

Customer Loyalty: Cure for the Drug Store Flu?

After a slow start, drug retailers are exploring new ways of ensuring that their customers keep coming back

By [Susan Reda](#)

Drug stores have a loyalty problem.

It's not hard to see the symptoms. Drug stores' market share has eroded in major product categories, including pharmacy, and margins in that vital area continue to be squeezed. Time-short consumers are showing increasing preference for one-stop shopping environments where they can get everything they need.

Encroachment from alternative shopping channels has only added to fading shopper fidelity. Industry experts agree that drug stores need to find an effective treatment before the problem gets worse, because continuing to ignore the warning signs could lead to long-term financial health problems.

Some drug chains are beginning to roll out programs aimed at boosting customer loyalty. CVS launched its ExtraCare program a little more than a year ago, Duane Reade has the Dollar Rewards Club and Rite Aid is testing its Rite Rewards program in nine markets.

Each claims to be making progress on the loyalty front, but it's hard to tell just how much -- especially since the CVS program is the only one with a nationwide footprint. Furthermore, since drug stores are latecomers to the loyalty program scene, they have some ground to make up -- particularly against supermarket competitors that have had loyalty programs in place for some time.

Drug stores also have a long haul ahead in terms of data collection, data warehousing and data analysis. While they've always kept records in the pharmacy area, tracking front-end sales presents a new set of challenges, including upgrading and reconfiguring the POS system.

The rest of the players in this channel are banking on convenient locations, drive-through pharmacy windows and a sprinkling of front-end commodity items like milk, bread and bottled water to drive loyalty and keep customers coming back.

In a volatile retail climate, where a nickel can sway volume and convenience is the calling card of everyone from 7-Eleven to Wal-Mart Supercenter, some outside experts are skeptical. While acknowledging that loyalty card and customer relationship management programs don't guarantee customer loyalty, analysts warn that continuing along the "business as usual" path while supermarkets and other retailers strengthen their head start in this area could be a prescription for trouble.

GUARANTEED LOYALTY

For decades, drug store retailers had one of the most effective loyalty programs

possible -- the pharmacy counter. Customers bought their toothpaste, shampoo and razors at the same place where they had their prescriptions filled.

Because of the strength of their pre-eminent position as dispensers of medicines, the basic issues of customer loyalty -- how to attract more customers, how to keep customers satisfied and how to get the best customers to spend more -- were not top priorities for drug store operators.

The advent of managed care and the entrance of supermarket and discount chains into the pharmacy arena changed that dynamic. Once-loyal customers became cherry pickers, searching out the best deals and dropping off their prescriptions wherever it seemed most convenient. Drug store retailers began to see the need for a change.

The chains' first response was to fasten on convenience as the key to keeping customers. They moved from shopping centers to stand-alone locations, situating units on high-traffic corner lots and leaving plenty of room for parking. It was a step in the right direction, according to industry experts, but still not enough to win true shopper devotion.

"Convenience is important, but there remains a vital need to create customer loyalty. There are a lot of drug store chains that are being purely pigheaded and refuse to see it that way," says Wendy Liebmann, president of WSL Strategic Retail. "The fact they have been so slow to introduce loyalty programs reflects that they don't recognize the urgency here."

Liebmann gives chains like Walgreens and Longs Drug credit for creating vehicles that distinguish their stores in the mind of the customer, such as having a cosmetician in the store or expanding their selection of general merchandise. "All those types of pieces help contribute to loyalty, but most drug store companies are still too dependent on the pharmacy to drive sales, even though profitability is lower than years ago," she says. "The focus really needs to be on finding a way to leverage the relationship in the pharmacy area to build loyalty."

LOSING GROUND

Research supports the need for action. While industry sales have grown steadily over the last five years, drug stores are losing ground in terms of consumer shopping preference in several core product categories, according to data compiled by Sandy Skrovan, vice president of Columbus, Ohio-based Retail Forward.

In 1995, for example, 61 percent of shoppers purchased prescription drugs most often at a drug store. By 2001, Skrovan reports, that level had fallen to 53 percent. Similarly, drug stores' share of shopper preference in the over-the-counter drug category fell from 26 percent in 1995 to 22 percent in 2001, while in cosmetics it declined from 21 percent to 17 percent and in fragrances and colognes it slid from 15 percent to 8 percent. In a majority of instances, supercenters and other alternative formats picked up market share at the expense of the drug retailers.

Still, it's important to note that while Retail Forward's consumer data indicates that drug stores' share of consumer preference has eroded in pharmacy, film processing and film sales, they remain the top format choice for prescription drugs and a dominant player in film sales and film processing.

Steve Perlowski, manager of front-end programs at the Alexandria, Va.-based National Association of Chain Drug Stores, thinks consumers see the drug store

as both a source for prescriptions and as a convenience outlet.

"People have more money than time, and anything that saves them a minute will win shoppers. The more convenient the drug store chains make it for shoppers to stop in and pick up an item or two, the more they'll gravitate toward this channel," says Perlowski. "Shoppers go to the supercenter once a week or once every two weeks to stock up, but it's the drug store that's on the corner or up the block from where you live or work, and that's where you go when you need to pick up a few essentials."

But other analysts warn that even if drug stores are winning the war for convenience, that doesn't necessarily mean they are building loyalty.

MIXED MESSAGES?

Drug store chains are sending mixed messages to consumers, says Natt Fry, a managing principal at IBM. "On the pharmacy side, they're working hard to build their relationship with the customer by installing new technology, monitoring drug interactions and designating areas where pharmacists can consult with patients. As a convenience store, they've added milk and paper towels and built conveniently located stores with drive-up windows.

"But when your strategy is convenience, loyalty is generally not perceived to be that important," Fry says.

What's making it even tougher for drug stores today, Fry points out, is that both drug makers and consumer product manufacturers are determined to own the customer relationship, and are working hard to do so via aggressive marketing. "The onus is on drug stores to carve out their own competitive advantage, but given the complexities of this market, it's not an easy thing to do."

Drug store retailers, on the other hand, feel strongly that convenience will ensure that shoppers continue to visit. "The nature of the trip to the drug store has a convenience factor," says Gary Charboneau, senior vice president of Duane Reade, a regional drug chain based in Melville, N.Y. "We make every effort to make our stores convenient because we know that the more often they come into the store, the more chances we have to build loyalty. Locating on corners and expanding our hours -- these steps are all about making the process easier."

Bari Harlam, director of relationship marketing at Woonsocket, R.I.-based CVS, is similarly convinced that convenience yields loyalty. "We're a convenience shopping trip for most consumers, but at the same time we recognize the value in increasing shopper retention. We feel that there is some upside to be gained by taking our existing base and rewarding them," she says.

EXTRA CARE AT CVS

After more than four years of tests, CVS introduced its ExtraCare loyalty card program chainwide in February 2001. To date, the company has signed up more than 27 million cardholders -- far exceeding initial expectations -- for the program, which combines discounts, rewards and information for consumers.

"The program is structured in such a way where we try to do it all well," says Harlam. "We're giving discounts at the point of sale and we're rewarding shoppers periodically with ExtraBucks, based on how much they've spent in the store. Based on the information we're gathering as shoppers use the card, we're able to send information to them that has an educational focus. For example, if a shopper is buying formula and diapers, we'll identify them by segment and send them a newsletter on parenting tips."

Harlam looks forward to using the data compiled via the ExtraCare program to refine marketing and make appropriate merchandising changes. "We can make modifications based on what's selling and what isn't. With the data we're collecting, we're able to measure who's buying, how frequently they're purchasing, and so on. The ExtraCare program allows us to get at some metrics that we couldn't get at a year ago."

One potential downside of the program is that some consumers may assume that they will not be eligible for sale prices if they do not have a card, as is true with many supermarket loyalty programs. But Harlam makes clear that CVS policy is to sell to non-cardholders at the same promotional prices available to members of the program. While the company is eager to have shoppers embrace the program and begin enjoying the benefits, she says, it has no desire to alienate those who choose not to sign up.

CVS' next step, according to Harlam, is to begin exploring CRM initiatives.

IDENTIFYING BEST CUSTOMERS

At Duane Reade, Dollar Rewards club members enjoy lower prices on a variety of items each week. More than two million customers have registered for the program over the last two years, reports Charboneau, adding that the company has already made strides in using the data to identify its best customers.

"We've found that 65 percent to 80 percent of the volume in the non-pharmacy area is driven by 30 percent of our shoppers. With that information, we can do direct marketing to those individuals who are most valuable to us," explains Charboneau. "Over time we'll continue to treat these customers differently in terms of pricing and attention, with the intent of keeping them loyal to Duane Reade."

Like Harlam at CVS, Charboneau describes the Dollar Rewards program as a stepping-stone to closer relationships with customers, and possibly to CRM. "As the technology develops and the ability to communicate more effectively with shoppers at the point of sale -- not by mail -- is enhanced, we'll continue to upgrade the program," he says.

Rite Aid began testing a loyalty card program, called Rite Rewards, in 1996. Now in nine markets, the program has enrolled almost six million shoppers, according to a spokesman for the Camp Hill, Pa.-based chain. Rite Rewards entitles the user to 10 percent off Rite Aid brand products, unadvertised specials for members only, 10 percent off select vitamins on Tuesdays and, in some markets, a photo benefit.

The company uses the data internally to target heavy users of certain categories with mailings. In every market where the company has rolled out the program, it has led to increases in average transaction size, shopping frequency or spending, either within a particular category or for the total store, the spokesman reports.

INFORMATION ISSUES

One major problem facing drug retailers is a lack of customer information. Companies that have successfully launched loyalty programs or CRM initiatives typically have amassed some customer data prior to the start of the program.

While drug stores have lots of data related to the pharmacy area and are up to speed in managing their inventory, the customer data in the pharmacy area is off-limits because of privacy protections, and data captured at the point of sale

has generally not been tied back to specific customers.

Drug stores are not known for having proprietary credit cards, and credit card penetration is low in this channel. So the introduction of a loyalty card program is the first step most drug store retailers will take toward gathering specific customer purchasing data.

"Building customer loyalty is about serving the customer better, and the only way to do that is to understand what they buy, when they buy and what motivates them to buy," explains David Schneider, executive vice president of consulting and education at NuEdge Systems, a Waukesha, Wis.-based specialist in CRM software solutions. "Right now most drug stores are missing that link to customer purchasing activity. The sooner they launch some sort of a loyalty program and can begin forming a clearer picture of their customers, the more competitive they can be.

"It really doesn't matter how big you are, if you don't know who your customers are and haven't figured out how to use this information to enable better decision making, you're in trouble -- especially in today's retail environment," he says. Schneider contends that a retailer cannot even begin to discuss using CRM technology to strengthen its customer relationships unless it has been amassing customer data for a year or more.

In addition, drug stores will have to invest in the IT systems needed to manage a loyalty program, says Fry at IBM. "Drug stores typically have solid back-end systems and robust pharmacy applications, but chances are they'll have to add tools if they intend to gather and analyze customer data," he says.

"With these systems in place, they'll be able to do customer segmentation, value analysis and customer migration analysis. We can now detect a pattern of purchase behavior that indicates a customer is about to defect," explains Fry. "It's possible to look at patterns for those you've lost and identify behaviors six months earlier that suggest the customer may defect. With this information, a retailer can take steps to prevent that from happening."

Fry acknowledges that drug stores have a long road ahead. Part of the problem, he says, is that the pharmacy and the front-end systems are not integrated. "When you identify a shopper and can see what they're buying, you can begin making inferences and doing some targeting. Leveraging this insight can enable a retailer to boost top line results by 1 percent to 3 percent. Drug stores are just not there yet."

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