The future of retail loyalty schemes

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The Future of Retail Loyalty Schemes

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ABSTRACT

Loyalty schemes are popular in retailing but there is uncertainty about their real effects. Two forms of loyalty could be affected by such schemes: retention and share of category spending. We examine evidence on the consumer acceptance of loyalty schemes and their effects. The future development of loyalty schemes is limited by their cost, doubts about customer response to such schemes, the information that can be extracted from card data and uncertainties about the targets to select when using such information.

INTRODUCTION

Marketing, no less than other fields, exhibits surges of enthusiasm for particular practices. In past years, marketing fashions have included positioning, integrated marketing communications, consumer satisfaction, quality, loyalty and, most recently, efficient consumer response. Loyalty programmes are the subjects of international surveys, newsletters and *Financial Times* reports. Claims are made that grocery retailing may be revolutionised by the use of data from loyalty schemes and that proprietary methods are available for detecting potential converts to a brand[1]. Are loyalty schemes going to become an enduring feature of the marketing landscape or are they about to be consigned to the scrap heap of marketing fads that have passed their *use by* date? Our best judgement of the future is derived from current knowledge but there is little hard evidence on loyalty schemes; their use is sustained mainly by management beliefs in their potential. This may change as we get more accurate answers to a number of questions:

- *What could loyalty schemes achieve?*
- *Do consumers like them?*
- *What have loyalty schemes been found to achieve?*

We address these questions below but we begin by considering loyalty itself.

CONSUMER LOYALTY

Marketers have borrowed the term *loyalty* from the language of human relationships; here disloyalty can be shown in more than one way. In marital relationships, people are disloyal to their partners either by sundering the relationship (desertion) or by engaging in additional relationships (infidelity). Consumers show parallels to these disloyalties. They may desert (or *defect* from) brands or suppliers; here the inverse loyal behaviour is called *retention*. And they may buy more than one brand in a category and hence be less exclusive in the *share* of their purchasing that they allocate to any one brand. Such multiple brand buying is well accepted in many markets (and polygamy is probably a more appropriate metaphor than infidelity).

Loyalty as retention

In the United States, Reichheld has explored the impact on profits of customer retention in industrial and financial service markets[2]. He claims that it is much cheaper to retain existing customers than to convert new customers to the brand. Existing customers spend more, recruit additional buyers, cost less to service, and accept higher prices. To retain customers, Reichheld advises management to sift their defection data, find out why customers have left, and then fix the product so that it is more attractive to customers and, as a result, they lapse less. Typically, firms lose and gain about 15-20 per cent of their customers each year so that a reduction in defection means that unchanged recruitment will enlarge the customer base. Customers differ in value to a firm and, in some cases, it may be expedient to discourage the light-spenders who reduce profit. Central to Reichheld's philosophy is a concern with improvement in the product so that it meets the needs of profit-making customers; he is not an exponent of 'bolt-on' loyalty schemes. He argues that it is important to retain company staff and investors, as well as customers, because these different forms of retention are mutually reinforcing.

Reichheld has established retention as an important aspect of loyalty but some of his claims may be disputed. In retailing, the set-up costs for new customers are limited to such matters as enrolment in loyalty schemes and sometimes credit arrangements, so customer acquisition is not expensive. Reichheld implies that increases in retention flow naturally from product improvement and points to the benefits from a five-percentage point reduction in defection from fifteen per cent to ten per cent. This 33 per cent change is difficult to achieve when many defections arise, not from dissatisfaction with the product, but from customer constraints that the supplier cannot affect, e.g. the inaccessibility of a store after the customer has moved home[3]. In these circumstances, additional *recruitment* may be easier to achieve than reduced defection.

Loyalty as share

Research on loyalty as share of category spend has emerged in industries where customers spread their purchases across a portfolio of brands or service providers in the category[4], e.g. groceries, stores, restaurants, airlines and hotels. If we focus on supermarkets, the loyalty of customers may be shown by a number of measures: a *share of category requirement (SCR)* in respect of Store X is the percentage of all their supermarket spending that Store X customers allocate to Store X; *first-store loyalty* in respect of Store X is the average SCR among customers who make this store their primary supplier in the retail category. We can also compare high and low first-store loyalty customers, irrespective of their store preferences. Market research companies mainly report SCR but suppliers are also keenly interested in total receipts from a customer and these may be described as *share of purse/wallet*.

Many researchers would claim that attitude to the supplier (compared with alternative suppliers) is part of what we mean by loyalty[5]. Others have emphasised satisfaction, trust and dependence but this leads to cumbersome thinking. We accept that states of mind such as attitude and trust may be causes, or effects, of loyal behaviour but we prefer to restrict consumer loyalty to behaviour and, in this way, to focus on the activity that relates directly to profit, an important criterion for marketers[6].

Are retention and share loyalties linked?

Loyalty schemes should be concerned with increasing, or maintaining, both retention and share loyalty but are these two forms of loyalty linked? If one form of loyalty entails the other we may expect that a loyalty scheme which promotes share will increase retention, and *vice versa*. If this is so, a loyalty scheme is doubly beneficial but we cannot assume a link between the two forms of loyalty just because they are both described by the same term. Surprisingly, there is little direct research on this topic but our unpublished work on supermarket loyalty in Britain throws light on this issue[7]. There is an association: the higher the first-store loyalty, the less likely it is that a shopper will switch from that first store. But it appears that the factors that pre-dispose high first-store loyalty are often different from those that raise retention. For example, older supermarket shoppers show more retention and less first-store loyalty than younger shoppers, particularly among the wealthier segments of the population. This means that specific interventions that promote one type of loyalty need not affect the other type. It follows that retention and share loyalty are different objectives and those running a loyalty scheme may need to decide upon which to focus.

WHAT COULD LOYALTY SCHEMES ACHIEVE?

Loyalty schemes can take many forms. They may emphasise product improvement for valued customers or simple financial incentives for all customers. Examples of the former are the C. & J. Clark programme for meeting the footwear needs of toddlers[8], sale previews to account holders in certain stores and the advantages secured by higher tier members of the BA Executive Club (seat upgrades, guarantees of boarding, and executive lounges). Simple incentives may be found in the DIY store schemes that focus on increasing the spending of heavier customers. In between these extremes we find supermarket loyalty schemes which apply to most of the store group's customer base.

The potential of a scheme is affected by its design. Schemes like Clark's, that focus on product improvement, may genuinely raise customer interest and make an investment in the firm's brand equity, raising retention as well as share. Simple incentive schemes are unlikely to have much effect on the way that the brand is valued and are more likely to operate like discounts; such schemes might raise share loyalty while they run but termination of the scheme could end this incentive effect[9].

Supermarket schemes appear to offer potential. The rewards may produce a general incentive effect that could raise both the retention and share loyalty of existing customers. Incentives can be targeted and based on the analysis of card-holder purchase data so that appropriate rewards are directed to specific customer segments. In addition to raising retention and share, the databases generated by schemes may be used to detect and recover lost customers, and may also serve to recruit new customers. The database may also assist in the development of new product fields such as financial services.

Scheme costs

The justification for loyalty schemes is found in their impact on the profit trend but this is difficult to forecast. Nonetheless, loyalty schemes should be costed, by customer segment, against realistic estimates, and those who are already running schemes may need to reappraise them in the same way[10,11]. Some aspects of cost are fairly clear; the one per cent incentive paid by British supermarkets has to come from extra sales and a margin which has reached eight per cent in Britain but is much more slender among continental store groups. In addition, there are costs of data analysis and management time spent using the information from the analyses; in total these costs are substantial[12]. There may be some escalation in the rewards offered by loyalty schemes that will tend to raise costs further[13]. Faced with these bills, suppliers should consider enhancing their product and trimming their costs as alternatives to a loyalty scheme. In the United States, the adoption by Walmart of everyday low prices has proved very effective and Asda's low-price positioning has worked well in the UK. The tide is running strongly for the several components of efficient consumer response (ECR) which, when implemented, reduce costs for both the supplier and the consumer[14]. Those who do not adopt the rigours of ECR may find themselves squeezed on price by those who do.

Other doubts

In these circumstances, it is not surprising that some academic commentators have taken a critical view of loyalty schemes[15]. Grahame Dowling and Mark Uncles have argued that patterns of consumer behaviour show a constancy that is hard to change. Since, in many product categories, consumers continue to buy a portfolio of brands, they can be loyal to a number of brands at the same time. In other cases, what looks like single-brand loyalty is the result of a situational constraint (their proximity to the store, for instance). When a scheme is successful, the gains may be short-lived as competitors copy the key elements of the scheme. Dowling and Uncles argue that schemes should focus on enhancing the core benefit that customers attach to the product, by raising brand value and by making repeat purchase more attractive. They also recognise that there will be specific market conditions that will favour (or not) the development of particular types of loyalty programme.

Dowling and Uncles do not evaluate specific schemes in detail but draw conclusions from known patterns of purchase behaviour. They suggest that the function of loyalty schemes, where there is one, is likely to be defensive, i.e. designed to hold onto a market, rather than to enlarge it. Market increase, when it is observed, tends to come from the growth in the supporting distribution structure, and management time might be better spent on this, rather than on loyalty schemes.

We are broadly sympathetic to these views but detailed analysis of loyalty schemes in particular contexts may reveal effects that are not easily inferred from general findings on consumer behaviour. To our knowledge there have been only two detailed evaluations of schemes which are reviewed after the next section.

DO CONSUMERS LIKE LOYALTY SCHEMES?

There is a possibility that consumers will become bored with schemes and that 'loyalty fatigue' will become endemic. Widespread apathy could lead to resistance to enrolment in schemes, less enthusiasm for the use of cards and more interest in alternative benefits such as discounts.

To investigate loyalty fatigue, a study was conducted in Stroud, Gloucestershire, in January, 1998. Stroud was chosen because it offers a wide choice of store groups, including Waitrose that does not have a loyalty scheme[16].

In our analysis we focus on Waitrose and the two leading grocery groups, Tesco and Sainsbury. Looking first at the attitude to supermarket loyalty schemes in general, Table 1 shows that such schemes were well liked; even shoppers who made Waitrose their primary store were more positive than negative about loyalty schemes.

Table 1. Stroud Shoppers' Attitude to Supermarket Loyalty Schemes by their Primary Store

	Shoppers who usually shop at:				
Attitude to scheme	*Tesco %*	*Sainsbury %*	*Waitrose %*	*Other %*	***Mean %***
Like	86	91	41	80	**78**
Dislike	4	4	27	20	**10**
No preference	10	5	32	0	**12**
No. respondents (total 201)	77	57	37	30	

Fifty per cent of respondents saw no inconvenience about loyalty cards; among the remaining fifty per cent the most common problem was having to carry the cards. Another question asked shoppers whether they would prefer discounts of the same value as the loyalty benefits. Fifty-six per cent favoured discounts but this is hardly a rejection of loyalty schemes since it means that nearly half the respondents preferred to present cards and use vouchers, rather than avoid this trouble with a discount.

The fact that the cards were liked does not mean that they were influential in maintaining loyalty. Respondents were asked where their last main shopping trip took place. Ninety-seven per cent of Waitrose shoppers last shopped at Waitrose (despite the absence of a loyalty scheme); this contrasts with an average of less than 80 per cent for all the rest. Nine out of ten Tesco and Sainsbury shoppers held the card for their main store group but many also held cards for other groups, for example 59 per cent of Sainsbury card holders also possessed a Tesco card. This pattern, familiar in airline loyalty schemes[17], suggests that customers *join the schemes of the* *stores that they use rather than use the stores whose schemes they have joined*. Where this occurs the net effect of the scheme is likely to be, at best, defensive.

WHAT HAVE LOYALTY SCHEMES BEEN FOUND TO ACHIEVE?

Two studies throw light on the effectiveness of loyalty programmes. In Australia, Byron and Anne Sharp have examined the impact of the Fly Buys scheme (similar to the Air Miles scheme in the UK). In the UK, Robert East and Annik Hogg have reviewed the effects of the introduction of the national loyalty scheme by Tesco[18].

Fly Buys

In Australia, the Fly Buys scheme was very popular; it covered 20 per cent of Australian retail spending and, less than eighteen months after it was launched, one Australian in four was enrolled. A feature of *Air Miles* and *Fly Buys* schemes is that consumers can gather points towards air flights by making purchases with specific suppliers in different retail sectors. Usually, only one supplier (who may have more than one brand/outlet) is permitted in each retail sector. In the *Fly Buys* study it was anticipated that the scheme would raise the spending, in participating firms, of consumers who had joined the scheme. This effect was assessed by measuring the mean purchase frequency achieved by these firms which was compared with Dirichlet norms derived using the penetrations of firms[19]. (The penetration is the percentage of the population buying the product in a period). This study took place shortly after the scheme had been launched and the researchers expected to see a relative increase in purchase frequency (which acts as a share-loyalty measure). Of the six firms in the scheme, five showed deviations in this direction; of the nine firms not in the scheme, three showed deviations in this direction. The overall effect supported the researchers' expectations, but was marginal, and the authors concluded that the impact of the programme on share loyalty was disappointingly small.

The *Fly Buys* scheme could have had a general incentive effect, raising both penetration and purchase frequency in line with Dirichlet norms. The authors checked on sales before and after the introduction of *Fly Buys* and found no evidence to support this. Thus, in this case, it appears that consumers took advantage of *Fly Buys* if they bought the product, rather than switched to the product to gain *Fly Buys*.

Tesco

The Tesco study was an analysis of how Tesco overtook its rival, Sainsbury, shortly after launching the first national loyalty scheme in the British grocery market in February, 1995. A review of company data showed that much of Tesco's advance over a two-year period (March, 1994 to March, 1996) came from a programme of sales-area expansion that was much greater than that of Sainsbury. However, part of the jump in sales was attributable to the loyalty scheme, together with improvements in the goods and service offered by Tesco. The Tesco loyalty scheme benefited from first-mover advantage and, with quarterly vouchers and communications with members, it was well designed to get lapsing customers back into the store. Assisting the store group's increase in market share were the quality of its goods, improvements in service, fairly low prices and the introduction of a range of 'value' brands to entice the discount purchaser[20].

The main thrust of Tesco's loyalty effort appeared to be directed to raising customer share loyalty rather than retention but the main outcome was an increase in customers, which arose from both greater recruitment and more retention. In fact, Tesco's expansion showed the normal pattern when gains take place. Table 2 shows that, in 1996, Tesco had much the same market share and SCR that Sainsbury had in 1994 without the benefit of a loyalty scheme. There is no evidence here that the scheme produced an 'excess share loyalty' in 1996 above the norm for the market share. The changes from 1994 to 1996 are consistent with evidence on aggregate customer behaviour where, in general, little movement in share-loyalty is found. This research on market-share gains indicates that these normally arise from a small movement in share-loyalty measures such as purchase frequency or SCR, and a relatively larger change in the number of buyers. This ubiquitous phenomenon fits the Law of Double Jeopardy, part of the Dirichlet formulation[21]. Table 2 also shows that, in 1997, when all store groups in Table 2 except Asda were running national loyalty schemes, the pattern of SCRs was broadly set by market share. (In Table 2, data for 1995 are not shown because these were gathered over the period when the loyalty scheme was launched).

Table 2. Supermarket groups' market share (MS) and share of category requirements (SCR) in 1994, 1996 and 1997

	1994		*1996*		*1997*	
Store	*MS*	*SCR*	*MS*	*SCR*	*MS*	*SCR*
Tesco	17.7	44.3	20.9	46.2	22.0	48.1
Sainsbury	20.2	46.4	19.0	44.5	19.6	47.5
Asda	11.1	41.5	12.1	41.9	13.2	43.8
Safeway	8.6	33.6	9.5	34.9	10.0	36.3
Gateway, Somerfield	7.0	30.5	5.7	29.1	5.1	28.4

Sources: Taylor Nelson AGB 1995, 1996, 1997 [22]

This evidence bears on a key issue that is likely to affect strongly the future of loyalty schemes. Can the card data showing a customer's pattern of spending be used to gain further sales from that customer? The data captured on past spending can be used to select rewards that may draw customers into categories that they do not usually purchase in the supermarket, and customers can be told about new products that fit their normal repertoires. The data may also be used to detect defecting customers so that inducements can be used to retain them. In addition to this, rewards in the loyalty scheme can be related to spending so that heavy spenders are given more encouragement to stay, and the light spending 'cherry pickers' are ignored.

In its first year of operation, Tesco relied mostly on the incentive aspect of the loyalty scheme, but then made more use of the sales data to target benefits with the objective of steering customers into new areas of consumption. Tesco may achieve gains by using these techniques but, on the evidence available, there has been little impact on the share loyalty of individual customers so far.

One problem for those using card data is that these are partial since they cover only the spending of cardholders in the operator's stores. The nature and frequency of this spending may indicate how much is spent in other store groups but this limitation of card data restricts one-to-one marketing which requires an accurate classification of customers. Also, the quantity of data from card schemes is massive and this can obscure the gains possible in specific segments. Those using such databases need a clear idea of what they are seeking.

CONCLUSION

Sainsbury archives show how, in the 1930s, their managers wrote to customers who had not made their usual shopping trip in an effort to maintain patronage. Later, many of us can remember *Green Shield* stamps which were well supported by consumers despite the need to paste them into many books. As Passingham[23] notes, loyalty schemes are not a new phenomenon.

Compared with the past, we now have a more varied selection of loyalty schemes and information processing now offers new ways of using data from customers. Consumers appear to like these schemes; there is little sign of loyalty fatigue but evidence that these schemes alter sales patterns is meagre. The multi-firm *Fly Buys* scheme and Tesco's loyalty programme did not display much share-loyalty effect. The Tesco scheme appears to have gained customers, probably through extra retention. Although we do not deny that the well-designed scheme appears to offer potential gains in the hands of the technologically adroit operator, there is little evidence, so far, that a loyalty database can be exploited to increase sales per customer. Lack of sales effect may arise from poor choice of marketing objectives and research may help if it can show where the greatest gains are likely to be made, whether from increases in share loyalty, retention or recruitment.

Against the potential gains from loyalty schemes must be set their costs. As we saw, these are large and spending on loyalty schemes runs counter to attempts to squeeze cost out of the supply chain. Loyalty schemes are just one part of a marketing mix and those who lack a clearly profitable use for the database that they generate may benefit more from an emphasis on other aspects of the mix.

We gratefully acknowledge data supplied by Taylor Nelson AGB.

Note
The 1998 till roll traffic from AGB is now available and shows the following figures:

Store group	Market share	Share of category requirement
Tesco	23.5	50.6
Sainsbury	20.2	50.2
Asda	13.8	47.1
Safeway	10.4	38.6
Somerfield	5.1	29.7
Somerfield/KwikSave	10.4	32.3

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[3] Here we draw on our unpublished work in Britain which is based on 551 respondents who responded to two mailed questionnaires. Half of the main reasons given for changing the primary supermarket were related to access, e.g. arising from a new store being built or a change of domicile.

[4] Many researchers see Cunningham as the forerunner of modern approaches to multibrand or portfolio buying. See: Cunningham, R.M. (1956) Brand loyalty - what, where, how much? *Harvard Business Review*, 34, Jan/Feb, 116-28. Also, Cunningham, R.M. (1961) Customer loyalty to store and brand, *Harvard Business Review*, 39, Nov/Dec, 127-37.

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[6] One review found little or no connection between retention and customer satisfaction. See Hennig-Thurau , T. and Klee, A. (1997) the impact of customer satisfaction and relationship quality on customer retention: a critical reassessment and model development, *Psychology and Marketing*, 14, 8, 737-64.

[7] This relates to the unpublished study cited in note 3. First-store loyalty to supermarkets was measured by claimed exclusiveness of store use, and retention was established by comparing the first stores named in each questionnaire. The second questionnaire was mailed 21 months after the first and over that period there was a 35% defection.

[8] Details of the Clarks Toddler Team programme were given in a presentation by Ted Hart at a *Workshop on Driving Loyalty*, 23rd April, 1997, Chartered Institute of Marketing.

[9] The effect of discounts is reviewed by East, R. (1997) *Consumer Behaviour: Advances and Applications in Marketing*, Prentice Hall. Generally, there is little carryover of effect after the discount has finished.

[10] The profitability of Tesco's operations is reported within the company by consumer segment (Clive Humby, *Workshop on Driving Loyalty*, 23rd April, 1997, Chartered Institute of Marketing).

[11] In the UK, two schemes have been abandoned: Esso's current *PriceWatch* campaign displaced a coupon-based incentive programme and Do It All ended their *BonusCard* scheme in 1998.

[12] Clive Humby, whose firm analyses data for Tesco, has reckoned an initial cost of 20% of profits, *Workshop on Driving Loyalty*, 23rd April, 1997, Chartered Institute of Marketing.

[13] In Britain, points on Boots' Advantage Card (launched in 1997) may be redeemed for products in the store at a rate of 4 per cent of the original spend; in 1998, Safeway announced increased loyalty returns for high spenders.

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