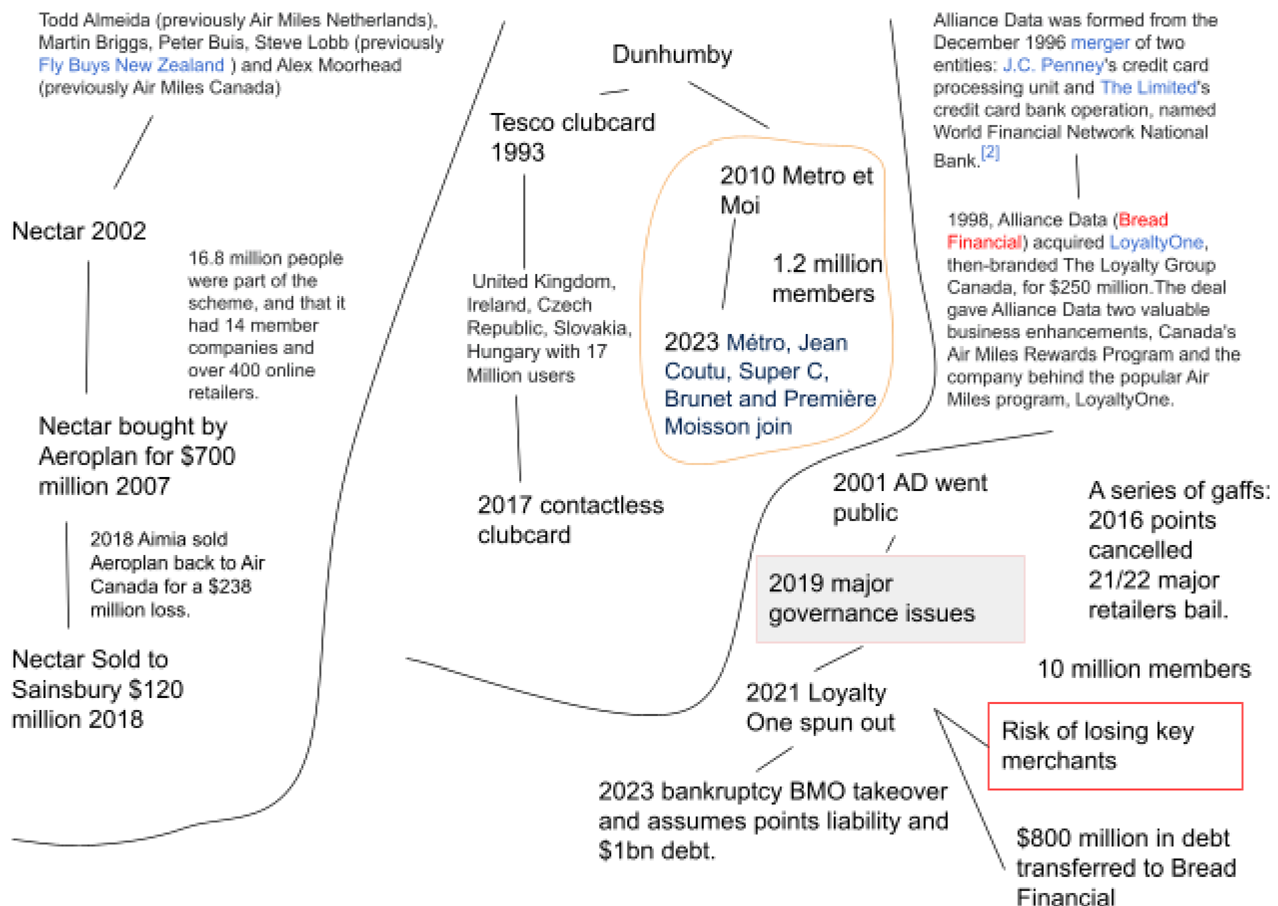
Catastrophic loyalty program meltdowns have rocked the loyalty industrial complex.[1]

Since November 2, 2021, Loyalty Ventures Inc.'s (**Airmiles**) market cap has decreased from $861.42M to $2.11M, a decrease of -99.75%. This compares closely to 2018, when Aimia sold **Aeroplan** back to Air Canada and partners TD and CIBC for $238 million. For reference, in 2005 Aeroplan launched an IPO valuing it at $2 billion. Related to Aimia's downfall, it had also previously sold the UK Nectar program to Sainsburys for $120 million, $580 million lower than it paid for Nectar in 2007.

See the below infographic for a quick infographic depicting the loyalty life cycle of key programs that most impact Canadian merchants:



Infographic 1. Key loyalty programs.

What happened to the competitive advantage from loyalty programs?

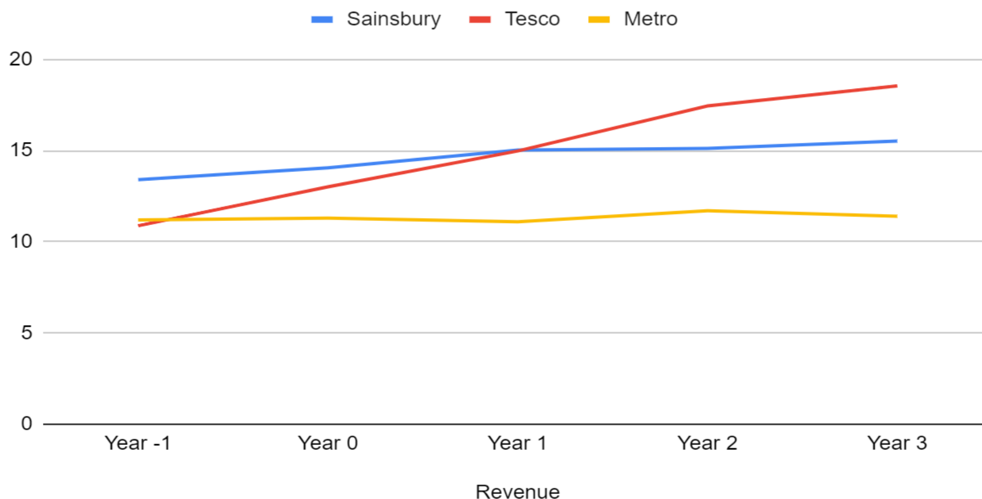
Loyalty used to work (Really it did!!). For example, in 1995, Tesco launched its famous Clubcard. This helped propel Tesco from a middle of the pack grocer to gaining 34%

[1] Warning merchants reading this report should remain calm and stay seated.

market share in the UK. In fact, Tesco became so dominant that even Warren Buffet jumped onboard with a pile of cash.

The party for Tesco was not to last however, as Nectar, Sainsburys' answer to Clubcard, was established in 2002. This venture was spawned by ex Air Miles, Fly Buys and Air Miles Canada execs and marked the beginning of the end for Tescos UK market dominance.

To illustrate the impact loyalty had for these merchants, I put together a chart (Graph 1) that reflects each merchant's revenue growth starting from the year before each individual loyalty program was established, and going forward 4 years.



Graph 1. Showing revenue trend from -1 to year 4 after loyalty program launch.

As you can see from the Graph 1, Tesco's market share growth accelerated soon after Clubcard launched. In the case of Sainsbury, soon after Nectar launched, Sainsbury reversed its decline. Meanwhile, Back in Canada, Metro's 'Metro and Moi' program launched but did not seem to have had a meaningful impact on its bottom line.

For me this was the clue that signalled that the age of loyalties diminishing returns was in play. It struck a nerve because Metro et Moi was conceived under the watchful eye of the highly regarded Dunhumby, the same team that launched Clubcard, yet, unlike Tesco, it failed to accelerate Metro's growth.

Chart 2 shows in raw detail Tesco's financial meltdown. The chart also shows Tesco's rapid revenue growth and sudden demise coinciding with when Nectar launched its competing loyalty program.

BTW, Target US had an even more costly collapse during the GFC. This was almost entirely due to risky credit card lending and the fact that its credit card was widely regarded as the card of last resort by US consumers. This is why it is not included in the covered programs. To learn mor I provide a complete breakdown of Target's demise in my book.

Warren Buffet's reaction to Tesco's crash describes it far better than I can. Buffet declared his investment in Tesco to be 'one of the biggest mistakes of my life ($800M).'

Does correlation mean causation?

Despite having stellar loyalty programs, from 2018 to now, both Tesco (-61%) and Sainsbury (-26%) declined in value over time (See Table 1). In the case of Tesco, many factors contributed to its meltdown: poor decisions, epic debt, and disgraced management.

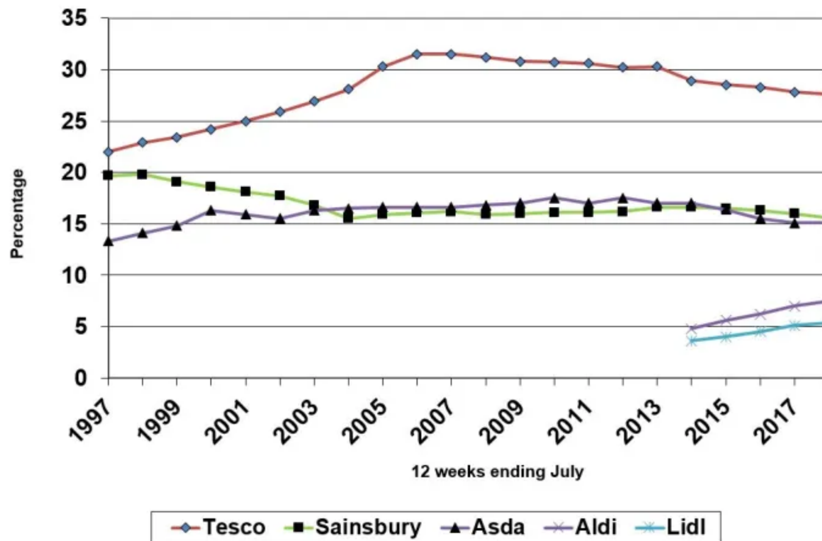
Michael Schrage asked in a 2014 report: is it a market signal that Big Data, predictive analytics, and customer insight aren't the sustainable competitive weaponry they're cracked up to be?[2] Clearly, the famous Clubcard, was not a silver bullet to ensuring Tesco's ongoing profitability.

	Market cap 2018-23	5-YEAR REVENUE TREND
Empire	25%	**5%**
Metro	42%	**7%**
Tesco	-61%	**2%**
Sainsbury	-26%	**2%**
Canadian Tire	-17%	**6%**

Table 1. Revenue growth for Canadian merchants compared to top first mover advantage UK merchants since 2018.

Continues next page

[2] Michael Schrage, 2014, Harvard Business Review, March 4, 2023
https://hbr.org/2014/10/tescos-downfall-is-a-warning-to-data-driven-retailers



Source: Press Releases and Reports on TNS Superpanel (now Kantar Worldpanel) (Note: 2001 is estimated)

Chart 2. Showing UK grocery market share over time.

Apart from Tescos meltdown, an argument that loyalty has lost its mojo is demonstrated by the success of Aldi and Lidl (see Chart 2). Not only do these merchants denounce reward programs, they have been stealing market share from loyalty loving rivals year on year. Aldi Australia (not on chart 2), also owned by the Austria-based Hofer KG, openly mocks what it calls 'pointless points.'[3] [4]

Does this make offering points 'pointless?'

Not according to Metro. In a message from the company, Pierre Boivin, Chairman of the Board, not only is its program a growing concern (1.2 million members), it announced in 2022 that it is doubling down by adding many additional merchants to the fold, including Jean Coutu, Super C, Brunet and Premiere Moisson banners.

So what is the point?

A 1995 research paper published in Harvard Business Review argues that loyalty is about design and implementation. The idea is that rewards accelerate the loyalty life cycle. One of the author's main points is that all customers are not equal. I.e. that it is mainly the customers who generate superior profits for a company who should enjoy the benefits of that value creation. Essentially, the point they make is that most companies launch rewards without assessing the economics of cause and effect.

---

[3] Aldi website: https://www.aldiloyaltycalculator.com.au/#:~:text=ALDI%20don't%20do%20pointless,rewards%20cost%20at%20other%20supermarkets.

[4] No, they are not both Australian (lol)!

An example of this latter point that also comes from the Harvard report is an anecdote about a 1994 scheme promoted by Transmedia which sold a pre-loaded restaurant charge card. The way the scheme worked was that Transmedia advanced payments to restaurants upfront in exchange for massive discounts on meals (i.e. 25% or more). Sound familiar - if not you let me introduce you to Groupon (2008) just click on the proceeding link to access a report that chronicles its rise and fall.

To understand the impact this has on the restaurant's bottom line is obvious, but if you can't figure it out, a good way to experience this is for yourself would be to punch yourself in the face till you fall down.

Image 1. Simulating the effect of Transmedia's scheme on the bottom line thanks to the movie 'Fight Club.'

Amazingly Transmedia managed to convince tens of thousands of restaurants to participate, but, thanks to Darwin, the reality of a really terrible idea could not be avoided forever. The logical conclusion was that Groupon and Transmedia cannibalized business from value clients who swarmed to the massive discounts intended to attract new customers. This seemingly cheap marketing's only achievement was to onboard customers that were already loyal but smart enough to buy Transmedia and Groupon snakeoil.

The original bad idea from Transmedia was subsequently taken to stratospheric stupidity by Groupon. Groupon compounded Transmedia's paltry 25% discount and ratcheted it up to 80%. Yet, somehow, despite losing money on every sale, it still took many months before merchants woke up. Note that as bad as merchants were taken in, Investors received the ultimate sucker punch, which was that its stock price went from $30 after its IPO (November 2011) down to $4 by September 2012. Apart from being the fastest company to reach a value of $1 billion after just 16 months in business, it crashed even faster.

Image 2. Groupon's stock price after IPO

Groupon's relevance to current loyalty programs

From 2021 when Loyalty One (Airmiles) went public at a valuation of $830 billion before crashing to $160 million (what BMO paid for the bankrupt company). Note that BMO's real cost for Airmiles 10

million members also included a $473 million rewards liability, effectively bringing the sticker price to $633 million. What it did not include were many marquee merchants like Sobeys, which accounted for about 10% of Airmile revenue, because these savvy merchants had already defected to Scotia's Scene+ program.

There are many reasons why BMO would pay such a high price. I have listed some of the arguments that may have been at play below:

1. The risk of dropping the program is extremely high. According to the Globe and Mail, of active members, 60% are heavy users and are BMO co-branded card holders. To quantify this, there are 10 million Airmiles members, and within this massive membership base, 473,000 heavy users (roughly 5%) are the valuable/loyal ones.

2. Profit from interest on outstanding card balances. I estimate (wild guess see footnote) about $700 million.[5] Based on average interest charges of 15.91% for credit cards in Canada, this could mean BMO would make in excess of **$100 million** per year less the cost of deposits.[6]

3. Program owners make money from points and managing data. Merchants pay to fund rewards and Airmiles receive a fee for processing the points. Loyalty One generated considerable revenue, although success depends on having desirable merchants, such as a leading grocer.

4. Breakage. Airmiles claim in their financials that 20% of rewards are never redeemed. This is profit for the program operator. Assuming $100 million in rewards are collected each year, that would mean **$20 million** in revenue for breakage alone.

5. The risk of another competitor scooping up the platform and the devastation that would follow is 'Priceless.'

6. The idea promoted by networks like MasterCard that co-branded cards deliver greater sales and valuable insight into customer spending. Monthly statements allow merchants to connect with loyal customers and deliver ongoing marketing opportunities.

Pointless points

Anti-loyalty merchants like Aldi and Lidl have a different take on points. A conundrum for loyalty promoters because Aldi and Lidl seem to be outperforming their points loving rivals (see chart 2). Stealing market and mocking programs as smoke and mirrors with just the illusion of lift and increased basket. There are arguments for and against loyalty programs. See the footnotes for pros and cons from both camps.[7] [8]

See below for a summary of the arguments against loyalty:

1. Points cutting into profit. Canadian grocers and fuel merchants are caught in a zero sum game of paying card fees and for expensive loyalty programs. POS Nation estimates that grocer profits

[5] In order to estimate the receivables I looked at a the Canadian Tire program. Its portfolio has 5 million cardholders and $3.5 billion in receivables. Generally most accounts are not active so I will assumed 1 million Airmiles accounts are active and have BMO a co-branded card. Roughly this would put the receivables at approximately ($3.5 bn is CDN Tires receivables/5 =)
[6] Nathan Paulus, 2022, Moneygeek, March 3, 2023, https://www.moneygeek.com/credit-cards/advice/how-credit-card-companies-make-money/#:~:text=Credit%20card%20companies%20mainly%20earn,and%20Mastercard%2C%20sustain%20their%20business.
[7] Clover, March 3, 2023, https://blog.clover.com/study-shows-loyalty-programs-increase-purchases-by-20/
[8] Aldi, April 2, 2023, https://www.decisionmarketing.co.uk/news/aldi-and-lidl-hit-back-as-customers-knock-loyalty-efforts

are between one to three percent. If this is true, how does it make any sense to pay 1%, 5% or more on rewards for every purchase (credit card fees + rewards costs)?

2. Zero sum game. The average consumer belongs to 14.8 loyalty programs, according to Blake Morgan.[9] Merchant playbooks are typically easily replicated which leads to a net neutral scenario.
3. Tesco were confirmed data junkies and loyalty leaders. This did not save this loyalty innovator from being Warren Buffet's worst investment ever. As discussed, part of the failure is because successful strategies are easily copied and BI technologies had become ubiquitous by the late 90s. Avoiding the race to the bottom is a real issue.

Amex may hold the key to loyalty's future

Amex is a master of big data, and has chosen to continue to back Amex branded Airmiles cards even though it is now owned by a rival issuer and operates on a rival card network. This makes sense because from Amex's perspective Airmiles add value to its existing programs at limited cost. It adds value because Airmiles gives members access to merchant subsidized rewards with limited financial liability.

Presumably merchants are excited by Amex's involvement because Amex cardholders typically have a superior demographic profile.

Amex's model of being a network and its own issuer has allowed it to outmaneuvered its very successful rivals. Visa, Mastercard and Amex have all continued to have exceptional growth. Amex,however has just done better, according to Ronen Shnidman in a recent report.

> "We ended 2022 with record revenues, which grew 25 percent from a year earlier, and earnings per share of $9.85, both well above the guidance that we provided when we introduced our long-term growth plan at the start of last year, despite a mixed economic environment," said American Express CEO Stephen Squeri in an investor news release.[10]

In the case of Amex, its growth was mainly due to increased card member spending and interest income, versus Visa and Mastercard gaining significantly from cross-border spending increase. One differentiator for Amex is that it has managed to maintain higher card fees. This means it can offer better rewards to its cardholders.

Amex also provides better service to its cardholders. This is an important differentiator because high net worth individuals expect this. A drill down into why Amex consistently attracts more high net-worth clients, has higher spend per client is outlined in the 2020 U.S. Credit Card Satisfaction Study by J.D. Power. In the survey Amex came in first.

Amex's advantage is that it is the issuer, whereas, Visa service relies on 3rd party issuers. So with Visa cards, you won't interact with Visa for customer service issues. You'd contact the credit card company that issued the card and since Visa partners with so many card issuers, that means customer service is

[9] Blake Morgan, May 7, 2022, Forbes, Marcy 3, 2023, https://www.forbes.com/sites/blakemorgan/2020/05/07/50-stats-that-show-the-importance-of-good-loyalty-programs-even-during-a-crisis/?sh=69ee92de2410

[10] Ronen Shnidman, Feb 8, 2023, Just.ai, March 3, 2023, https://justt.ai/blog/visa-mastercard-amex-all-grow-amid-a-turbulent-economy-whats-on-the-cards/#:~:text=The%20major%20credit%20card%20networks,jumping%2017%20percent%20to%20%242.3

more variable. Obviously service is a cost and individual banks likely do not offer the Amex level of service, which is why Amex is rated number one in the survey.[11]

Sobeys gets red pilled

Sobeys joined Scene+ in June, 2022. This was foreshadowed for anyone that cared to read its Loyalty One's IPO prospectus. Losing Sobeys was listed as one of the key risks for Airmiles because Sobeys represented 10% of Airmiles' profits. The thread of losing Sobeys was just one of many warning that the Airmiles program was on shaky grounds. The real alarm bells were the fact that Bread Financial saddled Loyalty One with $750 million in debt just after the IPO. This left Loyalty One with a crushing debt burden on top of the outstanding rewards obligations.

Sobeys was given co-ownership in the Scene+ program. A huge plus compared to being merely a participating merchant in Airmiles' program. This gives Sobeys' control of how points are awarded, better access to data, and also a share in its profits.[12]

Sobeys becoming a co-owner of the Scene+ program is not unlike the fate of Nectar in the UK. Nectar was bought by Sainsbury from Aimia in 2018 (Infographic 1). Bread Financial may have seen the 2021 IPO as a way to get out of Dodge and why it signed Loyalty One's death warrant by saddling the spinout with a $750 million payment from Loyalty One funded entirely by creditor money. An epic sum, and ironically, almost as much money as Buffet lost from his Tesco investment.

The way Bread Financial spun out Loyalty one reminds me of Groupon and how it duped merchants and investors. Loyalty changed from a competitive advantage to a zero sum game. A game that unlike Groupon's is nefarious in that its shortcomings are Machiovellian in that to profit, a certain level of deviousness is required as Bread Financial and Groupon have demonstated.

Loyalty is officially dead, long live loyalty

Going forward, loyalty no longer appears to be a competitive advantage but a zero sum game. Yet programs are bigger and more rewarding than ever.

This concludes part 2 of the of the series on why merchants should not waste time fighting card networks. The next part of this project series looks at how merchants can make the best of the terrible hand they dealt themselves.

To be sure to get the next part subscribe at www.fsim.ca or contact mark@banknews.tv

[11] Lyle Daly, March 16, 2023, Fool.com, March 3, 2023, https://www.fool.com/the-ascent/credit-cards/american-express-vs-visa/#:~:text=In%20the%202020%20U.S.%20Credit,Visa%20for%20customer%20service%20issues.

[12] Anis Heydari, June 2, 2022, CBC, March 3, 2023 https://www.cbc.ca/radio/costofliving/air-miles-sobeys-scene-switch-1.6494932