

The Future of Loyalty: Solving the Leaky Bucket Problem

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Brands are spending more than ever to acquire new customers – in fact, research shows that over the past 8 years, customer acquisition costs have increased by 222% ([SimplicityDX](#)). When spending big to acquire customers, the last thing a brand wants is a leaky bucket. Traditional strategies to increase discoverability and top-of-funnel (e.g., paid ads, leveraging marketplaces, etc.) can be effective for driving new users, but don't necessarily drive "high quality" customers who have brand loyalty or affinity. An oft-quoted Harvard Business School study cites that increasing customer retention rates by 5% increases profits by 25% to 95% ([HBS](#)).

But deeply embedding with customers – getting them to come back again and again... and again, and to use your product in more ways, more often – is not such an easy task. So how do brands leverage rewards to generate true loyalty? Below, we'll share more about the types of loyalty companies we've seen innovating in the space and where we think it's heading.

The biggest and "best" loyalty programs are good but not great

Starbucks, airlines, and Sephora are a few examples of the current gold standard of loyalty programs. They all provide customers with real, tangible rewards that they want: a free shot of vanilla; an upgraded seat; a free birthday gift. They have gamified rewards to encourage frequent spending, and users are more highly rewarded when that spend is captured in a closed loop (e.g., loading a Starbucks card with \$100).

These models work for the biggest players, but miss on a few key components. They don't effectively build community: the relationship is solely between the merchant and the customer. Starbucks, for example, doesn't provide insight into what our friends are drinking or when they're going to have a big reward moment. And the newest generation of shoppers – Gen Z – have extremely high expectations for community building. 54% say their favorite brands are the ones that make them feel like they are part of a community. "In other words, 'cool' brands are the ones engaging this generation with far more than just product. And with 84% saying they're more likely to purchase from brands that they see as 'cool,' compared to ones they don't, this universe building is key to winning their loyalty" ([Vogue](#)).

Legacy programs, while adapting and evolving, largely miss on personalization. Delta, for example, rewards me with drink vouchers I'll never use and a Clear membership I already have. We're seeing upstarts take individual preferences into consideration when designing loyalty programs, something the largest brands have historically ignored.

The biggest loyalty programs are just that – the biggest – and their structure/unique elements do not necessarily translate to smaller companies who typically do not already have large, devoted customer bases. Below, we dive into how many startups are white-labeling and democratizing access to loyalty programs for their SMB brethren.

The next gen of loyalty

We see a fair amount of capital, talent, and innovation converging around loyalty and believe there is something more innovative than the loyalty programs most of us engage with on a regular basis: more exciting than cashback, more community driven, more accessible, more personalized, and more fun.

Below are some of the companies we've noticed and some color on what gets us excited about the future of loyalty. For the most part, we feel it's early innings, but the more companies we speak with, the stronger our conviction that loyalty will soon be changing, likely for the better.

Democratizing loyalty for SMBs

There are a handful of players looking to make offering loyalty programs more accessible, specifically for SMBs. [TYB](#), for example, is led by Ty Haney, the founder and former CEO of Outdoor Voices. Ty is taking what she learned building a direct-to-consumer business that had an extremely strong organic community and translating it into white-labeled software for e-commerce brands. Using TYB, brands create their own challenges (e.g., encourage posts to social or poll on product names) for customers to then earn rewards which translate to the checkout. We expect programs like this to resonate particularly well with Gen Z consumers who rank community and “cool” as some of a brand's most important attributes.

TYB feels like a web2 experience, but like almost all of its competitors, it has roots on blockchain. TYB, [Toki](#), [Hang](#), [Blackbird](#), [Superloyal](#), and [Uptop \(which PayPal is an investor in via the Alumni Fund\)](#) were founded in a crypto bull market and incorporated web3 into their offerings because the blockchain allowed for interoperability of assets and – let's be honest – it was “hot.” We've seen each of these companies pivot to talking about the blockchain as an enabling feature, rather than key to their offering.

Beyond the punch card: Restaurant loyalty

In the restaurant space, we've seen buzzy and innovative approaches to loyalty. Buy 10, Get 1 Free punch cards might as well be ancient artifacts, as customers want and expect more from their favorite eating establishments. Hang, for example, is helping quick service restaurants (QSRs) build strong customer relationships through embeddable games and loot boxes, building community via features like leaderboards and hyper-personalization of rewards. Blackbird is essentially a modern-day Foursquare, where customers earn rewards every time they check-in to a restaurant (via QR code) .

[Loyalist](#) and [Bikky](#) are creating Customer Data Platforms (CDPs) to enable better in-person, white-glove loyalty for restaurants. Today, restaurants are manually reconciling data from sources like Resy and Toast so that they can see what someone is eating/how much they are spending and who that person is.

Loyalist, for example, shows restaurants who their regulars/big spenders are, and helps them create customized rewards programs. Imagine that on your fourth visit this month to your favorite local restaurant, the cocktail you always order is delivered to your table – comped and without having to ask, or that the General Manager comes over to your table and shares their cell number so that you can always text for a reservation.

A facelift for cards

We're also seeing affinity cards emerge with interesting hooks. Legacy players like Synchrony and CapitalOne exclusively serve large companies, making affinity cards historically unavailable to smaller companies. Companies like [Tandym](#) and [Ansa](#) offer white-labeled closed-loop rewards cards to SMBs that don't ride traditional rails, and instead deliver the cost savings back to merchants, who in turn use it to fund rewards for their customers.

[Cardless](#) and [Imprint](#) offer white-labeled co-branded cards that ride legacy rails. Cardless powers cards for large enterprises like TAP Air Portugal, the Boston Celtics, and Manchester United to offer both traditional and less traditional rewards like autographs, pre-game access, and discounts on merch. (Note: Cardless recently confirmed it was no longer accepting applications for its co-branded cards with various professional sports teams.)

To varying degrees of success, we've come across companies that are creating cards focused on specific rewards verticals. [Ness](#), for example, created a high-end credit card for consumers who were interested in wellness-focused rewards (the company shuttered at the end of last year per [Fintech Futures](#)). [Paceline](#) offers an interesting take on the space – their credit card, powered by American Express, connects to wearable devices, and allows consumers to earn rewards based on their physical wellness. The very buzzy [Bilt](#) allows customers to pay rent – commonly consumers' largest expense of the month – with a credit card and earn travel-focused rewards.

It's worth calling out that almost all of the innovation we're seeing in the space is centered around U.S.-first businesses and customers. Interchange is a huge part of the monetization strategy of many of the above business models. But where U.S. interchange averages about 2%, Europe interchange averages 0.3%, making the dynamics dramatically different across markets.

Browser rewards are new again

Others are innovating on already existing, known rewards experiences like Rakuten and PayPal Honey. [Wildfire](#), for one, is a white-labeled rewards company that surfaces rewards at the browser level. For example, a customer searching for a couch sees search results that include Crate & Barrel's site and a small call-out that if they purchase on Crate & Barrel using Citi (a Wildfire customer), they will earn 1% cashback. [Lolli](#), which is modeled heavily after Rakuten, offers cashback rewards that can be redeemed in Bitcoin. [Checkmate](#) has a product very similar to PayPal Honey.

Wrap it up already

We believe that brands have the opportunity to offer exciting, cool, engaging loyalty programs that will ultimately help them retain customers they've worked so hard to acquire. With better loyalty comes less leaky buckets, or as we like to say in VC, more favorable LTV to CAC ratios. Even though it feels like early days, we're encouraged by the sheer volume of exciting startups innovating in loyalty and rewards and look forward to what's to come!

Please reach out with thoughts, ideas, interesting startups, and any and all feedback.