The fallibility of purchased loyalty

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The more sprinkles you offer, the better the product appears to the customer. But, of course, sprinkles aren't free—at least from an owner's perspective.

By Richard Warnick

I'm often amazed by how significant brand loyalty programs are in driving business to hotels. There are hotels in our portfolio where more than 80% of the occupancy consists of customers participating in the respective brand program. Little wonder then that loyalty programs have turned into an "arms race" with ever-increasing benefits to loyal customers—and ever-increasing cost to owners. The cost-per-member stay for the major brands is roundly between 4% and 5% of total member spend.

Now add to these direct assessments the cost of concierge floors, club lounges, free food and beverage, free bottled water, free newspaper, free internet, free welcome gift, free bonus points, etc., etc. And don't forget hidden costs like the cost of the float (funds held by the brands on which no interest is paid) and redemption policies that drive misguided revenue management strategies (to clear preset occupancy hurdles so as to receive a reasonable reimbursement for rooms occupied by redeeming members). Clearly, there is a high cost to this purchased loyalty for owners.

Brands will rightly point out that loyalty program members have a higher spend per stay than other customers—at least at the elite levels. And restrictive awarding of points has been shown to be an effective method to drive direct bookings, thereby bypassing expensive third-party channels. So even if most "loyal" customers carry multiple membership program cards in their wallet, these programs are not without merit.

But forget the costs for a moment and consider how different these points-based loyalty programs are from true product-based loyalty. Apple is arguably the best example, but many other examples exist. Even commodities have loyalty. Think Virgin Airlines and Jet Blue. Few hotel brands have cracked the code on true brand loyalty versus *purchased* loyalty. Four Seasons Hotels and Resorts and Kimpton Hotels & Restaurants come to mind. These companies, and others who command true customer loyalty trade on characteristics that touch three core principles of successful branding:

1. Their product offering is true to who they are;
2. It is meaningful to the customer; and
3. It is differentiated.

Obviously, hotel brands must have product where customers want to travel. But beyond distribution, it is my assertion (admittedly, unproven) that the various points programs are the single most significant factor attracting customers, at least the most desirable customers—frequent travelers. So even ignoring their continuously escalating cost to owners, it seems risky to rely so heavily on points-based loyalty programs for a number of reasons. For instance:

- What if big companies that consume a lot of travel are pressed by, say, aggressive/active shareholders to capture, for the company, the value of loyalty programs currently going to traveling employees? After all, it is the company—not the individual—that is paying the freight. How loyal would Joe or Sue Traveler be if these rewards flowed to their corporate treasury instead of to them? Would the companies then be “loyal” to the points program—or might they simply negotiate lower prices? Conventional wisdom says that would never happen because of the impact on the morale of employees who travel. Yep, employee morale for a small percentage of the workforce is always the top priority of profit-oriented activist investors.

- What if some high-ranking official at the IRS looks at Brand X’s loyalty statement one day and says, hey, why aren’t we collecting taxes on the “income” that is being paid by brands to millions of travelers? Imagine an IRS ruling that says, henceforth, hotel companies must issue a W-9 to every loyalty program member, that it must be filled out annually to qualify, that they must then issue 1099 forms to the folks who were awarded points (or other benefits including upgrades) … and that the loyalty program members must then declare the value of the these rewards—whether redeemed or not—as income on their tax return. If you think this a pipe dream, I suggest that you have not been sufficiently observant of the government’s creativity in finding new tax revenue.

- What if the tectonic shift in consumer behavior that has been occurring for many years—the one where experience is valued over other hotel purchase decision factors (like points) —continues to gain traction with an increasing percentage of travelers? The major brands would be quick to retort that, with their stable of lifestyle brands, travelers can have both. True enough, but that does not explain how Airbnb, which has had no loyalty program thus far, has managed exponential growth and, by at least one credible measure, has a higher guest repeat factor than most hotel brands?

- What if intermediary loyalty programs gain traction? (Think Expedia, where it's possible for travelers to earn frequent user benefits across brands.)

In a world where every flavor is vanilla, perhaps the only way to differentiate your ice cream is with the sprinkles on top. The more sprinkles you offer, the better the product appears to the customer. But, of course, sprinkles aren't free—at least from an owner's perspective. More importantly, the occupants of every hotel company C-suite should be questioning what true brand loyalty is today. The last time the industry became addicted to a seemingly easy bridge to customers, it turned into a crack-cocaine-like nightmare called OTAs.

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