CUSTOMER LOYALTY PROGRAMS: IMPACTS ON BUSINESS AND THE CONSUMER

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ABSTRACT

Marketers spend about $250 billion each year to reach consumers [Etzel, Walker, Stanton, 2004]. The money is spent on a variety of vehicles and activities, designed to inform, persuade, or remind consumers to purchase the products and services offered [Etzel, 2004]. A Marketer's goal then is to spend their Marketing budget as effectively as possible. One way to effectively spend that budget is to retain existing consumers. This paper provides a review of the literature on the marketer's and consumer's view of customer loyalty programs, and their impact on business results and consumer behavior.

INTRODUCTION

Marketers spend about $250 billion each year to reach consumers [Etzel, Walker, Stanton, 2004]. The money is spent on a variety of vehicles and activities, designed to inform, persuade, or remind consumers to purchase the products and services offered [Etzel, 2004]. A Marketer's goal then is to spend their Marketing budget as effectively as possible. One way to effectively spend that budget is to retain existing consumers.

According to Reichheld, Markey, and Hopton [2000], improving a companies' retention rate just 5 percent can increase profits by up to 100%, thereby increasing funds available to spend or reinvest in the business. Dowling and Uncles [1997] write that the increased profitability can be driven by a variety of factors including a reduced sensitivity to price, an increased likelihood to spend at the same or increased levels, a reduction in costs to service those customers, and an increase in word of mouth advertising from the satisfied customers. There is also a belief that it costs a company more to reach a new customer than it does to retain an existing one [Hawkins, Best, & Coney, 2004; Skogland & Siguaw, 2004; Dowling, 1997]. This profit opportunity explains the interest marketers have in customer loyalty programs.

Customer loyalty programs or reward programs may look different depending on the industry. For more than 20 years, marketers have been offering consumers incentives to return and make future purchases of the same or related products and services [O'Brien & Jones, 1995]. The incentives may take the form of immediate price reduction, like those offered at grocery stores; reduced costs over time, like those offered by cell phone companies; price reduction on a future purchases – either at the same or a partner business,

like those offered by restaurants; and free rewards after multiple purchases, like those offered by airlines and credit cards [Mattila, 2001; O'Brien]. However, despite the millions of dollars spent each year on these programs [Coyles & Gokey, 2002; O'Brien, 1995], Dowling and Uncles [1997] propose that companies would be more likely to improve loyalty and motivate buyers if they focused on building the perceived value of the goods or services.

A *Restaurants & Institutions* survey supports Dowling and Uncles [Perlik, 2003]. According to the survey, almost 30 percent of those responding identified "good value for the price" as the primary reason they frequented an establishment [Perlik]. In addition to value, the literature lists other factors that consumers claim influence their continued support of a product or service.

Other factors impacting repeat purchases identified by consumers include customer satisfaction, more emotional involvement in the choice and in some instances, a lack of alternatives from which to choose. It is thought that a customer who claims to be satisfied is more likely to repurchase a good or service than a customer who is not satisfied [Hawkins, 2004; Naumann, Jackson, & Rosenbaum, 2001; Schultz & Bailey, 2000]. It is also believed that for brand decisions that involve high consumer involvement, consumers are likely to purchase the same brand again if an affiliation to the brand can be developed [Mattila, 2001]. However, the reason for customer retention may have nothing to do with the customer's loyalty to the product or service.

According to Henry [2000], there are several reasons that a consumer returns to a product or service that are not related to loyalty, either real or perceived. Consumers may return to an establishment, or repurchase a product or service,

simply because there are no other viable choices, such as the monopoly phone companies once enjoyed. Consumers may have a choice, but may not see any difference between the alternatives, and so will continue to purchase the known product, such as the choice to continue to purchase the same breakfast cereal year after year. Consumers may also choose the known product or service over others, because the consumer views the choice as safe; the product is generally accepted and recognized as a good choice, such as the choice to pick the market leader in a category. Consumers may stay with a current supplier, because the cost to switch to a new supplier may be a barrier, even if the new supplier offers a better product of service, such as the cost to switch cell phone carriers. Consumers may choose to return to a supplier because of related services that enhance the choice, such as the availability of store specific credit cards. [Henry, 2000]

Finally, in a review of marketers' versus consumers' view of loyalty programs, it should be noted that there is often a compromise. In some industries, while consumers are loyal to one supplier, they also choose to support rival suppliers. For example, Weiner [2000] points out that many consumers frequent more than one bank for different services – they are loyal to their bank for checking, but loyal to another for savings. An on-line survey supports that view. According to Yin [2003], more than 50 percent of shoppers are not loyal to the establishments they frequent.

This paper starts with a definition of loyalty, and then a review of the factors that influence customer loyalty. Following that is a review of how marketers interpret and influence repeat purchases, which may or may not lead to loyalty. Next, a review of loyalty programs in different industries is presented, along with the results of those businesses. Then a review of literature about customer relationship management [CRM] systems is offered. Finally a summary and recommendations for future research is presented.

LITERATURE REVIEW

What is loyalty? According to Reichheld [2003], "Loyalty is the willingness of someone – a customer, an employee, a friend – to make an investment or personal sacrifice in order to strengthen a relationship." For example, a loyal customer may purchase a good or service, even at a higher price, if that good or service is considered a good value and consistently satisfies the customer's needs [Reichheld].

Why are consumers loyal?

The literature suggests that consumers build loyalty to a brand or product for several reasons. First, consumers value a business that provides benefits in addition to those directly related to the product. For example, a restaurant that can provide social benefits, in addition to meeting the basic need of good food and service [Mattila, 2001], like the bar on the television show '*Cheers*', "where everybody knows your name" is likely to build high consumer loyalty.

Another factor influencing customer loyalty is consistency. Products or services that a consumer purchases often, such as a business traveler purchasing airline travel or a hotel room, that offer consistently satisfactory performance, are likely to build loyalty [Wansink, 2003; Henry, 2000].

A third factor that can influence consumer loyalty is the marketer's employee retention. According to Reichheld [1993], employees who stay with a company are more likely to become loyal to the company, and loyal employees are more likely to provide enhanced service, therefore improving the consumer's interaction [Reichheld].

What reduces consumer loyalty?

Just as there are factors to build consumer loyalty, there are also factors that can reduce consumer loyalty. Marketers who choose to build loyalty by focusing on what they perceive to be their core consumers tend to ignore the other consumer segments. As long as the core consumers remain loyal and represent a sufficient share of the market, business can remain strong [Henry, 2000]. There are cases where that strategy backfires, and other consumers will not have any loyalty to the brand. An example offered by Henry is Apple Computers. Apple built a strong core of Mac users, but ignored the rest of the market, allowing Windows and IBM-compatible computers to overtake Apple and market leadership today.

Schriver [1997] also offers several factors influencing a lack of consumer loyalty. First is an increase in the number of choices to meet consumer demand. In a global economy, there are more products, more brands, and more suppliers to meet consumer demand. Another factor is the increased availability of information. Consumers have easy access to find recommendations from web-sites and publications. A third factor influencing a lack of consumer loyalty is time. Since consumers are working longer hours, traveling further to work, and participating in more activities, they sometimes settle

for the product or service they can find in the time available, versus searching for their preferred brand [Schriver, 1997].

Loyalty Programs

Decades ago, retailers offered trading stamps to consumers as a reward for purchasing goods and services. Since then, industries have started programs to reward and attract users [Wansink, 2003]. Loyalty programs exist in the airline, rental car, hotel, sports team, grocery, wholesale club, mass market, and drugstore channels. Marketers use loyalty programs to gain competitive advantage, and improve consumers' satisfaction with the company [Fowler, 2003].

How then does a marketer use the factors listed above to influence consumers? The loyalty program needs to be an integrated part of the overall marketing strategy. While not all companies who enact loyalty programs realize all of the benefits, companies with loyalty programs realize sufficient return on the investment, versus other marketing choices, to continue its use [Dowling, 1997].

Fowler [2003] presents five steps that he feels are necessary to building a successful loyalty program in restaurants, but the five steps are easily adaptable to other industries. His first step is to build a loyalty program that is consistent with the company mission and strategies. He points out that a company's key beliefs and competitive advantages should be incorporated into the loyalty program, so consumers can make the connection between the company and the program.

Fowler's next step is to develop a program that has broad support of the organization and upper management. The consumer should feel the connection through interactions with employees, and the connection should be consistent.

The third step is to keep the program fresh. Update the messages, and use the program as an opportunity to stay close to the consumer, and make sure the program continues to meet the need. Wansink [2003] agrees with the need to keep the program current and not allow it to become administrative nightmare.

Fowler's fourth step is to not complicate the program. If the program is simple, it will be easy to join, support and maintain. Over time, using step three, the program can be updated adding content or features to keep the consumer involved and continuing to support the products or services.

Schriver [1997] also discusses the need to keep the program simple, both for the marketer and the consumer, so as not to become too demanding.

The last step is to maintain a personal relationship with the consumer, and to look for opportunities to interact both directly and indirectly through marketing materials [Fowler, 2003].

While Fowler's five steps are consistent with the key factors already identified to build product or brand loyalty, they are not widely used. It is helpful to compare existing programs versus the factors already identified to build loyalty.

Indirect benefits – In Home Field Advantage [2001], *American Demographics* provides examples of baseball team loyalty programs that provide additional incentives to the consumers, such as early access to buy tickets for important games, or simplified ways to purchase tickets.
Consistent delivery of products and services – Mattila [2001] provides examples of the importance of restaurants that meet and exceed consumer expectations.
Employee retention and bonding – Mattila also offers examples on the importance of employees, especially in the service industries, who remember frequent guests, and offer to serve the 'regular' drink or menu item.

According to Hawkins, Best, & Coney [2004], many customer loyalty programs are successful at generating repeat sales, but not necessarily successful at building consumer loyalty. Skogland and Siguaw [2004] offer results of a study showing that hotel consumers do not connect loyalty and customer satisfaction. O'Brien and Jones [1995] also provide examples of the mis-match between loyalty, expectations, and rewards.

If there is good news, it is that the mis-match is industry-wide. The competition is also struggling to capture the same consumers with the same tools [Henry, 2000].

All customers are not the same

According to Pareto's law, 80 percent of the volume comes from 20 percent of the consumers. However, the literature is consistent that consumers who represent the 'best' 20 percent are not necessarily the most loyal consumers [Dowling, 1997; O'Brien, 1995]. O'Brien also goes on to state that companies should treat the 20 percent who are generating the greatest profit better than the rest, but that most loyalty programs are not designed to treat

consumers differently. Reichheld [1993] goes further and states that companies should determine who their profitable customers are, and how to retain them.

In order to manage the information regarding consumer characteristics – what products they buy, how often they buy, where they shop, and where they live, it is necessary to develop a database to track that information. That database is commonly referred to as a CRM [customer relationship management] program or system.

Customer Relationship Management

CRM programs are used widely in many industries to track consumers. The CRM programs are often used in combination with loyalty programs to determine which customers are the frequent purchasers, which ones buy the most profitable products, which ones to target to spend more, and which ones can be ignored [Binggelt, Gupta, & de Pommes, 2002; Weiner, 2000].

Customer loyalty programs offer marketers a reason to gather specific data about their consumers. By asking the consumer to use an identification card, at the time of purchase, the marketer can build information on their consumers [Dowling, 1997]. The literature provides several examples of CRM usage; following are two examples.

In banking, CRM technology allows the banks to identify and focus on their most profitable customers. As stated earlier, consumers think of bank services in a silo, such as checking, savings, investment, and loyalty within services exists, but not across services. By using the CRM programs, opportunities for cross-selling can be identified and pursued [Shesbunoff, 1999].

By using CRM programs, banks (and other industries) can improve their relationship with consumers, thereby building loyalty as well. Use of CRM programs has allowed businesses to combine information from various departments regarding customer service issues and resolutions. The programs also allow for on-line 'real-time' entry of data, thereby eliminating the time lag created by off-line data entry. Finally, the businesses can use the CRM programs to bond with the consumer, by providing the businesses representative information about the consumer, as well as to gather additional information that may be useful at a future date [Rossello, 1997].

There are concerns about the implementation and use of CRM programs and systems. Shesbunoff [1999] offers resolution to common issues raised, including the cost and effort to implement and maintain a CRM system; the change in structure necessary to support an organization-wide system; and the importance of a bank to use the CRM system to compete with services locally and on the internet [Shesbunoff].

Although customer loyalty can not be built on technology, the CRM systems can help banks develop strategies that will enable them to compete in the years ahead [Shesbunoff, 1999; Rossello, 1997].

The other example in the literature on successful use of a CRM program is in baseball. Baseball and other sports teams are starting to use the CRM programs to keep track of their consumers. Baseball teams recognize that consumers have many choices for entertainment, and the cost to attend a baseball game, even a minor league game, is high. Therefore, teams have developed loyalty programs that reward fans for their ticket, souvenir and food purchases [Home, 2001].

Results of loyalty programs

Results of loyalty programs reported in the literature are mixed. Reichheld, Markey, & Hopton [2000] report that as a result of loyalty programs, sales and market share grow, because the loyalty of the best customers grow. In addition, because the number of existing customer defections declines, the cost to reach new customers also declines. Reichheld, et al. also maintain that employee retention also increases, driving increased consumer satisfaction, and improved profits.

Baseball is also showing positive results from their loyalty programs. One minor league team found that only 65 percent of attendees were there for the game. Others were there for the food and entertainment, and so, the team changed its menu choices to build loyalty with the non-baseball fans attending the games. A major league team found that fans attended an extra 3-5 games as a result of the loyalty program. In addition, the team determined that if they could influence half of their loyal customers to come to just one more game each season, the result would be an incremental $1.6 million dollars each year [Home, 2001].

On the other hand there are organizations who are not realizing similar results, or who had higher unmet expectations. At one business, after investing over $2 million in a loyalty program, the

management found that the customers who had purchased more than 50 percent of the products, and were considered loyal, were only purchasing unprofitable products. However, many of the customers who were not part of the loyal customer base were buying the more profitable products [Reinartz & Kumar, 2002].

Issues with loyalty programs

Even for the consumers who frequent loyalty programs, there are several concerns, both for the consumer and the business. Many consumers want their rewards sooner than they are eligible today, and that is driving some to leave their programs. 70 percent of consumers surveyed said that it takes too long to earn their reward. On the other hand, as much as 40 percent of consumers never claim awards they have earned [Abu-Shalback Zid, 2004].

Another concern is the amount of data collected. Consumers are concerned about the security of the data collected, and companies are concerned about the integrity of the data entry [Wansink, 2003].

An additional issue with loyalty programs is how companies account for consumers who are not completely loyal. It has already been shown that in many industries, consumers frequent competing marketers regularly, whether the competitors are banks, grocery stores, or credit cards. By using CRM programs, migration between competitors can be managed, by tracking purchases, and influencing high profit products of services not currently purchased [Coyles, 2002].

SUMMARY AND RECOMMENDATIONS FOR ADDITIONAL RESEARCH

The literature reviewed in this paper provides an overview of consumer loyalty programs. Although the programs may be helpful in identifying profitable consumer targets, there are also several concerns and issues.

Henry [2000] points out several flaws in discussion of loyalty. The first flaw is that loyalty is measured through customer retention, but as shown in this paper, retention is at best an indicator of loyalty. Another flaw is that profitability associated with loyal consumers may really be an outcome of an effective business plan [Henry].

Schriver [1997] also points out negative impacts to business as a result of consumer loyalty continuing to decline. One impact is that consumer defection continues to grow, especially in service industries, like cell phones. Another impact is the increase in price sensitivity, caused by competing retailers trying to capture consumers. A third impact is the increase in litigiousness. The increased costs caused by the increased litigiousness are passed along to the consumer through higher product costs [Schriver].

Dowling and Uncles [1997] state that many of the loyalty programs in place today may have been implemented without sufficient planning or integration. Additionally, many managers seem to be under the impression that frequent purchasers are profitable, and are the best consumers to target [Wansink, 2003]. Henry [2000] goes so far as to challenge managers' understanding of the word loyalty.

However, loyalty programs that are developed to reach the consumers through effective rewards and building an emotional-bond, can lead to improved profits [Michaud, 2000]. Additionally, if the program is focused on building a long-term relationship, it is more likely to succeed [Rossello, 1997]. O'Brien and Jones [1995] suggest that loyalty programs be designed to provide greater rewards for specific consumer behaviors, like purchasing products not normally purchased, or referring new consumers to the marketer.

In order to develop more sophisticated loyalty programs, CRM programs and systems will need to be deployed. Marketers who can effectively build CRM systems in combination with loyalty programs will gain a competitive advantage [Weiner, 2000; Shebunoff, 1999].

The literature identifies additional research to be completed. Research is needed to understand the impact of on-line shopping on consumer loyalty, and the interaction with loyalty programs [Hawkins, 2004]. Research is needed to build additional understanding on how to financially account for the costs and benefits of loyalty programs [Lewis, 2004; Weiner, 2000] Research is also needed to understand how loyalty programs influence consumer behavior, including whether any elements are more effective than others, and how loyalty programs influence problem resolution process [Hawkins, 2004; Wansink, 2003; Schultz, 2000].

This paper presented a review of literature on customer loyalty. Also included is a review of the marketer interpretation of loyalty, and the associated

results. The factors impacting consumer loyalty are included. In addition, the use of CRM systems to manage customer information is discussed.

It is hoped that the compilation of literature presented and additional research identified will provide a small step toward a better understanding of consumer behavior and loyalty programs.

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