Loyal-n-$ave
PREMIUM LOYALTY REWARDS™

An Enhanced
BUSINESS MODEL
for Customer Loyalty

Introduction

A well-designed customer loyalty rewards program will convert shoppers into members, increase program engagement, and significantly boost sales. But for a loyalty program to result in measurable business growth, the retailer must determine the exact value of their program's "points".

If the value of earning a single point is set too high, then members will get discouraged and participate in the program less. No one wants to have to spend $500 just to earn a single reward point.

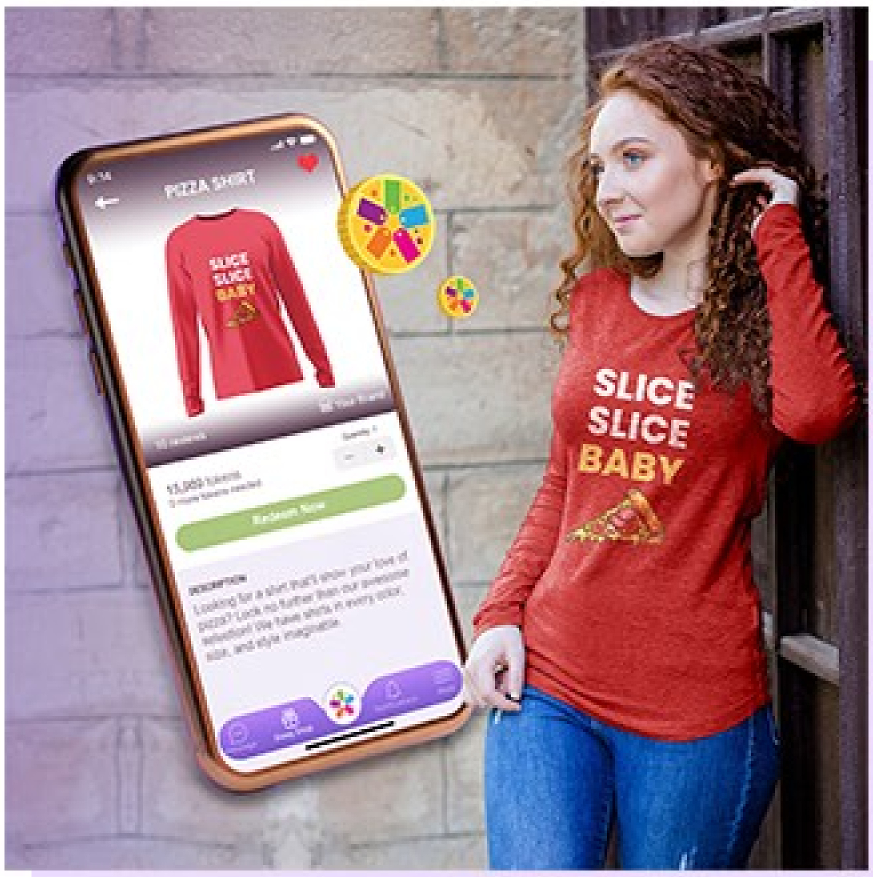
However, if the value is set too low, the retailer could accrue greater losses in proportion to rising member participation. For example, if a member receives 500 points after spending a single dollar, and the redemption value of 500 points equals $2, sooner or later, the retailer will have to file for bankruptcy.

Striking the sweet spot when it comes to setting the value of your program's rewards points is real science. Successful customer loyalty rewards programs use points values that render mutually beneficial results, leaving program members happy about their savings and retailers thrilled about their increasing revenue.

In this write-up, we will walk you through how to calculate the best value to set your program points and enhance your business model for customer loyalty. The three elements that contribute to an enhanced business model is a points model, a simple rewards program, and calculating rewards program liability.

HOW TO CALCULATE THE REDEMPTION VALUE OF YOUR POINTS

When loyalty members explore your program's rewards, they won't necessarily be able to calculate the dollar value of a "point". That's okay. A little mystery will work in your favor. What they will be able to see is the total points required to redeem each item (for example: 10,000 points for an Amazon Echo, 2,000 points for a stainless steel thermos, and 600 points for a branded hoodie—you get the idea).



As members begin interacting with the program, they will start to develop a perception of value. When a member discovers they've earned 50 points for a single shopping trip, they gain a sense that shopping at that location is rewarding—50 points is significant to them. They feel encouraged. Curious, they log onto the loyalty app and checks if there are any rewards they can redeem. There are! And one of the custom reward items happens to be his favorite product that he buys once a week! Suddenly, his perception of the value of a rewards point is improved.

Similarly, when another program member realizes that their points balance has climbed to 15,000 over the past four months, their perception about the value of a rewards point is shaped. In their mind, it wasn't all that hard to shop at the loyalty store consistently. They didn't spend more money than usual—how easy! They only chose to stay loyal to one store rather than a bunch, and it paid off! Excited, they open the loyalty mobile app to see what they can get for 15,000 points, and when they discover a number of quality products they're eligible to redeem, her perception of the store's brand improves.

As a retailer, you probably want to make your customers as excited to engage with your rewards program as our examples above felt. The good news is that while your loyalty members perceive that your program's rewards point has a high dollar value, it doesn't have to.

Break out the calculators and sharpen your pencils because it's time for the mathematical portion of this article to get underway!

The best way to put this equation into action is with a free product reward example. Let's say one of your rewards is branded swag—a stainless steel thermos. Psychologically, customers will perceive that the value of the points needed to redeem a rewards item is equal to the dollar cost of the item.
Meaning, if your thermos retails at $18 and can be redeemed for 1,800 rewards points, the customer will assume your points are worth 1 cent each. That is exact math.

However, the stainless steel thermos is meant to be a reward, a perk, a “thank you”…you aren’t simply selling the thermos via points; you’re rewarding customer loyalty with the thermos.

You can go in either one of two directions...

You could lower the rewards points needed to redeem the thermos to 1,500, or perhaps 1,000. By reducing the number of points required to redeem the thermos, your customers will think the thermos is attainable and will feel encouraged. They'll shop more, quickly earn enough points, and immediately redeem the thermos. The only downside is that they could perceive that the value of the thermos—and by extension, the value of a program "point"—is cheap.

Or…

You could raise the rewards points needed to redeem the thermos to 2,000 or even 2,500, for instance. It will have an equally appealing psychological effect but provoke a different perception in the minds of your program members. Members will perceive that the thermos is high-quality. They will believe a single rewards program point has a cash value of 72 or even 90 cents. They'll regard the program as offering a higher value in general.

But what if you've followed all of our advice, used our equation, and you still have a low redemption rate?

Keep reading…

How to Improve a Low Redemption Rate

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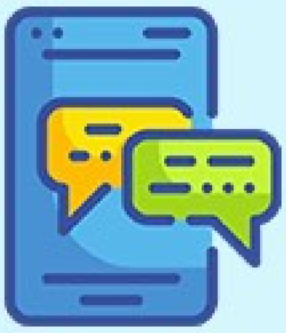
A low redemption rate stems from low program participation—it's that straightforward. The solution is to focus on increasing member participation. But how? You may have to go back to the drawing board in terms of crafting a rewards structure that's exciting and engaging. Here are 5 tips to help you improve your loyalty program redemption rate:

Devise and promote different ways to earn points

Offer a variety of rewards, from free products to experiences

Provide online and in-store incentives

Reward members for social engagement



Use SMS texts and in-app notifications to remind members of their points balances and how close they are to redemption tiers

Successful Programs Use Simple Rewards

Whatever points model redemption valuation you use, the most important factor to bear in mind is that if your customers can't easily understand the value of your program's points, they probably won't strive to earn points. Successful loyalty rewards programs use simple rewards structures.

Members should be able to calculate at a glance how many points they'll receive when they buy certain items at your store, and also how many points they'll need to redeem the rewards your program is offering.

So, what makes a good loyalty program? The answer to this question is truly complex, which is why the loyalty strategists at Loyal-n-Save have dedicated themselves to tackling this subject with every weekly blog we publish.

While there is no single strategy for building a "perfect" loyalty rewards program, you can follow these "best practices" and come pretty darn close:

- Use more than one sign-up channel
- Diversify your communication methods
- Incorporate personalized messages
- Analyze campaign engagement and adjust accordingly
- Survey members, collect feedback, and improve customer satisfaction

Loyal-n-Save, a premier customer loyalty rewards program, supports businesses of all sizes in their effort to convert shoppers into loyal customers and increase their earnings. We use proprietary technology to provide our clients with personalized loyalty program mobile apps that today's consumers love.

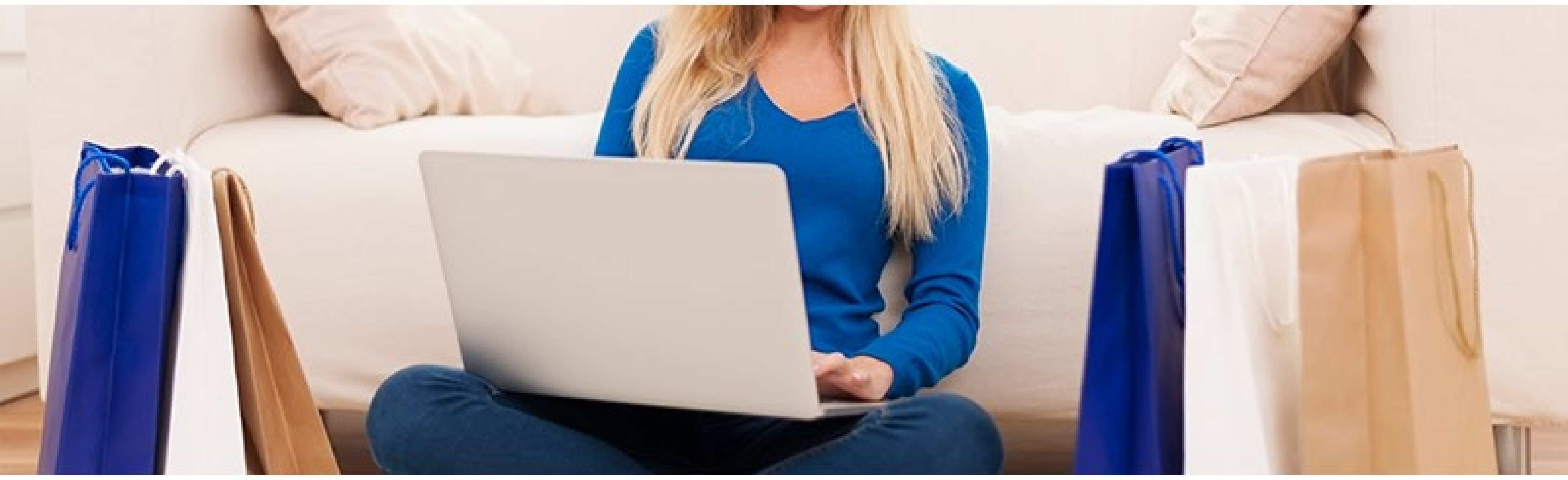
Our winning rewards program combines the power of digital marketing with proven rewards structures that engage members and incentivize spending—that's not all. Loyal-n-Save also comes with Swag Shop add-ons and gamification capabilities that make our program a cut above the rest.

With Loyal-n-Save, the more loyalty members shop, the more they save, and the more revenue the retailer earns. There are no pitfalls or unexpected losses with our tried-and-true loyalty structures and reward tokens valuation models, unlike our competitors. Whether you launch a reward tokens-per-dollar rewards structure, a reward tokens-per-item rewards structure, a tiered rewards structure, or all three, our system is 100% scalable.

Customer Loyalty Incentives

Implementing a customer rewards program at your business is a highly effective way to secure loyalty, strengthen CLV, and increase sales. But issuing rewards points and keeping your loyal members engaged is only one-half of the financial equation...the first half that is.

Your store offers its loyalty members a "valued currency", i.e., "points" for every unit of a real-world dollar-amount spent. This is the essence of your loyalty program, and it addresses the first half of the financial equation. As part of your program, this could mean allocating 50 rewards points for every $25 spent, or it could be structured so that the loyalty member earns 5 "nugs" for every 10 bottles of CBD oil they purchase. Either way, there is a real dollar value assigned to every "point", and that association is up to you.



Yes, the government expects accuracy. In 2014, a formal accounting standard on booking and reporting rewards "points" was determined as a result of the U.S. Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) reaching an agreement. What we have today, based on the Accounting Standards Codification (ASC) Topic 606: Contracts with Customers, is referred to as the IFRS-15 Accounting Standards.

Successful Programs Use Simple Rewards

If you're a store owner who recently launched a loyalty rewards program, if you're a marketing specialist that's promoting a store, or if you're one person wearing both of those hats, you might feel beyond intimidated right now by the prospect of venturing into the bookkeeping and accounting side of your customer loyalty rewards program. You might have even resigned yourself to hire a specialized accountant already. Whether you have or haven't, this article will equip you with a broad-based understanding of where, why, and how rewards points need to hit your financial statements.

IFRS-15 accounting standards both changed how rewards "points" hit a business's accounting books and mapped out how to record those transactions. Prior to the issuance of these accounting standards, a lot of retail stores were booking "points" incorrectly, associating outstanding points as liability that, once redeemed, showed up in an expense category.

There were many problems with this method, the most glaring of which was that it simply wasn't accurate. But a secondary problem with this method was that it was also being used for ordinary store sales that were not a part of the rewards points system or loyalty program. In other words, the books weren't differentiating between store sales and rewards points, even though the two are very different promotions.

To help you fully understand this difference, and in turn, grasp how you—or your bookkeeper and accountant—must record your loyalty program within QuickBooks, Quicken, Peachtree, MAS90, or whichever bookkeeping software your POS exports into, let's first define the differences.

Sales Discounts

Even prior to the advent of official loyalty programs, stores have been using traditional sales discounts as a way to incentivize customers into buying more than they had originally planned. This incentive method involves simply reducing the price of selected goods and services by either a certain percentage or amount.

For accounting purposes, the original sales price is fixed within the books, i.e., it does not change to reflect a lower price. While the customer pays a reduced price at the checkout register, the bookkeeping will reflect the original price, less the discount, so that two-line items within the journal entry are recorded. Remember, the discount is allocated as cost.

So, what makes a good loyalty program? The answer to this question is truly complex, which is why the loyalty strategists at Loyal-n-Save have dedicated themselves to tackling this subject with every weekly blog we publish.

If an item or service had no sales discount, the books would debit cash and credit sales. When an item or service has a sales discount due to your current promotion, the books require two separate journal entries as follows:

JE #1	JE #2 (relevant to COGS)
Debit Cash at a Value of Selling Price Minus Discount Debit Discount at the Value of the Discount	Debit Cost of Goods Credit Inventory

A real-world example of the above equations might look like this: a bottle of nail polish retails at $10, and there is a discount currently being offered on this item, which has a $2 value.

JE #1

Debit Cash: $8

Debit Discount: $2

Credit Sales: $10

As you can see, within our first journal entry, we are recording a full $10 collected on the sale of the nail polish, even though the customer only paid $8 at the register. But the $2 booked to discount as a debit will offset the overall sales figure on the P&L and the balance sheet.

Let's move on to the second journal entry for our nail polish example. What was the wholesale value of the nail polish bottle? That amount factors in here since COGS detracts from the gross on the P&L. Let's say the nail polish bottle wholesales at $4.

JE #2

Debit Cost of Goods: $4

Credit Inventory: $4

Bear in mind that your P&L income statement will reflect the additional cost of $2 that you accrued when your customer took you up on the discount promotion. This $2 will ultimately unite with the $4 COGS so that the $10 figure you've recorded in Sales gets pulled down.

Now, in terms of your accounting, it's also crucial to differentiate Sales Discounts that any customer can receive versus Sales Discounts that only your loyalty members are eligible for, meaning you must distinguish between the two within your books.

Promotional & Complimentary Sales

Promotional and complimentary sales, also referred to as "giveaways", could also occur because of a regular promotion that all customers have access to, or it could occur because of a loyalty program campaign. As we mentioned regarding sales discounts, you'll need to differentiate your giveaways within your books as either associated with your loyalty program or part of a regular incentive that any customer can participate in.

However, unlike sales discounts, these giveaway promotions imply that the customer receives the associated goods or services for free. So, what happens when you give away a product for free that has a COGS amount? After all, you paid a wholesale cost to obtain the product. Even if you're giving away a service for free, you're likely paying the employee who is providing the service, such as a hairdresser, if you're running a promotion at a salon.

Of course, the bookkeeping account side of recording "giveaways" must ultimately reflect the reality, which is that your company is incurring a loss whenever it gives away goods or services. Let's take a look at the journal entries for this type of free promotion, and remember that you'll need to record whether your promotional and complimentary sales are associated with your loyalty program or not.

JE #1 for Cash Sales to Allocate the Selling Price

Debit Cash

Credit Sales

JE #2: Complimentary Sales

Debit Complimentary Sales Expense

Credit Sales

Debit Cost of Goods

Credit Inventory

You might notice that for journal entry #2, the first two-line items balance the selling price, while the second two balance the cost price (COGS). What you might find unusual with this journal entries is that #2 will hit your income statement as revenue even though the item is given away at $0.

The reason for this is because the item or service is still a sale, regardless of the value it is sold at—a value of $0 is still a value. While you do not earn cash for these free promotional giveaways, they aren't a loss since you are earning customer loyalty, and the increased chance that the customer will shop with you more exclusively or truly exclusively, would be an asset.

Here we get into the nitty-gritty of accurately recording the earned and redeemed rewards points within your bookkeeping. As we mentioned in the sections above, your rewards program can have any number of particular promotions, including those that are relevant to sales discounts and giveaways.

When setting up your customer loyalty program promotions within the chart of accounts of your books, you'll want to include separate categories for each promotional type. You can get as detailed as you like, noting the various promotions you have been running.

The most productive option is to set up the line items of your chart of accounts for your loyalty program in such a way that you can get a snapshot P&L of the different promotional types whenever you like. This way, for instance, at a glance, you will be able to see if your gamified promotions are making more or less profit than your tiered promotional incentives.

To reiterate the outmoded accounting treatment of rewards points, most businesses book loyalty rewards credits as a "marketing expense" or "promotional expense". Because of the IFRC-15, this is no longer acceptable. The discount or giveaway must be treated as a separate component of the sales transaction, as we've shown in our journal entry examples.

Let's dive into further detail and take a look at deferred revenue, which is what accrues when your loyalty members purchase goods or services that earn them rewards points. As those rewards points rack up, and before their redemption, they must accrue within your books as a liability. What would that sales transaction look like within your books as a journal entry?

JE #1

Debit Cash (Purchase Amount)

Credit Sales Revenue. (Purchase Amount minus Loyalty Credit)

Credit Deferred Revenue (Loyalty Credit)

A practical example of this would include offering customers 5 points every time they spend either $5 or buy one item—let's say a tube of hand cream valued at $5. First, you would have to understand the value of 5 points within your customer loyalty rewards program, but for the sake of this equation, we'll make 5 points equivalent to $1. The following is how you would record the sale of one tube of hand cream.

JE #1

Debit Cash: $5

Credit Sales Revenue: $4 ($5 minus 5 points or $1)

Credit Deferred Revenue: $1 (5 points or $1)

As you can see, the journal entry clearly separates the collected revenue from the deferred revenue. What does this mean? In terms of your bookkeeping and accounting, recording your journal entries in this manner means that you are acknowledging the future redemption value at the time of the sale, as well as recording the discount. Even though the customer handed you $5 for the hand cream, your bookkeeping will reflect the future potential of that sales transaction, causing a loss of $1 when the customer redeems those 5 points.

Here is a more complex representation of recording earned rewards points at the time of sale with the same tube of hand cream example:

JE #2

Debit Cash: $5

Credit Sales Revenue: $5

Debit Customer Loyalty Component of Sales: $1

Credit Deferred Revenue: $1

Many business owners, as well as bookkeepers and accountants, prefer the second journal entry to the first since it shows a clear balance between cash and sales revenue and the customer loyalty component of sales and deferred revenue. By neatly matching the figures, it's visually easier to see where these figures will show up within the chart of accounts.

Your journal entries can get even more complex if you'd like to reflect the various promotion types you're offering at your store, but we won't get into the myriad of possibilities here. Just know that the possibilities are endless if you choose to reflect real-life promotions within your books.

Let's look at the other side of the rewards points program. We just reviewed how to record earned points at the time of the sale. Now, let's take a look at recording redeeming those points when the customer does so in the future.

JE #1
Debit Deferred Revenue: 5 points or $1
Credit Sales Revenue: 5 points or $1

As you can see, when recording the redemption of the points, only the value of the points being "burned" is reflected. You will also need to make adjusting journal entries within your books at the time the rewards points that have not been redeemed expire. Unredeemed rewards points should be "released" as follows:

JE #2
Debit Deferred Revenue: $1
Credit Sales Revenue: $1

You may have noticed that both journal entries are identical—and you're right.

At any given time of the year, you may want to understand the real-dollar value of the reward point's liability at your store. Hypothetically, if every customer with outstanding points suddenly redeemed them on the same day, your business would take a hit. While this is unlikely to occur, it's wise to have a grasp on the actual value of the liability of your program, which means that you'll need to know how to calculate that liability.

Calculating Rewards Program Liability

As you now understand, rewards points that are outstanding (i.e., have not yet been redeemed by the customer) are always a liability for your company. However, just because you may know that there is a total of 1 million unredeemed rewards points, for example, you still need to figure out what that means as a dollar value.

The formula below will assist you in calculating that precise figure, though your POS export to your accounting software should spit out the same figure. However, that would be the case if and only if your loyalty rewards program was properly integrated into your POS system wherein the rewards point to dollar value was accurately set up as well. Bear in mind when using the formula that rewards program liability is also equal to deferred revenue.

Defining those terms above, the outstanding points refers to the "points" that have been issued to the customers but not yet redeemed by them, nor have those "points" expired. In other words, they are a pure liability. The cost per point refers to the expected cost of each point that will eventually be redeemed.

An oversimplified example of this would be if your rewards program was set up so that 1 point was equal to $1. Finally, the redemption rate refers to the probability that a point will be redeemed. Calculating the redemption rate is by far the trickiest aspect of this equation because it's not possible to predict the future with 100% accuracy. However, by reviewing the true redemption rate of prior years and taking an average, you can gain a good sense of what the future will hold.

Representing your customer loyalty rewards program within your bookkeeping software can be a complicated endeavor, but not an impossible one. While this article only scratched the surface, by now, you should have a foundational understanding of what goes into accurately recording and reporting your rewards program so that it meets IFRC-15 guidelines.

That being said, grasping the particulars of the journal entries we went over won't do you much good if your loyalty rewards program software isn't exporting seamlessly and accurately into your accounting software. This is where Loyal-n-Save comes in.

Our loyalty rewards program does more than incentivize enrollment, increase sales, and succeed at branding and marketing your business. Our developers and strategists have kept your year-end planning in mind, and our solutions are tailored to simplify your life while accurately recording your accounting to meet IFRC-15 standards.

An ROI, or return on investment, is a direct measure that evaluates the efficiency of a particular investment with consideration to the upfront costs of that investment. Any savvy business owner is going to want to make sure that laying out $X in order to implement a marketing strategy, for example, is going to see a return, i.e., profits, on that investment that are at least equal to or greater than X.

The word "return" always refers to "value", and for the purposes of this article, "return" will mean "revenue generated" and "revenue saved".

If this is already sounding complicated, let's step things back and use a "profit" model. Profit is the result of "return" minus costs. If your business generated $1 million in additional revenue and incurred $500,000 in costs, then the profit generated is $500,000.

The formula to calculate the ROI is just as simple in mathematical structure, yet it's entirely different. The purpose of calculating your ROI is to help you understand the efficiency of an investment (for example, you want to see how efficient your new loyalty rewards program is at increasing your revenue). Typically, this formula is a way for investors—and business owners like yourself—to determine whether they are receiving enough gain to continue investing.

ROI does not measure the total amount of revenue a business generates. ROI measures which metric generated the best "return". Phew! That was a lot of groundwork, but it was necessary to lay it down so that you'll have ease wrapping your head around the actual formula.

ROI = net profit ÷ cost of investment

Another simpler way of looking at it is this:

ROI = (current value of investment – cost of investment) ÷ cost of investment

Bear in mind that ROI is not a financial metric but a percentage (a ratio), and it enables you to be rational in your investment decisions. The ROI will show you the percentage return of every financial effort you make. You will be able to see if your loyalty rewards program generates a 40% return or 60% return. If your return here is higher than other marketing efforts, you can cut unnecessary spending and pour even more funds into the marketing method that works more.

In this blog, we will teach you how to calculate your Return on Investment (in this case, investment for a loyalty program) and the Customer Lifetime Value of your shoppers. Using these figures will help you to make wise promotional marketing decisions on all of your future campaigns.

If you've gotten to this blog post, you're a business owner with at least one retail store, and you've probably read the rest of our "covering your bases" series of blog posts that includes:

Why Is Customer Loyalty Important?

What Is A Customer Loyalty Program?

Loyalty Program Types?

Best Loyalty Program Practices?

How to Build a Loyalty Program?

How Much Does a Loyalty Program Cost?

If you have already used the information contained in the above blog posts to choose the best loyalty rewards program for your business, that's great! We invite you to keep reading to learn about how to calculate your return on investment and the customer lifetime value of your shoppers. Using these figures will help you to make wise promotional marketing decisions on all of your future campaigns.

The purpose of increasing loyalty and customer satisfaction is to increase the lifetime of a customer. How do you calculate customer lifetime value or CLV? At the simplest level, CLV is essentially the length of time the customer patronizes your business versus the average amount a customer spends at your business during that same time frame.

CLV = (average monthly transactions × average order value)
× average retention rate in months/number of clients for the period

Watch out! You're not finished yet! The simple equation above will grossly overestimate the value of a customer because it ignores profit, costs, and the discount rate, all of which you're going to want to include to make your calculations as accurate as possible. An improved formula would also multiply this figure by the average gross margin. With this new formula, you will be able to tell how much profit you make from a customer rather than how much a customer spends.

CLV = ((average monthly transactions × average order value) × average retention rate in months) × average gross margin/number of clients for the period

Customer lifetime value can greatly inform your return on investment because CLV provides significant value when it comes to marketing ROI.

This is how you use the two resulting figures you've gotten from your ROI calculations and your CLV calculations to stay informed and make better business decisions. We'll show you an example with real numbers:

Let's assume you've calculated your average customer acquisition cost for your company and it's $100, but the customer spends $180 so you have a CLV of $80 ($180 - $100 = $80).

In this example, the marketing ROI equation is CLV/acquisition cost = ROI (or) $80 ÷ $100 = 80%. In other words, your marketing department has taken $100 and turned it into $180 by acquiring a new customer, which is an 80% ROI.

There you have it! A little math goes a long way, and now that you are able to calculate the ROI percentage on all of your marketing efforts, you can focus more funds towards the methods that work!

Alternatively, if calculating your CLV and ROI has you feeling overwhelmed, the Loyal-n-Save team is available to assess those calculations for you! It's all part of our hands-on loyalty strategist services, and when you sign up for our digital platform, you will receive step-by-step assistance in implementing all of your marketing efforts. Just click here to connect with a Loyal-n-Save strategist.

Our loyalty strategists serve B2B and B2C companies across all industries, and we can serve your business as well.

About The Company

Loyal-n-Save forms a part of the FasTrax enterprise suite of software solutions. It is owned and operated by Darren Schwartz and Doug Nolan. It assists retailers in creating customer engagement and expanding their customer base. What makes it different from others is its unique marketing approach with its loyalty programs. It allows retailers to give customers a percentage of reward tokens for providing references of friends and family to their store.

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