

**Networks, alliances and loyalty programs in Australia:**

**Power not passion drives the affair.**

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## **Networks, alliances and loyalty programs in Australia:**

### **Power not passion drives the affair.**

#### **ABSTRACT**

Previous research on loyalty programs in Australia has shown the benefits gained by partners in these programs. This paper develops this research and introduces the concept of network development in loyalty programs. It builds on the theory of network development (Hertz and Mattson, 2004) and uses the role of strategic alliances to explain the implications of networks for the success of loyalty programs. The loyalty program utilised in this paper is FlyBuys which is run by Loyalty Pacific, a joint venture formed by National Australia Bank, Shell Australia and the Coles Myer Group. The initiators of Pacific Loyalty recognised the need to increase and improve their individual customer databases. The development, maintenance and usage of a data system that size, requires special skills and a large financial commitment. A sophisticated hardware and software solution is essential in order to track and manage the growing amount of data, transactions and services offered such as statements, service call centre and point collections. As the computer system plays a vital and ongoing role in the survival of this consumer loyalty scheme, a strategic alliance with HP/Compaq services was formed. This paper highlights the importance of HP/Compaq as the provider of the information technology platform which drives the program and shows how their role has developed and been expanded overtime.

## **Introduction**

This paper aims to highlight the importance of the information technology platform which drives loyalty programs and show how the role of the information technology provider has developed and been expanded overtime. To achieve this aim we will look at one particular loyalty program in Australia, Flybuys, the joint venture which makes this program possible and the information technology provider. The paper will begin with a theoretical assessment of loyalty programs, a discussion of the method used to investigate the program researched, a description of the program and the benefits gained by program members (retailers not consumers). It will progress to discuss the joint venture which holds this program together and highlight the role of network theory in this research. Finally it will examine the role of HP/Compaq, the information technology provider and examine its position and importance in this joint venture.

## **Loyalty Programs**

Loyalty programs have become a commonly used marketing tool to build consumer loyalty. Customers are recognised and rewarded. Loyalty programs offer rewards to customers showing loyalty to particular businesses or groups of businesses.

Companies acknowledge the value of loyalty programs, as customer retention is more cost efficient than constant acquisition of new customers (Kivetz and Simonson 2002).

The growth in consumer loyalty programs has continuously increased over the past few years. Especially loyalty cards appear to be a must for major retailers, financial institutions and credit card programs to survive in the highly competitive market situation (Bannister 2001). As an example airlines introduced loyalty cards as a tool to

differentiate themselves from their competitors and to provide better services to their customers in the early 80's.

Companies encourage consumers to join their loyalty programs to collect points. They tend to build a bond between customer and company, which then leads to repeat business customers and increase in sales (Bond 1995). Another reason for offering and or being part of a loyalty scheme is to gain knowledge, in order to attract, retain and increase customer bases (Powaga 2002). Companies use loyalty programs to get a better understanding of their businesses, their customers and their competitors.

Gummerson (1996) notes the importance of the "customer as a member", he believes that the importance lies in the fact that the customers are brought closer to the provider through exclusive member benefits. If effectively used, then the knowledge gained through loyalty programs is more valuable than the actual customer loyalty created (Cant 2002 and Anonymous 2002b). For instance, monitoring trends in buying habits and fashions helps companies with product development and innovation. It then allows them to tailor product ranges to individual stores to ensure that the range provided is relevant to the local area. (Anonymous 2002c)

One of the overriding benefits of loyalty programs to companies is the opportunity to increase and improve customer databases. Companies aim to increase and improve the quantity and quality of their databases by combining their databases with loyalty program partners. Companies respond to consumers' individual needs and tailor their offers to it (Anonymous 2002a, Anonymous 2002b and Shelton 2001) via loyalty programs. From a customer point of view they are more likely to join loyalty programs with a larger number of participating retailers as the point collections is quicker and can be redeemed for rewards earlier (Anonymous 2002e). Additionally from a company point of view being part of a network/alliance which brings a group

of retailers together allows them to offer rich rewards beyond the reach of most individual retailers (Cigliano et al, 2000).

### **Research Methodology**

For the purposes of this paper one loyalty program in Australia was investigated with respect to its network connections and IT providers. In order to examine the network of this loyalty program data was collected from various sources. The prime source of data was a personal interview with the general manager of Loyalty Pacific, Australia, Doug Crocket. Loyalty Pacific Australia is the joint venture formed to manage the FlyBuys loyalty program in Australia. Additional data was gathered through extensive internet and database searches of the various partners of the loyalty program and the IT providers. Data was also gathered through personal contacts within the Coles Myer Group, the largest player in the loyalty program. Finally, we contacted by phone various IT providers who provided us informally with further information.

This research strategy is aligned with a case study approach in that “it attempts to examine a contemporary phenomenon in its real life context” (Yin, 1981). In carrying out this research, we are utilising data from various sources, this triangulation ensures the provision of accurate facts of the case.

### **Australian Loyalty**

Given the benefits discussed above for consumers and companies a loyalty program with more parties involved is likely to be more successful in attracting customers and thereby helping the company build a more effective and bigger database. With this in mind the FlyBuys program was established in 1994 by various major players in the

Australian market such as Coles Myer stores, Shell, National Bank and Budget.

Coles Myer is the major player in terms of the participating card partners.

FlyBuys with 5 million members<sup>3</sup> is one of the most popular loyalty programs in Australia. The program comprises of a variety of retailers such as department stores, supermarkets, and specialty shops who offer products ranging from food, petrol, banking, tyre and auto service, computer technology, clothing, real estate, hotel rooms and car rental. Customers collect points every time they shop with one of the participating stores.

FlyBuys is run by Loyalty Pacific, which is a joint venture formed by National Australia Bank, Shell Australia and the Coles Myer Group. The joint venture was created because it is believed that the benefits sought through FlyBuys which include the creation of long-term relationship with customers in order to ensure a competitive position in the market and to increase sales eventually is only possible through the development of relationships which require the use of sophisticated data bases allowing companies to target customers with promotion programs such as special offers. In a small market like Australia no one retailer could implement the systems provided and manage the program as a stand-alone entity (Crocket, 2004).

Therefore the joint venture Loyalty Pacific was established to bring resources together. The initiators of Pacific Loyalty recognised the need to increase and improve their individual customer databases. The development, maintenance and usage of a data system that size, requires special skills and a large financial commitment. The collaboration allows companies to achieve cost efficiencies and ensures the continuation of the program, which manages a large amount of data.

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<sup>3</sup> [www.flybuys.com.au](http://www.flybuys.com.au)

A sophisticated hardware and software solution is essential in order to track and manage the growing amount of data, transactions and services offered such as statements, service call centre and point collections. As the computer system plays a vital and ongoing role in the survival of this consumer loyalty scheme, a strategic alliance with HP/Compaq services was formed. HP/Compaq was chosen on the basis of *knowledge, competency* and level of commitment as well as price and costs considerations, which is vital for a continuing business relationship.

The data collected comprises membership details, members' shopping activities per store, spending profiles, number of visits per store, points built up and other trend related information. Individual membership details are matched with their shopping behaviour to create customer profiles and identify market segments.

The results are used for strategic marketing decisions such as design of distribution networks, choice of store locations, tailored marketing programs. The members aim for a long-term benefit - building relationships with their customers.

### **Joint Ventures and Networks**

Bamford, Ernst and Fubini (2004) define joint ventures as being where “the partners contribute resources to create a new company” as was the case with the Loyalty Pacific joint venture. They contrast this with an alliance which they define as a situation where “the partners collaborate without creating a new company” In addition to this clarifying definition they also note that the advantages in either type of alliance lies in managing risk in uncertain markets and sharing the cost of large scale capital investments. Xie and Johnston (2004) further classify alliances into various types. In examining their typology of alliances (see figure 1), we can ascertain that the alliance being investigated in this paper can be classified as a Type II non-equity scale alliance.

*Type II (non-equity scale) strategic alliances are characterised by the horizontal associations of firms involved and a lack of equity investment in the alliance. Firms in this kind of alliance often use it as a means of consolidating market positions, promoting brand equity, and enhancing distribution efficiency and effectiveness. (Xie and Johnston 2004, p215)*

“Insert Figure 1 here”

As well as pointing out the advantages companies gain from forming alliances many researchers have discussed their growth in business today. Hertz (2001) notes that “alliances are becoming increasingly common in most industries”. She specifically refers to the fact that they are an important tool in increasing the efficiency of the supply chain and serving customers. We will interchangeably use the word network and alliance. In achieving a definition of networks for this paper we have looked at a few sources; “A network consists of companies and the relationships between them” (Ford et al, 2003)... “Generalised connectedness of business relationships implies the existence of an aggregate structure, or form of organisation, we have chosen to qualify as a network” (Hakansson & Snehota, 1995). These definitions and this preceding discussion allow us to tie network theory with the concept of alliances, by doing this we are able to investigate what is needed to make a network/alliance successful.

In order to gain the benefits from the alliance/network there is a need to manage the alliance, this management is facilitated by information technology. In many networks and alliances the parties can be “geographically dispersed” in many cases information technology helps to eliminate the distance (Trondsen, 2000). Trondsen (2000) highlights the fact that “dedicated and systematic work is necessary to make a network successful” and borrows four important issues relating to networks from

Hakansson and Sharma (1996) these are issues which clearly relate to the case we are investigating in this paper. They are,

*“value concept” where clear value is provided for the target customers;*  
*“relationship development” which helps define the characteristics of ideal partners and the capabilities they will contribute to the network; “Network management” the underlying motivation for networks members to organise and integrate activities to create competitive advantage for the network;*  
*“partner learning’ transfers of specific skills and tacit learning as partners work together”*

All of these key issues are present when examining the Loyalty Pacific case, so clearly this loyalty program is a form of network/alliance, where rather than having a stand-alone program retailers have gotten together in an alliance. Parise and Casher (2003) have labelled such networks “collaborative networks” and use the example of the alliances between airlines such as OneWorld and Star Alliance, as a clear example of this type of network. As previously pointed out this brings additional benefits to both customers and retailers but has many hidden costs, the overriding one being the cost of managing the program.

Much research has been done into exactly how much is invested in managing loyalty programs. Cigliano et al (2000) in a study on the cost of loyalty programs found that these costs including; marketing and managing the program, investment in the systems etc can run into the millions. Given that the cost of managing and running the program is such a major investment for all parties involved the choice of information technology (IT) provider becomes of utmost importance to the network.

### **Dependence on Computers in Loyalty Programs**

IT systems play a major role in building relationships with suppliers, partners and customers while addressing individual business needs and offering quicker return on investment (M2 Presswire 2001). The use of IT systems have changed the way businesses manage customer data, build databases and made it possible to deal with and analyse large amounts of customer data. The advances in technology make it possible to operate sophisticated marketing information systems assisting managers in decision making and to run highly developed loyalty programs (Rowley 1999).

Retailers started using database marketing and loyalty programs to gain a competitive advantage in the late 90's (Raphel 1998). Most retailers' main objective was to retain customers through loyalty program, as an increase in customer retention rate by 5% could increase profits by 80% (Abernethy 2000). The key to this is to manage and analyse data efficiently.

A loyalty program succeeds and fails with the IT system running the program. Hence, a sophisticated IT system sets the parameters for a successful loyalty program, as it has to manage and analyse consumer feedback and business information efficiently to deliver actionable results (Leon 2003). Sufficient research has to be done with respect to IT provider and system choice, as experienced at the launch of the loyalty program nectar operated by Loyalty Management UK (LMUK) program. Problems were encountered during the first week of the program introduction, as an unexpected number of 100,000 customers tried to sign up for the program. The online registration facility had to be suspended while a reworked more powerful version of the website was developed (Clark, 2002). A more proactive relationship with this supplier may have avoided this problem, it is vital that the IT provider gets involved in the planning as early as possible so all contingencies can be planned for.

Technology allows companies to communicate and build relationships with their customers through loyalty programs. It also allows them to keep up with consumer trends and provides opportunities to gain a competitive advantage through improved customer services (Rowley 1999). The partnership between Pegasystems and BUPA, a health care provider's resulted in upgrade of the IT system for BUPA's loyalty program, which responds more consistently and efficiently to consumer needs and increases customer services overall (M2 Presswire 2002). For example FlyBuys New Zealand introduced a new content management system supplied by Synergy that updates data quickly and easily at real time. Improved websites allow for better availability and accessibility of information for FlyBuys members. The software includes a SMS messaging means and FlyBuys card holders can also check their balances and/or receive promotions via their mobile phones. In future, members may be able to browse and select rewards using their mobile phones. It is obvious from the information that is needed, that a relationship with the service provider becomes the main key to success of the program overall. The big question therefore is how did Loyalty Pacific choose an IT provider who was going to be such an important cog in the wheel.

### **Why Compaq?**

Compaq (now HP/Compaq) was chosen by Loyalty Pacific initially through a tender request for the supply of a hardware and software solution, as no off-the shelf solution was available that could run the loyalty program envisaged and process the large amount of data and tasks. Therefore, it was mission-critical to find a provider that could provide a suitable solution allowing for further software and hardware updates. Quality was an important objective along with cost and time considerations. Compaq was able to provide such a solution at low cost within three months time.

The custom written Tandem fault-tolerant system initially produced by Compaq was able to:

- Collect and redeem FlyBuys member points
- Produce statements re member transactions
- Enable online inquiries to a service call center
- Provide information about daily total expenditures by outlet
- Track transaction details
- Store about six months of member data

A complimentary hardware platform, able to analyse and report on FlyBuys members shopping activities and general purchasing trends, was added as a strategic marketing decision tool.

The Tandem NonStop system developed by Compaq allowed for further hardware and software upgrades and additions. Compaq achieved the objectives and supplied a cost efficient, reliable and easy to maintain system, which resulted in an ongoing strategic alliance with Loyalty Pacific.

### **Evolution of the role of IT**

Many companies reviewed their computer systems in the late 90's in anticipation of the Y2K challenges. In 1999, Coles Myer updated and changed their IT systems to a mutual system, e.g. UNIX system. Pacific Loyalty changed their systems to conform to the Coles Myer system and also changed to use most of the same software suppliers. The really fascinating thing about this from a network perspective was that most of the FlyBuys retailers followed suit. This change of It provider could be seen

as an example of the Domino effect made famous by Suzanne Hertz, where a change by one party in the network spills over to other parties

Along with a growing number of FlyBuys program members and advances in technology, the following changes also had to be addressed:

1. The biggest challenge has been to manage the amount of data and transactions resulting from more than 5 million members in Australia, and growing by 25,000 new households per month (Abernethy 2000)
2. Targeting and segmenting have become a major focus in the increasingly competitive Australian market. The system has been updated to not only track consumer purchasing data, but also consumer points redeeming information. The analysed data is intended to be used to tailor specific marketing programs.
3. Stricter privacy and confidentiality issues have been introduced by the government that require data to be managed more strictly.
4. The increased cost structure requested a more sophisticated databasing system that would increase return due to decrease mail-out cost and narrow profiles (Abernethy 2000).
5. The existing loyalty program was in the need of an upgrade to downgrade the value of other loyalty programs such as Qantas' Frequent Flyer Program (Cant 2003)
6. The initial system, managing point redemptions only, had to be updated to allow consumers to choose different types of rewards (originally offered flights only) for points and cash redemptions.

In order to face the challenges described the IT provider Shine Technology was chosen to provide the 'Application Development Software'. Shine Technology has

become the main IT application shop. This IT provider has developed FlyBuys web-based IT system to support the new rewards redemption system (Slattery's Internet Watch) that includes an online payment system for cash and points redemptions. Shine Technology also provides software that manages FlyBuys activities such as scheduling and event management. The new application gives existing participants increased capabilities and eases the entry for new participants ([www.shinetech.com/news.jsp](http://www.shinetech.com/news.jsp)).

### **The future of Loyalty Pacific**

Loyalty Pacific currently only works for FlyBuys members, they don't offer their services to other companies yet, however that might be an opportunity in the future. The major question here is whether the client companies would change their systems to match their basic system used by FlyBuys partners, which is seen as crucial in reducing the overall management costs of the program.

### **Conclusions**

By analysing the joint venture Loyalty Pacific, it was found that the IT provider play a vital role in maintaining and managing the network. Additionally, it is clear that the IT provider helps the joint venture to cut costs and operate more efficiently. The most interesting finding to come from this paper is the evidence of domino effects in loyalty programs. This was clearly seen when the FlyBuys retailers followed Coles Myer in their decision to change their Information Technology provider. It was also further evidenced in the choice of software providers. This paper has taken an unusual approach in looking at loyalty programs while customers are key to the ongoing success of the programs, and much research has been undertaken in this respect, we have effectively used network theory to better understand the dynamics of

loyalty programs and how they can be improved over time. The implications of these findings for managers are that in order to be part of a successful alliance or network they cannot underestimate of the importance of the IT provider. The affair only survives as a consequence of the power of the IT providers no matter how much passion exists.

**Figure 1: Typology of strategic alliances**

	Investment Characteristics: Equity versus Non-equity	
Association Characteristics: Scale versus Link	Type I: Equity-Scale	Type II: Non-equity Scale
	Type III: Equity-Link	Type IV: Non-equity Link

Source: Xie, F. T. and Johnston, W. J.

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