

Loyalty Management in Retail

Preparing for the next century of loyalty management in the retail industry

By

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Today nearly everyone has one or more loyalty cards in their pocket. Even in the current global recession, consumer participation in loyalty programs has increased and having a well managed loyalty program is more important than ever (COLLOQUY talk: After the Meltdown, June 2009). How active customers are using these loyalty programs heavily depends on the soft and hard benefits these programs are offering. In general, active program participation rates are modest and lie around 40%. (COLLOQUY talk: Quo Vadis, April 2007, COLLOQUY talk: The Big Sort, April 2009)

Not only is the airline industry heavily dependant on their loyalty programs, but also the retail business. A retailer cannot afford to be without a loyalty program, starting from the small coffee shop around the corner to the globally operating retail chains. The pressure to have a program is extremely high, but just setting up a program and having a stamp card is not enough for consumers anymore. Maturity of loyalty management, boredom of consumers with these programs and a company's cost-cutting strategy in times of a recession can be a deadly mix, potentially undermining the future survival of a company.

Being aware that in these difficult times a company has to balance the short and long term needs, one of the main focuses has to be a customer centric strategy. Part of this is to build a positive customer experience across all channels with a loyalty program as one of the core elements.

In this whitepaper we will outline a strategy on how to increase the participation in your loyalty program starting by explaining what loyalty management within the retail sector is. Then we will focus in on where companies are in the implementation of such a strategy. The last part is then to embed your loyalty program successfully in your customer strategy and finally to integrate it into the core CRM processes.

What does loyalty management in retail mean?

It would appear that loyalty management is viewed differently by consumers and companies and even the experts. Several definitions can be found on the internet or in literature. Each of these definitions focus on specific areas, none of them catching the whole truth:

- Loyalty management is part of customer experience. (SAP white paper: Enhancing the Customer Experience, 2008).

- Loyalty management is the action a company undertakes to attract and retain profitable customers. (Memberson Pte Ltd, 2009, www.memberson.com)
- Loyalty is a feeling or attitude of devoted attachment and affection. This is mostly measured by behavioural KPIs like share of value, purchase frequency or retention rate.
- Loyalty Marketing is about creating customers who don't need ongoing marketing investment and therefore are more profitable. (BuildingBrands, 2009, www.buildingbrands.com)

Summarised for companies a loyal customer is someone who shops with you more and more frequently.

Consumers think differently. For them someone is loyal if they shop exclusively at a single retailer in a particular category or at a particular retailer frequently. This loyalty is demonstrated by:

1. Years with retailer
2. Feeling treated as a valued customer and expressing that
3. Low-price sensitivity
4. Willingness to recommend (COLLOQUY talk, The Loyalty Marketing Index, June 2008)

Successful loyalty programs and loyalty management go beyond all these approaches. The objective is to focus on and to deepen the existing customer relationship by offering relevant rewards that reinforce the brand values. Effort has to be put into identifying, maintaining, and increasing the yield from best customers through long-term, interactive, value-added relationships while the performance is judged with a combination of behavioural and attitudinal measures. (BuildingBrands, 2009, www.buidlingbrands.com; COLLOQUY, 2006, www.colloquy.com).

Now that we know what loyalty management means we have to understand what drives consumers to be loyal to a retailer, so that the undertaken activities are successful. A consumer is definitely not loyal just because he has a loyalty card, especially with so many loyalty programs on the market. However they are definitely influenced by it. When looking into a survey COLLOQUY has undertaken in June 2008 in North America for segmented retail categories (see Table 1) approximately 30% of all respondents couldn't say why they are loyal to a specific retailer. This represents a big opportunity for loyalty marketers to build up more emotions to their brand and therefore win additional loyal customers. Further it is interesting to notice that customer service (above 30%) and low prices (around 27%) are the most important factors to loyalty. Wide Selection is also a notable attribute, but has to be seen critical as a lot of consumers are also complaining about having too much choice (ACRS Research Team: Retail 2020: Future Trends Impacting Retail, 2009).

Rank	Grocery & Personal Care	Department & Mass Merchant	Speciality
1.	Customer Service	Low Prices	Customer Service
2.	Low Prices	Selection	Low Prices
3.	Selection	Customer Service	Selection
4.	Location	Product Quality	Product Quality
5.	Product Quality	Not Loyal	Not Loyal

Table 1: Consumer Reported Factors of Loyalty (COLLOQUY talk: The Loyalty Marketing Mix, June 2008)

Both “Too much Choice” and “Low Price For Everything” are two trends of the last decade on their way out (TNS Research). Consumers are judging low prices as important, but they are only perceived to be a necessity. Low prices are far away from being emotionally rewarding, although they may be brand reinforcing if the brand stands for low prices. On the other side, companies struggle with the increase of production, transportation and marketing costs to hold the prices down. Last but not least frequent sales and specials can also actually breed disloyal customers by encouraging cherry pickers. Loyalty marketers therefore should carefully think about basing their customer strategy purely on the price. Competing on low prices eats up margins because price reductions can only be partly offset by increasing operational efficiencies in a company.

What is state-of-the-art loyalty management in the retail sector?

The retail industry is one of the biggest loyalty players after the airline industry and financial services. The airline industry has the most sophisticated loyalty and customer strategies and technology support. Where do we see loyalty within the retail industry?

First of all in the worldwide retail market environment we can find three different distinct loyalty models:

- Everyday low price (EDLP),
- Loyalty models
- Hybrid model

Within the EDLP model, a retailer is relentlessly focusing on the lowest category prices that lead to low customer service, low in-store experience and unimportance of customer relationships. Examples in New Zealand for this model are e.g. Pak'n Save, Bunnings, or Mitre10. In the worldwide markets we find Wal-Mart or Aldi. When applying this model there is no need to have a loyalty program with a card rolled out as the marketing budget is clearly spent by keeping the prices down. Unfortunately just one retailer can have the lowest prices within one category and therefore going down this path can only lead to a disaster for most of the companies. A good example of this is Wal Marts withdrawal from the German market after they were unable to successfully compete with the incumbents Metro, Aldi, Lidl and Tengelmann.

Instead retailers have to either attract consumers to their stores by focusing on differentiated customer relationships (loyalty model) or by providing members only wholesale prices by taking membership fees (hybrid model). Membership clubs with a de facto retail loyalty program include Costco that operates very successfully in the US and Canada and now has opened up the first store in Melbourne and Sam's Club.

Companies that build their strategy on a loyalty model have to undertake actions using recognition and rewards tactics to identify their customers and to monitor and track their behaviour. This data needs to be collected in a data warehouse and to be analysed for behavioural patterns and preferences. This provides companies with marketing insight to build and boost differentiated relationships with their customers. (COLLOQUY talk, The Loyalty Marketing Index, June 2008)

For a lot of retailers, especially mid-size companies, building up their own loyalty program isn't the most successful and cost-efficient way. Maybe being part of a coalition could be a strategy. Payback in Germany and AIR MILES Rewards Program in Canada are two very successful coalitions with penetration rates of over 70% in their countries. Flybuys in New Zealand reports moderate success. Some big players decided to leave this coalition in the last 12 months. Important in a coalition is to have at least one big player where consumers very regularly spend a high amount of their money, so that the reward points can be built up within a reasonable timeframe.

In general there exist two different kinds of program types: Cash back or points based. The cash back variant is very popular in the US and is the approach adopted by Woolworths owned Countdown for their Onecard program in New Zealand. The year is divided into periods and a consumer receives a cash back voucher based on their spending in the last period. For example for every \$200 spent the consumer gets a \$20 cash back voucher. These kinds of rewards are very popular by customer segments with low to modest income. In a point based program, like Flybuys, the consumer can redeem the collected points in certain physical products or services. Rewards that are very popular with consumers are flights or hotel stays.

The strategy behind this type of program is to drive the consumer to spend more to collect as many points as possible, so they can redeem the accumulated points for a goal reward. Within the last couple of years it is getting more and more important to have rewards with a WOW-factor in the program and to provide soft benefits to important customers within the loyalty program. Studies have shown that point based programs tend to build more loyal customers. People talk far more about their vacation they got from the redemption than of the 5% discount they received.

The loyalty market itself shows clear signs of maturity with the broad range of loyalty programs and consumers taking part in at least one of them. Consumers know what loyalty programs are and how they work. They are more alert than ever and clearly ask the question: What is in it for me? They seek those brands that bolster their overall value proposition with a sophisticated and differentiated rewards program. Therefore companies have to be aware of increased boredom and have to take steps to avoid high churn rates. In general, the active program participation rate is at around 40% (COLLOQUY talk: Quo Vadis, April 2007, COLLOQUY talk: The Big Sort, April 2009). This is not sufficient and there is clearly potential for optimisation available. Companies should take up this opportunity and strive to differentiate themselves from their competitors.

Sophisticated loyalty programs cannot be operated without technology anymore. Most companies are using smartcards to identify their customers at the POS. The POS itself is integrated to the loyalty application. The bigger companies are all operating their home-grown systems, but these systems are either lacking integration into the companies' CRM and ERP systems or functionality or their maintenance costs are getting too high.

As an integral part of the current CRM 7.0 version, SAP launched a highly functional Loyalty Management solution that is fully integrated into the CRM back bone and all channels, including the web channel and the interaction centre.

Companies like Tesco or Safeway in the UK are pushing the technology further. Safeway for example just launched E-Coupons. Consumers log in to their accounts on the loyalty web and select the vouchers they are interested in. These vouchers are then loaded onto the card and when paying at the POS they are automatically recognized and deducted from the bill.

However, it is paramount that loyalty program designers lead with a smart strategy and not with smart technology. The technology can only enable the strategy, but never be the strategy. Imagination is the key, a system is merely a tool.

In the world of loyalty marketing, the activities are set up in a way to drive the customer along the loyalty relationship chain™ (COLLOQUY). Figure 1 presents the relationship chain with its four steps and the increase of member retention and annual spend the further along a consumer moves on this chain. The support of the chain and its integration into the core CRM processes have to happen via state-of-the-art technology.

In the first step, the “Dialog”, a company has to make sure to enrol the right customers. Companies have to determine which customers they want to have engaged in their relationship strategy. One can focus on the following segments:

- Highest-value customers to recognize and reward their value
- High-potential customers who currently split their purchases
- Customers at the highest risk of churning
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We recommend setting up a recognition and reward strategy that is based on customer groups and that piques customers' interest.

During the “Engagement phase” the interest in the company's brands should be increased. This needs to happen by involving the customers in regular communications in the shops, via email, call centre, web site, and social networks and other media. The message needs to be consistent throughout the different channels and needs to answer the hidden questions “What is the advantage for me? And why should I follow this?”. The objective should be to build up a dialogue with the consumer and to design the communications in a way that intrigue the customer to respond regularly. Responses are signs of increased interest in the brand. After a number of positive communications, the customer collected enough points to make a first redemption.

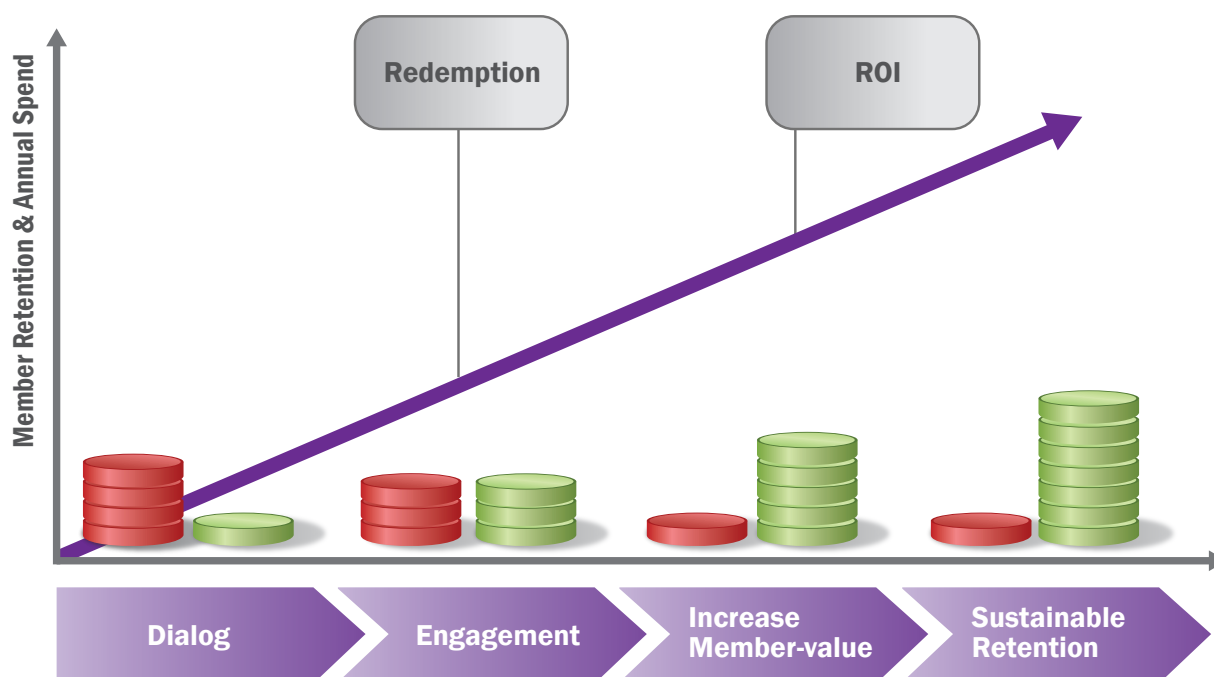


Figure 1: Loyalty Relationship Chain™ (COLLOQUY)

Within the step “Increase Member Value” a company has to stimulate active participation of the customers in their loyalty program via an effective customer engagement strategy. This can include product recommendations, bidding on auction items, completing surveys or loyalty campaign participation via the web site. One should watch out for any voluntary customer activity beyond the standard transactions and measure them via KPIs.

A customer is taken along successfully to the last step in the relationship chain if he triggers multiple redemptions. The loyalty strategy was successful and the consumers got their expected payoff by taking part. The questions from the second phase are successfully answered. Redemption happens whenever a customer extracts value from a loyalty campaign and it is therefore the ultimate measure for customer value. Multiple redemptions are the key to a successful ROI for both sides: the company and the customer. (Colleen Becker: Forcing the Relationship Chain, 2008)

How to increase loyalty program participation?

The described relationship chain presents the different phases a customer can be in. We now want to answer the question what activities need to happen to increase the program participation and therefore getting more customers into “sustainable retention” mode from a customer loyalty strategy point of view. This is like building a stable house that can be extended step by step in future. Figure 2 presents a complete strategy with the foundation of value proposition and loyalty analytics. Based on selected customer segments, traditional loyalty service, marketing and sales activities are happening. These traditional activities are the ‘bread-and-butter’ activities and in these times need to be extended by further loyalty marketing efforts in the area of Word-of-Mouth (WOM) and social networks.

All these activities need to have a clear linkage to the brand and a consistent message across all channels.

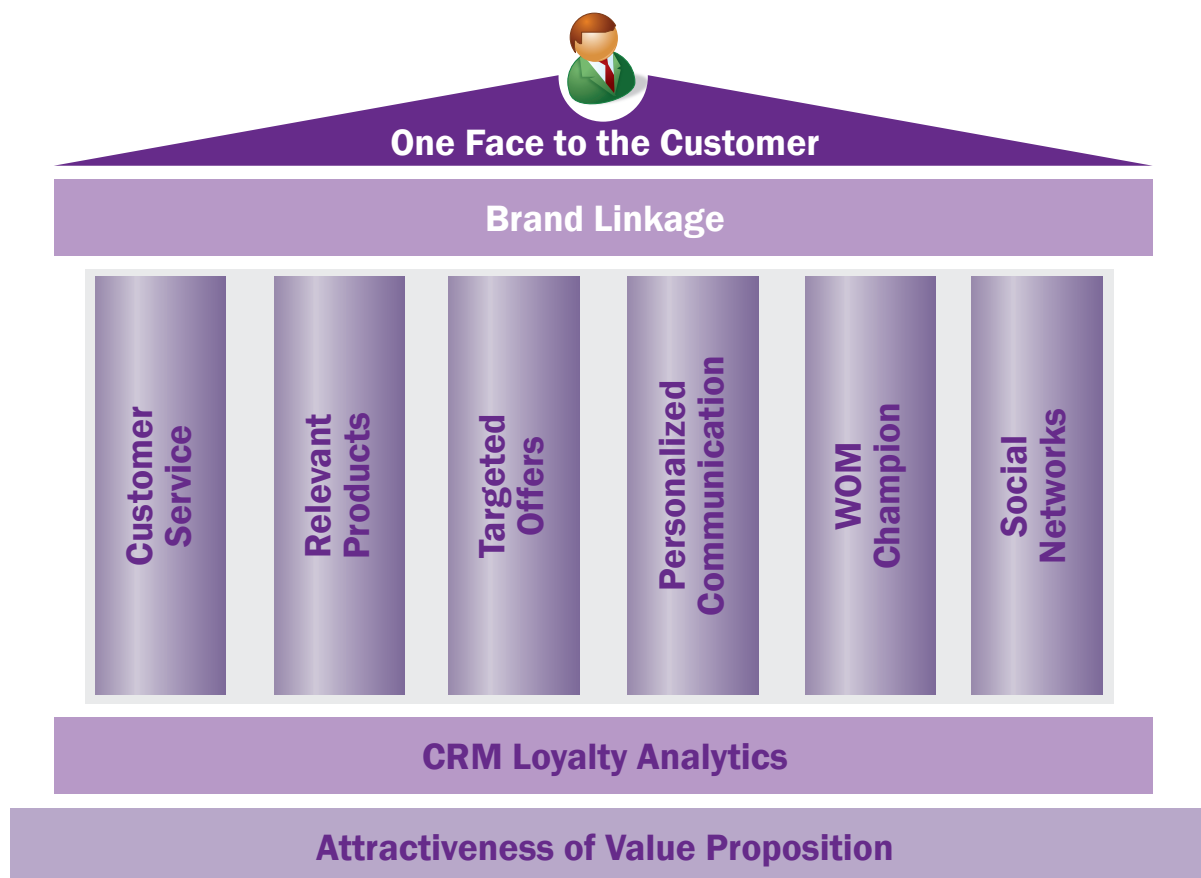


Figure 2: Strategy to Increase Loyalty Program Participation

The foundation of every successful loyalty program is an attractive value proposition for the consumer. Company T-shirts or cups as rewards will fail to engage most of the consumers. On the Contrary: Not offering interesting rewards is one of the biggest reasons for boredom within the consumer base. Therefore it is more and more important for companies to have very special rewards, so called WOW!-Factors, otherwise the program will soon be terminated. These WOW!-Factors should not only encourage customers to stay engaged, but even to spend more money and more often just to reach this once-in-a-lifetime experience, premium merchandise or lifestyle-themed reward that appeal to a member dream. A real-life example is from Harrods of London where a customer could, by invitation only, redeem points to create their own jewellery with a top designer or enjoy a classic motor racing experience. Therefore it may be necessary to partner with other companies as these rewards cost money and especially in times with tight financial constraints, one should have the margins and the program ROI always in mind.

Further elements in successful reward designs are soft benefits and personalised rewards. Soft benefits like special access and unique privileges are an important factor for differentiating oneself from the competitors. Just think about the lounges of the airline industry.

Based on the gathered transactional data it is possible to cluster your customers in homogeneous-segments, which you address with the appropriate customer strategy and, thus, make the most out of the marketing expenditures. The sheer amount of transactional data combined with the customer entity should give you enough business insights to promote the right merchandise to the right customer. Market analysis demonstrates how crucial it is for a retail company to manage their customer strategy and therefore the loyalty program in a more innovative and aggressive way.

The marketing activities are set up based on these customer segments and on the different stages within the chain. By comparing the behaviour of loyalty-marketing participators to the behaviour of established control groups, one can infer the financial impact by measuring success early in the chain. Proper analysis requires tracking and measurement of loyalty-marketing activity at both the individual customer and segment levels. Therefore it is crucial to have several KPIs set up dependent on the chain stages to see if activities

are steering in the right direction or if a change is necessary. Your customer strategy is then based on a good foundation.

Customer loyalty management has to be completely integrated into the three main pillars of a company's customer strategy, namely service, sales and marketing. Proposing the right products for sale needs to be based on customer data coming from standard transactions or loyalty marketing activities. Loyalty sales operations for point accrual and redemption are available and should happen in real-time.

Loyalty marketing operations from campaign planning to optimisation and execution need to be integrated to campaign and promotion planning. The offers should be targeted, e.g. through market basket analysis, and set up according to the different phases of the relationship chain. Start identifying new product opportunities based on customer data. The communication should be personalised and consistent across all channels. Spelling a name correctly does not qualify as personalisation anymore. Interactions should be processed over several channels with multi-channel marketing in mind. Direct-mail communications, email, and brand web sites must speak to the individual and be linked to the brand. It is crucial to build up an emotional bond between the brand and the consumer. This can only be achieved if companies identify their customer in every channel and then filter content through the prism of transactional and demographic customer data.

Celebrate the differences for each segment and differentiate the communication per brand!

It is mandatory that service ticket processing, complaint management and service interaction are happening smoothly. Lost, stolen or damaged card processes, point transfers or general inquiries regarding the loyalty program should be possible via several channels and are followed up fast. Never forget, it costs far more money to acquire new customers than to keep the existing ones. Dysfunctional support operations, where for example a customer wants to transfer some points or points haven't been credited after several complaints, will result in dissatisfied customers.

In addition it is crucial that typical loyalty operations like member registration, profile maintenance, statements or lost or damaged card processes are integrated into the CRM application and available via all relevant channels.

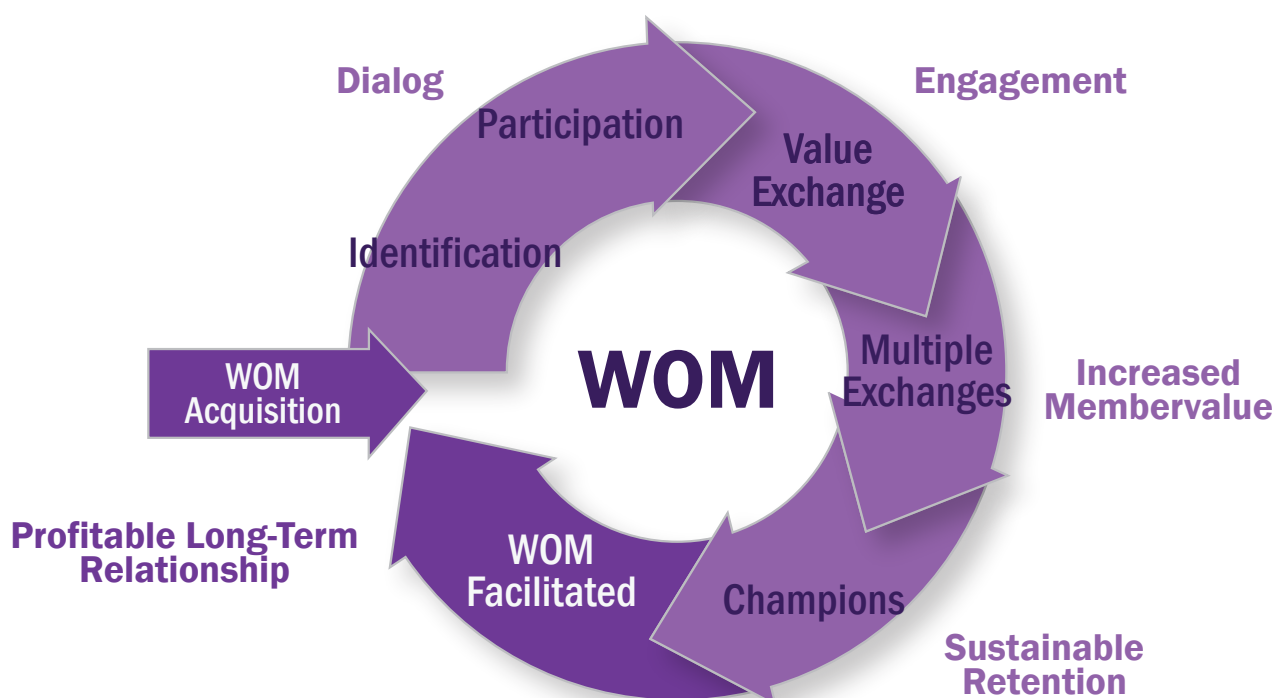
The two pillars “Word-of-Mouth” and “Social Networks” are the new areas loyalty marketers have to concentrate on. They have been around since products and brands were established and people were there to talk about them. However we have seen a transformation of internet, social network tools and mobile communication platforms within the last couple of years. Speed and scale are different – consumers have far more platforms to share product and brand opinion instantly with thousands of other consumers. As a result a single blogger can easily cause significant damage to a brand’s reputation and ultimately the entire company.

Be engaged on social networks like Twitter, Facebook or linkedin. Follow the blogs that are happening and react accordingly. E.g. GM just decided not to launch a new model due to the bad reputation within these networks. This has probably saved GM millions of dollars. Start using these social networks as a marketing and service tool, e.g. by launching loyalty marketing campaigns including them or by following up customer inquiries.

Personal recommendation (WOM) is the best marketing that can happen to a company and brand. People believe friends or colleagues or even strangers more than a marketing campaign

via TV, radio or internet. Therefore it is crucial to filter the so called WOM champion customer within the database. These reside at the intersection of emotional affinity and transactional loyalty. They have the loud voices and are the social network tools addicts, the influential bloggers, the email and web-link forwarders that carry the word about their favourite products and brands into the world. The chances that these customer champions are found within the loyalty program are very high. Research has shown that there is a direct correlation between levels of activity within reward programs and instances of WOM champions. Therefore consider providing WOM channels to the active members and find ways to recognize and reward them for engaging in WOM activities. Even further, these champions want to build up a relationship with their favourite brands. (COLLOQUY talk: The New Champion Customer, January 2009)

Going the next step - integrating WOM marketing into the loyalty relationship chain will lift the success of loyalty management and companies will achieve an even better ROI of their loyalty marketing efforts. The goal is to build profitable, long-term, differentiated relationships with the customer by additionally applying WOM tactics. These tactics should be designed from the WOM acquisition till some of the customers are champions and facilitate WOM themselves (see Figure 3).



Starting from the dialog phase, one applies typical awareness and product trial strategies in order to begin the new relationship. Behaviour is tracked and measured. Specific WOM metrics are set up and incentives for special WOM behaviour are offered. The more the relationship blossoms the more the company can reward them and recognise them as a WOM Champion. Companies need to provide communication platforms, develop social network tools, engage the customer in WOM activities and help them to talk about products and brands. WOM champions want to spread the word. These are just some best practices. We advise to start WOM marketing activities with small wins: set up a test, track the behaviour and measure the result and then if successful go for something bigger; if unsuccessful one will gain wisdom. Nevertheless following the strategy through the loyalty program will be a success with good returns on your investments.

Conclusion

Loyalty management is about focussing and deepening the existing customer relationships by offering relevant rewards that reinforce brand value. If this objective is met, customers will spend more money and buy more frequently from your company and will even recommend your brand to their colleagues, friends and communities. EDLP or too many price promotions are not a recommendable strategy to go with, as this can actually breed disloyal customers and is far away from emotionally rewarding. You will not deepen your relationship to your brands with this strategy. If you haven't done so yet, set up a customer strategy that has, as a core element, a loyalty program.

To fully enable this customer strategy, an integrated technology like SAP CRM Loyalty Management, is necessary to support CRM, ERP and loyalty management across several channels. All loyalty marketing activities should be based on loyalty analytics paired with demographic and transactional data and the stage the customers are in the relationship chain. Always have the question from the customer "What is in it for me?" in mind and highlight linkages to the brand. Invest in the design of the rewards, as they build up emotions in the consumer. This will deepen your relationships and reinforce your brand value. And last but not least, start implementing WOM tactics and integrated social network tools and you will be ready for the next century of loyalty management.

About The Author

Dr. Nicole Wieberneit is a Senior CRM Consultant with CIBER New Zealand. She is a recognised expert in SAP CRM with a focus on Trade Promotions Management, Marketing and Campaign Management, Key Account/Sales Management and Loyalty Management. Her skill set also includes significant experience in Lead & Opportunity Management and the integration to Mobile Sales, Web Channel and ERP. Nicole has implemented SAP CRM across a number of industries, with a focus particularly on CP/FMCG Industries with specific knowledge within Beverages and the Retail sector.

Prior to joining CIBER she was freelancing on the North American Market, working as a consultant within the SAP Group in Germany and as a research assistant at the University of Augsburg and HEC Montreal. She holds a PhD in economics and has more than 9 years of consulting experience including process design, implementation, project management and IT strategy consulting.

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