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Business-friendly Solutions

Focus on measurable loyalty effect - An imperative for multi concept retail loyalty programs

Retail loyalty programs are commonplace today. From Mom & Pop stores to large super markets, almost every other retailer has some form of loyalty program. Some offer instant gratification with upfront discount, some offer threshold vouchers, some are currency based etc. However, the success of retail loyalty programs, regardless of their structure, remains indistinct to business.

Despite significant investments, most retailers are still unsure about the real value creation by their loyalty programs. They tend to think loyalty programs are just a line item between their Gross and Net profit and an attribution of economic impact of any form (to the loyalty program), is highly disputable.

There are potentially two scenarios that emerge in the context of retail loyalty. In the first, the program is integral to the brand and often program loyalty is inseparable from brand loyalty. But in the second scenario, where the loyalty program services many brands (for e.g.: a retail conglomerate which has many retail brands), it is especially challenging for the program to be considered as an effective mechanism for value creation.

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Why?

Our research suggests that the answer to this lies in both retail loyalty strategy and its execution. In many instances, we saw great strategic blue-prints not being adequately supported with the right execution while in other cases, strategy itself was flawed.

Based on numerous retail loyalty consulting engagements that we have executed across the world, we concluded on lack of Fitness for program purpose and inability to achieve goal congruence within internal actors as strategic issues and an ineffective management control and suboptimal accounting framework as key execution failures.

This paper discusses each of these issues in detail.

Strategic Issues

1. Fitness for purpose

Most retail loyalty programs claim to exist to increase customer retention. However, most firms don't have a clear basis to identify if their customer loyalty is transactional, functional or attitudinal. Brands often claim that they do not require any loyalty program for inducing the first two forms of loyalty and quite rightly so. The acid test of a program is to be able to become a force multiplier on the top of the retail brand and induce the third form of loyalty.

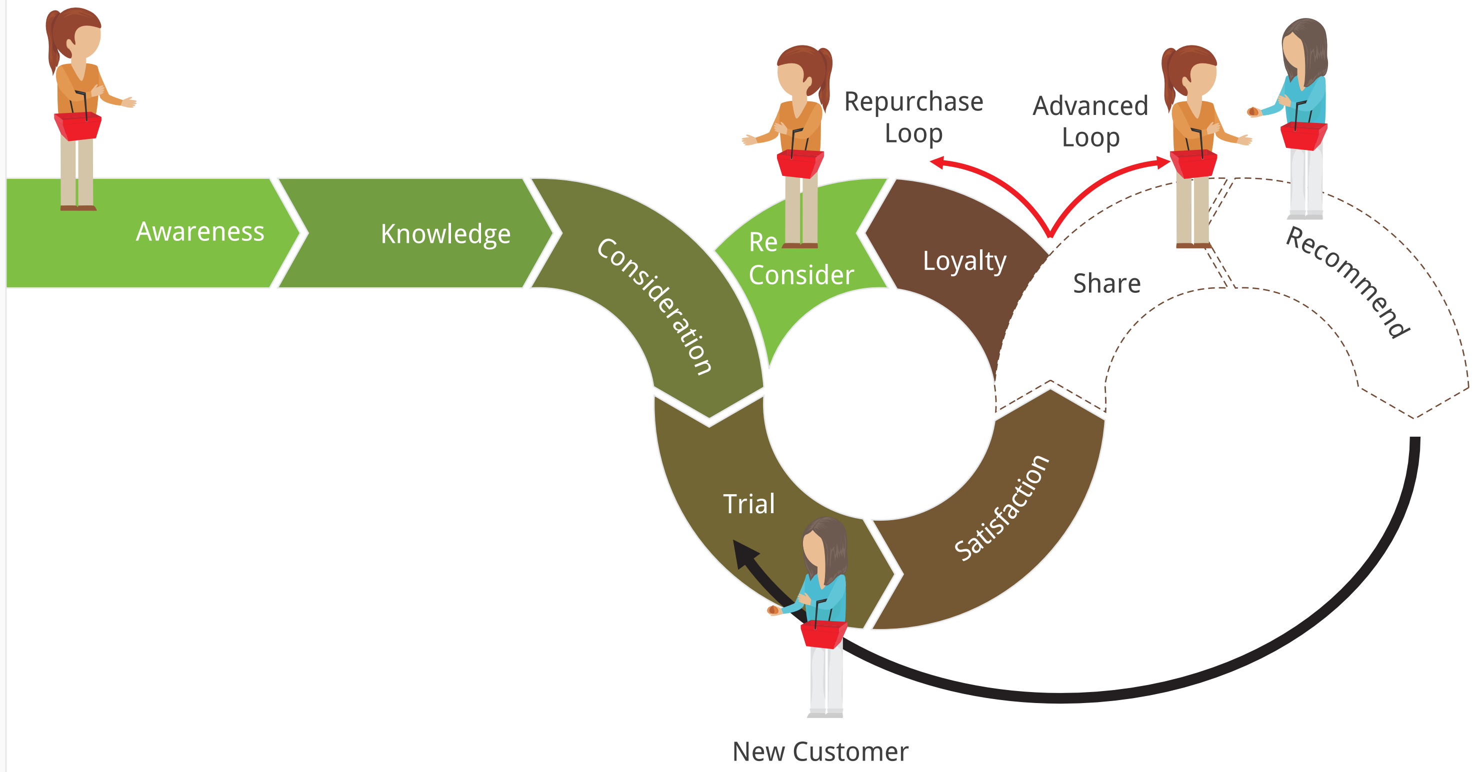
Today, programs just can't compete based on direct value payout or functional features and functionalities alone, as these are highly replicable. It has to create experiential differentiators which would work as a perceptual exit barrier for customers. It should make customers immune to either some tactical play of competition or acceptable price increase by the firm.

To this effect, the first step is actually to agree on a whole set of economic and non economic activities which can be attributed to the loyalty program without much dispute. The second step is to create a robust measurement framework around these agreed activities.

For example, in a generic retail customer journey, loyalty program needs to define how it influences both repurchase and advocacy loop which is distinct from the standalone impact of the brand or its categories. A large middle based retail conglomerate that we worked with, had defined cross concept (brand) loyalty as an evidence of loyalty program effectiveness as opposed to a uni-concept (brand) loyalty.

Similarly, all programs need to articulate their reason for existence in the context of the retailer's strategic objectives and their competitive context.

Through extensive data analysis, both the brand and the program managers need to first agree on the baseline performance, and if the status quo continues, then decide on how a loyalty program brings incremental economic impact. Once decided, it should be the sole basis for performance nd the program should owe its existence to that cause.



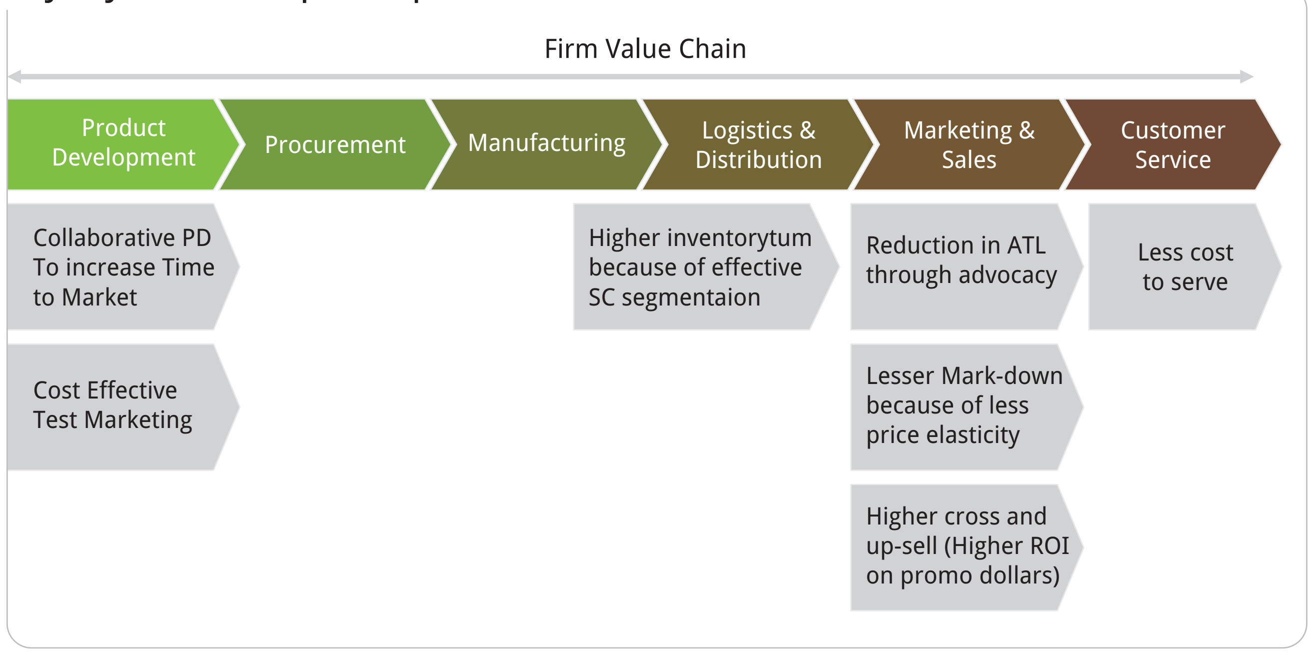
2. Goal congruence

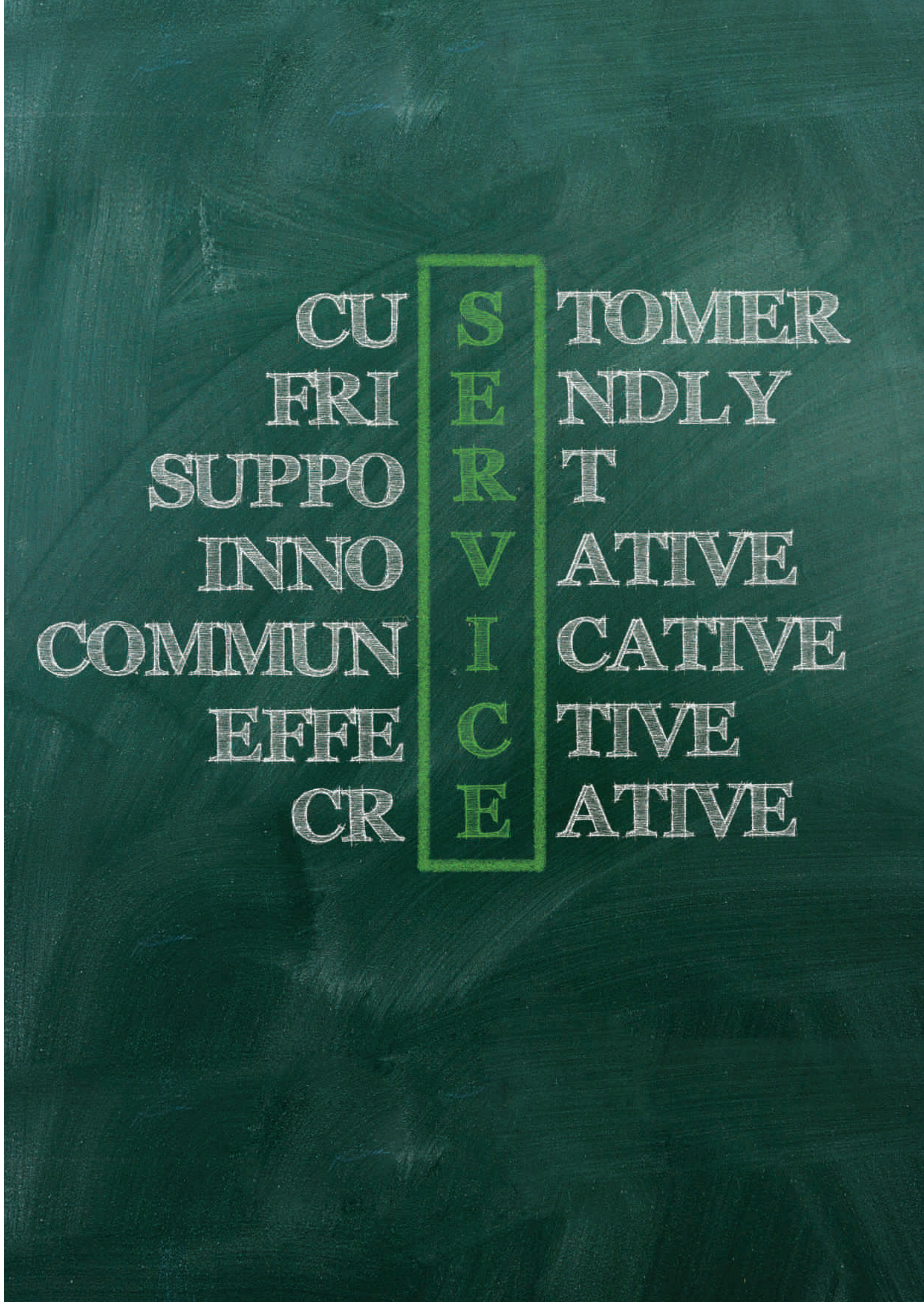
Once the program objectives are determined, it is quintessential to establish goal congruence between various internal actors through a robust performance management model. This is the key to foster collaborations within the organization. Cross functional KPIs need to be agreed upon between the program and the various functions.

It is good to start by identifying how loyalty can potentially impact the whole retail value chain, after base-lining the performance. While the impact of loyalty is usually felt on the down-stream part of the value chain, programs often struggle to establish its impact on the up-stream part. The program needs to share relevant KPI s with Merchandising – Gross Margin return on inventory investment , Marketing – ATL spend , Campaign revenue lift Supply Chain - Inventory turn, Finance – Income from current assets (depending on the structure) and Customer service (cost to serve) etc., based on its agreed impact on the value chain.

While the formulae of these metrics might seem to be quite straight forward, it requires concerted cross functional effort to decompose each of these metrics into their base constituents and agreeing on how loyalty program would impact some or all of them. The art of goal congruence lies in that detailing. A superficial measurement framework without these nuances is just a recipe for failure.

Loyalty benefit super-imposed on a firm value chain





Execution related issues

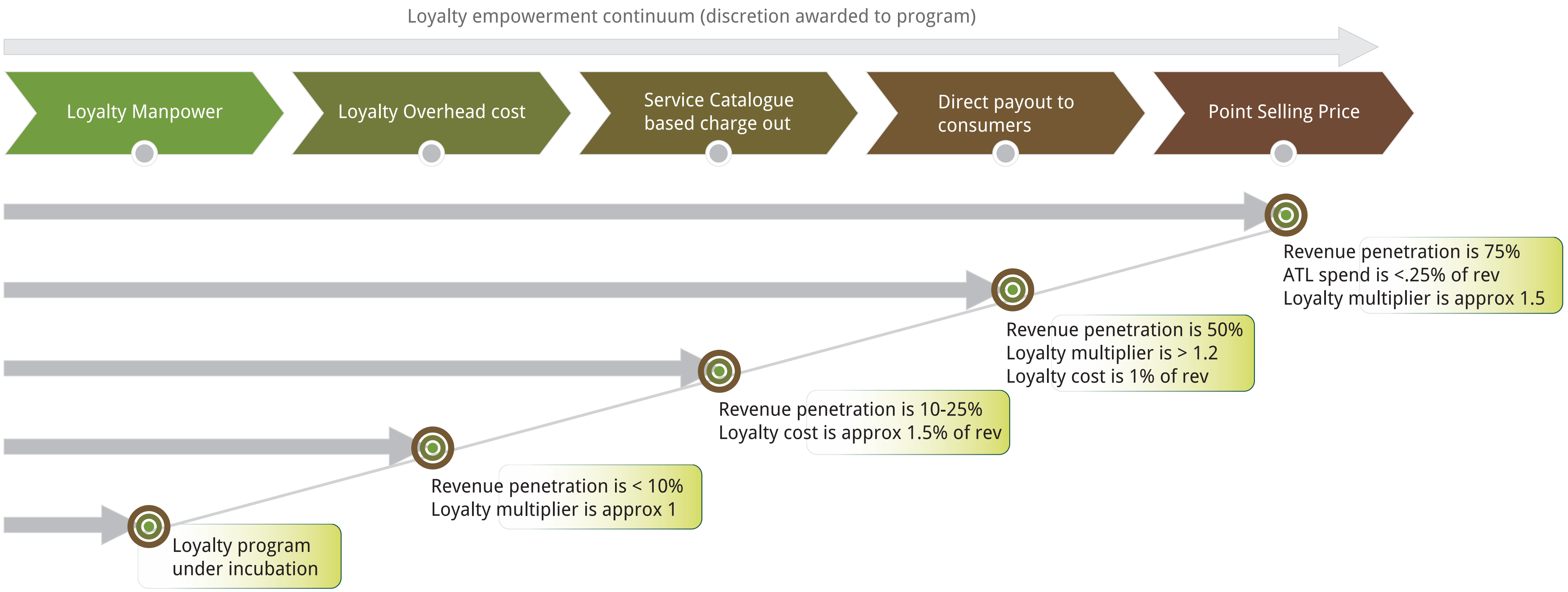
Control System

Mostly, retail loyalty programs are configured either as an independent cost centre or as a part of larger shared services. They usually do not enjoy the structural empowerment to decide their own budgets. Even the direct payout to the consumers is decided primarily by the brands, where program managers have very little to no say at all. While some retailers did experiment with some innovative structures like placing the entity at an arm's length and establishing transfer pricing relationship with the brands, none saw much success. Instead they ended up alienating the categories. Our experience tells that a premature separation of the loyalty program, just to empower the unit, is the not the way to go.

Management empowerment of the loyalty function should be progressively done based on the ability of the program to achieve certain performance thresholds for a given maturity. While an absolute lack of empowerment may deem the program ineffective, disproportionate and untimely empowerment may end up dividing the organization.

The balancing act is in drawing the control boundary, in a manner that awards the program enough discretion, to execute its agenda, without alienating the brands or the categories. The boundary needs to shift outward as the program matures and the value creation through loyalty program becomes increasingly less disputable.

Control maturity framework



Accounting Framework

Retailers all over the world tend to treat points as cost upon issuance. However, this cost is often recognized as marketing cost and is expensed below Gross Margin; making redemption or breakage as a mere recovery of that cost. During one of our consulting engagements, one leading Middle East based retailer expressed its growing frustration over lengthening point life-cycle, which actually made its cost recovery delayed. The problem tends to worsen, especially in the case of retail conglomerate, where many retail brands participate to form a mini coalition within the same program. Typically the brands which experience higher accrual than redemption are the ones who clamour the most.

In our experience, most loyalty programs have failed miserably to demonstrate the loyalty effect on the accrual side of the equation to pacify the brands. Brands continue to take a transactional look at the program and think of loyalty as “necessary evil”.

Some advanced programs like the Tesco Club Card, split loyalty cost into direct and in-direct components explicitly. While the direct component is deferred from revenue (and cognized as liability), indirect cost is treated as period cost in the P&L. In this scenario, cost is recognized only in the event of redemption. This brings more transparency in the equation and the brand’s propensity to collaborate with the program is usually much higher. However, we have seen some retailers vehemently opposing this framework, as it leads to their Gross Margin being underreported.

To sum it up, even though accounting framework influences the alignment between loyalty program and brand, the real loyalty effect for the brand is on the “accrual” side of the equation. Programs must expend effort to prove this point.

Success Imperatives

While strategic challenges tend to cast a long shadow over program's effectiveness, most programs' incapability to harness the power of analytics to prove their worth is also to be blamed. Most of the retailers we interacted with had concurred saying, they would not hesitate to allocate more management resources to the program; if it can prove that doing so has a value.

This is exactly where most of the programs fail. They fail at many levels – from target setting to measurement. Retail programs are plagued with lack of clarity and consensus.

While most retailers continue to struggle with excess operational challenges ranging from stock availability, excessive mark-downs, growing reverse logistics spend or vendor negotiation, loyalty comes far down in the pecking order.

Loyalty program should view all of these as their opportunities. If the program really wants to grow in prominence, it needs to share the responsibility of alleviating each of these issues with the various actors and leverage data to prove their contribution. Broader changes would fall in place, subsequently.

For more information, please write to: contact.us@itcinfotech.com | www.itcinfotech.com