

## *Loyalty-Marketing Programs In the Retail Food Industry*

### **Executive Summary and Introduction**

Food retailers use loyalty-marketing programs — also known as frequent-shopper programs, savings clubs or reward-card discounts — to identify their best customers and reward them with discounts on groceries. Retailers also offer many other benefits as diverse as charitable donations and savings plans for college tuition.

Retailers use the program sales data to tailor their product assortment to these most loyal shoppers. Only 12 percent to 15 percent of customers are loyal to a single retailer, according to the Center for Retail Management at Northwestern University, but these patrons generate between 55 percent and 70 percent of company sales. Some food retailers find that as much as 95 percent of their sales go to members of loyalty programs.

Loyalty-marketing programs have existed at least since the 1950s, when S&H Green Stamps rewarded grocery store and gas station customers with stamps redeemable for appliances, furniture and other merchandise. In recent years, loyalty programs have become more widespread and sophisticated as retailers have employed new technologies. Many retailers see these programs as a way to combat eroding sales growth and to attract and reward loyal customers.

About 40 percent of food retailers offer loyalty programs.<sup>1</sup> Three-quarters of customers participate in the programs, including 41 percent who use their loyalty cards almost every time they shop.<sup>2</sup> Retailers without such programs include supercenters, warehouse club outlets, limited-assortment and other stores that offer every-day-low prices. This variety gives consumers considerable choice in shopping for the best product values.

Some consumers oppose loyalty-card programs for what they perceive as privacy intrusions or price manipulation. Food retailers have responded by instituting strict privacy controls, agreeing not to share individual purchasing or personal data with any outside parties. Retailers who attempt to manipulate prices in today's highly competitive market are unlikely to succeed when consumers have so many alternative stores from which to choose. The overriding price trend is that consumers are benefiting from a long period of minimal food inflation, averaging 2.5 percent a year from 1994-2004.

*Retailers use the program sales data to tailor their product assortment to these most loyal shoppers.*

*About 40 percent of food retailers offer loyalty programs. Those that do not include supercenters, warehouse club, limited-assortment and other stores that offer every-day-low prices. This variety gives consumers considerable choice in shopping for the best product values.*

<sup>1</sup> FMI, *The Food Retailing Industry Speaks*, 2005.

<sup>2</sup> FMI, *U.S. Grocery Shopper Trends*, 2005.

Food Marketing Institute (FMI) conducts programs in research, education, industry relations and public affairs on behalf of its 1,500 member companies — food retailers and wholesalers — in the United States and around the world. FMI's U.S. members operate approximately 26,000 retail food stores with a combined annual sales volume of \$340 billion — three-quarters of all retail food store sales in the United States. FMI's retail membership is composed of large multi-store chains, regional firms and independent supermarkets. Its international membership includes 200 companies from 50 countries.



655 15<sup>th</sup> Street, N.W., Washington, DC 20005  
202.452.8444 fax: 202.429.4519  
fmi@fmi.org ■ <http://www.fmi.org>

### 1. What is a loyalty-marketing program?

An electronic method of identifying customer purchases and translating that information to reward customers based on their shopping habits. Loyalty programs help food retailers:

- Identify their most loyal customers.
- Learn more about their best customers' buying habits.
- Offer the products and services their best customers demand.

### 2. Do all food retailers offer loyalty marketing programs?

About half do not offer loyalty programs, according to FMI research cited above. Many retailers, including supercenters and warehouse-club and limited-assortment stores, opt instead to offer every-day-low prices. Other retailers use the more traditional sale-based pricing strategies and emphasize high quality and service.

### 3. How do loyalty-marketing programs work?

To enroll, customers typically complete an application asking for their name and address, and sometimes information such as gender, phone number, birthday, e-mail address or income. Each time cardholders make a purchase, the store scans their membership card, tracks the sale and converts this data into useful information. Most programs are free to join, although some charge an annual or one-time fee.

Some loyalty-marketing programs give customers points that accrue with their purchases and can be redeemed for various rewards. Most offer product discounts. Every week, stores may discount hundreds or thousands of items for program participants, such as half-price chicken breasts, 20 percent off all items from one manufacturer, or a set percentage off the total receipt. Some promotions target specific customer needs, such as discounts on diapers for families with newborns.

Cardholders receive their discounts by presenting their card at the checkout or by redeeming targeted coupons issued at their last visit (distributed automatically at checkout); or through direct mail, newsletter, e-mail and Web site promotions. Many programs automatically tabulate year-to-date savings or point value on each receipt. Other loyalty rewards:

- Benefits that increase in relation to the amount a customer spends. One food retailer's program rewards customers who spend a certain amount each month with "best-shopper birthday dinners" (\$20 food vouchers). Another offers "preferred pricing" — the higher the spending, the more generous the discounts. This model notifies customers in advance of the sale prices and registers them automatically at the checkout when their cards are scanned.
- Free or discounted products and services from stores, restaurants, car-rental companies, cruise lines, maid services, hotels and other businesses that partner with the food retailer. One retailer offers a learn-to-ski package with the purchase of eight key items.
- Charitable donations. Through partnerships with educational institutions, for example, food retailers allow cardholders to designate

*Loyalty program benefits are as diverse as charitable donations and savings plans for college tuition.*

*Through partnerships with educational institutions, food retailers allow cardholders to designate schools to receive a percentage of every dollar they spend. Contributions cost the cardholders nothing.*

*Program benefits are one way to help merchants re-establish a one-on-one relationship with their customers.*

schools to receive a percentage of every dollar they spend. Contributions cost the cardholders nothing. An electronic fundraising program called eScrip ([www.escrip.com](http://www.escrip.com)) facilitates some of these programs.

- Airline miles, savings plans to help cover college tuition for cardholders' children ([www.upromise.com](http://www.upromise.com)), long-distance telephone minutes, auto club memberships, free birthday cakes, and special food and wine tastings.

Many successful programs enable retailers to customize benefits to individual shoppers, whether their interests are travel, entertainment, education or other areas.

#### **4. How can food retailers help consumers and manage operations with the data they collect?**

Analyze shopping habits, refine marketing programs and fine-tune the product mix at the chain or individual store level. Among other applications, stores use data gleaned from loyalty-marketing programs to:

- Identify the promotions that appeal most to various customer groups, e.g., discounts or rebates for price-conscious shoppers; convenience foods and delivery services for busy shoppers.
- Reduce the shelf space devoted to slow-moving items in order to stock the products that customers prefer.
- Keep popular items from selling out.
- Reveal when products were sold and whether they were sold on or off promotion, and the profit margin on each sale.
- Improve speed-to-shelf and decrease out-of-stocks.
- Determine how product deletions affect their best customers, and take steps to keep those customers from taking their business elsewhere.

Key to the success of these efforts are tools that interpret data from loyalty programs more quickly, cheaply and frequently than the retailers themselves could do. Predictive software helps retailers uncover subtle buying patterns and relationships, as well as expand categories to customers who never purchased products in those categories before. Such information has helped retailers double or even triple the effectiveness of targeted promotions.

Although food retailers send targeted offers to individuals, they typically analyze data at the aggregate level, i.e., data from groups, not individuals. Some stores track total purchase amounts and shopping frequency but not individual items.

*Key to the success of these efforts are tools that interpret data from loyalty programs more quickly, cheaply and frequently than the retailers themselves could do.*

## 5. What do consumers like about loyalty-marketing programs?

In addition to the concrete benefits of savings, convenience (coupon-free discounts) and better product selection, loyalty programs give customers the sense that the retailer values them personally and respects their business. Perhaps ironically, this “corner-store” or localized approach, as it is sometimes called, is made possible by sophisticated data analysis.

For instance, scanning a customer’s card notifies the cashier who the customer is by name and what level of shopper he or she is. Personal touches take the form of sending Christmas cards to best customers or having a store manager call customers whose spending has dropped, to explore what can be done to win back their business. Some retailers demonstrate their community commitment by giving loyal customers tickets to local cultural events.

Other popular aspects of loyalty-marketing programs include watching savings or points accrue through the year and receiving special-occasion bonuses such as half-price Easter hams, free Thanksgiving turkeys and birthday specials.

The most successful loyalty programs are easy for customers to use and understand. Some food retailers send new cardholders a welcome package explaining the program’s benefits. About half use their Web sites to explain the programs, according to ACNielsen Homescan.

## 6. How does it benefit retailers?

The program data help retailers adjust their product assortment to customer demands. Retailers remove or cut back slow-moving items and devote more shelf space to the products that program members buy. These measures reduce out-of-stocks and inventory costs and increase sales. In addition, target marketing is typically more cost-effective than mass marketing, which reaches an audience much larger than most retailers’ actual customer base. Retailers can generate more sales at a lower cost by notifying cardholders of specials that, based on purchasing data, they are most likely to use. Retailers can also communicate this marketing information through less expensive mediums, such as mailings, e-mail or point-of-sale discounts.

## 7. How are food retailers addressing consumer privacy concerns?

FMI member companies take the issue of consumer privacy very seriously. The companies developed the following principles to protect the privacy of consumers who participate in loyalty-marketing programs:

- Create a data privacy policy committee and implement a written privacy policy.
- Ensure that the retailer’s business partners understand and adhere to the privacy policy.
- Make the terms and conditions of a data-driven program easy to read, easy to understand and readily accessible. Customers should be able to withdraw from the program and have all personally identifiable information about them deleted from the program database.

*Loyalty programs give many customers the sense that the retailer values them personally and respects their business.*

*The program data help retailers remove or cut back slow-moving items and devote more shelf space to the products that program members buy. These measures reduce out-of-stocks and inventory costs and increase sales.*

- Keep data collection to a minimum to ensure the effectiveness of the program without intruding on customers' privacy.
- Inform customers how their information will and will not be used. "Consumers are more tolerant of [marketers] collecting lots of information if its use is tightly limited," said Howard Beales, director of the Federal Trade Commission's Bureau of Consumer Protection, in *Promo* magazine.
- Give customers the ability to control access to their personal information. For instance, they should be able to opt out of certain aspects of the program, such as being able to join without providing personal information, or not receiving marketing materials through the mail or e-mail.
- Allow customers access to their data.
- Place time limits on the maintenance and storage of data.
- Ensure that the data collected are secure.
- Implement business processes to ensure that the retailer's practices are consistent with its privacy policy.

These guidelines are detailed in FMI's *Consumer Privacy Program Implementation Guide* (copies can be downloaded from the FMI Web site at <http://www.fmi.org/gr/consumerprivacyprogram.pdf>). The guide includes a model privacy statement and list of Privacy Seal Programs, in which objective organizations attest to the retailer's commitment to protecting customer privacy.

## 8. What about charges that food retailers may inflate product prices in loyalty-marketing programs?

Some critics believe that retailers inflate their prices for non-cardholders or inflate the purported full retail price during promotions, making card savings appear to be greater than they actually are. Unscientific comparisons showing loyalty-card and non-card prices of 20 items or fewer at different retailers have suggested that programs do not save consumers money.

However, these comparisons tend to focus on staple items, whose prices are the most volatile and are often featured as loss leaders at discount retail stores. It is not surprising then to find that discount-store prices for some items are lower than loyalty-card prices at traditional supermarkets. Prices vary by cities and by stores across the U.S. It is important not to ignore price as a merchandising strategy by which different products may be highlighted at different stores in order to encourage shoppers to visit their particular store that day, week or month. The critics do not take these variations into account, but rather assume product A is on special in one store, so therefore it must be on special in all stores.

Consumers are benefiting from a long period of minimal food inflation. From 1994 to 2004, yearly food inflation averaged only 2.5 percent. In addition, the percentage of family income spent on food-at-home (retailers) continues to decline — from 16.9 percent in 1950 to only 6.1 percent in 2003.<sup>3</sup>

<sup>3</sup> Economic Research Service, U.S. Department of Agriculture, "Food CPI, Prices, and Expenditures: Expenditures as a Share of Disposable Income."

*To protect privacy, retailers give customers the ability to control access to their personal information. For instance, they should be able to opt out of certain aspects of the program, such as being able to join without providing personal information.*

*Consumers are benefiting from a long period of minimal food inflation. From 1994 to 2004, yearly food inflation averaged only 2.5 percent.*

*The percentage of family income spent on food-at-home continues to decline — from 16.9 percent in 1950 to only 6.1 percent in 2003.*

### 9. What are the costs associated with running a loyalty-marketing program?

A study by McKinsey & Company estimated that a program's first year can cost as much as \$30 million, with annual maintenance and marketing costs reaching \$5 million to \$10 million.<sup>4</sup> Smaller operators may be able to mitigate these expenses by buying off-the-shelf CRM (customer relationship management) software instead of developing proprietary software. Another cost-effective alternative may be enlisting an application service provider for retailers that lack the systems resources or expertise.

Additional expenses include training and compensating employees to run the programs, giving these employees the flexibility and resources to turn the data into useful insights, and investing in “knowledge-distribution” tools (such as a company intranet) that disseminate findings and recommendations to top managers with decision-making authority. Nonmaterial costs include ensuring that top management truly buys into the program and is willing to shift from a mass-marketing mentality to one of targeted marketing.

### 10. How are loyalty-marketing programs changing?

Faced with intense price competition, food retailers are challenged to ensure that their programs offer both value and other customer benefits. More rewards through partner companies are likely, as are creative services for preferred customers such as self-scan lanes and higher check-cashing privileges. Some industry executives believe retailers should focus less on promoting high-volume products and more on understanding what their best customers want — even if they want slow-moving products that the retailer might be tempted to stop carrying. The more targeted approach may result in less use of mass-market advertising.

Retailers are exploring how to leverage technology such as predictive software to uncover subtle buying patterns and identify customers who may be likely to buy in categories they have never bought in before. Many are making greater use of the Internet to promote their loyalty program through accessible and informative Web sites and targeted e-mail.

Even while harnessing technology, growing numbers of retailers are stepping up efforts to reconnect with consumers and to meet their changing needs on a more “local” level. In the past, store owners knew their shoppers well and could easily anticipate needs. Today, we use computers and data to help do the same. These include using loyalty programs to support community initiatives, encouraging staff to get to know customers personally, and otherwise making cardholders feel that the store values their business and respects their right to limit access to their personal information.

*Faced with intense price competition, food retailers are challenged ensure that their programs offer both value and other customer benefits.*

*While harnessing technology, retailers are stepping up efforts to reconnect with consumers and to meet their changing needs.*

---

<sup>4</sup> Leech, Peter, “Gaining Value From Loyalty Cards,” *SuperMarket Research*, FMI, January/February 2002.