It's Time to Rethink 1% Programs

The biggest challenge of the standard 1% point-based rebate program is that a lot of the cost is wasted. Refining the program will produce better bottom-line results…

by Brian Woolf (September 29, 2014)

Can You Justify the Cost?
Many food retailers offer some type of 1% points program that provides a 1% rebate on what customers spend. The standard program is structured something like this: receive 1 point on each $1 spent; upon accumulating 500 points, receive a certificate for $5-off a subsequent purchase. As in this case, points often have a perceived value of about 1¢ each so many customers attach little value to them.

If all sales were to clubcard members and all certificates were redeemed, the cost to the retailer would be 1% of sales. But this doesn't happen in practice because it is common to see 80-90% of the sales accounted for by members and about 90% of the reward certificates redeemed. This means that the cost of the standard program is usually in the range of 0.72 – 0.81% of sales. [Calcn: 1% x 80% x 90% = 0.72% sales; 1% x 90% x 90% =0.81% of sales.] Let's pick a middle number, say 0.75% sales, to be a typical retailer's cost. (This would occur if 85% of sales are to members and 88% of their certificates are redeemed.)

Here's the critical question: how do you justify the cost of offering one point, worth 1¢, on every $1 of sales? The usual answer: by an increase in sales. But how big an increase will it trigger? Can this program, on its own, generate enough additional sales to cover its cost? To answer that, let's identify what that growth number is.

Globally, many food retailers' Profit Before Taxes (PBT) to Sales ratio is around 3%; some are 4%; and a handful are 5%. Let's work with the majority case. If there is no change in sales or offsetting costs with this standard program, then profits will fall 25% when launched. [Calcn: PBT = 3.0%, less the Rebate Cost of 0.75% (above), gives a new PBT of 2.25%. If sales don't change, falling from 3.0% to 2.25% is a 25% drop.]

Using that as background, let's calculate the required sales lift to break-even. If sales are $1 million week, that means before the program our PBT was $30,000 week (ie, 3.0% sales) and our new PBT is $22,500 (2.25% sales). Given this, what sales increase is needed to have our PBT back at $30,000? Answer: 5%. This is based on the assumption that the PBT on the incremental sales is 15% (including the rebate cost on them). This PBT of 15% is up from the 3% on the base sales due to fixed costs having already been paid, together with other incremental savings.

The following table shows how the 5% figure was derived.

Breakeven Calculation:

	Base		**Incremental**		**New Total**
Sales	$1,000,000		50,000	+5%	$1,050,000
Base PBT	**30,000**	3.00%			
Less Rebate Pgm	(7,500)	(0.75%)			
New PBT	22,500	2.25%	7,500	15%	**$30,000**

Note that I have been very generous with the incremental 15% PBT figure. Many retailers' incremental PBT% is not that high and this figure is after deducting 0.75% of the incremental sales for its associated Rebate cost. Retailers with an incremental PBT% less than 15% would obviously have to increase their sales by more than 5% to break-even.

How realistic is it for a standard program to increase sales by 5%? Not very. Consider this: a 1% rebate program is similar to an across-the-board 1% price reduction. This doesn't get many customers excited; certainly not enough to increase their weekly spending. So if customers who provide 50% of the sales don't increase their spending in response to a 1% program, the other 50% have to increase their spending on average by 10% to provide the company-wide 5% sales gain required! Of course, this is extremely unlikely.

In short, the core of the standard 1% rebate program contains an expensive giveaway element that is very difficult to recover. Fortunately, it can be corrected.

How To Correct It

Here is a framework for your consideration. It is based on an amalgam of programs I have studied around the world over the past decade. You may vary it to suit your own company's numbers and needs.

Let's set three objectives:

1. Provide easy opportunities to earn points
2. Operate at a lower average cost per point than the standard program
3. Provide customers reasons to return

1. Provide easy opportunities to earn points
Giving one point per $1 of spending is a slow way for customers to earn rewards and is expensive for the retailer. Therefore, we shall switch the emphasis towards providing opportunities for customers to earn points when buying individual items and significantly downplay the one point per $1 of total spend mentality.

This can be achieved by offering:

- Points rather than price reductions on selected weekly advertised and unadvertised specials
- Points rather than price reductions on selected targeted electronic offers
- Points that reward long term multi-buy promotions (eg, buy any 10 yogurts and earn 300 points)
- Points on selected slow-moving, high-margin items
- Points on "Orange Tag Offers". These are long-term item shelf promotions arranged with manufacturers that offer points rather than price reductions (eg, a 6-month Orange Shelf Tag offer of 100 points when you buy a bottle of Deals 16oz Ketchup)
- Manufacturers' Temporary Price Reductions (TPRs) in the form of points (eg, instead of a $0.50 price reduction, offer the item with 50 points).

Offering points by rewarding and encouraging large orders is another way. (On average, the larger the order size, the larger the gross profit percentage.) For example, to reward/encourage its customers to do three major shops a month, one successful retailer's program offers 5-points per $1 of spending on the easy-to-remember 5th, 15th, and 25th of each month. This program was introduced when it stopped weekly print advertising. Alternatively, each month another retailer sends its regular customers two spending certificates worth 5-points per $1 usable on any day of the month. Coincidentally, this retailer doesn't have a weekly print ad either.

2. Operate at a lower average cost per point than the standard program
There are two primary ways to achieve a lower cost per point:

The first way: Change the one point per $1 formula
Some retailers offer one point for every $2, $5 or even $10 spent, rather than 1 point per $1. This will significantly reduce the cost of the points issued, assuming points are worth approximately 1¢ each in all cases. The downside is that customers must spend $1000, $2500, or $5000 instead of $500 to earn a $5 certificate.

One way to continue a generous point-for-spending reward is to credit just one spending point total monthly; say, 300 points on the first of each month to all who spent $200 or more the previous month. All customers are eligible but, obviously, only the higher-spending customers each month will receive this particular point credit.

What would this mean? While researching one retailer, I found the average monthly spend of all customers who spent over $200 was about $400 per month. For this retailer's Best Customer group as a whole, the average point value per $1 of spending was only 0.75¢, which is less than the current standard program. As these Best Customers typically account for 55-65% of company sales this program would cut its spending reward cost in about half. But it's the right half: all the spending rewards go to the 12-18% of customers who provide the majority of sales and profits and who, in addition, have the lowest attrition rates.

This approach rewards the loyal regular customers who spend a significant part (over $50 per week) of their weekly food budget with the retailer. But shouldn't this be what a loyalty program is all about? The cost of $3 per month (300 points x 1¢ point = $3) is a low price to pay. In fact, the cost should be charged to a special Best Customer Thank You account where all Best Customer appreciation costs are expensed, including their free hams and turkeys, special discounts, gifts at Christmas, etc. Remember, these are the customers who comprise a company's economic backbone.

The advantage of this once-a-month approach rewards Best Customers, lowers the average cost per point, and sidesteps paying for total spend rewards to the large number of low-spending and/or occasional customers whose primary food retailer is a competitor. While they accept and redeem the point rewards they generally do so without increasing their spending. My observation has been that if your intent is to change the spending behavior of these customers, a 1% rebate program is a very weak weapon. Better to redirect your efforts towards more appropriate targeted offers.

The second way: Offer points that are free

As a retailer, imagine issuing points to customers that have no cost (ie, free) yet give approximately 1¢ per point value to the customer. Obviously, the larger the share of these free points issued, the lower a company's average cost per point will be … and the better its profitability.

Free points are easy to understand and incorporate in your program. They derive from the customer and the manufacturer.

When you offer customers an item with bonus points that have taken the place of a weekly, in-store, or targeted promotional markdown (eg, a promotion of 100 points with a pound of peaches instead of $1-off per pound) the customer pays full price for the item and receives 100 points at the time of the transaction. She receives the equivalent of that original $1 discount when she later redeems her 100 points (with its $1 value) for a designated reward.

When you take a manufacturer's Temporary Price Allowance (TPR) and give it to customers in the form of points or when a manufacturer reimburses you for their Orange Tag Offers the manufacturer is fully reimbursing you for those points issued.

3. Provide customers reasons to return

Quite frankly, I am underwhelmed by 1% rebate offers. They don't excite me either as a customer or as a retailer. The $5 reward certificates are nice to receive occasionally but they are forgettable. A reward offer that makes the retailer special, memorable, or unique is preferable.

One way to accomplish this is by changing the program reward from a $5 gift certificate for every 500 points accumulated to a selection of permanent loss leader items available with points. These are popularly known as Crazy Prices. For example, eggs that have a shelf price of $1.99 dozen are offered, on a long-term basis, at $0.09 a dozen plus 200 points, or a half-gallon of milk with a shelf price of $2.19 is offered at $0.09 plus 200 points.

This alternative approach allows immediate redemption of points, even within the same transaction, thereby providing strong appeal to customers seeking immediate satisfaction. More importantly, it transforms the retailer's clubcard program from a 1% rebate program into a price image program. It lists 10-15 items at Crazy Prices (with points) that no competitor can match. And the only people who can take advantage of these offers are regular customers. This is a reinforcement of the idea that loyalty should be rewarded while split shopping is not. The Crazy Prices are imbedded in customers' minds so that, even when shopping at a competitor, they remember your eggs and milk are only $0.09 (plus points). You have thereby won a share of your customers' minds and your Crazy Prices provide them with reasons to return.

The Bottom Line

The essence of achieving better results with 1% programs is to change the mix of the points issued. In the standard plan, every 1 million points issued is at full company expense. By reducing the points issued as a reward for total spending (full company expense) and increasing the rewards whose points are free (advertised and unadvertised point specials, TPRs, and Orange Tag Offers), you lower the average cost per point issued; such being the case, it allows you to offer even more points. As an added bonus, when you switch point rewards from a cash rebate to Crazy Price items it both differentiates you in the marketplace and enhances your price image.

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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