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Making Loyalty Simple

The Business Case for a Consumer Loyalty Program

Why maintaining customers is more cost-effective than finding new ones.

Loyalty programs have become increasingly popular among forward-thinking organizations, given their ability to impact customer purchasing behaviors and lift company revenue. After all, by increasing customer retention rates by just 5 percent — a key effect of loyalty programs — a company can increase profits anywhere from 25 to 95 percent, according to the Harvard Business Review.

Moreover, a number of additional statistics make the case that loyalty programs can make a significant impact on customer engagement, loyalty, and revenue:

- A loyalty increase of 7% can boost lifetime profits per customer by as much as 85%, and a loyalty increase of 3% can correlate to a 10% cost reduction.
- Over 70% of consumers are more likely to recommend a brand if it has a good loyalty program.
- The Pareto Principle shows 80% of your profits come from just 20% of customers.
- The probability of selling to an existing customer is 60-70%.
- 72% of US adults belong to at least one loyalty program.
- 95% of loyalty program members want to engage with their brand's program through new and emerging technologies.

Finding the Right Loyalty Metric

As you begin to build a business case, it is imperative that you find the right metric to place your argument on the strongest possible grounds. Understanding that a loyalty program will increase your company's revenue, we recommend one key metric in particular: customer lifetime value (CLV). Defined as "the present value of future cash flows or the net profit attributed to the customer during his or her entire relationship with the company," CLV represents, in itself, the substantial and ongoing value that loyalty programs can provide.

To put it simply:

> *An increase in customer loyalty leads to increased CLV, and therefore increased revenue. Moreover, increasing the loyalty of current customers is significantly more cost-effective than acquiring new customers.*

There are a number of reasons why improvements to CLV — the direct result of effective loyalty programs — are so valuable:

- Loyal customers trust your brand, which means they're willing to pay more for products and services.
- Loyal customers make purchases more frequently than non-loyal ones.
- Loyal customers are data-rich: they're more likely to share more of their data, more often, which reduces operating costs and improves your ability to further engage customers with valuable, targeted offers.
- Loyal customers are emotionally attached to your brand. This increases referrals and word of mouth advertising which, in turn, reduces marketing costs.

When assessing the potential for your loyalty program to improve CLV, you should focus on how your program can drive three core metrics:

1. Customer growth: the increase in customer spend and frequency over time
2. Customer acquisition cost: the cost of acquiring a new customer
3. Social advocacy: the marketing impact and cost-savings related to customer advocacy (referrals, word-of-mouth advertising etc.), equal to the value X that it would have cost to drive the same publicity with marketing.

Finding the Right Loyalty Metric

Any well crafted loyalty program should be able to drive these above-mentioned metrics. With such metrics at hand, you can clearly showcase the business value of a loyalty program to your executives and the board — demonstrating the direct, positive impact on CLV and revenue.

You can follow simple steps to build a strong business case. First, you need to determine your company's starting point, or loyalty baseline, as seen in the table below. Begin with your "year one" metrics, which will be used to determine CLV lift: number of transactions per customer, expected increase in customer transactions, decrease in marketing expenditure, and expected yearly increase to the customer database, among others. Then, you can forecast the anticipated impact of a customer loyalty program to these metrics, over multiple years.

The table below shows expected performance improvements of a basic loyalty program, relative to company baselines. Using such a table, you can readily showcase to your board the clear and ongoing business benefit of a well-crafted loyalty program and its impact to your bottom line.

	Year 1 No LP	Year 2 Without LP	Year 2 With Fielo LP	Year 3 Without LP	Year 3 With Fielo LP	Year 4 Without LP	Year 4 With Fielo LP
Average transaction	$100.00	$102.50	$104.50	$105.06	$109.20	$107.69	$114.12
Number of Transactions per customer per year	5	5.15	5.25	5.30	5.51	5,46	5,79
Number of Transactions per customer per year	1,000,000	1,020,1000	1,020,000	1,040,808	1,041,216	1,062,465	1,063,740
Forecasted revenue per customer per year	$500.00	$527.88	$548.63	$557.30	$601.98	$588.37	$660.52
Forecasted revenue in total - yearly	$500,000,000	$538,432,500	$559,597,500	$580,046,494	$626,789,938	$625,126,574	$702,622,565
Percentage of revenue destined to Marketing per year	12%	11.88%	11.64%	11.76%	11.29%	11.64%	10.94%
Marketing budget per year	$60,000,000.00	$63,965,781.00	$65,137,149.00	$68,220,428.27	$70,769,598.40	$72,787,162.79	$76,878,150.65
Expected increase in customer database per year	2.00%	2.04%	2.08%	2.08%	2.16%	2.12%	2.25%
Number of Customers end of year	1,020,000	1,040,808	1,041,216	1,062,465	1,063,740	1,085,015	1,087,671
Cost of reward per customer	$20.00	$22.00	$22.00	$24.20	$24.20	$26.62	$26.62
Total Cost of rewards per year	$20,400,000.00	$22,897,776.00	$22,906,752.00	$25,711,656.22	$25,742,497.95	$28,883,100.97	$28,953,797.54
Total Revenue per year	$419,600,000.00	$451,568,943.00	$471,553,599.00	$486,114,409.67	$530,277,842.35	$523,456,310.51	$596,790,617.51
Difference in Revenue comparing with/ without Fielo			$19,984,656.00		$44,163,432.68		$73,334,307.00
Percentage uplift with Fielo			**4.43%**		**9.08%**		**14.01%**

The performance improvements above are based on the assumption of a 2% improvement across variables — a fairly conservative projection. In fact, research has demonstrated that, leveraging Fielo, companies can expect to see 1-9% improvements across their core metrics, depending on their loyalty program design and industry.

What this case clearly demonstrates is that loyalty-building is a long-term investment — the benefits are cumulative, and begin to snowball after the first year of implementation. Note that one of the biggest costs associated with a loyalty program — the incentives and rewards on offer to customers — are its greatest revenue-driver and the primary customer retainer tool; the stronger the relationships you build with customers through incentivized engagement and rewards, the more likely they are to purchase from you, more frequently, and refer your brand to family and friends. Therefore, it is imperative to frame those costs as the very engine of the loyalty program, and critical to increase the profitability of the program over the mid- to long-term.

This information, in total, should form the basis of your business case for a loyalty program. With it, you can make a persuasive case to any key stakeholder about the undeniable value of a loyalty program, the expected results over the long-term and the ongoing benefit for your customer relationships.

Sources:

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Endnote:

1. https://economictimes.indiatimes.com/definition/customer-lifetime-value

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