

## Getting Retail Loyalty Right

In a retail environment, true customer loyalty is driven by selection, service, value and store layout – reward those who shop at your stores with a positive experience and they will return. However, the stakes for customer mind share have never been higher, as consumers are courted by increasingly aggressive retail competitors. In response, many retailers have pursued rewards programs designed to strengthen their relationships with otherwise fickle shoppers.

While these efforts have the potential to generate substantial benefits, L.E.K. Consulting research shows that too many rewards programs are poorly conceived – resulting in initiatives that don’t meet retailers’ goals and loyalty cards that are passively exploited by consumers.

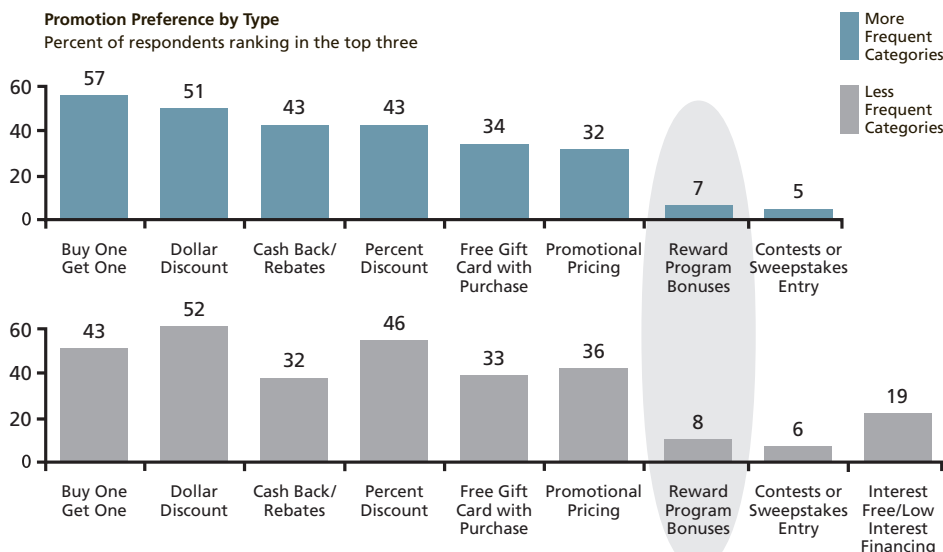
In an anemic economy, marketing resources are especially precious. Therefore, retailers must continually reevaluate the effectiveness of their rewards programs to determine if they are generating true value or simply becoming ill-defined cost centers. To address these issues, L.E.K. has outlined steps that retailers can take to determine whether their programs are creating effective customer engagements and fostering long-term relationships.

### Realize That Consumers Are Skeptical

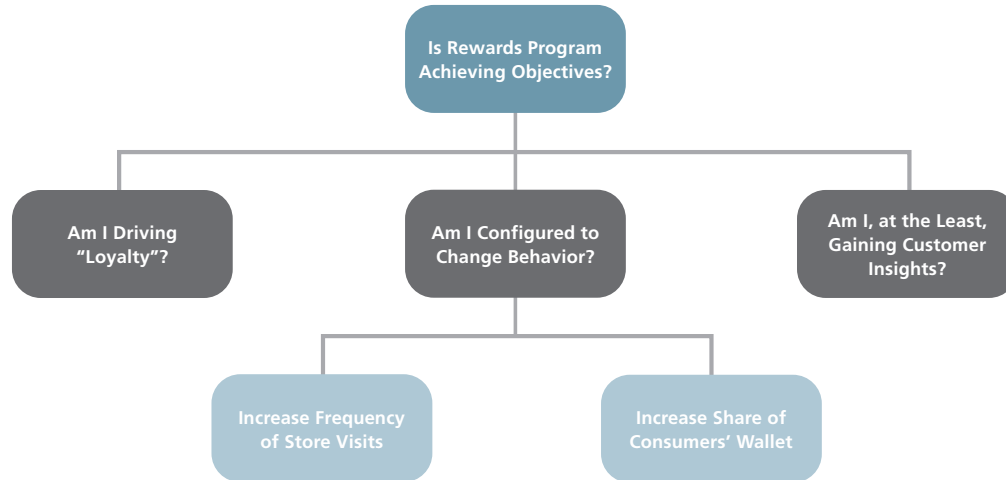
Overall, only a minority of retailers have cracked the loyalty code. Rather than supporting long-term brand affinity, many programs are essentially functioning as lagged discount programs.

**Figure 1**

Customers Rank Rewards Low Among Promotional Preferences



Getting Retail Loyalty Right was written by **Dan McKone**, Vice President of L.E.K. Consulting. Please contact L.E.K. at [retail@lek.com](mailto:retail@lek.com) for additional information.

**Figure 2****Framework for Effective Customer Loyalty**

In a recent survey of 2,000 households<sup>1</sup>, L.E.K. found that when used in this way, basic accrual/redemption schemes are one of the least popular promotional vehicles for consumers (See Figure 1 on page 1). Our study featured a test that required consumers to choose between *economically equivalent* promotions. As our results clearly showed, consumers shied away from rewards programs, opting instead to select traditional (and in many cases more straightforward) incentives.

## Reexamine Your Loyalty Goals

Retailers must decide if they are willing to give the required focus and investment to their rewards programs. Specifically, retailers should ask themselves three key questions about their current programs to diagnose the effectiveness and importance of their customer loyalty initiatives (Figure 2):

1. Am I strengthening customer loyalty?
2. Am I driving changes in customer behavior?
3. Am I gaining valuable customer insights?

While retailers don't need to answer "yes" to each question to have an effective rewards program, a successful program must pull at least one of these levers hard enough to justify itself (i.e., fund its own existence and earn a return). If not, the program requires a substantial rethink.

<sup>1</sup> Source: L.E.K. Consulting Consumer Sentiment Survey, September 2009  
<sup>2</sup> Household income >\$150,000 per annum.

### 1. Am I strengthening customer loyalty?

For this discussion, L.E.K. will define "loyalty" as a positive attitude toward a retailer, which ultimately drives customers to be more dependable. Strong affinity influences consumers to narrow their set of retail options within a given category, and perhaps even evangelize the retailer's virtues to others.

The key distinction is that while it is possible to "buy a transaction" through an effective discount, it is nearly impossible to "buy loyalty," which reinforces an ongoing relationship. As such, if a rewards program's objective is truly to drive loyalty, it must enhance the elements of the retailer's proposition that would motivate this customer's "goodwill" naturally. It should nudge shoppers to commit more dollars during an extended period than they would if the rewards program was not in place and, ideally, encourage in-category monogamy.

Most rewards programs, however, fail at this objective – and consumers appear as promiscuous as ever. Our recent survey showed that the average shopper retains cards in seven different retail programs. Interestingly, the most affluent 10% of households<sup>2</sup>, who drive substantial U.S. buying activity, hold nearly 20 cards each.

Members continue to collect points passively, but do not appear to greatly value the programs themselves. In our survey, nearly 70% of consumers who belonged to a specialty apparel program did not rate the retailer behind the program as their category favorite. Looked at another way, half of respondents

who cited having a “favorite” specialty apparel rewards program also claimed to be members of other comparable specialty apparel programs. So the intangible objective of “driving loyalty,” as defined, is quite elusive.

Executives appear to be aware of the challenges of cutting through all this noise – a survey of 600 marketers<sup>3</sup> reported that only 15% thought their programs were highly effective at leveraging member loyalty/brand preference.

## 2. Am I driving changes in customer behavior?

Beyond “loyalty,” the more direct objective of all rewards programs should encourage the customer to increase store spending. There are two primary ways to do this:

1. Motivate customers to make more trips
2. Entice customers to spend more once they are at your store

L.E.K.’s study found that 70% of consumers said they would spend more with retailers if the rewards associated with their programs were more achievable. Starbucks, for example, encourages customers to become vested through a very low threshold of five trips, after which benefits accrue with each subsequent visit (e.g., free “extras”). Additionally, some graduation in the program motivates consumers to achieve “gold” status where additional benefits kick in. This tiered structure demonstrates tangible benefits in every purchase while encouraging customers to reduce their purchases at alternatives.

In many categories, however, share of wallet is a very hard lever to pull through a rewards program. In specialty apparel, for example, the typical customer simply enjoys making purchases across multiple stores and channels – and many purchases are purely discretionary. In the case of a category like this where the customer is less inclined to “sole-source” with a particular store, a program should remain laser-focused on giving consumers compelling reasons to visit the store. There are some good examples of retailers that focus on trip frequency (e.g., DSW Shoe Warehouse’s double points days and Victoria’s Secret’s invitation-only VIP member events). However, most programs are ill-calibrated to achieve this objective.

## 3. Am I gaining valuable customer insights?

Rewards programs have the potential to generate copious amounts of data that can be invaluable to retailers. Even rewards programs that are doing little to indirectly generate loyalty or directly change behavior can still generate sufficient customer insight to justify the investment.

Unfortunately, few retailers convert this data into actionable findings that enable tangible business decision making. Recent studies have shown that while nearly 75% of rewards programs collect basic data on customer demographics, fewer than one-third track member product preferences, satisfaction or loyalty in a meaningful way. We have often found that retailers aspire to use their data more creatively but do not know exactly where to begin. Other times, the retailer has a hypothesis about how the data can be used effectively, but has insufficient evidence to justify the resources required to get there.

There are many examples of how retailers can get the most out of the treasure trove of data that is generated by their rewards programs. Some best practice examples include:

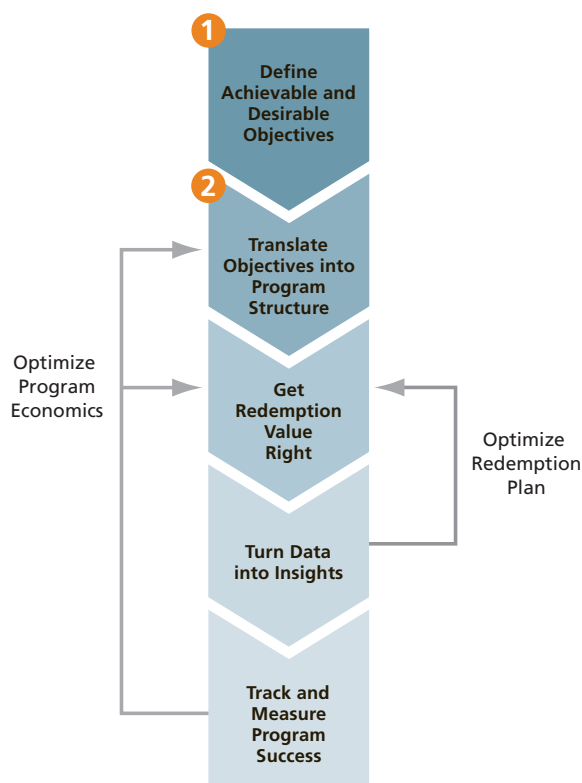
- **Personalized Micro-Marketing:** Targeted member promotions can be an effective tool if they are customized. Some retailers (e.g., CVS/pharmacy) have increasingly provided discounts based on shopping patterns. Intuitively, retailers can use this approach to market higher-margin items or increase promotional yield through predictive algorithms.
- **Richer Customer Segmentation:** Retailers typically have multiple areas from which they can draw insight (e.g., ticket analysis from the register, data from credit card partners, primary research from occasional surveys, etc.). It’s rare, however, to have simultaneous visibility into the three key customer dimensions: profiles, preferences and behaviors. Many companies outside the retail market (e.g., Harrah’s) have been tremendously successful at using the rewards currency to entice customers to help them build a better marketing engine. Retailers need to devise their own programs to show customers that if they “share more” they reap higher rewards.

- **E-commerce Sales Driver:** One of the best uses of retailer rewards programs is to provide the mechanism to encourage better insight on multichannel behavior and, in turn, enable a more holistic customer relationship management (CRM) strategy. Starwood and other travel industry companies successfully use targeted emails and carefully crafted promotional points offers to:

1. Generate business
2. Up sell customers through higher-margin online channels

- **Communication & Community Development:** Program-based outreach can foster a community among shoppers. The secret is identifying the lifestyle elements your shoppers cleave to, embedding these elements within your offers, and then rewarding customers for engaging (as a reinforcement mechanism). In their most advanced form, rewards programs help create an ongoing online pool of users that can be tapped for primary research or as a source of brand proponents in viral and guerilla campaigns.

**Figure 3**  
Key Steps in Getting Loyalty Right



## Audit Your Rewards Program

If the answer to all three key rewards questions is “no” (or, perhaps, “not really”), then your rewards program is, at best, an inefficient use of promotion dollars or, at worst, a pure cost-center. When a retailer finds itself in this situation, there are generally two options:

### 1. Rethink and Improve the Rewards Program:

It often helps to revisit the program’s foundation and clarify overarching program goals (Figure 3). Consider:

- If the rewards program’s aim is to increase loyalty, then emphasize perks, special member events, VIP tiers and other mechanisms that enhance the store’s own proposition and make customers feel special in that context.
- If the program objective is behavioral change, such as increasing store visits, then blunt instruments will not do. The program must refocus on motivating specific target behaviors and then carefully measuring responses.
- Alternatively, if the program goal is to derive customer insights, the investment and focus should be on maximizing card uptake, motivating members to “share more” about themselves, and providing the resources required to analyze and drive business change from the data.

After establishing a crystal-clear set of objectives, retailers must structure all program elements to align with this blueprint. In the end, the retailer will also need to establish systems to measure the rewards program’s return on investment (ROI) during longer time periods.

### 2. Minimize (or End) the Rewards Program:

If your customer rewards program has effectively become just another promotional vehicle, it is probably an ineffective use of your marketing budget. Rather than continue to invest in the program, it may make more sense for retailers to reevaluate which initiatives have the greatest potential to drive customer interest – products, service and store layout/online presence. Instead of continuing ineffective rewards programs, retailers can continue to capture customer data effectively through surveys and other means, and nudges to behavior may be better driven through more direct promotional tools.

The decision to discontinue a rewards program must not be undertaken lightly, and it must undergo a careful formal evaluation that measures trade-offs quantitatively. However, it may very well be the right question to ask.

## Conclusion

While many retailers have been investing in rewards programs to enhance short-term sales and build long-term relationships, many of these programs are not resonating sufficiently with consumers. Consumers that participate in rewards programs often do so indiscriminately. When programs fail to generate true loyalty, motivate real changes in behavior or reveal action-

able insights, they effectively become weak promotional tools. L.E.K.'s proprietary research (the L.E.K. Consumer Sentiment Survey) and client experience reveals that customer rewards programs rank near the bottom of all promotional types when they are used in this way. Many rewards programs fail because they are either ill-defined or are unrealistically tasked to achieve too many goals. Effective rewards programs focus on clear, repeatable messages, as it is difficult to address all three potential objectives equally well. L.E.K. recommends that retailers carefully consider how their rewards programs are configured, reexamine program goals and calibrate revised goals against measured results.

L.E.K. Consulting is a global management consulting firm that uses deep industry expertise and analytical rigor to help clients solve their most critical business problems. Founded more than 25 years ago, L.E.K. employs more than 900 professionals in 20 offices across Europe, the Americas and Asia-Pacific. L.E.K. advises and supports global companies that are leaders in their industries – including the largest private and public sector organizations, private equity firms and emerging entrepreneurial businesses. L.E.K. helps business leaders consistently make better decisions, deliver improved business performance and create greater shareholder returns. For more information, go to [www.lek.com](http://www.lek.com).

### For further information contact:

#### Boston

28 State Street  
16th Floor  
Boston, MA 02109  
Telephone: 617.951.9500  
Facsimile: 617.951.9392

#### Chicago

One North Wacker Drive  
39th Floor  
Chicago, IL 60606  
Telephone: 312.913.6400  
Facsimile: 312.782.4583

#### Los Angeles

1100 Glendon Avenue  
21st Floor  
Los Angeles, CA 90024  
Telephone: 310.209.9800  
Facsimile: 310.209.9125

#### New York

650 Fifth Avenue  
25th Floor  
New York, NY 10019  
Telephone: 212.582.2499  
Facsimile: 212.582.8505

#### San Francisco

100 Pine Street  
Suite 2000  
San Francisco, CA 94111  
Telephone: 415.676.5500  
Facsimile: 415.627.9071

### International Offices:

*Auckland*  
*Bangkok*  
*Beijing*  
*London*  
*Melbourne*  
*Milan*  
*Mumbai*  
*Munich*  
*New Delhi*  
*Paris*  
*Shanghai*  
*Singapore*  
*Sydney*  
*Tokyo*  
*Wroclaw*