A step-by-step guide to

# Loyalty Programs

**Part 1:** Considerations, Concepts and Logic, Business Case

# Contents


## 1. Foreword 3

## 2. Getting started 4

2.1 Database 4
2.2 Incentivization & incentive systems 5

## 3. Concepts and Mechanics 7

3.1 Status-level concepts 7
3.1.1 Incentives 7
3.1.2 Ascent and descent logic 8
3.2 Earn-and-Burn Concepts 11
3.2.1 Incentives 11
3.2.2 Redeeming 12
3.3 Comparing the different concepts 12

## 4. Calculating the business case 13

4.1 Program Costs 13
4.2 Revenue 15
4.3 Measuring the impact (KPI's) 16

# 1. Foreword

**The mindset is shifting: more and more companies are putting the customer at the center of their actions. Reaching real customer centricity is a lengthy but rewarding process. Customer data forms the basis for customer centricity and a loyalty program helps to gather and keep the data updated.**

The decision to align all areas of a company with the customer is the first important step. The basis for customer centricity is not a technical solution, a marketing tool, a web shop or the adaptation of internal processes. Neither is it the choice of a service provider or consulting firm, nor the collection of internal knowledge or external experts. Rather, it is data which provides the basis for a deep understanding of the customers.

When it comes to customer centricity, market leaders benefit from the large amounts of personal, behavioral and transactional data they have collected about their customers over years and decades.

One of the greatest challenges any company faces is to continuously generate customer-related data and keep it up-to-date. This is where loyalty programs can play an important role in gaining better understanding of the needs and interests of customers. The basic idea of a loyalty program is ultimately to offer customers incentives to provide information about themselves in return for special benefits.

In this guide you can learn about different loyalty mechanisms and concepts along with their advantages and disadvantages, have some food for thought on the business case and system selection, and finally read recommendations on possible operating models. This guide primarily discusses loyalty programs in the B2C context; however, many of the topics highlighted are also relevant and applicable in the B2B environment.

# 2. Getting started

As with many other groundbreaking business decisions, a thorough analysis of the initial situation is recommended before diving into creating a loyalty program. In this chapter we want to lead you through some fundamental questions that help you with planning.

Companies that are just starting to become customer-centric usually encounter one of the following two initial situations: there is very little or no data available, or there is large amounts of data that cannot be used for a variety of reasons. These reasons often include:

- **Lack of appropriate marketing permissions (the customer has never given their consent to the use of their data for any purpose other than order fulfillment).**
- **The data is scattered in numerous silos.**
- **The quality of the data is inadequate (outdated or incorrect contact data, duplicates, etc...).**

Most of the time, it is a combination of all of these. Ultimately, these inevitably lead to one of the first considerations: is it worth the complex process of cleansing the data to make it usable, or is it better to start from scratch and build up a completely new database?

## 2.1 Database

The existence of a database often comes with a desire to use it. However, it should be considered whether the effort to make the data usable does not exceed the ultimate benefit. Ask yourself:

- **Where is the data stored? It is not uncommon for historical data to be spread across several silos and systems that were never intended as a CRM system or a data warehouse.**
- **Are there duplicates? This data is very likely to contain duplicates, which are extremely difficult to identify as, for example, the same person may appear with different spellings and addresses.**
- **How accurate is the data? Even if duplicate identification is possible, the question still remains as to which data record contains the correct information.**

Another problem that frequently occurs when using existing data is the lack of verifiable marketing permissions, or opt-ins. Basically, it is recommended to clarify early whether there is a legal basis for using this data for marketing purposes. In many companies this is not the case, if only because the data was originally collected and stored for completely different purposes. Data that cannot be used for marketing purposes without risk of legal complications is ultimately useless for a loyalty program.

Another aspect that should be taken into account is the subsequent organization of the program operation. It is important to consider which employees will later work with the data, and in which function. Based on this, it's worth checking whether and to what extent their existing employment contracts allow working with personal data. In some cases, separate companies are set up for this purpose and the people involved are given new employment contracts. By then, at the latest, old data in old systems can no longer be used by the new company. In any case, the early involvement of lawyers is strongly recommended.

## 2.2 Incentivization & incentive systems

A loyalty program in the B2C context is ultimately an agreement between a company and a private individual. The company promises advantages and in return receives information and consent to use it. Of course, the company hopes to make the customer more loyal in terms of purchase frequency and average shopping cart size. This is achieved through the advantages granted and the targeted use of the data obtained.

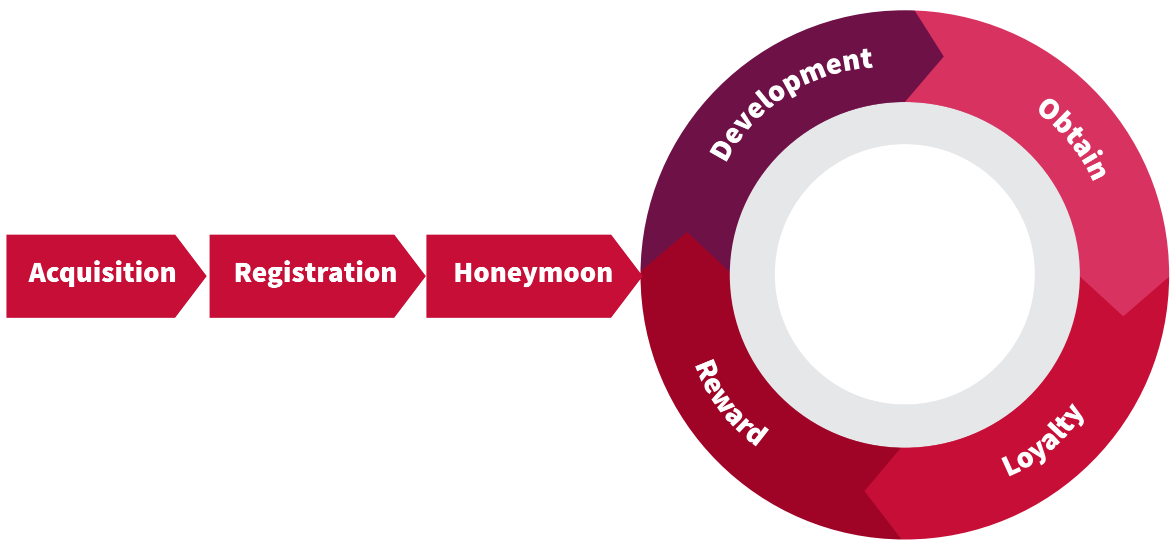


*Fig. 1: Exemplary loyalty journey*

Two central questions must be clarified:

- **Which incentives could your customers be interested in, and which system do we derive from them?**
- **What data do you want to collect and for what purpose?**

As we will explain in more detail in the following chapter, a fundamental distinction is made between two loyalty mechanisms with different incentive systems: status level concepts and earn-and-burn concepts.

Both concepts (or mechanisms) suggest certain incentive systems. If you would like to control the behavior of your customers primarily through the supply of physical incentives, such as cooking pot sets and the like, you will most likely opt for an earn-and-burn option. If you prefer to advertise discounts, advantages and additional services, a status level concept will be your choice. Hybrid models are also possible.

In both cases you need to answer two questions:

1. **How should the benefits be financed and offset?**
2. **Which incentives work better for your target group?**

The first question should be clarified very early in the creation of the business case. Not only is the financing concept important, but also the clarification of the subsequent processes. It is not uncommon for internal billing and charging between different company areas or with external service providers to be necessary. Even a virtual currency, whatever its name, ultimately incurs costs.

Thorough market research is recommended for the second question. No matter how convinced you are that you know your target group, even experienced marketing experts are often surprised by the results of a comprehensive survey. The preparation, conception and introduction of a loyalty program is a complex and often cost-intensive process. It is therefore strongly recommended to keep the risk of incorrect assessments as low as possible.

In some cases, however, the decision does not depend solely on the customer, but primarily on the company's situation and its products or services. More on this in the next chapter.

# 3. Concepts and mechanics

In this chapter you'll learn the two essential concepts — status level and earn-and-burn— and their advantages and disadvantages. In practice there are also mixed forms and variants. For example, some companies offer status levels that cannot be acquired through a certain behavior or certain activities, but are offered against payment. Some earn-and-burn concepts include two currencies, one of which can be redeemed for material assets, the other gives certain discounts.

## 3.1 Status level concepts

In this chapter you'll learn the two essential concepts — status level and earn-and-burn— and their advantages and disadvantages. In practice there are also mixed forms and variants. For example, some companies offer status levels that cannot be acquired through a certain behavior or certain activities, but are offered against payment. Some earn-and-burn concepts include two currencies, one of which can be redeemed for material assets, the other gives certain discounts.

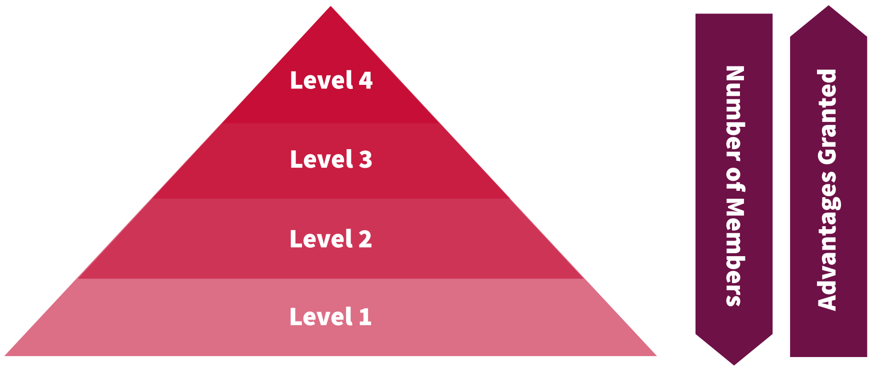


*Fig. 2: General idea of a status level program*

### 3.1.1 Incentives

As a rule, unlike earn-and-burn concepts, non-material benefits are granted here. Collected units of the currency cannot be redeemed for material assets, but lead to promotion to a higher level. A higher level entitles further discounts and benefits. These range from free delivery of goods to access to a premium hotline with shorter waiting times to extended exchange rights, to name just a few examples.

**Coupons**

Coupons also play an important role as an incentive. A coupon in a certain amount is issued for reaching a new level, which creates a direct incentive for further activity.

The particular attraction of status level concepts, in addition to the achievement of real advantages, lies very much in the intrinsic motivation of most people to consciously or unconsciously reach the next higher level. One should not underestimate how much people strive to stand out from the crowd and to belong to a supposedly better-off group. This perception is supported in addition to correspondingly valuable communication by the issue of a card as an additional status symbol. This can be done either in digital or physical form. Even if a physical card causes high costs in production, personalization and shipping, its effect should not be underestimated.

It is important to note that each additional level increases the complexity of the necessary calculations for probable members per level and thus for the probable program costs. The same applies to the number of benefits granted. For each benefit, it must ultimately be simulated how the costs change depending on the redemption rate and the number of eligible members.

## 3.1.2 Ascent and descent logic

It is very important to understand the impact of different ascent and descent logics. Here are the main points to consider.

### Logic complexity

The definition of the logic of promotion and relegation should not be underestimated in its complexity. First of all, it is important to consider which limits should apply to reaching the next level. If the level limits are set too low, too many members will be in higher levels in no time at all, which not only has a negative impact on their motivation but also has serious effects on the program costs.

The number of levels that can be reached offers various advantages and disadvantages. The greatest advantages of a high number of levels are:

- **It is easier to create long-term motivation among program members.**
- **The entire program costs can be better distributed over the levels depending on the value achieved by the members.**

For example, with a four-stage concept only those who bring the company the greatest value and thus refinance significant advantages are actually in the highest level. With a two-stage concept, on the other hand, it is more difficult to distinguish between B customers, A customers and AAA customers, which ultimately leads to a rather risky mixed calculation.

It is worth noting that many levels automatically lead to a significantly higher complexity of the entire program, which has an impact on calculation, communication, processes and much more.

## Considerations for status evel concepts

In general, status level concepts are usually better suited to establishing a lasting interaction with the customer that is not reduced to purchases. In contrast to a classic earn-and-burn concept, status level concepts usually do not only reward actions that lead directly to sales. However, if not for purchases, it is important to consider precisely what units of the defined currency should be used for.

For example, units of the currency can also be obtained if the customer evaluates purchased products online, completes their own profile or recruits other members. The number of units granted for non-transactional behavior should of course be designed in such a way that the weighting of the total currency points earned is clearly on transactions. It should not be possible for a member to level up solely through activity in the community without ever making a purchase.

In the following section we will go into more detail about when it is best to decide on a status level concept.

## Level membership

How do you want to define your assessment period, and do you want to use a rolling system or a set date range? Here are a few concrete examples:

If the level affiliation is to be continuously determined in a rolling system based on the currency units collected within 12 months, units don't have to expire. It only has to be checked how many currency units have been collected for each member in the last 365 days. The level membership is redefined accordingly. If a member had a high turnover 366 days ago and has not booked any turnover or other activities of a comparable amount since then, this member will not be classified at the same level again and will lose their status. A distinction must be made whether the logic allows a downgrade by several levels at the same time or  just one level at a time.

If, on the other hand, the logic checks the score for each member only once a year on a certain date, for example on January 1st or at the time of joining the program, the member can only lose their status at this point in time, even if the last large sale was more than a year ago. For example: On January 30th, a member makes a large turnover and moves up a level. On January 1st the following year, a check is made to see whether the required account balance is available to receive the level, which is the case this time. A year later it is checked again. If there is no new turnover of a comparable amount that year, the member loses their status, but had this status for 23 months.

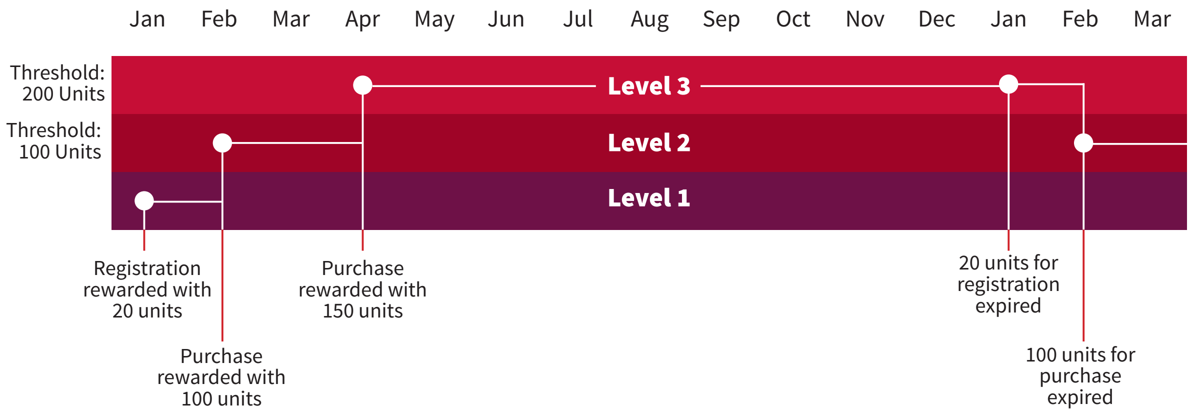


*Fig. 3: Level down mechanic without fixed check date (rotating system)*

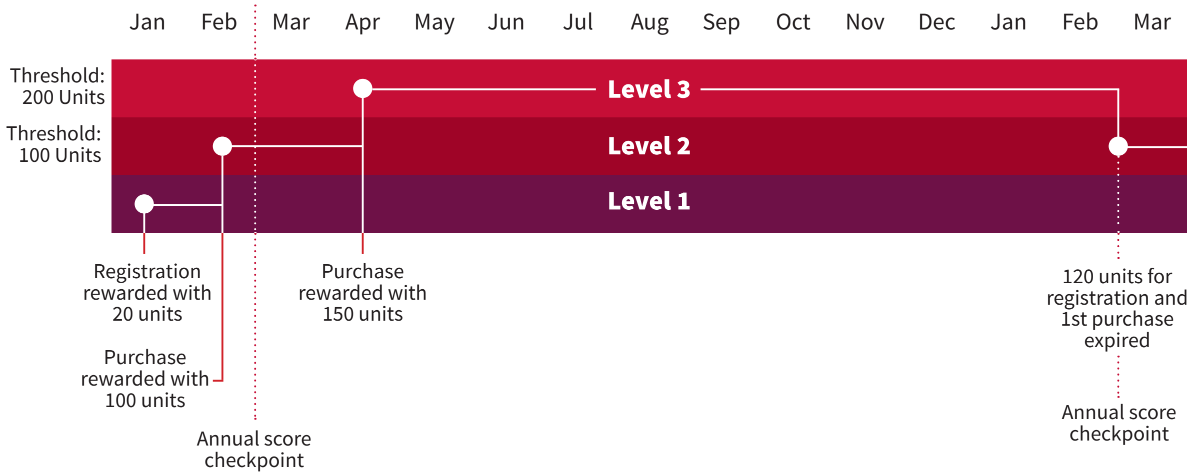


*Fig: 4: Level down mechanic with fixed check date*

It goes without saying that these two scenarios will have very different effects on the business case. The fact that this is usually easier to understand for the customer speaks in favor of the second scenario. If you want to work with physical cards, this can also make production and logistics easier.

Of course, similar considerations should also be made for level advancement. However, it is very unusual for a level-up to only take place on a certain deadline. This would probably also be perceived as not very customer-friendly. For example, if a customer makes a lot of sales, they are likely to expect an immediate reward in the form of a higher status.

It is also important to consider whether and when a member can lose his or her status completely. The eternal preservation of the status of an inactive member naturally contradicts the basic idea of generating loyal and active customers. On the other hand, there can also be scenarios in which members are not allowed to lose their status. This is especially true if the status was purchased. If this is not the case, consider when and under what circumstances collected currency units “expire”, ie are deducted from the account balance.

# 3.2 Earn-and-burn concepts

Compared to the rather complex logic of a status level concept, the basic idea of earn-and-burn is very simple: units of a certain currency are collected through certain behavior, mostly primarily by purchases. These units can then be redeemed for certain non-cash rewards.

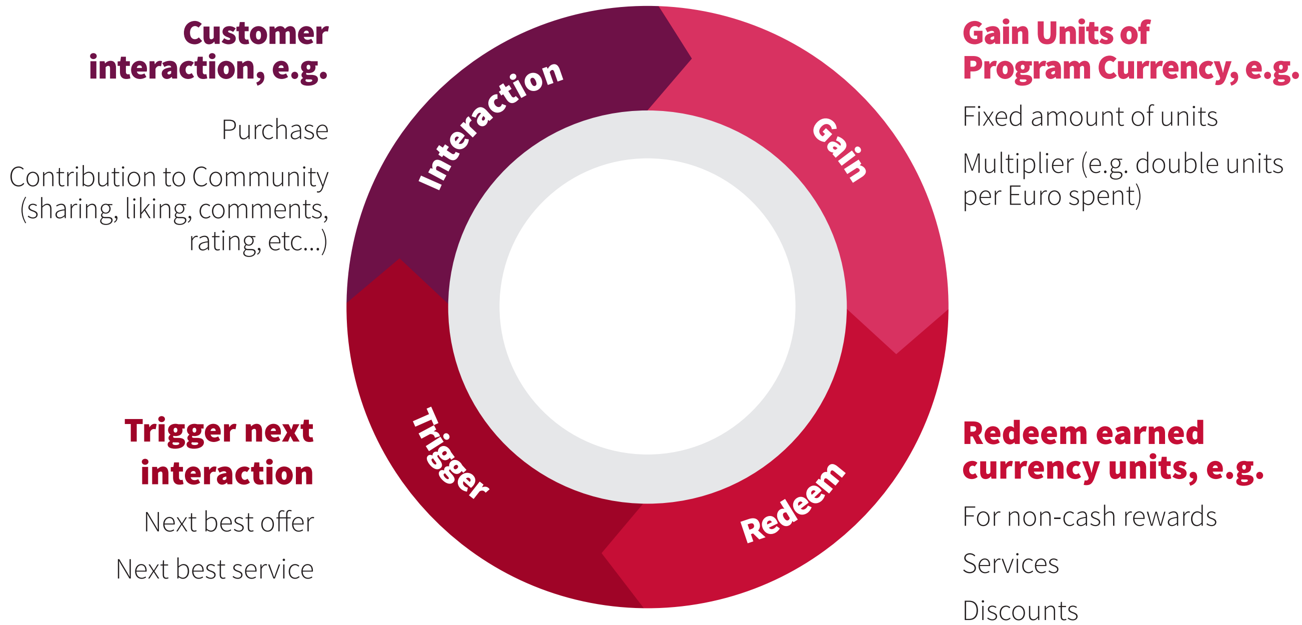


*Fig. 5: Basic mechanics of an earn-and-burn program*

## 3.2.1 Incentives

The incentives here are very immediate and tangible. In terms of communication, too, it is much more rewarding to present the advantages of a new bicycle than those of an online receipt for exchanges.

The calculation is also easier here. A bonus has a certain purchase price. In contrast, the monetary value of the currency units required for this can be derived from the underlying conversion rate between real and fictitious currencies. For example, if the pot set costs 30 euros to purchase and the conversion between real and fictitious currency is 1:2, then this set should cost the customer at least 60 units of the fictitious currency to cover costs. Of course, it can be decided at any time to consciously calculate the deficit to subsidize the program.

### 3.2.2 Redeeming

The redemption of currency units can be complex, especially if this is to be made possible both online and in-store and if the rewards are offered and possibly also distributed by external service providers.

Another driver of complexity is when in-kind rewards can be acquired through a combination of real and fictitious currency.

## 3.3 Comparing the different concepts

One of the advantages of a status level concept is the intrinsic motivation to improve one's own status. The basic prerequisite for this is that the associated advantages are genuinely perceived as such.

This is precisely one of the disadvantages compared to earn-and-burn concepts: the benefits granted are often less tangible and obvious. For example, an extended exchange right or free delivery is only perceived as a clear advantage if it is actually used. But even then, the benefit remains rather abstract, whereas redeeming collected currency units for a bonus is actually a visible and very tangible benefit.

Another advantage of status level concepts, on the other hand, is that the benefits granted are mostly directly related to the company's products or services and thus also contribute to them, while the selectable rewards of an earn-and-burn program often have nothing or little to do with the company's products or services. The knife block that the customer receives by redeeming the currency units has no direct relation to the sales they made in a pet shop. In this respect, it can be discussed whether and to what extent an earn-and-burn concept actually contributes to the customer's bond with the company.

If you compare the complexity of the two systems and thus also the risk that the customer will be deterred or at least not motivated because they do not understand the system, the advantage is clearly on the side of earn-and-burn concepts. These usually do not require much explanation and the incentives are also obvious and tangible.

**Hybrid models**

In practice, there is a possibility for a wide variety of combinations of these models. Sometimes two currencies are also used to separate level affiliation and the acquisition of non-cash rewards from one another in terms of calculation, process and logic.

# 4. Calculating the business case

As you progress in the development phase, the business case is your compass and guiding motivation for designing all professional and technical concepts. Every technical concept, from which technical requirements and IT requirements are derived, should clearly answer the question of which of the KPIs contained in the case should be influenced in which way.

The business case for a loyalty program is company specific, which is why generic information and recommendations are difficult to offer. The exact structure of the business case is heavily dependent on the defined program logic. However, it usually makes sense to first simulate all expected program costs and then compare them with an equivalent value using the uplift described here.

## 4.1 Program costs

First of all, consider if the loyalty program actually has a chance of economic success, or whether it is likely just a money-burning machine. If you still see a red number at the bottom right, despite the most favorable forecasts and assuming only best-case scenarios, you should possibly refrain from your project.

We want to assume a calculation based on partial costs, since a full cost calculation would be too complex. The majority of costs directly incurred by the program are usually caused by the added value offered. As already described in Chapter 3, the calculation of costs for earn-and-burn programs is usually easier than for status level programs.

### Redemption rate

One of the major risk factors when simulating the cost of earn-and-burn programs is the redemption rate. The question of how many of the currency units collected by program members are actually redeemed and thus cause costs, of course, has a serious impact on the total costs. A blanket statement on this would probably not be serious, as many factors can play a role here, starting with the value of the offered incentives, through to the frequency and aggressiveness of the communication to the customer's loyalty to the company.

You should carefully weigh up whether a low redemption rate and thus lower costs by avoiding a high contact frequency should be considered worthwhile. Ultimately, you want the customer to have a strong interaction with your own company, as this in turn hopes for a higher purchase frequency and a higher average shopping cart for the customer. The strong perception of the added value for the customer is a decisive factor for their loyalty and thus for the success of your program. Read more about this in the second part of this guide.

Another unknown, regardless of the mechanics used, is the redemption rate of coupons. These can play an important role in program communication and campaigning, but are not easy to calculate for the same reasons as incentives in the earn-and-burn program.

## Simulation of costs

The simulation of costs resulting from the added value is usually more complex in earn-and-burn programs. Two reasons are decisive here. On the one hand, it is often not easy to derive the costs for some added value, such as an extended right of exchange. The much more difficult and time-consuming part, however, is simulating the number of program members per level. Since a level mechanic ultimately only achieves the desired effect if the advantages offered become more and more valuable from level to level, members in higher levels logically incur more costs. The expected number of members per level is therefore of crucial importance.

One solution can be to use existing customer data, for example on the basis of receipts from a certain period of time, for a corresponding simulation. It does not matter that this data is anonymous, i.e. no person can be assigned, as long as the data contains some unique selling point, a unique identifier. With this, it is possible to simulate which proportion of customers made which turnover in a certain period and how many purchases were completed. Measurement inaccuracies cannot, of course, be ruled out here, since one and the same person may, for example, have used different means of payment. In addition, this data does not take into account any positive effect of a loyalty program. Still, it can be a good indicator.

## Conversion factor

Finally, the conversion factor between real currency and your fictitious currency must be taken into account. At the beginning it is certainly not wrong to simply leave the exchange rate at 1:1. This not only contributes to a lower complexity for your calculations, but also to a better and easier understanding of the program logic on the customer’s side. For industries and companies with a low average purchase frequency, it may make sense to adjust the exchange rate in favor of the fictitious currency in order to quickly make the fictitious account balance appear subjectively high even with only a few customer interactions.

# 4.2 Revenue

Most of the revenue from your loyalty program should come from your normal business model. Remember, the yardstick for success of the loyalty program is increased purchase frequency and larger shopping cart compared to non-members.

If your average customer buys from you 3 times a year and generates an average of 100 euros per sale, whereas a program member buys from you 4 times a year for an average of 120 euros per sale, the uplift of your program is 180 euros per member each year. Compare this value with the program costs per member in your calculation. If the average program costs, at partial costs, are less than 180 euros per member, your program should be profitable.

The same applies to the uplift applied for shopping cart and purchase frequency as for the redemption rate for incentives: a blanket statement or recommendation would not be worthwhile, as numerous factors are decisive here.

In addition to the uplift, other sources of income can be introduced through a loyalty program. For example, certain incentives can be offered against additional payment. In this way, the contribution margin for the premiums can be influenced favorably. Another source of revenue can be the sharing of customer insights. This does not mean the transfer of customer data to third parties. Rather, the idea is to market certain behavioral patterns of a certain group, obtained through systematic evaluation of purchase and behavioral data.

For a detailed derivation of the revenues, it can make sense to calculate basic campaign ideas in addition to the business models described above. For example, it makes sense to make recurring campaigns, such as newsletters, an integral part of the case right from the start. Assuming certain opening rates, click rates and conversions, sales can already be assigned to this.

Finally, you should definitely not forget to take into account the additional revenues that can be achieved through coupons. Coupons are a tool that should not be underestimated in triggering additional purchases as well as in increasing the shopping cart.

# 4.3 Measuring the impact (KPIs)

The difference in shopping cart size and purchase frequency between members and non-members — the uplift — is the best way to measure the success of your program and the evaluation basis for your return on investment. The two most important parameters or KPIs (Key Performance Indicators) are:

- **the average shopping cart**
- **the average buying frequency of your members.**

Both should be significantly higher than for non-members.

Depending on how your members can collect units of your currency in addition to transactional interactions, other KPIs are of course conceivable. However, it is of course usually difficult to assign a direct equivalent value to them, which is why it is often not possible to take them into account in the business case. For example, it is difficult to calculate value for the content generated by customers, such as product reviews. Even if a corresponding logic is developed for this, in the vast majority of cases it is ultimately a fictitious value.

Of course, you would like to evaluate the extent to which your program members perform better than non-members.

To measure the uplift, it should be clarified in advance whether both parameters can be measured for non-members. If this is not the case, a study on the zero point measurement in advance can also help here.

It is also advisable to set up at least one control group to measure campaign and communication effectiveness. In concrete terms, this means that a certain percentage of the members are excluded from any program communication in order to measure the effects of the communication on the KPIs. In addition to a global control group, there are often campaign-specific control groups. All of this will help later in evaluating the success of your program by comparing the planned values with actual values.