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Merchant Networks and Critical Mass

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Merchant networks have become a very popular feature of the nation's loyalty programs. All large credit card issuers have or soon will have a merchant network incorporated into their existing loyalty programs. The same is true for airline frequent flyer programs and several large debit card issuers. Even more remarkable than the growth of these networks generally is the proliferation of the online shopping mall. These simple merchant networks will soon be available as a link from virtually any website. The popularity of merchant networks, like any hot topic, is fueled by the perception that they are free or cheap, easy to implement, loved by consumers and will generate loyalty and significant revenues. This paper will examine these issues and the importance of critical mass and velocity in driving merchant network performance.



In the context of loyalty, a merchant network is two or more merchants participating in an external loyalty program by supplying members with offers for their products and services. Consumers will earn additional rewards (e.g. points, miles or cash-back) for shopping at participating merchants. Loyalty program sponsors can either assemble merchants independently or solicit the services of a merchant network provider. In any case, a merchant network is a technique and a type of partnership marketing.

There are many variations to a merchant network. In-store networks offer consumers bonus earnings for shopping at participating merchants with an enrolled payment card. These networks can have "always on" offers where the entire transaction is rewarded. They also can have restricted offers that may emphasize certain products, average ticket size, day of week, 1st time trial, frequency, thresholds, and any other promotion that usually has a limited duration. Discount networks offer consumers product or merchant level discounts off of the normal prices in-store and online. These offers reduce the price at the point of sale and are often initiated with a coupon or promotional code. Online shopping malls assemble content from online merchants. These are generally not transactional sites but are portals that direct consumers to specific online merchants where the transaction will occur. Finally, merchant networks can include other

variations such as restaurant programs, dining reservations, gift card purchases, travel bookings, and many others.

Who Pays?

Funding of loyalty program bonus earnings is provided primarily by the merchants. They do this for the purposes of generating new shoppers, higher purchase frequency, higher basket size, trial of new lines of business, visibility, share shift vs. their competition, etc. As a broad generalization, merchants will fund on average 5% of the entire ticket for always on offers and 10% for restricted offers. Top name national merchants and merchants in categories with lower margins will fund lower offers while smaller and regional merchants will fund higher offers. In addition to merchant funding, program sponsors, manufacturers or merchant network providers will sometimes provide supplemental funding. This is done to supply additional awareness, brand appeal, test performance and to generate some momentum in the program. Funding by any party is provided in exchange for merchandising to consumers. So it naturally follows that if merchandising is not effective and consumers don't shop in compelling numbers, then funding disappears.

With shopping in a competitive marketplace, a consumer will always have more choices than money. The issue therefore is not the availability of offers but how to build preference. Doesn't this sound like the key issue facing all loyalty programs? The average U.S. household participates in more than 10 loyalty programs. If we assume that they are truly loyal to 3-5 of these programs, then it is reasonable to predict that they will consolidate their activity into these core programs that fit their lifestyle and preferences. Why do they participate in the other programs? Several reasons are possible including a trial offer such as a discount on first purchase, curiosity, testing to see whether the new program will become core in the future or an easy to access deal whereby the loyalty program offers instant cash-back or other easily obtained benefits. Returning to merchant networks, the same dynamic applies. If a merchant network supports a consumer's "core" loyalty program, they will use it as an earnings accelerator. On the other hand, a stand-alone merchant network or one that is linked to a non-core program is likely only to get an initial trial. Therefore, with so many choices available, a consumer will prefer a merchant network connected to their core loyalty program(s).

Critical Mass

A merchant network will thrive on momentum, velocity and critical mass. Much of what we do in loyalty marketing is test, measure and refine until we hit on something that delivers results that are big enough to matter. Critical mass is achieved when the results pass the inflection point where they exceed the cumulative costs and efforts expended. A merchant network must achieve critical mass for each key constituent: the merchant, the program sponsor and the consumer. For the consumer, merchant offers need to be strong enough to encourage trial and the convenience of using the network coupled with strong on-going offers will stimulate repeat usage. For the merchant, the consumer base exposed to the offers must be big enough to stimulate enough in the way of first time shoppers and enough in the way of increased spending from returning shoppers that the offer funding is justified.

The program sponsor, and its merchant network provider, has the interesting role of being a matchmaker. To get consumers to engage, you need a reason to trial and a reason to return. To get merchants, you need to generate enough business for them to stay in the program. This is a balancing act and success is achieved with critical mass. How? First, scale matters. You will need a big enough merchant network and rich enough offers to drive the volume that would interest merchants. In practical terms this means having in-store always on offers, discount offers, targeted offers, an online mall and any other earnings channels that can be conveniently assembled. One element, such as an online mall alone, is not enough to generate critical mass. Second, a combination of “always on” offers and targeted offers must be used. For all the appeal of a rich and well-targeted offer, a merchant wants a consumer to respond to a targeted offer once and never again. Repeat usage is encouraged by a lesser, “always on” offer and presumably a growing loyalty to the merchant fueled by good experiences. Third, active merchant network marketing must be maintained. Merchants will only participate in a network if their brand and offers are made available in an attractive way to consumers. As you can see, merchant networks function best with active program sponsors.

In summary, merchant networks can generate the critical mass necessary to satisfy consumers, merchants and program sponsors. They work best in combination with a consumer’s core loyalty programs. Multiple earnings channels and multiple offer types drive usage. Active marketing drives velocity and momentum in a program to the point where the consumer becomes a regular user and merchants can measure incremental sales. If these results are generated, then a program sponsor will also achieve “performance critical mass” by maximizing the gross merchant commissions earned. Finally, it helps to remember that all partnership marketing is about...partnership and marketing. Therefore, in the case of merchant networks, it is vital to ensure that the merchant objectives are met. Focus on this and the funding will follow. That is critical mass.

Lars is responsible for business development, specifically optimizing the growing demand for Vesdia’s turnkey merchant-funded reward solutions within the financial services industry. Holmquist brings a wealth of experience to his role. He was formerly President of TSYS Loyalty, where he led the company’s growth in their end-to-end loyalty services and successfully developed and expanded relationships with many of the nation’s top card issuing financial institutions. Prior to TSYS, Mr. Holmquist was the vice president of Loyalty Consulting Services for MasterCard International. His responsibilities included their U.S. business development and client management areas, where he again successfully partnered with financial institutions to maximize the growing demand for customer loyalty solutions. Holmquist also spent two years with Brierley & Partners, a targeted marketing and loyalty agency, and nearly nine years with American Express, in both Sweden and the U.S. Mr. Holmquist has an M.B.A. in marketing and international business from New York University and a B.A. from Colgate University.