From loyalty cards to micro-marketing strategies: Where is Europe's retail industry heading?

Received (in revised form): 1st December, 2003

Cristina Ziliani
is a senior research associate in retailing and a lecturer in direct, database and internet marketing at Università degli Studi di Parma, Italy. Her main areas of interest are retail marketing, database marketing and targeted promotions.

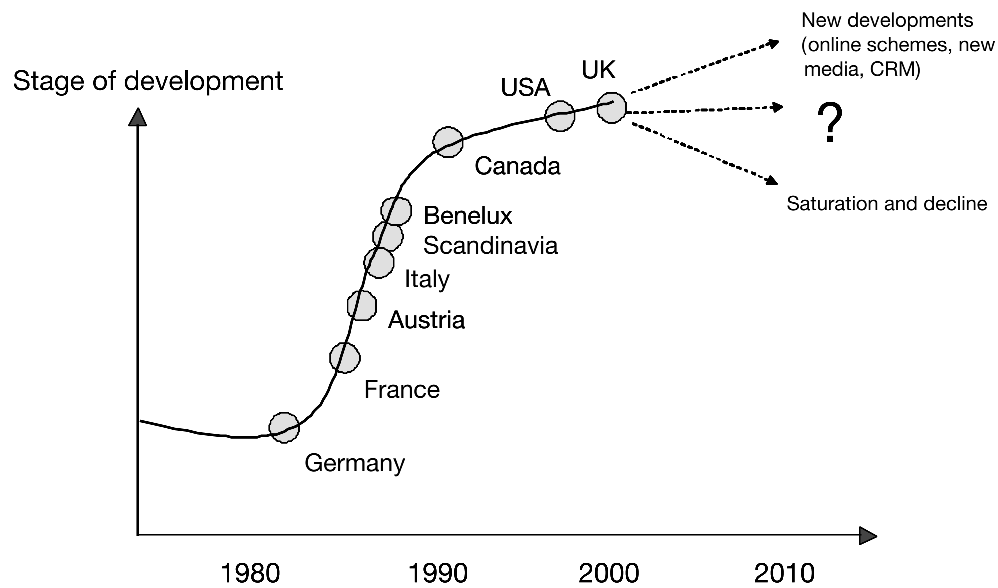
Silvia Bellini
is a PhD student in retail marketing at Università degli Studi di Parma, Italy. Her main area of research interest is the economics of digital markets.

Abstract Loyalty cards are commonplace in European retailing; few retailers, however, are leveraging customer information to become more customer-oriented. The paper addresses the current trends in European loyalty schemes, drawing from data collected by the Observatory on Loyalty Cards at the University of Parma, and suggests that the real drivers of a retailer's transition to a 'micro' (ie customer-specific) marketing orientation are (a) the level and nature of competition in the retailer's market and (b) the retailer's value and culture.

One of the most conspicuous trends in retail marketing since the 1990s has been the launch of card-based loyalty programmes. Along with the flood of plastic came a stream of contributions extolling the virtues of a loyalty/relationship approach in retailing. Authors welcomed the retail industry into the exclusive club of lifetime value (LTV) calculation and customer churn tables. Low growth rates and increased competition did the rest, making retailers sensitive to retention and loyalty issues. After growing by 25–30 per cent a year during the 1990s, loyalty cards are now commonplace in European retailing, almost showing signs of maturity. Penetration has approached saturation point in some markets, such as the UK, while in others it is still advancing at a steady pace. In Germany, the last country to enter the loyalty arena, as many as 200 schemes have mushroomed since 2000, after a ban was lifted (Figure 1).

The presence of loyalty cards and programmes, however, tells little about European retailers' intention to embrace information-intensive marketing. Few are leveraging customer information to become less product-centred and more customer-oriented. In many cases companies have adopted loyalty programmes as the ultimate marketing fashion, because competitors were doing

Cristina Ziliani
Università degli Studi di Parma, Via J.F. Kennedy 6, 43100 Parma, Italy.
Tel: +39 0521 9032012
e-mail: cristina.ziliani@unipr.it



Source: The Observatory on Loyalty Cards at the University of Parma and Datamonitor

Figure 1 The 'life cycle' of loyalty programmes in grocery retailing

it and chief executive officers (CEOs) or client information officers (CIOs) were keen to do the same. This will lead to programme closures, as costs become unsustainable. As for the retailers that do not feel cost pressures (either because the programme is successful or because of poor return on investment (ROI) measurement), they might also feel less of an urge to put the data generated by such programmes to work to extract higher returns on the investment. Again, this will translate into a slow pace of change towards information-intensive and customer-centred marketing strategies.

There is a paradox here: programmes that fail to deliver confirm promoting retailers in their long-established retail marketing practices, which are product-focused and buyer-dominated. On the other hand, programmes that deliver provide a competitive edge in themselves, leaving promoting retailers satisfied with more resources to support traditional marketing practices.

In sum, loyalty programmes are not sufficient to drive a retailer's transition to a micro-marketing (ie customer oriented) orientation. The authors argue that the real drivers are:

— the level and nature of competition in the retailer's market
— the retailer's values and culture.

The Observatory on Loyalty Cards at the University of Parma, Italy, has been monitoring 40 retail schemes across Europe since 1998, by means of direct interviews with marketing and loyalty managers at major retailing companies, extensive literature and press reviews, questionnaire-based surveys and a biannual conference. The findings are used in this paper to outline the above thesis and shed some light on the development of loyalty and micro-marketing activities in the European grocery industry.

The goal of this paper is first to highlight some major trends in the 'visible' side of loyalty marketing: that is, trends affecting card penetration, reward mechanisms and new developments in the area of loyalty programmes. Then the assumption that once loyalty cards and databases are commonplace retailers will leverage data-enabled insight to move to micro-marketing strategies is questioned. When the retail organisation and its processes eventually become information intensive, the distinction between macro and micro retail marketing blur but, just as much as a successful long-running loyalty programme, this is a step that only a handful of champions take.

TRENDS ON THE TANGIBLE SIDE OF LOYALTY MARKETING: CARDS, SCHEMES, REWARDS, COALITIONS AND MORE

In the early years, retailers concentrated on the launch of their card programmes and, just like their customers, many lost interest a few months later. The magic aura surrounding the word 'loyalty' seduced many into thinking that cards would build loyalty *per se*, and that the attached programmes would automatically expand share of wallet and sustain repeat buying.

Most retailers displayed a 'wait and see' attitude — as often happens in an industry where innovation can be rapidly imitated and wrong choices can have an immediate and disastrous impact on customers' shopping experience and satisfaction. Often there was just one pioneer retailer in each country (eg Tesco in UK, Esselunga in Italy, Albert Heijn in the Netherlands) which enjoyed up to five years of the monopolist's real privilege, a quiet life, before an imitation phase followed.

The first entrants' advantage was further prolonged because imitators seldom put serious effort into differentiating their schemes from the pioneers. As is typical of a developing market, to satisfy the basic need was enough and with so many wallets still devoid of any loyalty card, why bother offering something more than a me-too?

Early loyalty programmes looked the same all over Europe: immediate price discounts at the checkout for all cardholders, points that could be saved over time and exchanged for gifts (Italy, Ireland), for vouchers (UK, Spain, Portugal) or multipurpose cards serving loyalty, payment and membership needs (Scandinavian cooperatives). The spectrum of above and below the line rewards offered by European programmes is recorded by the Observatory and shown in Tables 1 and 2.

The proliferation of schemes in local markets forces retailers to upgrade and innovate their programmes.

— Care is taken to integrate the scheme with the retailer's communication strategy.
— A distinctive positioning is sought.
— Two-tier reward models (cardholders vs noncardholders) give way to more subtle approaches, as several demographic clusters are addressed with *ad hoc* marketing activities.
— Gift catalogues, although still very popular in Italy and Ireland, are being substituted by more versatile 'discount points'.
— Elements of 'self segmentation' are added to the scheme, so that each consumer can tailor the programme and its benefits to his or her needs (ie special clubs for vegetarians, senior citizens, wine lovers and so on, as shown in Table 1).
— Below the line rewards (ie price discounts as illustrated in Table 2) are tied to thresholds, filters and other mechanisms to encourage desirable behaviour, rather than simply reward

Table 1: Above the line rewards in loyalty programmes across Europe

Fun and free area	Service area	Self-segmentation area
Immediate gift:	Cheque cashing	'Lifestage' clubs:
stand alone	Home delivery	mother and baby
piece a week	Remote ordering	families with kids
Gift catalogue:	Consumer magazine	students
self-liquidating offer	Shopping evenings	pensioners
only points needed	Extended range (on catalogue)	'Lifestyle' clubs:
In-shop lottery:	Partners for point collection/redemption	gourmet
sweepstakes	Product samples/trials	world of wine
instant gift certificates	E-commerce	healthy eating
	In-shop nursery	fitness
	Self-scanning	weight loss
	Debit card	quit smoking
	Payment card	'me-time'
	Internet service provider (e-mail etc)	travel and leisure time
	Financial/insurance services	Cause-related marketing (schools, charities etc)

Source: The Observatory on Loyalty Cards at the University of Parma, 2003

Table 2: Below the line rewards in loyalty programmes across Europe

Type of price discount	Immediate	Over period of time	Example
Electronic price discounts at checkout	×		Caprabo
Checkout coupons (Catalina Marketing style or printed on receipt)		×	Leclerc, Carrefour
Electronic price discounts at in-store kiosk	×	×	Boots
Straddle pricing on selected items	×		Delhaize
Coupon mailer based on periodic purchase (amount)		×	Sonae
Coupon mailer based on periodic purchase (items)		×	Tesco
Price discounts at partner companies	×	×	Superquinn
Web coupons (printable or electronically delivered at till)		×	Interdis (I)

Source: The Observatory on Loyalty Cards at the University of Parma, 2003

customers for what they have done in the past.

As differentiation efforts drain an increasing amount of resources, with the scheme costing €0.5m per year for an Italian medium-sized retailer, retailers:

— investigate early adopters' mistakes;
— look for ways to reduce costs;
— evaluate the benefits of adding partners to the scheme.

Early mistakes were mainly concerned with wrong estimates of the programme's power to modify shopping behaviour. In fact, McKinsey[1] found that average sales increases among providers of loyalty programmes amount to 1 to 3 per cent in the grocery industry, and tended to erode over time. Fewer than half of the participants in grocery programmes say they spend more, as a consequence of the programme, than they otherwise would. This, coupled with the modest value of rewards allowed by 1 per cent schemes (one pence for every pound spent), typical of the supermarket industry, ought to make retailers realistic about the programme's foreseeable impact on sales. Other common mistakes are concerned with underestimating the costs of managing the database and the huge cost of rewards.

Direct communication with customers is a building block of any loyalty

Table 3: Direct media employed in loyalty programmes across Europe (all sectors)

Media	Kirstgens[2]	Meyer-Waarden and Benavent[3]
Direct mail	55	89
Customer magazine	71	72
Newsletter	24	87
Call centre	21	93
Special events/clubs	21	18
Website	5	81

programme. As Meyer-Waarden and Benavent[4] discuss, retailers employ a variety of promotional media, of which direct mail is the most popular (almost 90 per cent of schemes). Despite its well-known advantages, direct mail requires a variety of skills (creative, segmentation, printing) and time to be managed, that make it costly and cumbersome when fine targeting and/or high frequency of communication are sought. In the future, electronic media such as kiosks and e-mail promise to make direct communication with customers viable, for small and large companies alike.

For example, despite their small size compared to foreign loyalty giants, and a more recent interest in customer information, Italian retailers who have set up direct communication media such as direct mail (77 per cent) and cardholder magazines (45 per cent) also:

— have successfully experimented with kiosks (23 per cent) and e-mail (23 per cent);
— are going to introduce checkout couponing (45 per cent) and SMS marketing (32 per cent).

Last, but not least, coalition schemes such as Payback in Germany (15 million cardholders) or Britain's Nectar, launched by Sainsbury's, BP, Barclaycard and Debenhams in September 2002 (12 million) seem to have a promising future too, in that they:

— provide more convenience to customers, who earn points more quickly;
— save costs for participating retailers (reportedly up to 30–40 per cent);
— allow retailers from more peripheral sectors access to loyalty marketing tools;
— change customers' 'mental algebra' by making programmes less easily comparable. In fact, the value of points changes when collection and redemption occasions differ in type and number, even if the point accumulation mechanism is the same (one point per pound spent).

A notable effect of coalition programmes is the rise of new information intermediaries, as the companies managing the schemes (eg Loyalty Management UK for Nectar) become database marketers, leveraging huge databases to sell customer access to interested third parties. Companies will discover, however, that questions concerned with ownership, access and use of customer data need to be clearly addressed by partners beforehand; accordingly, the value of customer data for prospective buyers (manufacturers, direct marketers, service providers) should be calculated, before engaging in database marketing efforts that cannot repay their cost (especially in fast-moving consumer goods, where names of individual customers are of little use), as pointed out by Hughes.[5]

These trends in loyalty programmes may lead observers to think that some kind of convergence is in progress, and the retail scene will look more and more the same all over Europe, as far as marketing activities are concerned.

The measure of differentiation that retailers can attain with their loyalty activities is directly correlated with the grasp they have of their customer base preferences and behaviour. The more retailers get to explore their loyalty databases, the more marketing strategies and activities can be fine-tuned, thereby taking routes that are different from those taken by competitors.

At present, however, there is another paradox: when moving from the tangible side of loyalty marketing to the less tangible (ie towards the use of marketing information derived from the programmes), similarities between companies start to increase. Data analysis is in its infancy everywhere; even retailers who have accumulated huge amounts of data are not doing much with them. Tesco is the exception that seems to confirm the rule; in France, Italy, Germany or Spain, the domestic supermarket businesses are just now scratching the surface of micro-marketing.

THE DARK SIDE OF LOYALTY MARKETING: FROM DATA TO INSIGHT

It was mentioned earlier that retailers' focus so far has been on the scheme, rather than on the use of data derived from it. Italian companies, for example, after storing gigabytes of data for years, are just now starting to investigate what to do with them. Loyalty programmes in themselves do not turn retailers into data-based organisations. Nonetheless, it could be argued that programmes do serve to accelerate the retail industry's transition towards information-intensive practices. To support this view it should be considered that loyalty cards and schemes:

— enable customer identification (thanks to plastic cards) and the construction of a database that can be leveraged to take better informed decisions;
— provide a learning experience with new promotional tools and mechanisms that can be progressively fine-tuned and accurately targeted;
— influence the top management's attitude towards micro-marketing, the bias depending on the economic results achieved by the programme itself; and
— programme-related partnership opportunities (both horizontal and vertical, ie with suppliers) provide resources and stimuli toward marketing innovation and experimentation; while
— information technology choices made in the early days of the programme determine what kind of data will be collected and will therefore be available for marketing decisions.

Loyalty schemes and associated technologies and direct media will certainly play a role in turning retailers' attention to the value of customer insight. Indeed, several retailers in the Observatory are mining their databases, carrying out analysis such as product-buyer profile, promotion analysis, promotion effectiveness, cross-purchasing analysis, basket analysis, exploration of customer purchasing patterns, new product launch performance and new product launch cannibalisation. This new insight can be leveraged to create value: examples of information-based value creation can be made in all areas of retail marketing, from range to format, from service to layout.

Such analyses, however, are often occasional, not systematic, and confined to the marketing department, as retailers hesitate to translate them into decision-making routines. Retail companies are traditionally product or logistics driven. Without top-level commitment and support the marketing function — where information is produced but not where the power is — may have to do a lot of work to convince the others of the importance of being customer driven.[6]

The authors believe that, despite the loyalty programme's positive thrust, other conditions need to be present in order for a retailer to take the 'quantum leap' from a traditional product and purchasing-centred organisation to an information-intensive one. Such conditions have little to do with technology but are to be found:

- outside the company, in the market structure and conduct. Concentration, level and nature of competition are the main drivers behind information-intensive strategies in retailing. An expert on the North American retail market declared to the Observatory that to investigate what drives the adoption of loyalty cards in the USA is 'as easy as reading the map of Wal-Mart new store openings'. In other words, when the firm enters the market with its strong price proposition retailers are forced to take the only other open route to competition, that is customer-insight driven. If the UK market is considered (Figure 2), fierce competition in the loyalty arena is forcing retailers to extract more value from their programmes by means of putting data to use. Moreover, in a market situation where the typical customer has a choice of three supermarkets within a similar drive time, and where the average supermarket chain gets about 40 per cent of a customer's grocery spend, it is almost foolish to engage in price wars for acquisition, and the main issue is consolidation through retention, an orientation that can be best pursued through information intensive activities;
- inside the company, in its values and culture. Crawford Davidson, director of Tesco Clubcard, says on this point: 'in Tesco, our whole organisation is aligned around a different philosophy and a different set of rules from most other organisations. I have worked in many organisations and most would define their main objective to create shareholder value — earn the bottom line … Tesco's core purpose is to earn our customers' lifetime loyalty. When you earn lifetime loyalty, the shareholder value comes as a consequence. We earn lifetime loyalty through a whole set of values, underpinned by our "no one tries harder for customers" philosophy, and that becomes our edge. We believe in being innovative, energetic, first for customers. We want to understand customers better than any one else. We recognise that we have to use our strengths to deliver unbeatable value for customers, and that we have to look after our people so they can look after the customers, and that is expressed in "every little helps" … In fact, a natural tension exists within Tesco when we think of the tension between those who manage retail formats, those who focus on categories, those who focus on the marketing levers of price, quality, range and service. The balance is achieved with good insight, some really good underpinning values and a customer perspective. Although aspects of the business are in opposition, and although there will necessarily be

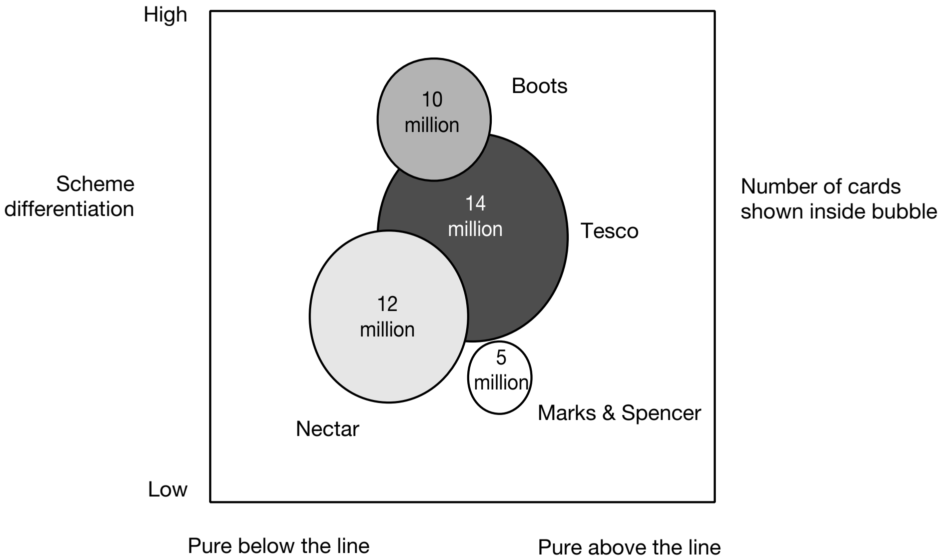


Figure 2 Competition among schemes in the UK market

> conflict, those who manage the customers have no agenda other than the wishes of the customers'.[7]

A peculiar market environment, the right values and culture, a learning curve with loyalty programmes; it is hardly surprising to read what the *Daily Telegraph* wrote back in 1997: 'sometime in the next millennium, when we look back at how companies embraced data-driven activity … the one initiative that will stand out as the major influence in database marketing has to be Tesco Clubcard'.

LESSONS FROM THE WEB, AND CONCLUSIONS

The rush to loyalty programmes and cards that is sweeping Europe these days is quite similar to the web frenzy of the turn of the century. Just as happened with building websites, distributing cards among customers looks inexpensive, compared to other marketing activities. Loyalty cards are expected to bear the same sort of magical power of customer acquisition as was believed of early websites. Some retailers entrusted them with the ability to expand substantially the customer's share of wallet, and boost the retailer's up- and cross-selling ability. This can be true, just as it turned out to be for a few internet ventures. But many soon discovered to their cost that:

— customers must be given a good reason to visit a website (use a card);
— customers can always be attracted, but the cost can be so high that the whole effort turns out to be worthless;
— after a promise is made (the promise of extra care for the customer that is implicit in a loyalty programme or company website), failure to deliver translates into disappointed customers who never come back and tell many others;
— an established reputation that is built through good old mass marketing is often a prerequisite for the site (programme) to be attractive;
— a new marketing tool works best when integrated in the overall marketing process and organisational

routines, but then it can become expensive and difficult to manage;

— first-mover advantages exist but cannot make up for poor planning: just like websites, a loyalty programme's running costs can be as high as these and set up costs need to be accounted for;

— before rushing to build databases of names and preferences with profit in mind, a little database marketing mathematics should be done, in order to find out if it is worthwhile. Who should want to buy/rent these names? In the fast-moving consumer goods industry manufacturers are discovering that lists of names and customer relationship management programmes are not a profitable way to go;

— technology is an enabler, not the reason for the website's (programme's) success.

In short the retailer should start with the old question 'why should I want to do this?' that translates into 'is this appropriate to the characteristics of competition in my market? And with my values and mission?', before heading down a potentially dangerous route guided only by cheap technology, consultants' white papers and the loyalty literature.

References

1 McKinsey (2000) 'The power of loyalty', *McKinsey Quarterly*, No. 2.

2 Kirstgens, T. (1995) 'Erste bundesweite Marktuntersuchung Kundenclubs', IM Fachverlag, Ettlingen.

3 Meyer-Waarden, L. and Benavent, C. (2001) 'Programmes de fidélisation — Stratégies et pratiques', Actes du congrès de l'AFM, Deauville.

4 *Ibid*.

5 Hughes, A. M. (2003) 'The customer loyalty solution', McGraw-Hill, New York.

6 Laine, A. and Reynolds, J. (2004) 'Evaluating the barriers to using individual customer information: Evidence from the UK', in Lugli, G. and Ziliani, C. (eds) 'Micromarketing. Creare valore con le informazioni di cliente', UTET, Torino.

7 Cuthbertson, R. (2004) 'Every little helps: Interview with Crawford Davidson, Director of Clubcard at Tesco, UK', in Lugli, G. and Ziliani, C. (eds.) 'Micromarketing. Creare valore con le informazioni di cliente', UTET, Torino.