



Building the Loyalty Scheme Business Case

An Accountant's View

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- Today's European consumer wants more out of their shopping than just the goods they are paying for.... They expect something extra – and usually get loyalty rewards.
- But loyalty reward has been with us for decades! Cardholders are jaded – so issuers and acquirers have been rethinking the offer.
- So what does this mean – and in particular, how can banks work out how to make money out of their generosity?



Building a Business Case for Loyalty Reward

Loyalty Scheme Objectives

- To increase short-term and long-term customer value
- To attract new and retain existing valuable customers (cardholders and merchants)
- To collect and analyse profitability data
- To gain a competitive advantage
- To enhance customer satisfaction
- To increase revenues and profitability – for banks and merchants
- To counter the erosion of interchange levels.

Factors to Consider

- Costs of rewarding of existing customers for doing what they have always done
- Estimating the extent of new volumes which the scheme will generate
- Making a the merchant proposition compelling enough to make a financial contribution
- Risk of making rewards unaffordable in the long term
- Recovery of investment into technical solution and marketing and promotional campaigns
- Management of multiple parameter sensitivity analysis



Case Study Basis

Volumes of case study bank before loyalty scheme

Issuing volumes	Today
Credit cards ('000)	6,200
Turnover (£m)	15,000
Per card (£)	2,400
UK Market share (turnover)	10%

Acquiring volumes	Today
Large merchants	50
Small merchants	9,500
Turnover (£bn)	15
Per merchant (£'000)	1,500
UK Market share (turnover)	10%
On-us	10%

Methodology and key assumptions:

- The case study explores three issuer and acquirer based schemes. Coalitions such as the Nectar scheme have not been considered.
- The three scenarios have been based on a fictional UK bank, which is an issuer and acquirer. Its key volumetrics are set out in the panels.
- The case study looks at the credit portfolio only, and assumes a bank branded card.
- Take-up of the loyalty scheme by existing cardholders is self-selected.
- The basic scheme of rewarding all purchases is maintained and added to in the second and third scenarios.
- All three scenarios have been modelled to result in a positive outcome for the bank as a whole.



Loyalty Scenarios

In this session we will walk through the elements – and some of the pitfalls – to be considered when building a range of business cases for a sophisticated loyalty scheme

Traditional Card Issuer Basic Loyalty Offer

- The card holder receives rewards on all their purchases
- No merchants are directly involved - the bank funds the total scheme.



Basic Loyalty Offer + Simple Discount Card

- The card holder receives rewards on all their purchases as in the basic offer
- In addition, they receive instant discount at the POS or online when presenting their payment card – the discount being funded by the merchant.
- The transaction is processed net by issuer and acquirer



Sophisticated Multi-partner Scheme

- The card holder receives rewards on all their purchases as in the basic offer – funded by the bank.
- Customers can earn premium rewards at selected merchants – funded by the merchants.
- Sophisticated programmes include online redemption and data mining
- Special promotions at specific merchants run regularly – joint effort between the merchants and the bank.



Traditional Card Issuer Basic Loyalty Offer

Defensive Strategy

Proposition

- Cardholders are rewarded for POS and online purchases
- A 0.5% - 1.0% reward on purchases is credited to the balance at regular intervals.
- Merchants' involvement is passive.

UK Examples

- Issuer branded: Santander 123 Cashback, Capital One World, NatWest Your Points, etc....
- Retailer branded: John Lewis, Marks & Spencer, Asda, Debenhams, etc.....

Advantages

- Existing cardholders push more volume through cards
- New customers apply for the card
- Interchange and revolving interest revenues are increased.
- Some acquiring benefits are derived through marginally greater on-us volumes

Disadvantages

- Rewards must be paid on BAU volumes
- Cardholders are frequently automatically enrolled to a scheme which may not address their need
- Investment in promotional costs typically required – this is subsidised by revolving revenues
- Incremental processing and operational costs are incurred
- Low customer retention and no data analytics



Traditional Card Issuer Basic Loyalty Offer

Issuer Business Case

Issuing	Year 1	Year 2	Year 3	Year 4	Year 5	Total
New cards ('000)	50	90	100	110	120	
New turnover (£m)	130	240	270	300	340	1,280
Take-up by existing cardholders					5%	
Additional revenues (£k)						
Interchange	1,000	1,800	2,000	2,300	2,600	9,700
Revolving credit interest	4,600	8,000	9,100	10,300	11,400	43,400
Additional costs (£k)						
Rewards paid – 0.5%	4,400	4,900	5,100	5,300	5,500	25,200
Processing, scheme, ops	1,000	1,800	2,000	2,300	2,500	9,600
Promotional costs	3,100	3,100	3,200	3,200	3,200	15,800
Issuer case (£k)	-2,900	-	800	1,800	2,800	2,500
NPV (10%)						£0.9 m



Traditional Card Issuer Basic Loyalty Offer

Summary Business Case

Total for bank	Year 1	Year 2	Year 3	Year 4	Year 5	Total	NPV
Basic loyalty offer (£m)	-2.9	-	0.8	1.8	2.8	2.5	£0.9m





Basic Loyalty Offer + Simple Discount Card

Enhanced Offer

Proposition

- Cardholders are rewarded with cashback or other rewards on all purchases as for the basic loyalty offer
- Selected on-us merchants offer instant discounts – to gain the increased revenue from the bank's card base.

UK Examples

- Issuer branded: Capital One Click, Bank of Scotland Plus, etc....
- Retailer branded: Virgin All Round, AA, etc.....

Advantages

- Increase in over the basic scheme - customers take up both benefits
- New customers apply for the product
- Interchange, revolving interest and acquiring MSC revenues are increased.
- No investment in technology typically required.
- Merchants benefit from increased revenues / profits

Disadvantages

- Rewards must be paid on BAU volumes
- Extra investment in promoting discount offers
- Merchants must be persuaded to fund the discounts



Basic Loyalty Offer + Simple Discount Card

Issuer Business Case

Issuing	Year 1	Year 2	Year 3	Year 4	Year 5	Total
New cards ('000)	60	100	120	130	150	
New turnover (£m)	170	290	330	370	420	1,580
Take-up by existing cardholders					6%	
Additional revenues (£k)						
Interchange	1,200	2,100	2,500	2,800	3,100	11,700
Revolving credit interest	5,600	9,800	11,200	12,600	14,000	53,200
Additional costs (£k)						
Rewards paid – 0.5%	5,300	6,000	6,200	6,400	6,600	30,500
Processing, scheme, ops	1,200	2,200	2,500	2,800	3,100	11,800
Promotional costs	3,100	3,200	3,200	3,200	3,200	15,900
Issuer case (£k)	-2,800	500	1,800	3,000	4,200	6,700
NPV (10%)						£3.9 m



Basic Loyalty Offer + Simple Discount Card

Acquirer Business Case

Issuing	Year 1	Year 2	Year 3	Year 4	Year 5	Total
Merchants in Scheme	6	8	9	10	10	
New turnover (£m)	20	30	40	40	50	180
On-Us						10.8%
Additional revenues (£k)						
MSC	260	450	520	580	650	2,460
Merchant Contribution	-	-	-	-	-	-
Additional costs (£k)						
Premium reward paid	-	-	-	-	-	-
Capital investment	-	-	-	-	-	-
Processing, scheme, ops	40	80	90	100	110	420
Promotional costs	-	-	-	-	-	-
Acquirer case (£k)	220	370	430	480	540	2,040
NPV (10%)						£1.5 m



Loyalty Offer – Merchant Instant Discount

Summary Business Case

Total for bank	Year 1	Year 2	Year 3	Year 4	Year 5	Total	NPV
Basic loyalty offer (£m)	-2.9	-	0.8	1.8	2.8	2.5	£0.9m
Basic + discount (£m)	-2.6	0.9	2.2	3.5	4.7	8.7	£5.4m





Multi Partner Scheme

Pro-active Strategy

Proposition

- Cardholders are rewarded with cashback or other rewards on purchases with all merchants
- In addition, premium rewards are earned with participating merchants
- Accumulated rewards may be instantly redeemed at any of the participating merchants
- Instant discounts and other promotions for additional rewards run regularly at merchants

UK Examples

- Issuer branded: Barclaycard Freedom
- Retailer branded: Tesco Clubcard Credit Card (not instant redemption)

Advantages

- High profile programme attracts greater volume and new customers than other schemes
- Revenues are increased significantly.
- Relationships with merchants are strengthened and churn reduced.
- Data mining and customer profitability information for merchants.

Disadvantages

- Rewards continue to be paid on BAU volumes
- High investment in technology solution to support instant redemption and data mining, as well as scheme promotion and cardholder support.
- Enhanced merchant support for analytics and short term promotions results in higher back office costs.
- Merchants must be persuaded to contribute to the points pool for funding the discounts – as well as special promotions.
- There can be a conflict over who owns the customer relationship.



Multi Partner Scheme

Issuer Business Case

Issuing	Year 1	Year 2	Year 3	Year 4	Year 5	Total
New cards ('000)	120	210	240	270	300	
New turnover (£m)	350	620	710	800	890	3,370
Take-up by existing cardholders					9%	
Additional revenues (£k)						
Interchange	2,400	4,300	4,900	5,500	6,100	23,200
Revolving credit interest	11,900	20,900	23,900	26,900	29,900	113,500
Additional costs (£k)						
Rewards paid – 0.5%	8,500	9,900	10,300	10,800	11,200	50,700
Processing, scheme, ops	4,000	7,100	6,500	7,300	8,100	33,000
Promotional costs	6,300	6,400	6,500	6,500	6,500	32,200
Issuer case (£k)	-4,500	1,800	5,500	7,800	10,200	20,800
NPV (10%)						£13.2 m



Multi Partner Scheme

Acquirer Business Case

Issuing	Year 1	Year 2	Year 3	Year 4	Year 5	Total
Merchants in Scheme	13	17	19	21	21	
New turnover (£m)	60	110	130	140	160	600
On-Us						12.2%
Additional revenues (£k)						
MSC	830	1,450	1,660	1,870	2,080	7,890
Merchant Contribution	6,360	8,890	10,040	11,200	11,450	47,940
Additional costs (£k)						
Premium reward paid	4,240	5,930	6,690	7,460	7,630	31,950
Capital investment	1,000	1,000	1,000	1,000	1,000	5,000
Processing, scheme, ops	220	380	440	490	550	2,080
Promotional costs	1,300	1,700	1,900	2,100	2,100	9,100
Acquirer case (£k)	430	1,330	1,670	2,020	2,250	7,700
NPV (10%)						£5.5 m



Multi Partner Scheme

Summary Business Case

Total for bank	Year 1	Year 2	Year 3	Year 4	Year 5	Total	NPV
Basic loyalty offer (£m)	-2.9	-	0.8	1.8	2.8	2.5	£0.9m
Basic + discount (£m)	-2.6	0.9	2.2	3.5	4.7	8.7	£5.4m
Basic + Multi-Partner (£m)	-4.1	3.1	7.2	9.8	12.5	28.5	£18.8m





Conclusions and Critical Success Factors

For issuers

- Cashback programmes are simple and inexpensive to implement – but an overworked offer which fails to retain cardholder base
- Paying rewards to existing cardholders reduces today's profits and often reach 4-5%, which significantly exceeding interchange. This must be subsidised by the revolving interest.
- Consumers no longer want passive systems – they expect the scheme to be interactive – with instant balances, online redemption and SMS or email promotions.
- Provided enough of the cardholder base revolves, the margins can be positive.
- Data mining and analysis delivers benefits to issuer business as well.

For acquirers

- For a positive case for the acquirer, a significant merchant contribution is essential – this may be unsustainable for some retailer models.
- Instant redemption is currently involves significant investment.
- Supporting multiple merchant promotions can be complex and expensive.
- Confidence that volumes will be great enough to recoup significant capital and on-going investment in the scheme.
- Integrated schemes which channel card issuer purchases into the merchant base offer significant advantage. Such schemes also offer good potential for merchant co-branding.



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