOYALTY PAY

Loyalty Pay is a game changing rewards payment solution which expands the value of rewards programs. Loyalty Pay drives loyalty to Brands, and gives consumers universal ability to pay with reward currencies at the POS in retail stores and in-app through digital wallets, wherever Apple Pay or Android Pay is accepted.

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AUTHORS

Bryce VanDiver, Partner, Capco

Larry Wine, Chief Commercial Officer, Bridge2 Solutions

Daniela Hawkins, Principal Consultant, Capco

Andrew Althausser, Executive Vice President, Bridge2Solutions

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