fluido
an Infosys company

Strategic Guide

Loyalty Programs in Manufacturing

Part 1: Considerations, Concepts and Logic, Business Case

Contents

1. Preface

1.1 Importance of loyalty programs in manufacturing

Companies increasingly strive to place customers at the centre of their actions and thinking. And there are good reasons for this. One of the most important reasons is that retaining customers is easier and more cost-effective than acquiring new ones. However, achieving true customer-centricity is a time-consuming and resource-intensive process.

It's not a new revelation: retaining an existing customer is cheaper than acquiring a new one, and the expected revenues are higher than with a new customer. This applies equally to both the B2C and B2B sectors and is not significantly different from one industry to another. However, it should be noted that sales cycles can naturally vary significantly depending on the respective business model. Consequently, when considering the so-called "Pirate Funnel" (see Figure 1), consisting of the phases Acquisition, Activation, Retention, Referral, and Revenue - abbreviated as AARRR, hence Pirate Funnel - companies should place much greater emphasis on Phase 3, "Retention," which involves retaining and encouraging the return of existing customers.
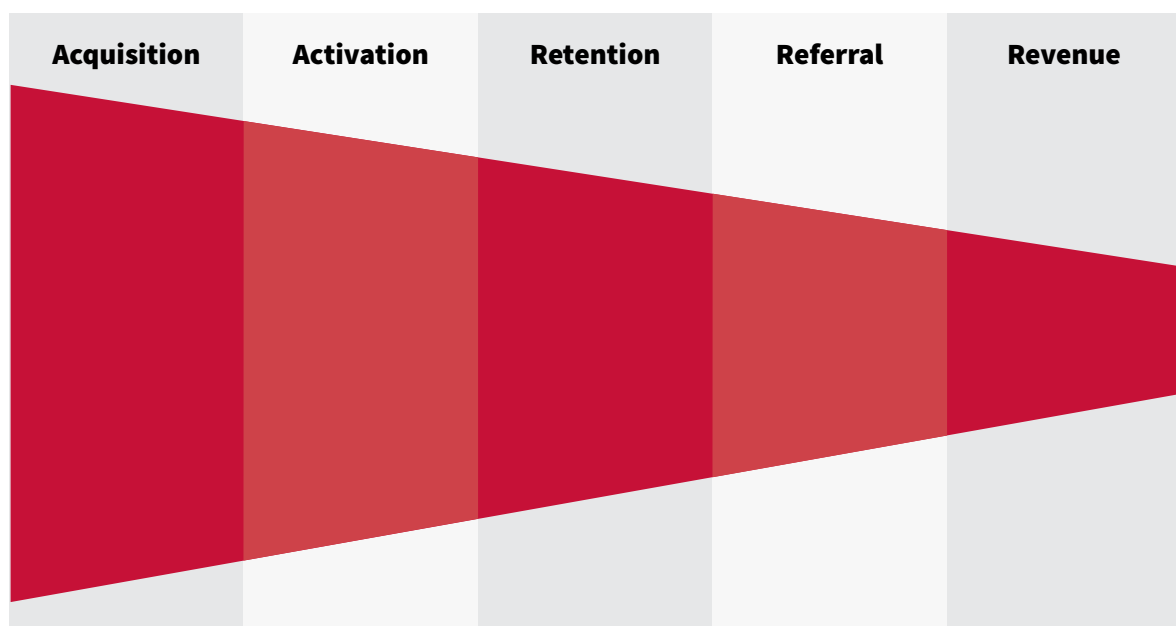
Acquisition	Activation	Retention	Referral	Revenue

Fig. 1: The Pirate-Funnel

Instead, many companies still place immense importance on acquiring and activating new customers. There are undoubtedly valid reasons for this as well. We discussed the significance of different sales cycles earlier. Especially in manufacturing, it is crucial to consider whether everyday consumer goods like food or clothing are being produced, products for personal use with a longer lifespan, such as televisions or laptops, are being manufactured, or if it involves long-term investments for businesses, such as tool machinery or aircraft for an airline. In the latter case, it is usually assumed that customers place significant orders frequently.

Consequently, focusing the entire strategy solely on existing customer business would be extremely risky. Additionally, the number of market participants in this sector is often quite manageable. One would typically refrain from implementing an elaborate customer retention program for these reasons alone.

In the case of the first scenario mentioned, such as food products, the market is already dominated by generic loyalty programs, where customers can accumulate points while shopping at their chosen supermarket and then redeem them for rewards. In this case, the manufacturer is typically not directly involved, and loyalty is established with the respective retailer.

The situation differs for consumer durables manufacturers like televisions, laptops, or similar household-use products. While retailers have long been trying to engage and collect customer data by offering loyalty programs, it also appears sensible and advantageous for the respective manufacturer to invest in its customer loyalty program. Purchase frequency, the number of market participants, and the motivators for the next buying decision make investing in their loyalty program quite opportune.

1.2 Differentiation

At this point, in addition to loyalty programs, many other aspects should naturally play a role in the strategic focus on existing customers. However, we intend to exclusively address this aspect here and leave others, such as branding or user experience, out of consideration.

As briefly mentioned above, the range of sub-industries within manufacturing is so vast that it is impossible to discuss all specific conditions and use cases here. Market volume, market potential, the number and type of market participants, competitive environment, distribution structure, sales cycles, purchase processes, and purchase motivation can vary so significantly from one manufacturing company to another that this work, considering all these and additional factors, could easily span several hundred pages and still not adequately address all individual cases. Therefore, only a generic overview of the aspects that should be considered in discussions about loyalty programs can be provided here.

2. Getting started

As with many other groundbreaking business decisions, a thorough analysis of the initial situation is recommended before creating a loyalty program. In this chapter, we want to lead you through some fundamental questions that help you with planning.

Companies that are just starting to become customer-centric usually encounter one of the following two initial situations: there needs to be more data available, or there are large amounts of data that cannot be used for various reasons. These reasons often include:

- **Lack of appropriate marketing permissions (the customer has never given their consent to use their data for any purpose other than order fulfilment).**

- **The data is scattered in numerous silos.**

- **The quality of the data needs to be improved (outdated or incorrect contact data, duplicates, etc.).**

Most of the time, it is a combination of all of these. Ultimately, these inevitably lead to one of the first considerations: is it worth the complex process of cleansing the data to make it usable, or is it better to start from scratch and build an entirely new database?

2.1 Database

The existence of a database often comes with a desire to use it. However, it should be considered whether the effort to make the data usable does not exceed the ultimate benefit. Ask yourself:

- **Where is the data stored? It is not uncommon for historical data to be spread across several silos and systems that were never intended as a CRM system or a data warehouse.**

- **Are there duplicates? This data is very likely to contain duplicates, which are extremely difficult to identify; for example, the same person may appear with different spellings and addresses.**

- **How accurate is the data? Even if duplicate identification is possible, the question remains as to which data record contains the correct information.**

Another problem frequently occurring when using existing data is the need for verifiable marketing permissions or opt-ins. It is recommended to clarify early whether there is a legal basis for using this data for marketing purposes. This is not the case in many companies, if only because the data was originally collected and stored for entirely different purposes. Data that can only be used for marketing purposes with risk of legal complications is ultimately useless for a loyalty program.

Another aspect that should be taken into account is the subsequent organisation of the program operation. It is important to consider which employees will later work with the data and in which function. Based on this, it's worth checking whether and to what extent their existing employment contracts allow working with personal data. In some cases, separate companies are set up for this purpose, and the people involved are given new employment contracts. By then, at the latest, old data in old systems can no longer be used by the new company. In any case, the early involvement of lawyers is strongly recommended.

2.2 Incentivization & incentive systems

A loyalty program in the B2C context is ultimately an agreement between a company and a private individual. The company promises advantages and, in return, receives information and consent to use it. Of course, the company hopes to make the customer more loyal regarding purchase frequency and average shopping cart size. This is achieved through the advantages granted and the targeted use of the data obtained.
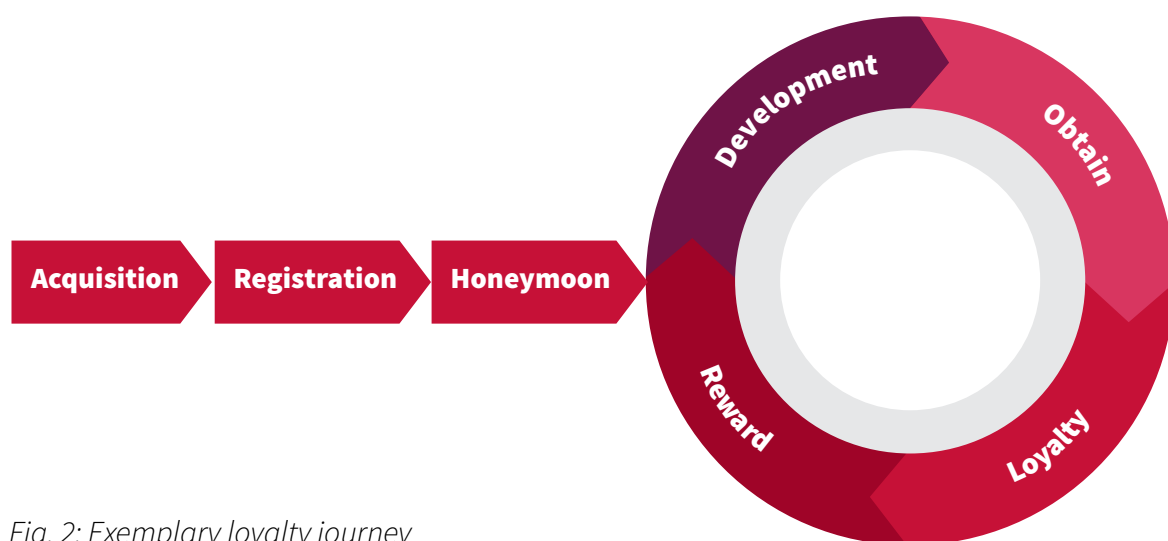

Fig. 2: Exemplary loyalty journey

Two central questions must be clarified:

- **Which incentives could your customers be interested in?**
- **What data do you want to collect, and for what purpose?**

As we will explain in more detail in the following chapter, a fundamental distinction is made between two loyalty mechanisms with different incentive systems: status-level concepts and earn-and-burn concepts.

Both concepts (or mechanisms) suggest specific incentive systems. If you want to control your customers' behaviour primarily through the supply of physical incentives, such as cooking pot sets and the like, you will likely opt for an earn-and-burn option. If you prefer to advertise discounts, advantages and additional services, a status-level concept will be your choice. Hybrid models are also possible.

In both cases, you need to answer two questions:

1. **How should the benefits be financed and offset?**
2. **Which incentives work better for your target group?**

The first question should be clarified very early in creating the business case. Not only is the financing concept important, but also the clarification of the subsequent processes. It is not uncommon for internal billing and charging between different company areas or with external service providers to be necessary. Even a virtual currency, whatever its name, ultimately incurs costs.

Thorough market research is recommended for the second question. No matter how convinced you are that you know your target group, even experienced marketing experts are often surprised by the results of a comprehensive survey. Preparing, conceiving and introducing a loyalty program is a complex and often cost-intensive process. It is therefore strongly recommended to keep the risk of incorrect assessments as low as possible.

In some cases, however, the decision does not depend solely on the customer but primarily on the company's situation and its products or services — more on this in the next chapter.
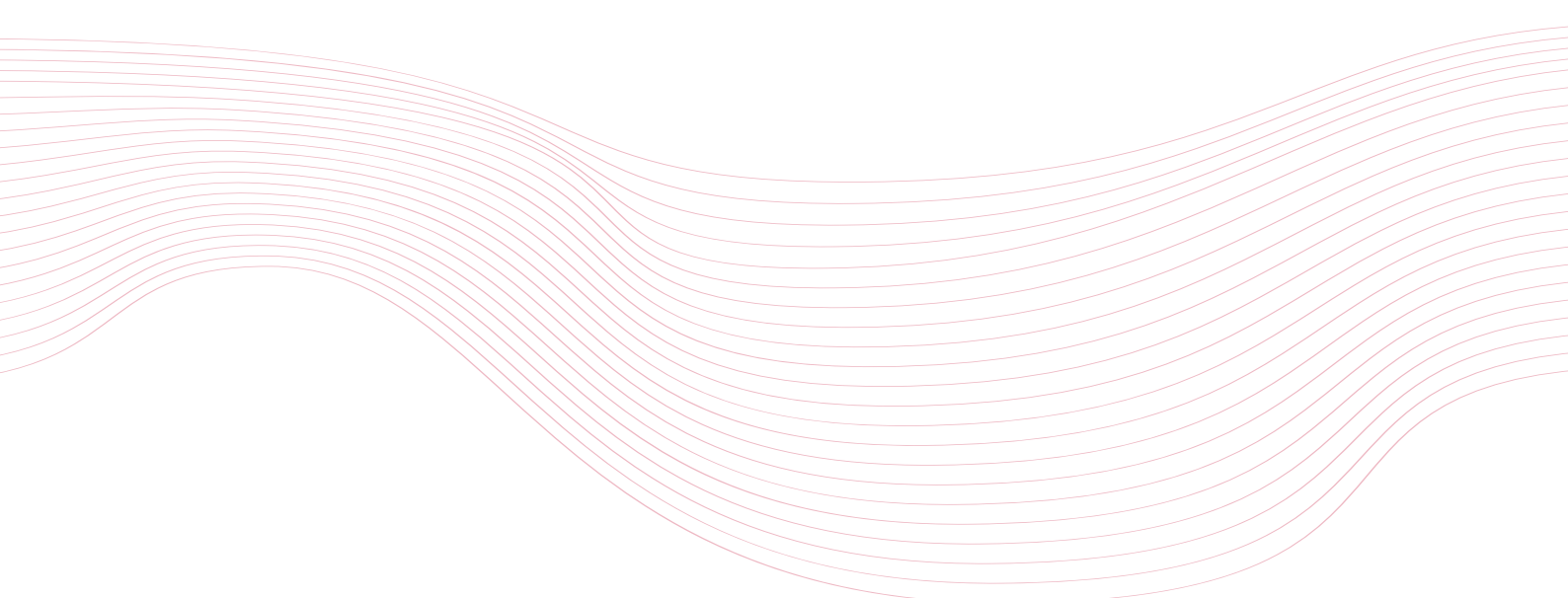
3. Concepts and mechanics

In this chapter, you'll learn the two essential concepts — status level and earn-and-burn— and their advantages and disadvantages. In practice, there are also mixed forms and variants. For example, some companies offer status levels that cannot be acquired through certain behaviours or activities but are offered against payment. Some earn-and-burn concepts include two currencies, one of which can be redeemed for material assets, and the other gives specific discounts.

3.1 Status level concepts

The basic idea of this concept is that units of a particular currency are collected until a certain amount is reached and the collector moves to a higher level. There are almost no limits to the imagination and creativity when naming the currency or individual levels, as long as these are not protected by copyright or violate other laws. The number of achievable levels can also vary greatly. The concepts range from the simple distinction between basic and premium levels to multi-level concepts in which the levels are then named, for example, with colours or titles that are intended to express ever higher value. Sometimes hidden levels are included, which are not communicated to the customer when joining the program and are only revealed after reaching the highest level to keep the motivation for a certain behavior high.
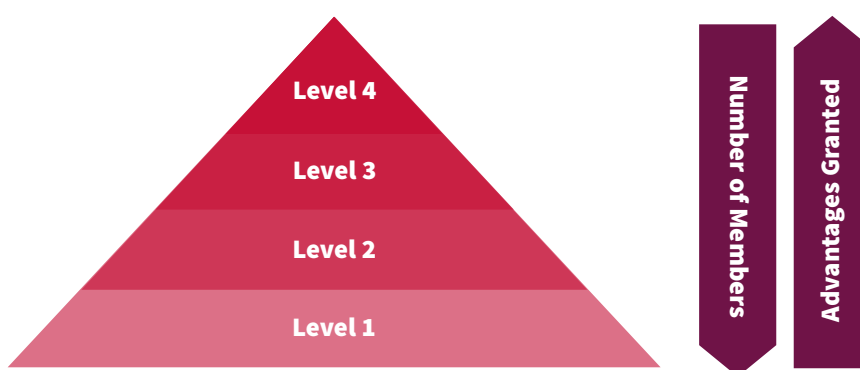

Fig. 3: General idea of a status level program

3.1.1 Incentives

As a rule, unlike earn-and-burn concepts, non-material benefits are granted here. Collected currency units cannot be redeemed for material assets but lead to promotion to a higher level. A higher level entitles further discounts and benefits ranging from free delivery of goods to access to a premium hotline with shorter waiting times to extended exchange rights, just to name a few examples.

Coupons   Coupons also play an important role as an incentive. A coupon in a certain amount is issued for reaching a new level, which creates a direct incentive for further activity.

The particular attraction of status-level concepts, in addition to the achievement of real advantages, lies very much in the intrinsic motivation of most people to consciously or unconsciously reach the next higher level. One should not underestimate how much people strive to stand out from the crowd and to belong to a supposedly better-off group. This perception is supported in addition to correspondingly valuable communication by the issue of a card as an additional status symbol. This can be done either in digital or physical form. Even if a physical card causes high costs in production, personalisation and shipping, its effect should not be underestimated.

It is important to note that each additional level increases the complexity of the necessary calculations for probable members per level and, thus, for the possible program costs. The same applies to the number of benefits granted. Each benefit must ultimately simulate how the costs change depending on the redemption rate and the number of eligible members.

3.1.2 Ascent and descent logic

Understanding the impact of different ascent and descent logics is very important. Here are the main points to consider.

Logic complexity

The definition of the logic of promotion and relegation should not be underestimated in its complexity. First of all, it is important to consider which limits should apply to reaching the next level. If the level limits are set too low, too many members will be in higher levels in no time at all, which not only has a negative impact on their motivation but also has serious effects on the program costs.

The number of levels that can be reached offers various advantages and disadvantages. The most significant advantages of a high number of levels are:

- **It is easier to create long-term motivation among program members.**

- **The entire program costs can be better distributed over the levels depending on the value achieved by the members.**

For example, with a four-stage concept, only those who bring the company the greatest value and thus refinance significant advantages are actually in the highest level. With a two-stage concept, it is more difficult to distinguish between B customers, A customers and AAA customers, which ultimately leads to a somewhat risky mixed calculation.

It is worth noting that many levels automatically lead to a significantly higher complexity of the entire program, which has an impact on calculation, communication, processes and much more.

Considerations for status evel concepts

In general, status-level concepts are better suited to establishing a lasting interaction with the customer that is not reduced to purchases. In contrast to a classic earn-and-burn concept, status-level concepts usually do not only reward actions that lead directly to sales. However, if not for purchases, it is important to consider precisely what units of the defined currency should be used for.

For example, units of the currency can also be obtained if the customer evaluates purchased products online, completes their own profile or recruits other members. The number of units granted for non-transactional behaviour should be designed so that the weighting of the total currency points earned is clearly on transactions. It should only be possible for a member to level up solely through activity in the community if they make a purchase.

In the following section, we will go into more detail about when it is best to decide on a status level concept.

Level membership

How do you want to define your assessment period, and do you want to use a rolling system or a set date range? Here are a few concrete examples:

If the level affiliation is to be continuously determined in a rolling system based on the currency units collected within 12 months, units don't have to expire. It only has to be checked how many currency units have been collected for each member in the last 365 days. The level membership is redefined accordingly. If a member had a high turnover 366 days ago and has not booked any turnover or other activities of a comparable amount since then, this member will not be classified at the same level again and will lose their status. A distinction must be made whether the logic allows a downgrade by several levels at the same time or just one level at a time.

If, on the other hand, the logic checks the score for each member only once a year on a certain date, for example, on January 1st or at the time of joining the program, the member can only lose their status at this point, even if the last large sale was more than a year ago. For example, On January 30th, a member makes a large turnover and moves up a level. On January 1st of the following year, a check is made to see whether the required account balance is available to receive the level, which is the case this time. A year later, it is rechecked. If there is no new turnover of a comparable amount that year, the member loses their status but had this status for 23 months.
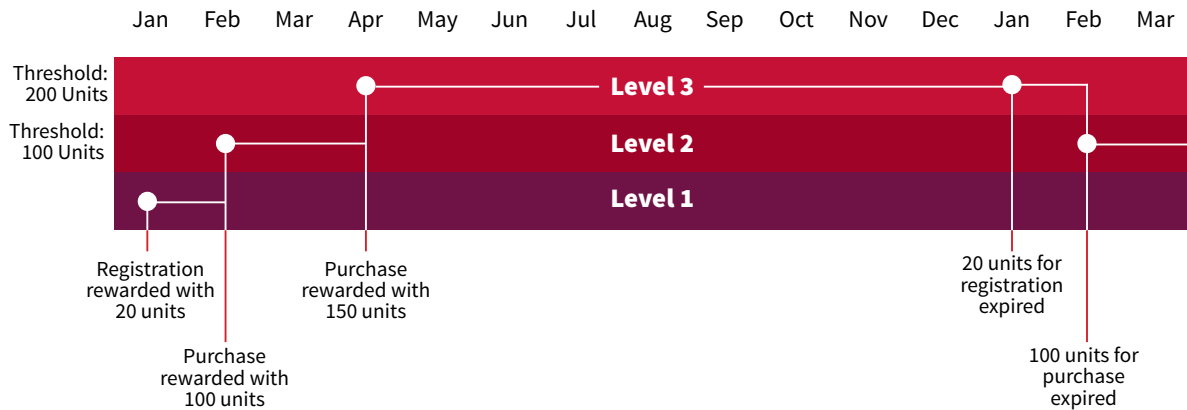
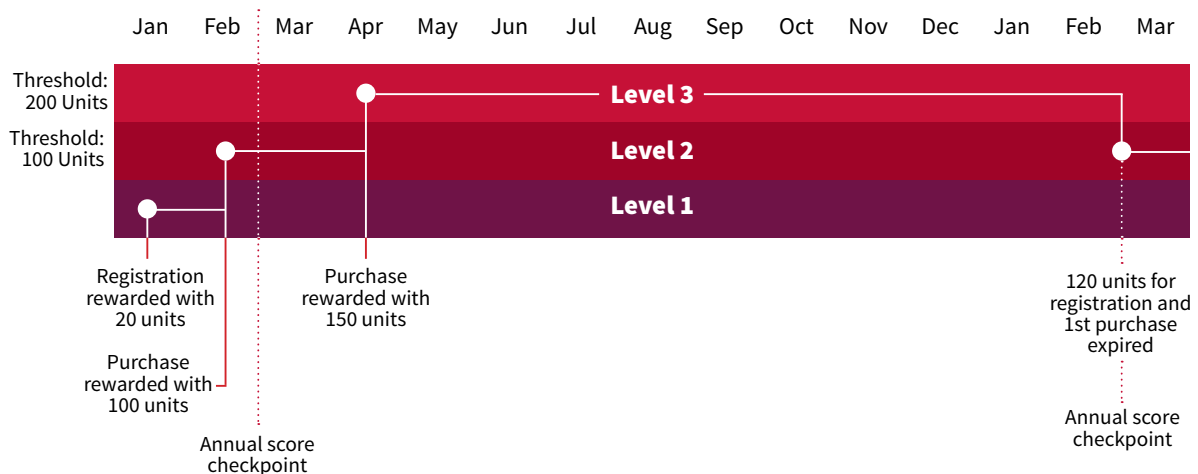*Fig. 4: Level down mechanic without fixed check date (rotating system)*

Fig: 5: Level down mechanic with a fixed check date

These two scenarios will have very different effects on the business case. The fact that this is usually easier to understand for the customer speaks in favour of the second scenario. If you want to work with physical cards, this can also make production and logistics easier.

Of course, similar considerations should also be made for level advancement. However, it is very unusual for a level-up to occur only on a particular deadline. This could also be perceived as not very customer-friendly. For example, if a customer makes a lot of sales, they are likely to expect an immediate reward in the form of a higher status.

It is also important to consider whether and when a member can lose their status completely. The eternal preservation of the status of an inactive member naturally contradicts the basic idea of generating loyal and active customers. On the other hand, there can also be scenarios in which members are not allowed to lose their status. This is especially true if the status was purchased. If this is not the case, consider when and under what circumstances collected currency units "expire", i.e. are deducted from the account balance.

3.2 Earn-and-burn concepts

Compared to the relatively complex logic of a status-level concept, the basic idea of earn-and-burn is straightforward: units of a particular currency are collected through certain behaviour, mostly primarily by purchases. These units can then be redeemed for certain non-cash rewards.
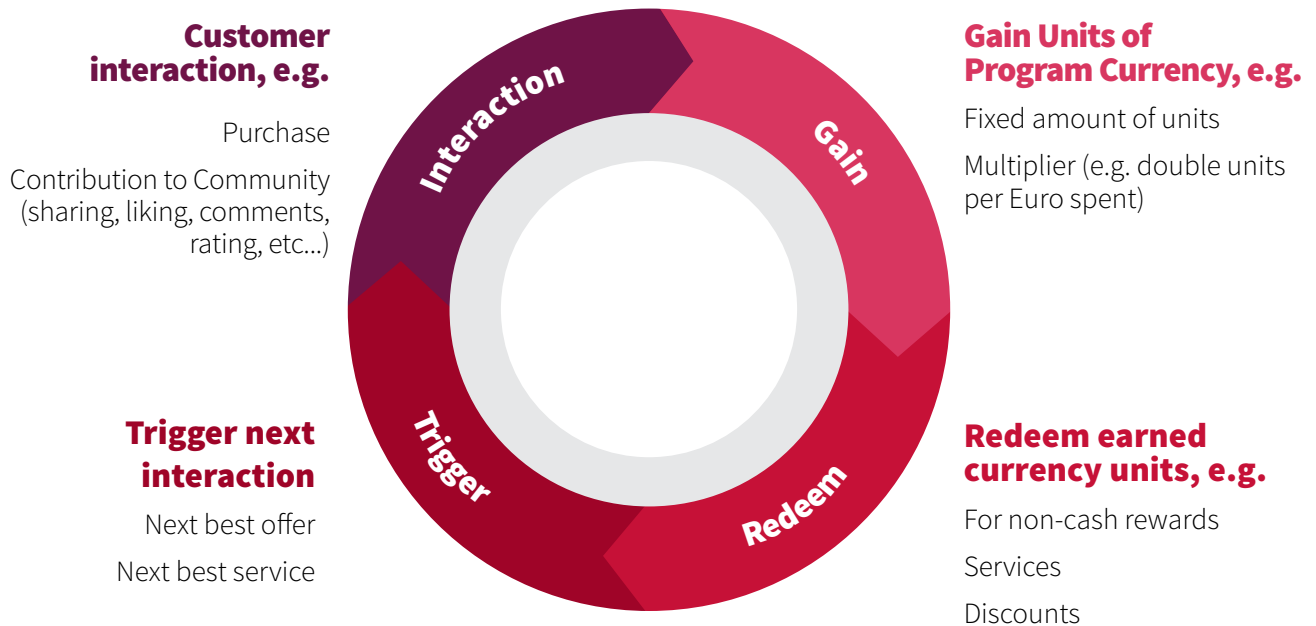
Customer interaction, e.g.

Purchase

Contribution to Community (sharing, liking, comments, rating, etc...)

Gain Units of Program Currency, e.g.

Fixed amount of units

Multiplier (e.g. double units per Euro spent)

Interaction

Gain

Trigger

Redeem

Trigger next interaction

Next best offer

Next best service

Redeem earned currency units, e.g.

For non-cash rewards

Services

Discounts

Fig. 6: Basic mechanics of an earn-and-burn program

3.2.1 Incentives

The incentives here are very immediate and tangible. In terms of communication, it is much more rewarding to present the advantages of a new bicycle than those of an online exchange receipt.

The calculation is also more straightforward here. A bonus has a certain purchase price. In contrast, the monetary value of the currency units required for this can be derived from the underlying conversion rate between real and fictitious currencies. For example, suppose the pot set costs 30 euros to purchase and the conversion between real and fictitious currency is 1:2. In that case, this set should cost the customer at least 60 units of the fictitious currency to cover costs. Of course, consciously calculating the deficit to subsidise the program can be decided at any time.

3.2.2 Redeeming

The redemption of currency units can be complex, especially if this is made possible both online and in-store and if the rewards are offered and possibly distributed by external service providers.

Another driver of complexity is when in-kind rewards can be acquired through a combination of actual and fictitious currency.

3.3 Comparing the different concepts

One of the advantages of a status level concept is the intrinsic motivation to improve one's own status. The basic prerequisite for this is that the associated advantages are genuinely perceived as such.

This is precisely one of the disadvantages compared to earn-and-burn concepts: the benefits granted often need to be more tangible and obvious. For example, an extended exchange right or free delivery is only perceived as a clear advantage if it is actually used. But even then, the benefit remains rather abstract, whereas redeeming collected currency units for a bonus is a visible and very tangible benefit.

Another advantage of status-level concepts, on the other hand, is that the benefits granted are mostly directly related to the company's products or services and thus also contribute to them, while the selectable rewards of an earn-and-burn program often have nothing or little to do with the company's products or services. The knife block that the customer receives by redeeming the currency units has no direct relation to the sales they made in a pet shop. In this respect, whether and to what extent an earn-and-burn concept actually contributes to the customer's bond with the company can be discussed.

Suppose you compare the complexity of the two systems and thus also the risk that the customer will be deterred or at least not motivated because they need help understanding the system. In that case, the advantage is clearly on the side of earn-and-burn concepts. These usually only require a little explanation, and the incentives are also obvious and tangible.

Hybrid models In practice, there is a possibility for a wide variety of combinations of these models. Sometimes, two currencies are also used to separate level affiliation and the acquisition of non-cash rewards from one another in terms of calculation, process and logic.

4. Calculating the business case

As you progress in the development phase, the business case is your compass and guiding motivation for designing all professional and technical concepts. Every technical concept from which technical and IT requirements are derived should clearly answer the question of which KPIs contained in the case should be influenced in which way.

The business case for a loyalty program is company-specific, so generic information and recommendations are difficult to offer. The business case is exact structure heavily depends on the defined program logic. However, it usually makes sense to simulate all expected program costs and compare them with an equivalent value using the uplift described here.
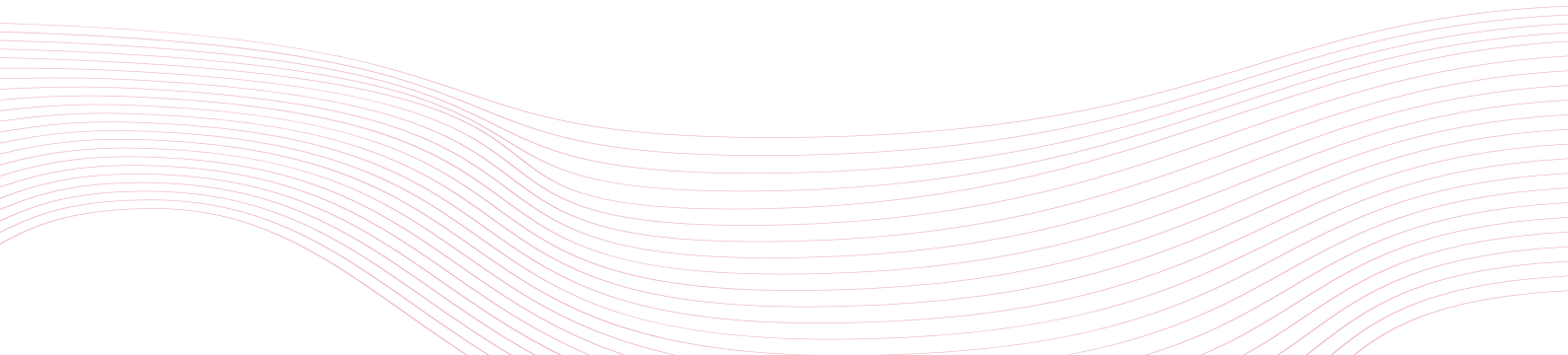
4.1 Program costs

First of all, consider if the loyalty program actually has a chance of economic success, or whether it is likely just a money-burning machine. If you still see a red number at the bottom right, despite the most favourable forecasts and assuming only best-case scenarios, you should refrain from your project.

We want to assume a calculation based on partial costs since a full cost calculation would be too complex. Most costs directly incurred by the program are usually caused by the added value offered. As already described in Chapter 3, the calculation of costs for earn-and-burn programs is usually easier than for status-level programs.

Redemption rate

One of the major risk factors when simulating the cost of earn-and-burn programs is the redemption rate. The question of how many of the currency units collected by program members are redeemed and thus cause costs, of course, seriously impacts the total costs. A blanket statement on this is likely not serious, as many factors can play a role here, starting with the value of the offered incentives through to the frequency and aggressiveness of the communication to the customer's loyalty to the company.

You should carefully weigh whether a low redemption rate and, thus, lower costs by avoiding a high contact frequency is worthwhile. Ultimately, you want the customer to have a strong interaction with your own company, as this, in turn, hopes for a higher purchase frequency and a higher average shopping cart for the customer. The strong perception of the added value for the customer is a decisive factor for their loyalty and for the success of your program. Read more about this in the second part of this guide.

Another area for improvement, regardless of the mechanics used, is the redemption rate of coupons. These can play an important role in program communication and campaigning but are more challenging to calculate for the same reasons as incentives in the earn-and-burn program.

Simulation of costs

The simulation of costs resulting from the added value is usually more complex in earn-and-burn programs. Two reasons are decisive here. On the one hand, it is often challenging to derive the costs for some added value, such as an extended exchange right. However, the much more difficult and time-consuming part is simulating the number of program members per level. Since a level mechanic ultimately only achieves the desired effect if the advantages offered become more and more valuable from level to level, higher-level members logically incur more costs. The expected number of members per level is therefore of crucial importance.

One solution can be to use existing customer data, for example, based on receipts from a certain time, for a corresponding simulation. It does not matter that this data is anonymous, i.e. no person can be assigned, as long as the data contains some unique selling point, a unique identifier. With this, it is possible to simulate which proportion of customers made which turnover in a certain period and how many purchases were completed. Measurement inaccuracies cannot, of course, be ruled out here since the same person may, for example, have used different means of payment. In addition, this data does not consider any positive effect of a loyalty program. Still, it can be a good indicator.

Conversion factor

Finally, the conversion factor between real currency and your fictitious currency must be taken into account. At the beginning, it is certainly not wrong to leave the exchange rate at 1:1. This contributes to a lower complexity for your calculations and a better and easier understanding of the program logic on the customer's side. For industries and companies with a low average purchase frequency, it may make sense to adjust the exchange rate in favour of the fictitious currency to quickly make the fictitious account balance appear subjectively high, even with only a few customer interactions.

4.2 Revenue

Most of the revenue from your loyalty program should come from your standard business model. Remember, the loyalty program's success yardstick is increased purchase frequency and larger shopping cart compared to non-members.

If your average customer buys from you three times a year and generates an average of 100 euros per sale, whereas a program member buys from you four times a year for an average of 120 euros per sale, the uplift of your program is 180 euros per member each year. Compare this value with the program costs per member in your calculation. If the average program costs, at partial expenses, are less than 180 euros per member, your program should be profitable.

The same applies to the uplift used for shopping cart and purchase frequency for the incentive redemption rate: a blanket statement or recommendation would not be worthwhile, as numerous factors are decisive here.

In addition to the uplift, other sources of income can be introduced through a loyalty program. For example, certain incentives can be offered against additional payment. In this way, the contribution margin for the premiums can be influenced favourably. Another source of revenue can be the sharing of customer insights. This does not mean the transfer of customer data to third parties. Instead, the idea is to market certain behavioural patterns of a certain group obtained through systematic evaluation of purchase and behavioural data.

For a detailed derivation of the revenues, it can make sense to calculate basic campaign ideas in addition to the business models described above. For example, it makes sense to make recurring campaigns, such as newsletters, an integral part of the case right from the start. Assuming certain opening rates, click rates and conversions, sales can already be assigned to this.

Finally, you should definitely remember to take into account the additional revenues that can be achieved through coupons. Coupons are a tool that should be considered in triggering additional purchases as well as in increasing the shopping cart.

4.3 Measuring the impact (KPIs)

The difference in shopping cart size and purchase frequency between members and non-members — the uplift — is the best way to measure the success of your program and the evaluation basis for your return on investment. The two most important parameters or KPIs (Key Performance Indicators) are:

- **the average shopping cart**
- **the average buying frequency of your members.**

Both should be significantly higher than for non-members.

Depending on how your members can collect units of your currency in addition to transactional interactions, other KPIs are of course conceivable. However, it is of course usually difficult to assign a direct equivalent value to them, which is why it is often not possible to take them into account in the business case. For example, it is difficult to calculate value for customer-generated content, such as product reviews. Even if a corresponding logic is developed for this, it is ultimately a fictitious value in the vast majority of cases.

Of course, you would like to evaluate the extent to which your program members perform better than non-members.

To measure the uplift, it should be clarified whether both parameters can be measured for non-members. If not, a study on the zero-point measurement in advance can also help here.

Setting up at least one control group to measure campaign and communication effectiveness is also advisable. In concrete terms, this means that a certain percentage of the members are excluded from any program communication to measure the communication's effects on the KPIs. In addition to a global control group, there are often campaign-specific control groups. All of this will help later in evaluating the success of your program by comparing the planned values with actual values.

fluido
an Infosys company

www.fluidogroup.com