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# Sports Loyalty International

## The Economics Behind Customer Loyalty: Using Coalition Program Assets to Turbo-Charge Results

## White Papers

- Coalition Loyalty: A Model with Sustainable Advantages for Retailers
- The Economics Behind Customer Loyalty: Using Coalition Program Assets to Turbo-Charge Results
- The High Cost of "Ghost" Points: Will the short-term gains from high breakage gas discount and other "loyalty" programs yield long-term pain?
- Is the U.S. the Afghanistan of Coalition Loyalty? Overcoming the challenges of the U.S. market
- The 6 A's of Coalition Loyalty Success & the Virtuous Cycle of Profitability


**Summary:**

### Part 1 – The Economic Benefits of Customer Loyalty

*Loyal customers can be several times more profitable for consumer businesses, driven by the five economic benefits of increasing customer loyalty:*

1. ***Reduced defections***
2. ***Increased spending per customer***
3. ***Lower cost to serve***
4. ***Increased purchases of higher margin products/services***
5. ***More customer referrals***

### Part 2 – Loyalty Program ROI Economics 101

*Well-designed loyalty programs can help drive each of the five economic benefits of customer loyalty, while also driving a sixth benefit:*

6. ***More efficient acquisition of highly profitable new customers (outside of referrals).***

*The overall financial impact of a loyalty program can be evaluated based on several key customer behavior metrics, including:*

- ***Retention** – the incremental percent of current customers who are program members that remain loyal.*
- ***Lift** – the incremental increase in spending by current customers who are program members.*
- ***Shift** – the incremental spending from competitors' customers who are program members and start shopping at your business.*

*Using the "loyalty math" behind retention, lift, and shift, executives can quantitatively evaluate the economic value from implementing a loyalty program and answer the critical questions revolving around "What do I need to believe?" in terms of customer behavior change in order for a program to drive an attractive ROI.*

*A well designed loyalty program can be profitable, but only if the incremental value exceeds the program cost, and will only be sustainable if it offers a truly unique consumer value proposition.*

### Part 3 - The Superior Economics of a Coalition Program

*A coalition loyalty program maximizes opportunities to generate and reward loyalty and optimizes the ROI to sponsoring companies because:*

1. *A coalition program will accelerate the consumers' time to earn a reward and therefore drive much greater behavior change than a standalone loyalty program.*
2. *A coalition loyalty program will almost always be lower cost to operate than a single company program and will therefore typically generate a meaningfully higher ROI.*
3. *A properly designed and managed coalition loyalty program will always generate better data for results analysis and opportunity targeting, enabling participating sponsors to identify high potential customer households who currently only shop at competitors.*

## Part 1 – The Economic Benefits of Customer Loyalty

### *Why is Customer Loyalty So Important?*

Customer loyalty has become an increasingly important focus area for creating sustainable stakeholder value. Harvard Business Review editor Theodore Levitt wrote 30 years ago, the "purpose of business is to create and keep customers"[i]. There is ample evidence that not all customers are equal – loyal customers are far more profitable. Frederick Reichheld's pioneering work at Bain & Company in the 1980′s demonstrated the powerful economic benefits of increasing customer retention across multiple industries, product and service companies. Concentrating management's attention on attracting and maintaining loyal customers is crucial for businesses to succeed in today's competitive world.

Even small changes in customer retention rates and spending levels of loyal customers can have a very big impact on companies' bottom lines. Also, transforming customers into staunch "promoters" or "raving fans" of your business – referring others to become loyal customers too – can turbo-charge profitability as well.

So how does one measure and quantify the benefits of customer loyalty?

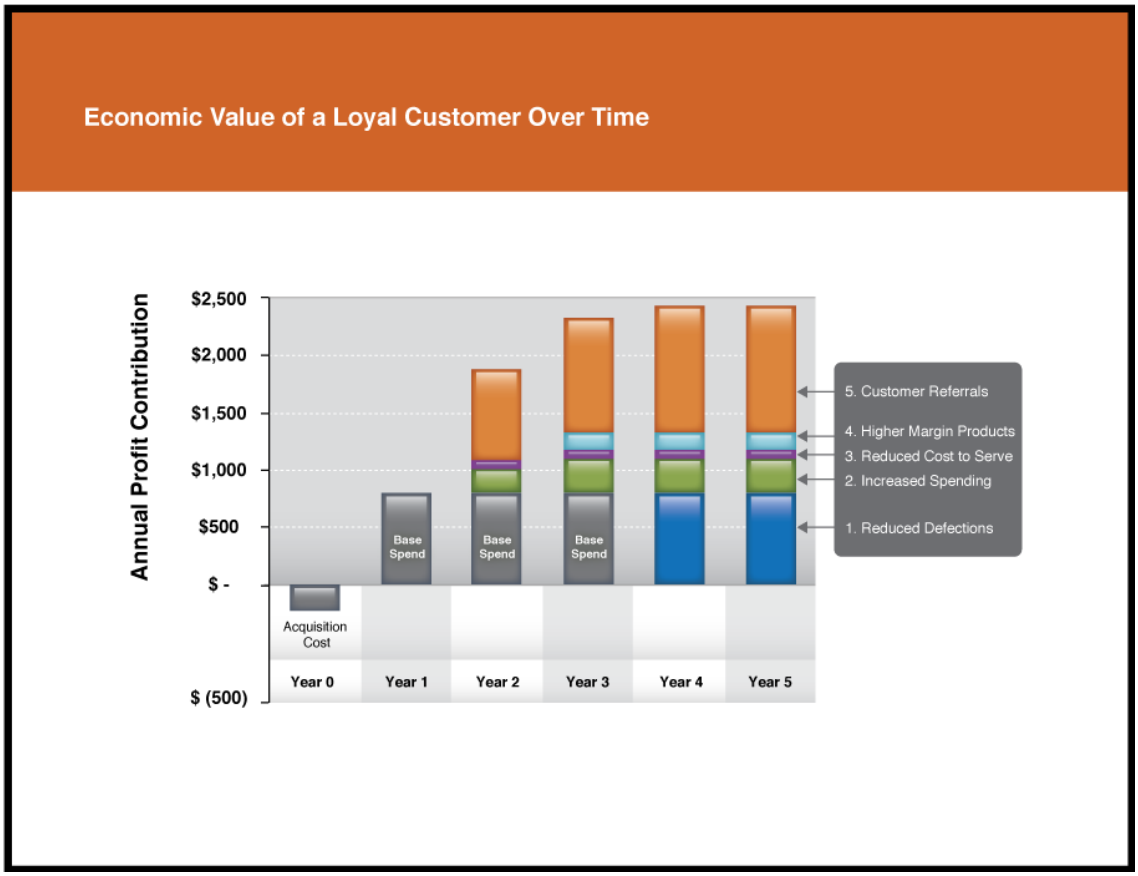
### *Basic Customer Loyalty Math*

Reichheld in a 1990 *Harvard Business Review* article[ii]. Earl Sasser is a renowned Harvard Business School professor and Frederick Reichheld, head of Bain & Company's Customer Loyalty Practice, went on to publish several books on loyalty including *The Loyalty Effect: The Hidden Force Behind Growth, Profits, and Lasting Value* (1996) and *The Ultimate Question 2.0: How Net Promoters Thrive in a Customer-Driven World* (2011).

The primary economic benefits to a business of increasing customer loyalty include:

1. **Reduced defections to maintain base profits**
2. **Increased profits as loyal customers spend more over time**
3. **Increased profits as loyal customers cost less to serve**
4. **Increased profits as loyal customers purchase higher margin products**
5. **Increased profits as loyal customers refer others to the business they love**

Using this framework, we can quantify the economic value of a loyal customer. The following chart shows the potential value of a loyal supermarket customer over a five year period.



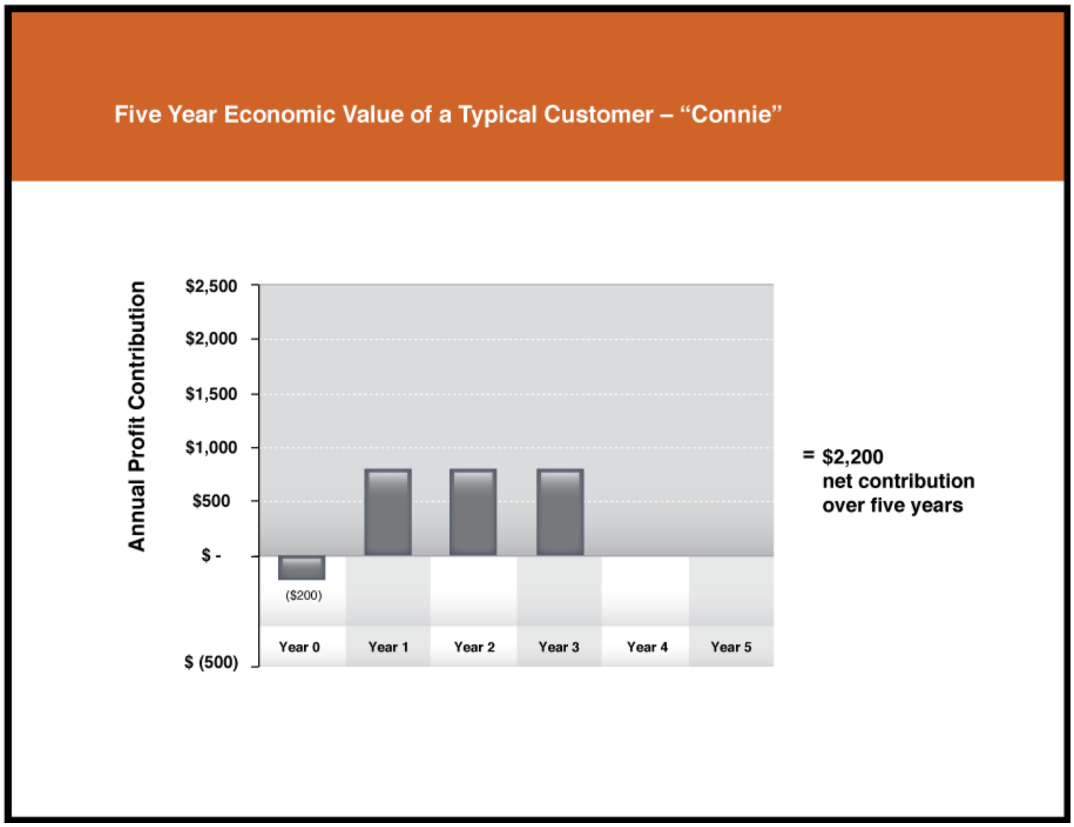

In this section, we will walk through simple examples of each driver of the incremental economic benefits of increasing customer loyalty to a consumer business – in this case, a supermarket company "Super Foods." We will show the economic impact to Super Foods of turning an illustrative customer, who we'll call "Connie", into a loyal customer.

For purposes of the illustrative analyses below, we'll assume that Connie is a fairly typical Super Foods customer who shops there weekly and spends $80 of her $120 total weekly grocery budget at Super Foods. (Her remaining $40 of weekly grocery spend is split

We'll also assume that, in acquiring Connie as a new customer of Super Foods, the company spent approximately $200 in marketing costs (direct mail, mass media, etc.) to entice her to begin shopping there.

Historical research by various sources has shown that 20-50% of customers switch grocery stores each year[iii]. A recent *Consumer Reports* study in 2012 found that 33% of 24,203 surveyed shoppers had switched grocery stores in the past year[iv]. For the purposes of this analysis, we'll assume that Connie will defect to another store after 3 years.

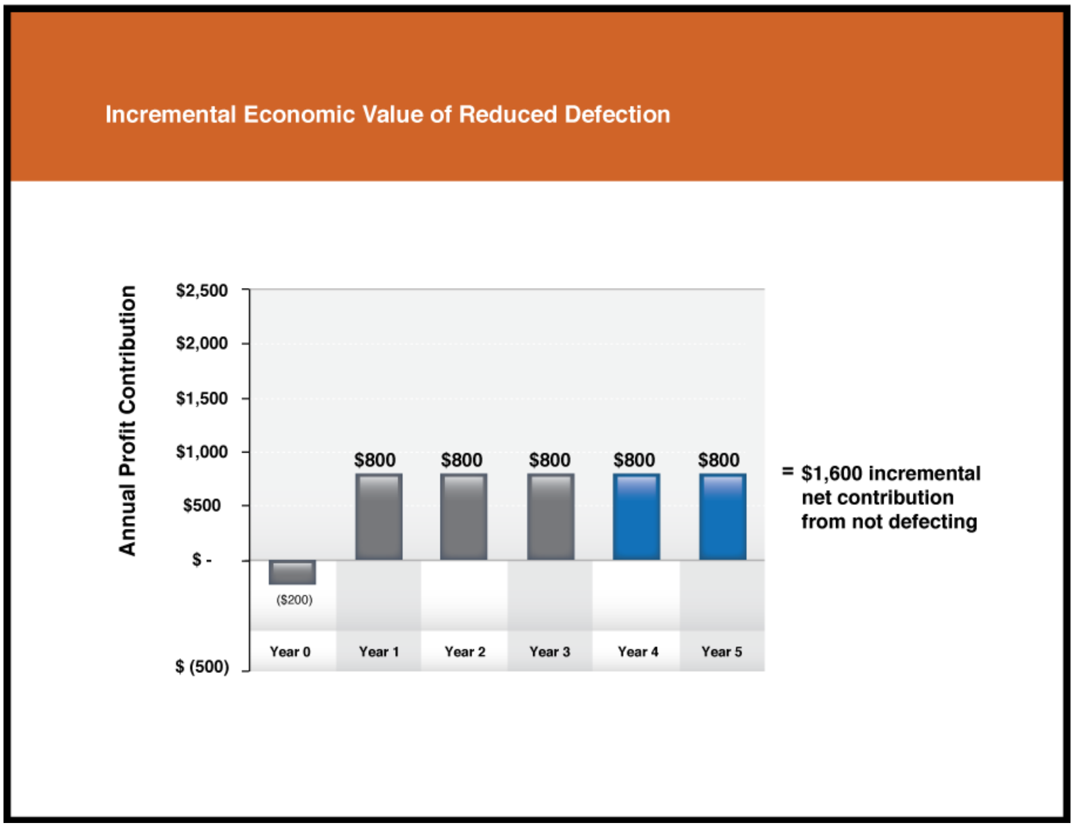
Thus, the overall economic value of Connie to Super Foods over five years would be $2,200 ($800 x 3 years – $200 acquisition costs = $2,200), and her individual yearly contribution to the company's bottom line would look like the chart below. *(Note: For simplicity, we are not applying a discount factor to arrive at a customer NPV.)*




Here's how Connie's economic value to Super Foods would increase over the same five year period if she becomes a loyal customer:

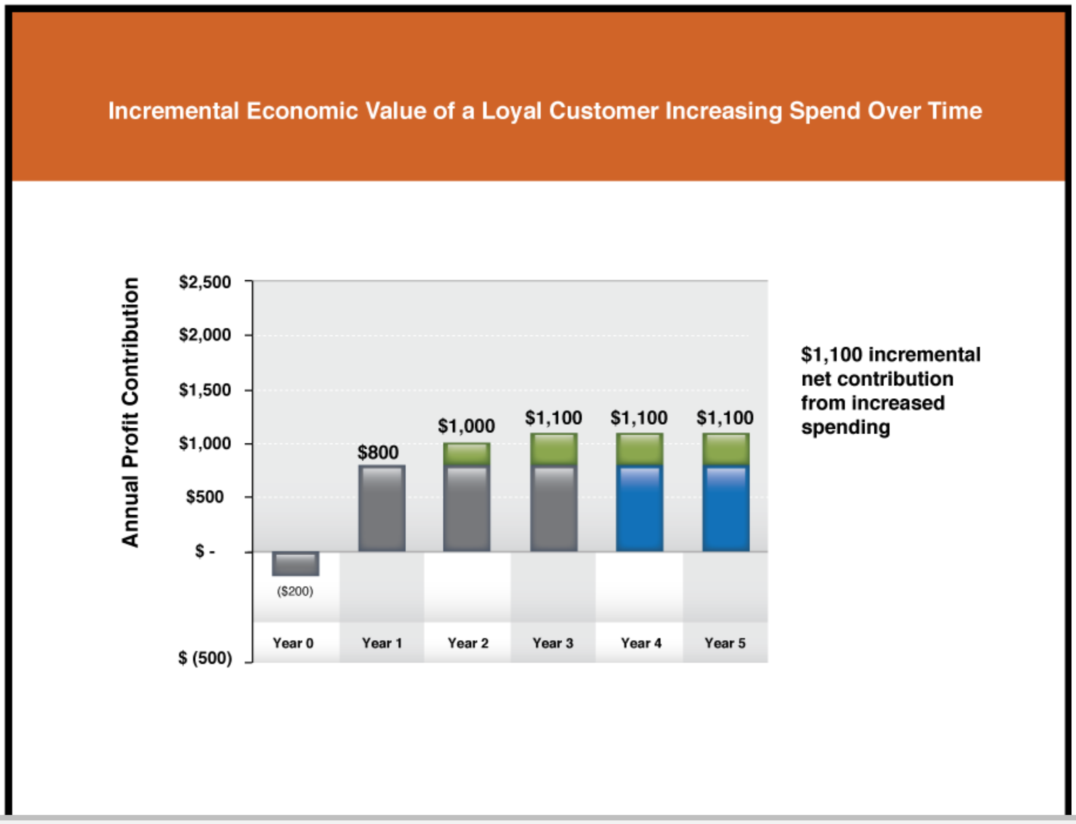
**1) Reduced defections to maintain base profits**

If Super Foods were able to keep Connie as a customer over the full five years, and maintain her current spending of $80 per week, *the company would generate another $1,600 in economic value from Connie ($800 annual gross margin x 2 incremental years).*




**2) Increased profits as loyal customers spend more over time**

If Connie were to increase her spending at Super Foods from $80 per week in year 1, to $100 in year 2 to $110 in year 3 and remain at that level of spending through year 5, *the total contribution to Super Foods' gross margin from Connie's increased shopping would be $1,100 over the 5 years* ($200 in year 2, and $300 in each of years 3-5).



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