

Loyalty Marketing Works in the Convenience Store Industry*

* The data analysis presented in this article was conducted through an independent research project led by Dr. Yuping Liu at Old Dominion University using Outside Networks' consumer transaction database.

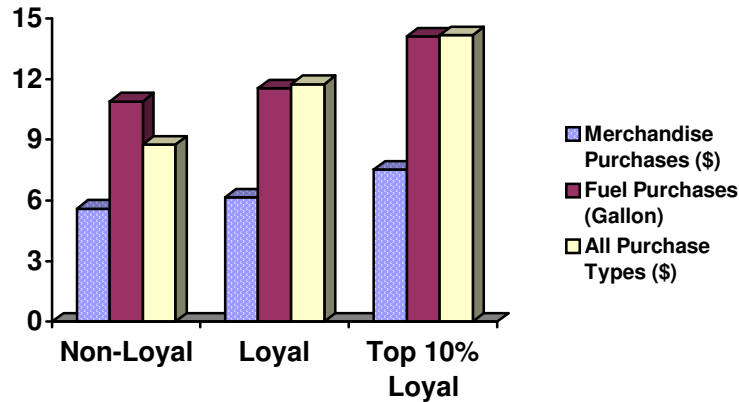
Amid economic downturn and increased competition, convenience stores are facing a more difficult business environment. Not only do stores need to fence off competition from prospering warehouse clubs and superstores like Wal-Mart, but they also have to deal with rising operating expense and lower profit margin. In fact, 7.4% of all convenience stores have closed their doors in 2002, the highest level since 1990, according to the 2003 State of the Industry (SOI) Report released by the National Association of Convenience Stores (NACS).

To survive in the adverse environment, it is important for stores to retain their loyal customers and to derive higher sales and profits from this customer base. Repeatedly, studies have found loyal customers to be more profitable than non-loyal customers. They are willing to pay higher prices and require less "maintenance" costs. But how can convenience stores retain existing customers and convert them into loyal customers? A brief look at other retail channels suggests a possible answer. For years, supermarkets and warehouse clubs have used loyalty programs to attract and reward loyal customers. By joining the various frequent buyer's clubs, shoppers are rewarded with price discounts and free products. These programs inspired consumers' loyalty and rewarded retailers with increased profit and a great amount of knowledge about their customers. Do such loyalty marketing strategies work in the convenience store industry? Data from Outside Networks suggest some very encouraging results.

Outside Networks is a provider of turnkey loyalty systems to the retail petroleum and convenience store industry. Its Fidelis Loyalty Media System uses radio-frequency identification (RFID) technology to identify loyal customers and uses either audio or video to target market. Convenience stores across some 12 states have adopted the system and have enrolled over 50,000 consumers. Participation in the programs is free for individual consumers. They accumulate points with their purchases and as a return for their patronage earn special discounted products, targeted coupons, and free products such as a free cup of coffee or a free carwash.

Analysis of 4.8 million consumer transactions conducted between March 2002 and June 2003 reveals distinctive behavioral patterns between the 51,988 loyal consumers and the other non-loyal consumers (Exhibit 1). Consumers participated in loyalty programs spent \$11.74 per transaction, 36% more than did consumers not enrolled in loyalty programs. Loyal consumers also shopped frequently, averaging 2.78 times per month during the analysis period. Among these loyal consumers, the top 10% shopped at convenience stores approximately 7 times per month, buying an average of 14 gallons of fuel and \$7.52 worth of store merchandise in a transaction.

Exhibit 1. Average Transaction Size for Loyal vs. Non-Loyal Consumers



Most significantly, consumers who participated in the loyalty program changed their behavior and became more profitable to the retailer over time (Exhibit 2). When first joining the program, they were not very different from regular consumers. But after 18 months into the program, they led non-loyal consumers by a wide margin. Their average transaction size increased 25% from when they first joined the program, and their purchase frequency more than doubled, from 1.79 times per month to 4.08 times per month (Exhibit 3). This suggests the ability of loyalty marketing to gradually change consumer behavior and motivate them to become better/loyal consumers. With an average store enrolling between 1,500 and 2,500 consumers in its loyalty program, these changes in behavior can translate into approximately \$1,000-3,000 in extra gross profit per month¹.

Exhibit 2. Transaction Size Change Over Time for Loyal vs. Non-Loyal Consumers²

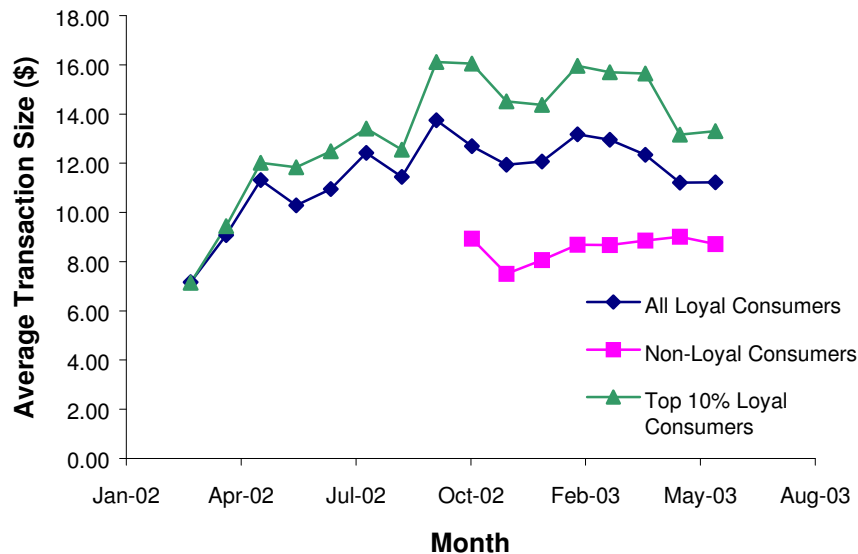
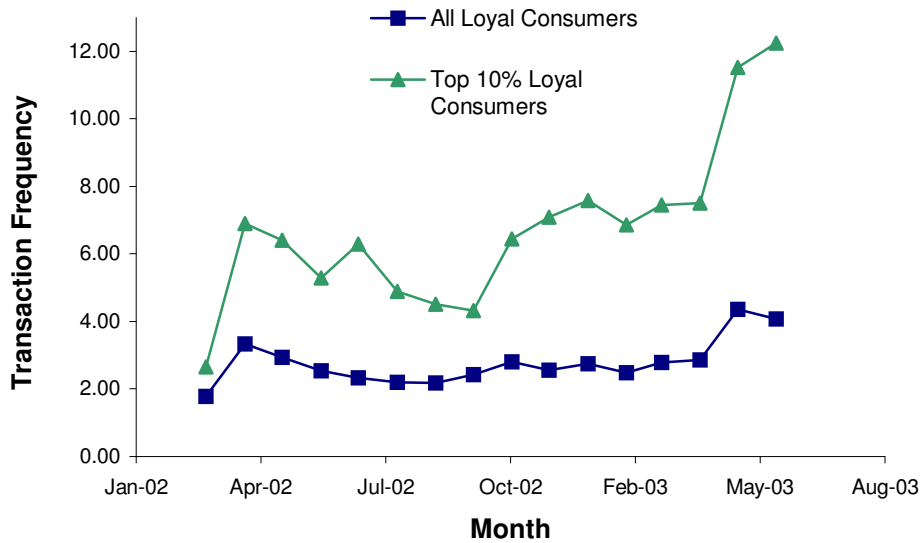


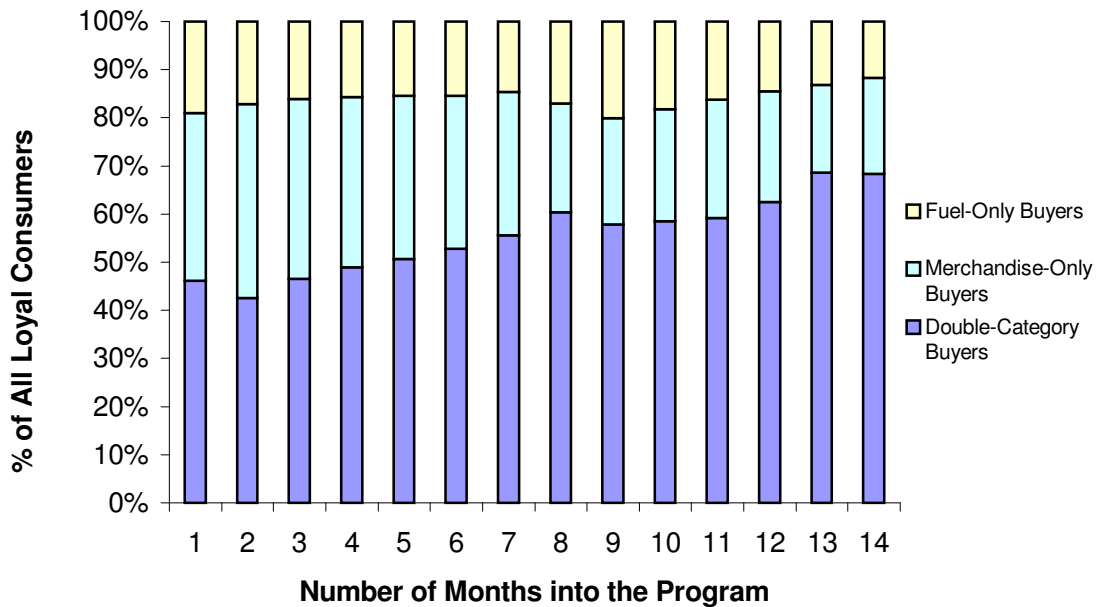
Exhibit 3. Transaction Frequency Change Over Time for Loyal Consumers



Beyond increasing consumer transaction size and purchase frequency, it is also important for convenience stores to increase cross-selling. As the NACS 2003 SOI Report suggests, one major strategic difference between top performance convenience stores and the other stores is the top stores' ability to generate high profit margin merchandise sales from fuel customers. By attracting fuel buyers into the store, these top stores enjoyed 69% higher sales than other stores and a 30.4% gross profit margin, compared with a 28.6% gross profit margin for the other stores.

Loyalty marketing can help in cross-selling efforts too. Outsite Networks uses in-store coupon and reward statement printers to attract consumers into the store. While only 29% of fuel purchases conducted by non-loyal consumers were paid in the store, consumers in the Fidelis loyalty programs paid 58% of their fuel purchases in stores. This redirection of consumer flow has enticed consumers to diversify their purchases. Over the 18 months period, a total of 3,433 consumers converted from fuel-only buyers to both fuel and merchandise buyers³. The percentage of double-category buyers increased from 46% to 68% (Exhibit 4). As another indication of the effect of the loyalty program on consumer purchase diversification, loyal consumers were also more likely to add merchandises to their in-store fuel purchases than were non-loyal consumers. For all loyal fuel purchases that were paid inside the store, 38% also included merchandise sales. The corresponding percentage for non-loyal consumers was only 26%.

Exhibit 4. Composition of Loyal Consumers



To make loyalty marketing efforts more effective, it is important how loyalty programs are managed. Undoubtedly, information gathered through loyalty programs can yield very useful insight into consumer behavior. A critical point in making such programs successful is to properly manage this consumer information and utilize knowledge about consumers to target marketing efforts. For example, Outsite Networks allows store owners to access real-time sales information online and can customize audio/video messages to a consumer based on the consumer’s past purchase behavior. In today’s Internet age, such capability for one-to-one targeted marketing is extremely important. It establishes a relationship with customers and increases their loyalty (and with loyalty, repeated patronage). It also makes marketing messages much more effective by adapting to each consumer’s idiosyncratic characteristics.

Although today’s business environment is challenging for convenience store owners, properly utilizing and managing loyalty marketing can help increase sales and overall profit. It will also help the convenience store industry to compete with other retail channels for consumer loyalty.

¹ These financial gains figures are based on a gross profit margin of 30% for store merchandises and \$.10 CPG.

² Not all transactions conducted by non-loyal consumers prior to October 2002 were recorded. Thus, an accurate calculation of average transaction size for non-loyal consumers can only be done from after October 2002.

³ A consumer must have been fuel-only buyer for at least two weeks for a cross-category purchase by the consumer to be considered diversification.