

**THE ASSESSMET OF ECONOMIC EFFICIENCY OF
IMPLEMENTATION OF CONSUMERS' LOYALTY PROGRAMS**

**ОЦІНКА ЕКОНОМІЧНОЇ ЕФЕКТИВНОСТІ ВПРОВАДЖЕННЯ
ПРОГРАМ ЛОЯЛЬНОСТІ СПОЖИВАЧІВ**

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АНОТАЦІЯ. У статті узагальнено основні підходи до визначення поняття «лояльність споживача» та «програми лояльності». Автором обґрунтовано важливість упровадження програм лояльності споживачів з метою утримання вже наявних споживачів та заохочення нових, що дозволить укріпити конкурентні позиції підприємства на ринку та забезпечити стабільний грошовий потік. Наведено систему показників для оцінки економічної ефективності програм лояльності.

КЛЮЧОВІ СЛОВА: лояльність, програми лояльності, управління відносинами з клієнтами, економічна ефективність програм лояльності.

ABSTRACT. The article represents main approaches to the definition of «consumer loyalty» and «loyalty program». The author substantiates the importance of the implementation of consumers' loyalty programs for the purpose of retaining existing consumers and encouragement new ones. These measures are aimed at strengthen the competitive position of the company at the market and provide a stable cash flow. The system of performance indicators for assessment the economic efficiency of loyalty programs is presented.

KEY WORDS: loyalty, loyalty programs, customer relationship management, economic efficiency of loyalty programs.

Introduction. Modern companies are operating in the situation of tough competition, so the tendency of focusing on consumer preferences is typical. Earlier the focus was put on the product itself, the development of its functionality and other competitive advantages, but now enterprises concentrate on the building long-term relationships with customers. It is clear that technical characteristics of products and their prices create only short-term effect, due to the possibility of rapid copying by competitors. Thus, the ineffectiveness of price competition methods served as a powerful driver for revising previously applied business strategy aimed at the product and development a cli-

ent-oriented approach. Long-term relationships with customers are economically viable, as they guarantee regular purchases and require lower marketing expenses. Loyalty programs are considered as an effective marketing tool, because the volume of company sales is determined by the level of customer satisfaction and loyalty, their commitment to the service or brand.

Formulation of the problem. It is important for managers to understand the nature of the customer loyalty and how they can influence on the behavior of clients through step-by-step implementation of loyalty programs. Implementation of loyalty program can lead to the increase of company profitability for such reasons: 1) loyalty program focuses on attracting and retaining the most valuable customers, because of greater concentration on target audiences and more specific offers for clients; 2) these measures ensure active communication campaign aimed at the increasing of volume and frequency of purchases.

The assessment of economic feasibility and efficiency of loyalty programs is extremely important, because money spent on this measures are considered as investments, thus, payback and the change in client loyalty should be under attention. These problems are investigated in the works of Starov S., Reicheld F., Dymshits M., Vasin Y., Butcher S. and Lamben Jean-Jacques. However, the economic efficiency of consumers' loyalty programs is not researched deeply in Ukrainian companies, so the article is devoted to this problem.

Results. Loyalty is a positive attitude of consumers towards everything related to the organization activities, products and services, company personnel, organization image, trade mark and logo. Loyal ones can be called those consumers who have a long time (in comparison with the term of the product operation) stay with the company and make re-purchases. Loyalty is characterized by a high level of client trust in a particular organization, which results in disregarding offers from competitor organizations [1].

Loyalty means building long-term relationships in which the consumer relies heavily on the products of the company, brand or shop and becomes its regular customer. The theoretical content of loyalty contains three elements: trust; commitment to values; long-term relationship. Consumer loyalty is defined as consumer preference for a product, service, service/trade mark, logo, appearance, personnel, and service system of a particular enterprise. Loyalty program is a marketing tool which is aimed at formation of the loyalty of selected target group in order to establish and maintain long-term relationships with them. It is characterized by a systematic approach. [2, p. 116-121].

According to results of a survey of top managers, the implementation of customer-oriented strategies allowed to achieve (as a percentage of the total number of respondents):

- increase in the number of repeated purchases — 66%;
- cost reduction — 81%;
- reduction of customer losses for the reason of dissatisfaction — 77%;
- attraction of new clients — 51%;
- increase in productivity — 80%;
- acceleration of the output of new products and risk reduction — 46%.

According to the IDC Research Group, a decrease in the number of consumers moving to competitors by 5% a year leads to an increase in profits by 25-55% depending on the industry. Most of the companies on the Fortune 500 list lose up to 50% of their clients every 5 years, taking into account ineffective interaction with them [1].

Consumer loyalty creates additional competitive advantages for the company:

- reduces marketing costs;
- provides premium prices;
- holds the majority of consumers when macroeconomic situation deteriorates;
- reduces the risks of consumer losing associated with mistakes of the company operations or with a new offer of competitors [2, p. 113-115].

First of all, consumer loyalty contributes to reduction of marketing costs. Advertising and promotion, aimed at attracting new consumers, require higher costs compared to holders of existing consumers. According to some studies, «the conquest of new consumers costs six times more than the maintenance of already existing». There is also evidence that a 5% increase in loyalty can lead to a 100% increase in company profits; in some market segments, loyalty increase of 2% equals cost reduction by 100% [3, p. 105 — 111].

Secondly, consumer loyalty allows companies to set premium prices. Price elasticity growth is observed with the increase of consumer loyalty. Loyal consumers are willing to pay a higher (premium) price for provision of additional unique value that the company offers them.

Thirdly, consumer loyalty allows the company to retain more than a half of consumers when the macroeconomic situation is worsening. A strong brand can maintain its strong positions for a long period of time (6-10 cycles of purchase) without advertising support. [4, p. 29-57].

Enterprises with a big amount of loyal customers are better in managing with risks associated with mistakes of the enterprise operations and new offers of competitors.

Many Ukrainian and foreign companies have begun to build their strategy of increasing customer satisfaction and loyalty. Within the framework of the implementation of such a strategy, they began to develop and implement consumer loyalty programs, to build CRM (customer relationship management) systems, to conduct consumer surveys. Loyalty programs are designed to establish an emotional relationship between a client and a company in the long run to provide a positive financial flow that will shape the company's profit base.

Richard Barlow, the founder and executive director of the company providing loyalty advertising and marketing services, outlined the relationship that the company should strive for in its work with clients: «Voluntary information exchange and other useful interactions between buyer and seller with mutual expectations of benefits.» The greatest value of the regular customer card for the firm is that it allows you to get data that helps to understand the behavior of clients. The information, that is provided by customers, increases knowledge of them, allowing managers make more successful decisions in many areas of the company [5, p.102-114].

There are some definitions of «customers' loyalty programs» given by executives of different companies.

Loyalty programs are long-term programs of mutually beneficial cooperation between customers and the company. It is a business process for identifying, supporting and increasing the «returns» from the best customers, using interactive relationships and building an emotional relationship between customers and business. They provide an opportunity to choose for each group of clients the most important and appropriate measures for development of relations and maintenance of these clients in the database. It is easier to maintain relationships with customers than to crowd out competitors from the market. The strategic goal of such programs is to increase the profitability of key segments of customers and extend the period of their lives.

The company hierarchy of goals may look like this (table 1). The key goal of any marketing program is to increase revenue, profit and market share.

It is worth noting that goals may differ in different companies, depending on their specialization [6, p. 400-412].

*Table 1***THE LIST OF GOALS FOR THE LOYALTY PROGRAM**

The main objectives of the loyalty program	Additional loyalty program goals
1. To build relationships with customers for a long time; to gain their loyalty by a lifelong satisfaction of their needs	1. Improving the image of the brand and company
2. Attracting new customers due to valuable (attractive) offers or with the help of recommendations of existing customers	2. Increasing the frequency of visiting retail shops
3. To create an opportunity for communication with customers (indirectly and personally)	3. To increase frequency of purchases
4. Creating a customer database (benefits and frequency of purchases)	4. Solution of company problems
5. To provide other departments of the company with the information for product research and development	5. Public relations support

The loyalty program is the formation of long-lasting mutually beneficial relationships between the company and the client. Loyalty programs are a wide area for creativity and activity of the company employees, not only marketers and advertisers, but all personnel without exception.

Nevertheless, it should be noted that these definitions describe loyalty programs as a process. Each process must have its own algorithm, which will shape the activities aimed at the development of a customers' incentive programs in the future. Therefore, we may give the following definition: «Consumers' loyalty programs include a certain set of privileges to stimulate customers make additional purchases and to increase the number of re-sales of services and goods in the future. These programs strive at creating and maintaining customer loyalty for building long-term relationships with customers».

The key components of loyalty programs are as follows:

1. Customer database (customer identification).
2. Complex of communication with clients (customer retention).
3. A package of privileges (tangible and intangible stimulation of the client's desired behavior).
4. Analytical kernel, which allows company predict client behavior tomorrow, and how his behavior will affect the indicators of business performance. [7, p.187]

The money spent on creating loyalty programs should be considered as investments: the company contributes monetary resources to strengthen relationships with its customers.

The main difficulty in assessing the effectiveness of loyalty programs is that it is not easy to determine the direct dependence of sales growth from activities associated with these programs. It is difficult to eliminate the effect of loyalty programs from the influence of advertising, product quality and personal sales.

In practice, there are no universal methods for evaluation of the effectiveness of loyalty programs. The first approach allows to calculate the economic efficiency, since investing in loyalty programs can be defined as marketing investments that should bring additional sales through repeated purchases of loyal consumers. The indicators of changes in sales volume, payback period, growth of the profit rate per customer will show the impact of implementation of loyalty program. Boyko M., Starov S. and Reicheld F. are representatives of this approach. The second approach shifts the focus to an assessment of the non-economic effectiveness of the loyalty program (intangible assets, such as the formation of a detailed client database or growth of reputation). Arenkov I. and Butcher S. investigate this direction of research. Despite the fact that intangible assets are difficult to measure quantitatively, their role is extremely important. In a short period of time profitability is expressed in increasing sales volumes of sales, but from the strategic point of view the success of loyalty programs can be measured by the increase in the number of potential consumers and formation of positive image of the brand (goodwill).

The economic feasibility of conducting loyalty programs is expressed by payback. With a high payback, investments in the loyalty program will bring a significant profit, exceeding the money invested in the project.

Payback of the loyalty program can be calculated by the following formula:

$$\text{Payback} = (S_{lp} \times P) - PE - (S \times P) - AC, \quad (1)$$

where S_{lp} is the volume of sales after the introduction of the loyalty program; S — sales volume before the introduction of the loyalty program; P — price per unit of branded products; PE — «the price of encouragement» (money spent for or did not received as a result of implementation of measures of purchase encouragement like coupons or discounts); AC — administrative costs of implementation the loyalty program [2, p. 130-131].

It should be noted that the effectiveness of the loyalty program cannot be determined only by subtracting the costs of implementation of the program from the company's total profit. Such simplified approach does not take into account long-term investments in the expan-

sion of the segment of potential buyers and the formation of a positive image of the company and its branded products. This model also does not take into account the funds spent on remuneration of those customers whose consumption has not changed. They bought and will buy goods without any lotteries, coupons and discounts. At the same time, the introduction of loyalty programs helped to prevent their transition to the products of another manufacturer.

It is worth noting that the question of assessment of the economic feasibility and efficiency of the implementation of consumers' loyalty programs is complex. Taking into account the variety of factors which influence on the loyalty, we can conclude that it is difficult to express the impact of the loyalty program on company profitability in numerical value. In the practice, there are a number of methods that allow assessing the level of loyalty to the company products/services, but all of them have their disadvantages and do not always reflect real picture. Thus, there are some performance indicators of the loyalty program that can be used in a complex, supporting the proposals of Boyko M., Starov S. and Reicheld F. The first indicator is the coefficient of consumer fluidity, which reflects the proportion of consumers who did not buy products of the enterprise within the year in the total amount of consumers at the beginning of the year. The formula is as follows:

$$C_{cf} = N_{nl} / N_t, \quad (2)$$

where N_{nl} is the number of consumers who did not buy products of certain brand during the year, N_t — the total number of consumers at the beginning of the year.

The critical value of this index is 0, 7, which is proved by the practice of companies that were in a state of bankruptcy or financial difficulties.

The loyalty index represents the ratio of consumers who repurchase product to the total number of consumers within the year:

$$LI = N_l / N_t, \quad (3)$$

The consumer retention ratio describes the proportion of consumers who remained loyal to the company during the year in the total number of consumers at the beginning of the year:

$$CRR = \frac{N_i^1}{N_i^0 + N_i^t}, \quad (4)$$

where N_i^0 is the number of consumers at the beginning of the year, N_i^1 — the number of consumers at the end of the year, N_i^t — the number of customers involved during the year.

Enis-Paul Index is used for the calculation of profit from implementation of the loyalty program:

$$L_i = \sqrt[3]{b_i - s_i(n+1)/(k+n) - p_i/m} \quad (5)$$

where L_i — consumer loyalty towards the enterprise, b_i — the proportion of the consumer budget for the purchase of products in a particular enterprise, s_i — the number of switches from the enterprise to other enterprises during a certain period of time, p_i — the number of enterprises in which the consumer bought certain products/received services, n — the number of possible visits of other competitors to buy the product/receive service, m — the total number of visits to all enterprises for a certain period, $k = m-1$ — the number of opportunities to switch enterprises [7, p.190-192].

The average annual profitability of one consumer reflects the value of the client in terms of all current and future revenues received during the period of consumer cooperation with the enterprise:

$$P_i = \sum_{j=1}^t \frac{\sum_{l=1}^{N_i} (I_{jl} - E_{jl})}{N_t} \quad (6)$$

where I_{jl} is the operating income received from the l -th consumer by the j -th product, E_{jl} — operating expenses for the l -th consumer by the j -th product, N_t — the total number of consumers [8, p. 72-85].

The cost of maintaining a loyal customer and engaging new to a certain extent depends on the type of product and loyalty program used by the company. These costs should be compared to the "value of loyalty" (VL) constantly. We propose to define "value of loyalty" as the difference between the amount of profit that brings a completely loyal client for a certain period of time (P_{lc}) and the profit that brings a new client for the same period of time (P_{nc}) [9, p. 95-115].

We can describe this by the formula:

$$VL = P_{lc} - P_{nc} \quad (7)$$

In general, the measurement of loyalty is a very complex process, since it is difficult to relate financial costs to non-financial results. Despite the fact that loyalty has its qualitative characteristics (behavior and attitude of the buyer to the product or brand), it can be measured by quantitative indicators.

Conclusions. The introduction of loyalty program leads to encouragement of the most valuable consumers and expanding of the market share. Company constantly tries to offer consumers a unique value and, in this way, it can afford choosing the most beneficial consumers and invest in the most cost-effective and potentially renewable orders. The implementation of loyalty programs effect different aspects of company activities. It is clear that such efforts will lead to the increase of company value for all stakeholders: from usual customer to investors. The main task of the loyalty program is motivation of customers to make an additional purchase, which leads to increase of sales turnover and provides stable cash flow.

It was identified that there is no universal methodology for assessment of efficiency of implementation of consumers' loyalty programs. Some of them concentrate on the economic «returns» and measurement of the efficiency through specified indicators (payback, changes in profit and sales volumes, profitability of one customer). Other approaches focus on assessment of non-economic effectiveness and changes in intangible assets of the company. As a consequence, further research should be aimed at investigation of methodologies and indicators for measurement of feasibility of consumers' loyalty programs.

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