Measuring Results of Your Loyalty Program Investment

Remember Department Store pioneer John Wanamaker's famous quotation, " I know I waste half the money I spend on advertising… The problem is I don't know which half." One of the problems with advertising is that it is devilishly difficult to measure the results beyond traditional advertising measures such as awareness and purchase intent. There is clearly a big difference between those measures and actual sales increases.

Loyalty programs on the other hand, are one of the most measurable forms of marketing expenditure. However, many program managers and CFOs struggle to measure the results of a loyalty program.

"Does the program work… and is it driving sales?" "How much does the program cost?" "What's the ROI?"

While these are fundamental questions for management to ask of any program, many companies struggle to answer these questions about their loyalty programs.

Ask yourself:
- Is there a true and consolidated accounting of the cost of the program: one that includes the staff, the technology, communications and the cost of the rewards?
- Do we have a way to measure the incremental sales the program generates?
- Does the program have a P&L?

With any loyalty program, a P&L of expenses and incremental revenues can be developed.

Armed with this P&L, a Loyalty Program Manager knows if the program is working and how much money the program is dropping to the company's bottom-line. The Loyalty P&L allows a Program Manager to demonstrate that the program works, and supports an incremental budget, or if it isn't working fix the program or shut it down.

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Building a loyalty P&L

A Profit and Loss statement is the most basic of all accounting tools — revenues less cost equals profit (or loss). A program P&L is a roll-up of the incremental contribution margin generated by the program, less the cost to operate the program.

A program P&L is a relatively straight-forward calculation:

Incremental revenues generated by the program
×   Contribution margin
=   **Total program actual dollar benefits**

Total program costs
-   Ancillary revenue (e.g., membership fees, point sales, partner payments)
=   **Net program costs**

So, **(Hard program benefits)** less **(Net program costs)** = **Profit/Loss**

The P&L obviously has two components… revenues and costs. Assessing the revenues that the program drives, and getting an accurate and complete roll-up of program costs requires some accounting and analytical rigor.

The incremental revenue generated by the program includes:
- Revenue generated by increased frequency
- Larger basket sizes
- Reducing the defection rate of program members

The program costs include:
- Depreciated capital charges — i.e., the cost of the systems, building the Web site and establishing the call center
- Program overhead — i.e., the people necessary to run the program
- Program communications
- Reward liability
- The cost of soft benefits — i.e., perks, recognition, member events

Accounting for the program's cost is a relatively straightforward process, that mainly requires cost accounting rigor. Two places where the cost side of the P&L can get tricky are allocating program overhead and accounting for the accruing liability.

Allocating overhead issues can arise when the loyalty program shares capabilities with other programs and initiatives. This may occur, for example, if a call center supports the loyalty program and other business initiatives. Another area where rolling up program costs can get very complicated is with regard to accounting properly for the liability in a rewards-based loyalty program (a separate article in its own right and a topic we're always glad to discuss).

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Measuring incremental benefits

The revenue side of the P&L requires both analytical rigor and some creativity to develop metrics that truly measure the incremental revenue associated with the program.

In general, there are 3 ways to assess the program's incremental impact:

1. *Member sales pre and post.* How does a customer's activity compare before joining the program versus after joining the program? The difference is the lift the program generates.

For example, if an average program member spends $500 a year before joining the program and $700 a year after joining the program, the program is generating a 40% lift in sales and $200 per year per member in incremental revenues.

2. *Member versus non-member customer value.* How does average shopping basket size, average trips per year, and frequency of trips compare between members and non-members. This allows the Program Manager to understand and to demonstrate the difference in customer value between members and non-members.

This metric can be a bit misleading though. Program membership will often skew to a company's best customers. So, one would expect that their spending and value would be higher, even if there were no program. Looking at member and non-member activity pre and post can help Program Managers understand the true magnitude of customer value lift that the program is driving.

3. *Member versus non-member defection rates.* What is the tenure of program members versus non-members. Consider an example where member churn is 5%, non-member churn is 20%, and the program has 1MM members. In this case, the program has delivered a benefit of 150,000 customers saved times the average annual spending per customer.

This metric can also be a bit misleading. As program membership may skew to the company's best customers, one would expect that their defection rates may be lower. One way to compensate for this is to compare the defection rates of members to defection rates of a historical set of cohort (look-alike) customers to current members.

3 Ways to Assess Program impact

1. Member sales before and after they join the program

2. Member vs non-member customer value

3. Member vs non-member defection rates

Measuring incremental behavior of otherwise anonymous customers

In segments like telecommunications, utilities, catalog sales or credit cards – where all customer transactions are inherently identifiable – it's easy to measure members' versus non-members' behavior overall and their behavior pre and post program implementation, as well as member versus non-member customer value and defection rates. But what about in industries like retail where customers are largely anonymous without a loyalty program and where the loyalty program serves as <u>the</u> primary means to track customer behavior?

Certainly it is much more difficult to measure "incremental impact" in these industries. However, with a little bit of creativity and analytic work, some pretty good metrics can be developed. Techniques that can be employed include:

Measuring pre and post behavior of customers that can be identified.   Even if customer transactions are largely anonymous, there may be segments of customers whose behavior is trackable without the program. For example, retailers who have an in-house credit card can track the behavior of cardholders. A Pre-Post analysis of customer value, transaction frequency and churn rates can be accomplished for these members

Using a pilot program. When launching the program, piloting it in a few stores, and then measuring the impact on sales between the pilot stores and cohort stores, can offer a reliable read of the program's incremental impact. Of course a pilot is not a viable way to assess a program that is already up and running.

Creating control groups for loyalty promotions. While it may not be practical to hold some stores out of the loyalty program, Program Managers can hold certain stores out of specific loyalty promotions. Comparing period results in stores where the loyalty promotion was executed to cohort sores in the control group can provide a good analysis of a program's ability to drive incremental sales.

Assessing member versus non-member promotion response. If, before the program's introduction, the Program Manager had a customer database against which he/she performed direct marketing, a comparison could be developed with respect to the direct marketing response of members versus non-members.

Up-trender versus down-trender analysis. Looking just at members who have been members for 24 months, compare each member's spending in the last 12 months to that same member's spending in the 12 months prior to that. Then, categorize those members as up-trending (sales in month 1-12 exceed sales in months 13-24) or down-trending. Depending on how seasonal a business is, an up-trender / down-trender analysis can be accomplished around shorter increments.

Calculating the cumulative sales increase year over year among all the up-trenders and subtracting the cumulative sales decrease among the down-trenders provides insight as to how well the loyalty program is working, *and* even quantifies its impact.

Surveying members and non-members. Finally surveys can be employed to help gauge program impact. While the information is self-reported, a well-designed survey of members and non-members can provide solid insight. Although a survey by itself usually is not a definitive measure, a survey in concert with other metrics can be definitive.

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A program P&L as a valuable tool for program management

The P&L provides a bottom-line number for
the program and helps to answer: Is the program driving a contribution margin that exceeds the cost to operate the program? Simply stated — Is the program in the red or in the black?

The P&L also provides insight as to the program's return on marketing investment. ROMI flows easily from the P&L. The annual return on investment for the program is determined by dividing the annual program profit/loss by the total annual cost program.

Assessing a program in this manner helps management to quantify whether the program works and understand to what extent it works or doesn't. Armed with a Program P&L, the Loyalty Manager can tell the CFO…

" In my program…

- · We have 100,000 members.
- · The program costs $10 per member per year.
- · We drive $100 per member in incremental spending.
- · We are driving $10 MM in revenue at a 30% contribution margin.
- · We return $3MM in contribution margin against $1MM in cost.
  $3 in contribution for every dollar invested: a 300% ROMI.

Remember the old maxim: '…only half of advertising works and we don't know which half…' Well, my part of the marketing budget is part of the half that works… and I can <u>prove</u> it."

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If you have any questions on loyalty program strategy, design, development or management – or are simply interested in an assessment of your current program - please contact us at 1-800-844-5000.   For more on Loyaltyworks, visit us at <u>www.loyaltyworks.com</u>.

About Loyaltyworks

Loyaltyworks designs, develops and manages a wide array of loyalty and incentive programs – from turnkey programs and promotions to fully customized solutions – with a focus on measurable results. For nearly 30 years, Loyaltyworks has successfully implemented employee recognition, sales incentive, customer/channel loyalty and performance improvement programs.

Loyaltyworks supports its programs with a full range of capabilities and services, and approaches client relationships based on core values of openness, ease and accountability. The result – Clients find it easy to do business with Loyaltyworks and be successful.