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RETAIL STRATEGY CENTER

The Customer 5% Reward Program

A common practice of card-based food retailers is giving benefits (discounts, gifts, etc) to their regular (ie, "better") customers. But how much should be given? How? And to whom? The Customer 5% Program shows the way…

by Brian Woolf (June 28, 2014)

How much extra are your regular customers worth?
"We would like to introduce a card program that rewards our regular customers. Neither the standard two-tier pricing nor the 1% (point-based) rebate programs seem to reward regular customers enough. What are you seeing that might address our goal?"

This was the essence of a recent call from a very successful food retailer. It excited me: here was someone who not only wanted to make rewards the centerpiece of his company's "loyalty" card program but wanted to quantify how much he should deliberately set aside to reward his regular customers, so that he could measure and manage his investment.

The call reminded me of Gerald Weinberg's Law of Raspberry Jam: *The wider you spread it, the thinner it gets*. And the thinner it gets the less you taste it, which describes many "loyalty" card programs today. Weinberg tells us that if you want customers to take notice put a blob of jam on just one part of the slice; don't spread it thinly. If customers don't taste (and remember) the jam, you are wasting your money. My caller clearly understood the principle.

So, how much extra should your regular customers be rewarded? And how can you make your rewards meaningful, memorable, and measurable?

What follows is a composite picture of practices of various retailers in several countries quietly rewarding and retaining their regular customers. It foreshadows a new element in card-based marketing of food (and some non-food) retailers.

Imagine having a program…

- Offering 12-15 unbeatable Loss Leaders to your regular customers every day
- Having 5% of your total Gross Profit allocated to markdowns on just those items
- With markdowns going mainly to customers who provide 70-80% of your sales
- Whose crazy low prices aren't advertised; just featured in-store as rewards
- To which competitors have great difficulty responding

Launching your 5% Rewards Program
Imagine a quiet, in-store launch with no radio, TV, or circular promotion (remember, this is a rewards program for regular customers, not a promotional program for all in the marketplace). Customers entering your stores see large signs and one-page explanatory sheets highlighting a list of 12-15 items at crazy unbeatable prices available every day as rewards to regular customers. Possibly the items are eggs for 1¢ each (12¢ dozen), soda pop for 5¢ can (60¢ 12-pack), bananas for 9¢ lb, and diapers for $3.99. These are in addition to your regular promotional program. Such crazy prices remain the same for 6-12 months (seasonal items for 1-3 months) for the longer the price period, the more you "own" each price in your customers' (and the marketplace's) minds.

To receive such rewards for being a regular customer, a customer simply redeems a specified number of points (eg, 100 points for the bananas and 200 points for the eggs). Points come easily to regular customers. Typically, a customer accumulates them based upon her spending, when she buys bonus point items, and when she gains additional points on multi-point purchases. All customers are invited to opt into the program: most regulars will, many irregulars may not (because rewards are based on spending).

Obviously, if you don't have a card program in place, you launch your new rewards program..

If you already have a card program, such as two-tier pricing, you decide to either add these rewards to the two-tier program or you can retire the two-tier program and just focus on rewarding regular returning customers.

Alternatively, if your existing program is the standard 1% (point-based) rebate type, this is a great opportunity to replace it with a more flexible, more competitive, and more compelling program. The biggest decision in this case will be how to best handle members' existing point balances during the transition to the new rewards program with its different point-based configuration.

Underpinning this deceptively simple program lie four key decisions: choosing the crazy price Loss Leaders, their markdowns amounts, the ways (and weightings) of points issued, and then how they are financed. The following will familiarize you with the program's decision-points and metrics.

7-Step Planning Process

These steps are presented to help you create your own Customer 5% Reward Program:

1. Calculate the 5% Markdown Rewards to be given away. For example, assume Deals Stores has a 30% Gross Profit. Then, for every $1 million sales, its GP is $300,000; and 5% of its GP is $15,000. Therefore, for every $1 million of sales, Deals will give its regular customers $15,000 in Markdowns on these "Crazy Price" Rewards.
2. Calculate the Points that will be Redeemed. For each $1 million in sales, $15,000 is in markdown value, meaning that 1,500,000 points will be redeemed. [Calculation: $15,000 x 100 points per $1 = 1,500,000 points, as Deals assumes that 1.0¢ will be a typical point's markdown value.]
3. Calculate the Points Issued. Once customers have built up their "points cushion", Deals expects customers will redeem, on average, about 90% of the points they issue each month. Therefore, for each $1 million in sales, Deals expect to issue 1,666,667 points of which 90% (ie, 1,500,000) will be redeemed for Markdown Rewards.
4. Choose 15 Crazy Price Reward Candidates. Draw possible candidates from Basics (eg, Bananas, Eggs, Milk), Big Promo Items (eg, Soda Pop, Ice Cream), Health (eg, Organics), Signature Items (eg, Rotisserie Chickens, Potato Salad), and other target segments (eg, Diapers).
5. Choose Candidates' Tentative Crazy Prices. For each candidate, list its Regular Shelf Price (RSP), its tentative Crazy Price, and the tentative number of points required to redeem it. Calculate the Markdown Per Point. For example: Deals Private Label Ice Cream RSP is $4.99 and its tentative Crazy Price (with 300 points) is $1.99, which means a Markdown Reward of $3.00 and a 1.0¢ Markdown Value per Point.
6. Quantify the Candidates. For each, obtain its average weekly item movement per $1 million sales. Divide that number in half, as Deals assumes half of the Crazy Price items will be sold at their Crazy Price (and half at full price). Alongside each candidate's item movement, show its Markdown Reward (eg, $3.00 for Deals Ice cream) and the points needed to access the reward (eg, 300 for the Ice cream). Multiply the movement by these values to get the initial tentative total Points Redeemed and to calculate the average total Markdown per Point. Compare these totals to the planned 1,500,000 points to be redeemed per $1 million sales and the planned 1.0¢ Markdown per Point. Then begin tweaking various Candidates' details (including eliminating a candidate or two) to move you close to your planned totals (in Step 2).
7. Price Optimization. Deals are planning to reward their regular customers (the 30% who provide 75-80% of sales) access to additional markdowns equal to 5% of its total Gross Profit. The cost of these markdown rewards obviously needs to be offset. Deals plans to do this in various ways including savings from eliminating some existing promotional

and card programs; less aggressive weekly ad pricing now that a number of Loss Leaders will be added to the promotional mix; replacing some ad price reductions with points; replacing some manufacturers' Temporary Price Reductions (TPRs) with bonus points; offering bonus points on high margin items; and using the industry's Price Optimization principles and, if already installed, tools to make insensitive price adjustments across each store.

Who Wins When Giving Your Regular Customers Access to Additional Value?

- The 30% customers who provide you with the majority of your sales and profits
- You, the retailer, as you gain a "price halo" and you offer a point of differentiation most competitors cannot match
- Your customer-retailer relationship as it becomes clear you care about rewarding your regular customers

What's Special About this New Approach?

It's a rewards program. It focuses on your regular customers with rewards that are meaningful, memorable, and measurable. Its purpose is refreshingly clear: to reward your customers' loyalty. In addition, it integrates merchandising with your card program; it muddies the price gap between you and the competitive low-price giants; and it gives your customers more reasons to return. There's really only one question: is 5% of your Gross Profits enough? The answer, from the numbers I have seen, is yes … to start. Once your Rewards Program settles down, however, you will discover what happens when you offer more rewards. The optimal percentage has yet to be discovered!

About the author…

Brian Woolf is a global leader in loyalty marketing and has written three definitive works on the subject, Measured Marketing: A Tool to Shape Food Store Strategy, Customer Specific Marketing, and Loyalty Marketing: The Second Act. He devotes his time to helping retailers develop, critique and strengthen their loyalty programs.

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