Demystifying Incentive and Loyalty Program Pricing

A unique, open overview of approaches to pricing for Sales, Employee, Channel and Customer-facing programs

At Loyaltyworks, we believe in an up-front, flexible and open approach to incentive and loyalty program pricing.

We want to make sure the program we develop and implement is the right one for each client’s business situation. So, we like to help each client understand the different pricing models available.

To make sure you understand your options, we offer below an overview of standard pricing models for points-based programs, as well as important considerations. We encourage you to review your options toward making a more informed determination of what’s best for you.

Please keep in mind that this guide benefits you most effectively if you take all sections into account. For example, knowing that you want a “Bill on Issuance” model for your program does you no good if you don’t have clarity on the value per program point and the cost and service variables that are bundled (or not) into the cost per point by your solution provider.

What You Can Get Out of This Overview

☑ First – Understand the True Value of a Point
☑ Second – Establish Which Pricing Model is Appropriate for Your Situation
  a. Bill on Redemption
  b. Bill on Issuance
  c. Professional Services Model
  d. Hybrid Model
☑ Third – Determine What is Incremental versus What is Built-in
☑ Note on Pricing of Incremental Services

For What Program Type Does This Paper Apply?

• Employee Recognition and Loyalty
• Employee Performance Improvement - Safety, Wellness, Cost Savings, Attendance, Customer Satisfaction, etc
• Call Center Reps - Performance Improvement & Recognition
• Sales Force/Sales Rep Performance Incentives
• Channel or B-to-B Customer Loyalty
• Customer and Channel Incentives
  • Motivating toward specific activities
  • Driving product sales - new and incremental
  • Encouraging purchase of better/best products
  • Achieving revenue and margin objectives
• Among Others...

See page 8 for additional topics not included in this paper, but available separately from Loyaltyworks.
Understand the true value of a point

Client companies should not be lulled into thinking that a program with points priced at $.005 each is somehow less expensive than one utilizing $.01 or $.02 per point. The true cost of any incentive or loyalty program is determined by:

- How much a client is willing to pay an incentive program participant (e.g., customer, employee, etc.) for a desired behavior or activity
- How much of that desired behavior or activity actually occurs

Many times, these conditions are expressed as a percentage, which takes into account the incentive budget. For example, the typical Loyaltyworks client allocates a budget of between 1% and 4% of sales/purchases as the basis for its incentive or loyalty program.

Once the general budget has been established, the next step is to establish the Reward Rule. Simply stated, the Reward Rule specifies the number of points that the customer receives as a reward for the desired behavior or activity. A couple of simple steps are required to determine the Reward Rule.

Consider an example from the first line of the table below. Let’s say that a client company has determined that it wants to reward its customers 2% in points for purchases of qualifying products (e.g., a line extension, new brand, etc.). Let’s also assume that an average customer purchases $20,000 of those qualifying products. If the client establishes a price/point of $.02, the number of points awarded is 20,000. This is determined as follows: 2% x $20,000 = $400 / $.02 = 20,000 points.

In this example, the Reward Rule is “1 point for every $1 purchased.”

### Examples of Various Reward Rule Scenarios

<table>
<thead>
<tr>
<th>Customer Purchases ($)</th>
<th>Incentive/Reward Budget %</th>
<th>Price / Point ($)</th>
<th>Points Awarded</th>
<th>Reward Rule (Communicated to the customer)</th>
</tr>
</thead>
<tbody>
<tr>
<td>20,000</td>
<td>2.0%</td>
<td>0.020</td>
<td>20,000</td>
<td>1 point / $1 purchased</td>
</tr>
<tr>
<td>20,000</td>
<td>2.0%</td>
<td>0.010</td>
<td>40,000</td>
<td>2 points / $1 purchased</td>
</tr>
<tr>
<td>20,000</td>
<td>2.0%</td>
<td>0.005</td>
<td>80,000</td>
<td>4 points / $1 purchased</td>
</tr>
<tr>
<td>20,000</td>
<td>1.0%</td>
<td>0.020</td>
<td>10,000</td>
<td>1 point / $2 purchased</td>
</tr>
<tr>
<td>20,000</td>
<td>1.0%</td>
<td>0.010</td>
<td>20,000</td>
<td>1 point / $1 purchased</td>
</tr>
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<td>20,000</td>
<td>1.0%</td>
<td>0.005</td>
<td>40,000</td>
<td>2 points / $1 purchased</td>
</tr>
</tbody>
</table>

1 It is important to note that program cost is only one aspect of the financial justification for an incentive program. The program's benefit must also be determined, so that the program ROI can be calculated. For more on calculating your program’s ROI, feel free to call us at 1.800.844.5000.
The table above shows how the Reward Rule can vary at the same level of customer purchases, dependent on the price per point. If the client had selected a price/point of $.01 (for any number of reasons), the number of points awarded would have been 40,000, even though the purchased volume of $20,000 remains unchanged from the previous example. Here is the calculation:

\[ 2\% \times 20,000 = $400 / .01 = 40,000 \text{ points}. \]

Now the Reward Rule is “2 points for every $1 purchased.”

Irrespective of the price/point, the amount of reward for the desired behavior or activity remains the same. It is determined by the conditions noted at the beginning of this discussion, which are:

- How much the client is willing to pay a participant (e.g., customer, distributor sales rep, employee, etc.) for a desired behavior or activity
- How much of that behavior or activity actually occurs

Refer again to the table and note that, if incentive budget changes (e.g., 1% versus 2%), the Reward Rule at any given price/point changes.

How does all of this affect the program participant?

In setting the program budget, the client company should consider the value of influencing the desired behavior or activity – i.e., “how much am I willing to pay to get [result].” This is essential in developing the ROI calculation that is the foundation of any program.

However, the client company should also have an understanding of the amount of reward that a customer would find meaningful enough to initiate or reinforce the desired behavior or activity. This is typically referred to as the Value Proposition.

Let’s return to our original example in the previous section. In this case, the program participant (customer) buys $20,000 of qualifying products. The client pays $400 to the program operator (e.g., Loyaltyworks), based on the reward budget at 2% of purchases of qualifying products. In turn, Loyaltyworks awards the program participant (customer) 20,000 points, based on a price/point of $.02.²

² Based on a Bill on Issuance model – While the timing of payments to the incentive program operator changes under a Bill on Redemption model, the Reward Rule and Value Proposition considerations remain the same.
The program participant can then "spend" his/her 20,000 points on any one of a number of reward items offered in the program catalog. Reward items in most of Loyaltyworks' programs include the following elements as part of the point value, or cost the client pays per point:

- Cost of the reward
- Technology platform maintenance and ongoing enhancements
- Participant support, including call center and fulfillment
- Program communications
- Program operations, including reward compilation and maintenance
- Loyaltyworks' profit

The cost of the reward item alone is typically 70-76% of the total cost to the client (in the example, $280 – 304). This reward cost approximates the reward item's value to the participant that should be considered by the client in determining the Value Proposition. Since the program participant does not (and really should not) know what the client has paid for the points that have been awarded, his/her only frame of reference is to compare the perceived value of a reward item with the desired behavior or activity.

In effect, the program participant thinks like this:

"If I buy $10,000 worth of Client’s products, I can get 10,000 points (using the Reward Rule). If I get 10,000 points, I can get a Ping putter (using the Value Proposition). That’s great!"

Since the Value Proposition is based on the perceived value of the reward item, the number of points required to obtain an item is only important in its relationship to the points awarded for the desired behavior or activity. Refer again to the previously mentioned Reward Rule table. As you can see, the number of points awarded changes depending on the price/point and the Reward Rule. The points required to obtain an item at a given cost changes accordingly, as shown in the following table.
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Points Awarded as Function of Price / Point & Reward Rule

<table>
<thead>
<tr>
<th>Price / Point ($)</th>
<th>Reward Rule (Communicated to the customer)</th>
<th>Item Cost to Client ($)</th>
<th>Points Req. to Redeem</th>
</tr>
</thead>
<tbody>
<tr>
<td>0.020</td>
<td>1 point / $1 purchased</td>
<td>$ 200</td>
<td>10,000</td>
</tr>
<tr>
<td>0.010</td>
<td>2 points / $1 purchased</td>
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<td>20,000</td>
</tr>
</tbody>
</table>

A Final Note on the Value of a Point

The preceding discussion is provided by Loyaltyworks to help you understand that a successful incentive or loyalty program must have balance among the client, participant and incentive partner/solution provider. It must:

- Generate cost-effective, valuable results for the client that meet their objectives
- Provide compelling, meaningful rewards to program participants
- Be sustainable and make sense to the program partner or solution provider

These three pillars form the basis for the Balanced Triangle™ of an effective incentive or loyalty program. For more on the Balanced Triangle™ and its implications for your program, please call us at 800.844.5000. As your program partner, Loyaltyworks can help you establish the Reward Rule and the Value Proposition that allow you to achieve this critical balance.

Establish which pricing model is appropriate for your situation

There are three widely-used, standard pricing models for non-monetary incentive and loyalty programs: Bill on Redemption, Bill on Issuance and Professional Services models. Any of these models - or hybrid combinations of the approaches - may work for your situation, depending on a range of factors discussed throughout this Overview.

Bill on Redemption Model

Summary: The client pays a program set-up fee for standard technology, creative services and administrative start-up activities. The client is then invoiced for points at the time they are redeemed for rewards by program participants. Since client payment for points occurs later in the program (at redemption), incremental compensation is common to cover the program provider’s ongoing expenses of managing and administering the program. This may be in the form of a monthly program management fee or a combination of a management fee and either a fee on points redeemed or an incremental mark-up on reward item values.
**Advantage:** In this arrangement, the client enjoys somewhat lower up-front program costs, because they are paying for points at the time that program participants are redeeming points for rewards. As participants get “vested” in the program by accumulating points, the redemption of points for rewards may take place well after the positive desired behavior has occurred.

Companies that use this pricing model may require lower up-front costs before proving some level of program success. Or they may need an alignment of program costs more in line with actual redemption as a means of tracking ROI month-by-month, versus tracking over a quarterly or annual period.

**Disadvantage:** The client bears the liability for points redeemed, without knowing the eventual redemption rate for the program. So, the client is exposed to redemption-based costs that may rise well above their planned program budget on a monthly or periodic basis, if the redemption rate for travel and merchandise rewards is high. Moreover, for programs that run from one fiscal year to the next, the client must carry the accrual for unredeemed points.

**Bill on Issuance Model**

**Summary:** The client pays a program set-up fee for standard technology, creative services and administrative start-up activities. The client is then invoiced for points at the time they are issued (awarded) to program participants. Clients employing this model often fund the program as a percent of sales for customer and sales force incentive programs.

Companies that use this pricing model may need high control over their budget – costs and timing – but are not able to forecast redemption rates.

**Advantage:** In this arrangement, the client pays for points up-front – when issued to participants – allowing for better accounting control when costs hit their bottom line. The client is not affected by the rate that the participants redeem their points for rewards (and the eventual cost associated with delivering those rewards), which is unknown until redemption occurs. Consequently, the client is protected from unforecasted, redemption-based costs above their program budget. Loyaltyworks assumes the redemption liability. So, if the redemption rate is high, Loyaltyworks absorbs the higher redemption costs.

**Disadvantage:** The client has higher up-front program costs and, in exchange for being protected from high redemption costs, receives no benefit from “breakage” - unredeemed points.

**Professional Services Model**

**Summary:** The client is invoiced for the actual cost of reward items and their shipping/handling at the time the participant redeems points for their reward. Since redemption costs are passed-through, the client pays for all services from Loyaltyworks on an as-used basis.

Companies that use this pricing model may need an “at cost” agreement with their partners, while also requiring the incremental benefit of strategic management of their program.

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The most common factors considered in structuring incentive programs:

- Cost versus shared result
- Freshness, uniqueness over time
- Perceived value
- Ease of administration
- Being fair to everyone
- Profitability

**Advantage:** Program costs are spread out more evenly and the value focus of the arrangement is on the use of Loyaltyworks’ systems, operations, people and thinking. In this arrangement, the charges for program design, delivery and administration are unbundled from the cost of points. In the Issuance and Redemption models above, these costs are imbedded in the price of the points themselves.

**Disadvantage:** The client bears the liability for points redeemed, without knowing the eventual redemption rate for the program. So, the client is exposed to redemption-based costs that may rise well above their planned program budget on a monthly or periodic basis, if the redemption rate for travel and merchandise rewards is high.

**Hybrid Model**

In the past, Loyaltyworks has worked with clients on program agreement variations that involved combined elements of the billing models mentioned above. We are willing to consider “hybrids,” as long as they fairly and reasonably meet the requirements of all parties involved.

This model is a potential fit for all clients, where their unique business measurement, accounting philosophy and budget need a pricing relationship that works just for them.

Most client companies prefer pricing models that bundle much, or all, of the program cost into a price per point. The biggest advantages to this approach:

- Controls program cost under one variable, which typically aligns with and relates directly to the program’s performance
- Avoids unplanned cost spikes
- Enables more consistent, accurate and aligned budget projections

However, in theory, a company that promotes charging separately for variable fees would assert that the client’s total costs would net out in the end. Clients that wish to evaluate that approach should run scenarios depicting low, medium and high (worst case) exposure.

**Determine what is incremental vs what is built-in**

Some companies build a range of variable fees into the price that their clients pay per point. Others break out many of these fees and charge clients separately from the core pay-per-point model.

If a client considers a pricing model that involves separate – or incremental – fees, be aware. They may appear innocuous and minimal, but these seemingly small fees can burn an unexpected, big hole in your budget.
If any of the following items are not rolled up in a straightforward price-per-point model, clients should understand how they will be charged for:

### Telephone calls

In-bound from and out-bound to participants, usually via call center – typically tied to general program support and Rewards customer service. Some companies charge up to $1 to $1.20 / minute.

**Keep in Mind**

- Just one redemption may involve multiple phone calls from inquiry to order.
- Travel-related redemption calls can easily exceed 6 for packages and cruises.
- Redemption and inquiry calls cannot always be “modeled” and planned for – Call volume spikes do occur.

### E-mail communications

In-bound from and out-bound to participants, usually via call center – typically tied to general program support and rewards customer service.

**Keep in Mind**

- Just like phone communications, redemptions and inquiries cannot always be “modeled” and planned for – E-mail volume spikes do occur as well.

### Program communications

Critical to a program’s success, but often neglected as a line item, some companies charge a la carte for communications elements such as launch materials, welcome letters, reward brochures and/or catalogs, monthly point statements, etc.

**Keep in Mind**

- Incremental charges may be all-inclusive or apply solely to postage and handling.
- If fees are applied incrementally for communications, estimate launch-related and ongoing communication expenses separately for more accurate view of cost exposure.

### Reward taxes / Reward order processing

Charging separately for sales taxes associated with redeemed rewards and for order processing fees associated with redeeming for rewards.

**Keep in Mind**

- Since taxes vary by state, a current trend is for the reward provider to build an assumed tax into the cost per point, removing any concern of cost unpredictability for the client and placing the burden on the rewards provider. Also, if vehicles (i.e., ATVs, autos, motorcycles, etc.) and watercraft are part of your reward mix, be aware that the extra fees – such as tax, title and registration – typically are the participant’s responsibility.

### Rewards fulfillment

Charging separately for postage and handling of reward redemptions.

**Keep in Mind**

- To avert potentially excessive charges, make sure postage and handling fees are clearly defined – ground and air – including when air versus ground delivery would be used.

### Program administration

For Bill on Issuance models, many companies roll program administration into the price-per-point. For Bill on Redemption pricing models, they may cover their program management costs through set monthly fees or a range of other approaches.

**Keep in Mind**

- Some companies charge for program administration by the hour (hourly fees). Clients should be wary of this open-ended approach.
- Rule of thumb is simple – Companies should be up-front about how they fund program administration and, likewise, clients must be persistent in understanding the model.
A Note on Pricing Additional Services

When Loyaltyworks provides incremental services for our clients, we typically work on a model where we bill on our time and a “pass-through” of hard costs (i.e., print production), rather than marking-up all costs incurred. This way, we ensure a solution-neutral approach, giving our clients the best possible value for their investment.

For reference, Loyaltyworks provides a full range of capabilities and services, including:

- Program assessment and consultation
- Solution strategy and design
- Custom technology design and development
- Creative services
- Program communications
- Database marketing
- Advanced reporting and analytics
- Market research
- Custom rewards and fulfillment
- Call center services

Additional Items Not Included in This Paper (but available separately from Loyaltyworks)

In addition to how you value and pay for your incentive or loyalty program, there are a number of areas that you should address. We cover these topics elsewhere for the benefit of our clients, friends and partners.

Other topic areas include:

☑ Understanding the “Balanced Triangle” of incentive program economics and its implications
☑ Establishing needs & objectives for the program, how it aligns with company strategy and fits with other established programs or initiatives
☑ Determining program parameters, including program length, audience, value proposition, budget, success measures, etc.
☑ Mapping program needs to suppliers, solution providers and technology
☑ Preparing for and launching the program
☑ Managing the ongoing program, including data management, measurement, ways to assess and improve the program
☑ Leveraging the data long-term to build relationships and business and to drive key behaviors

If you have any questions on incentive and loyalty program pricing or would like information on our solutions, please call us at 800.844.5000, send an e-mail to info@loyaltyworks.com or visit our Web site at www.loyaltyworks.com.

About Loyaltyworks

Loyaltyworks designs, develops and manages a wide array of loyalty and incentive programs – from turnkey programs and promotions to fully customized solutions – with a focus on measurable results. For nearly 30 years, Loyaltyworks has successfully implemented employee recognition, sales incentive, customer/channel loyalty and performance improvement programs.

Loyaltyworks supports its programs with a full range of capabilities and services, and approaches client relationships based on core values of openness, ease and accountability. The result – Clients find it easy to do business with Loyaltyworks and be successful.