

Three Perspectives for Making Loyalty Programs More Effective

Lena Steinhoff and Robert W. Palmatier

Abstract Loyalty programs are an ubiquitous instrument of customer relationship management. However, many loyalty programs perform poorly, which ultimately results in their abolition. Among both marketing managers and researchers, reasons for loyalty program failure are far from clear. The aim of this research is to enhance our understanding of loyalty program effectiveness. We propose a broadened framework for analyzing loyalty program performance which relies on three perspectives: a customer portfolio perspective, a reward elements perspective, and a reward delivery perspective. Further on, we identify three psychological mechanisms, i.e. customer gratitude, customer status, and customer unfairness as the positive and negative forces mediating loyalty programs' impact on performance outcomes. We validate our framework in two experimental studies and one field study.

Lena Steinhoff

University of Paderborn, Marketing Department, Paderborn, Germany,
✉ lena.steinhoff@wiwi.upb.de

Robert W. Palmatier

University of Washington, Michael G. Foster School of Business, Seattle, WA, USA,
✉ palmatrw@uw.edu

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1 Introduction

Loyalty programs, both in business practice and as a focus of marketing research, have become popular over the past decade. With US companies annually spending more than \$1.2 billion on their programs, program participation topping 1.8 billion households and the average US household subscribing to 14 different programs (Ferguson and Hlavinka, 2009; Wagner et al, 2009), loyalty programs without any doubt “have become a key component of customer relationship management” (Kivetz and Simonson, 2003, p. 454). However, the financial performance of loyalty programs rarely meets expectations (Dowling and Uncles, 1997; Henderson et al, 2011; Meyer-Waarden, 2012), often resulting in their abolition (Nunes and Drèze, 2006). While marketing researchers substantiate the marginal effectiveness of some loyalty programs (Meyer-Waarden, 2007; Meyer-Waarden and Benavent, 2009; Shugan, 2005), to date “it is far from clear what sets a successful [loyalty program] apart from an unsuccessful one” (Kumar and Reinartz, 2006, p. 172). In view of these mixed effects, the focus of this research is to improve our understanding of loyalty program effectiveness.

2 Perspectives for Understanding the Effectiveness of Loyalty Programs

We propose that the framework for understanding the effectiveness of loyalty programs needs to be expanded in three key ways in order to draw a more holistic picture of loyalty program performance. Fig. 1 outlines our overall framework for a typical airline loyalty program.

1. First, a *customer portfolio perspective* should be utilized when evaluating loyalty program performance to account for the effect of a loyalty program on both target and bystander customers (point 1 in Fig. 1). While the exclusive rewards rendered to target customers may positively affect their receivers, companies do not account for how their loyalty program might impact those customers around the focal customers, i.e. the bystander customers. Unintended negative reactions of bystanders might hurt the overall effectiveness of a loyalty program. Thus, we do not consider solely the target customer,

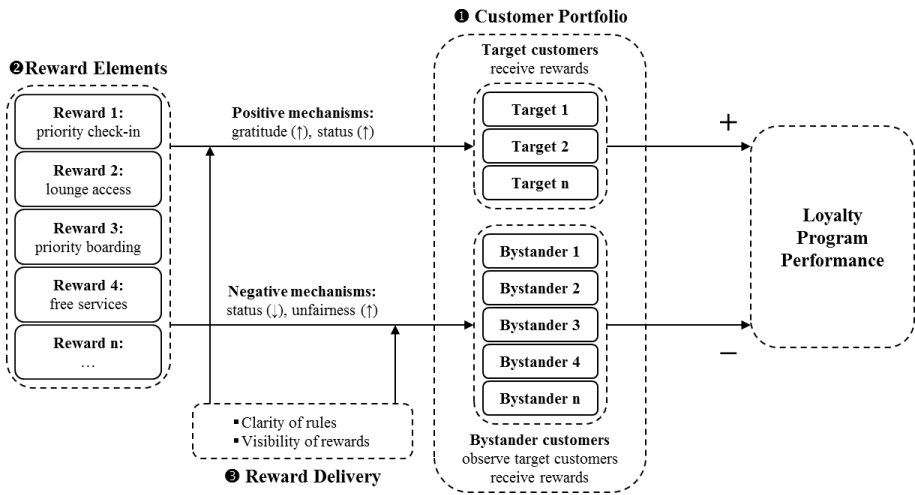


Fig. 1 Framework for understanding the effectiveness of loyalty programs

but rather the whole customer portfolio as the unit of analysis when determining loyalty program performance.

2. Second, a *reward elements perspective* should be utilized when evaluating loyalty program performance to account for the differential and potentially opposing effects of each reward element of the program (point 2 in Fig. 1). Extant research typically investigates loyalty programs on an aggregate level. However, since most loyalty programs consist of multiple rewards, both positive and negative effects of specific reward elements on both target and bystander customers may be masked. Disentangling rewards and their respective impact enables us to identify and understand the drivers and impediments of loyalty program effectiveness.
3. Third, a *reward delivery perspective* should be utilized when evaluating loyalty program performance to account for the differential and potentially opposing effects of reward delivery on the linkages between specific reward elements and target or bystander customers' responses (point 3 in Fig. 1). Loyalty program effectiveness might be contingent on the way rewards are delivered. Including reward delivery into loyalty program analyses enables managers to not only evaluate what rewards to adopt, but also how to implement them to accomplish optimal performance impact.

3 Loyalty-Influencing Mechanisms

Expanding our framework to include the effects of bystanders, multiple reward elements, and reward delivery on loyalty program performance, we suggest three psychological mechanisms to capture the link between loyalty programs and performance outcomes.

1. First, *customer gratitude* represents the emotional appreciation for benefits received involving a desire to reciprocate (Emmons and McCullough, 2004; Palmatier et al, 2009). Gratitude has been identified as an important positive mechanism linking rewards to performance.
2. Second, *customer status* is defined as the customer's perception of holding an elevated position within a firm's customer hierarchy (Drèze and Nunes, 2009; Festinger, 1954). Experiencing preferential treatment bestowed by the firm enhances target customers' perceived status. Indeed, due to its inherently relative nature, status acts as double-edged sword: Making target customers feel superior status naturally leads to perceptions of inferior status among bystander customers.
3. Third, *customer unfairness* denotes the customers' view of the degree to which the ratio of their received outcomes relative to their inputs as compared to the corresponding input-outcome ratios of other customers is inequitable (Adams, 1965; Samaha et al, 2011). Unfairness issues are likely to arise among bystanders and can trigger severe negative reactions.

4 Conclusion

We empirically test our framework in three complementary studies. In Studies 1 and 2, we use an experimental approach in an airline and hotel context. In Study 3, we assess our conceptual model in a field setting for actual airline loyalty programs. Results support the validity of our broadened approach in analyzing loyalty program effectiveness. Our contributions can be summarized as follows.

1. First, we demonstrate that in order to get a complete picture of loyalty program performance, we need to consider the whole customer

portfolio affected by a loyalty program. We simultaneously account for target as well as bystander customer effects when analyzing loyalty program effectiveness.

2. Second, we disentangle the differential effects of specific loyalty program rewards on target and bystander customers. Analyzing customer responses towards typical rewards employed by airlines in their loyalty programs, we underscore the importance of a detailed assessment of each reward in order to make informed decisions on the introduction, adaptation or abolition of rewards.
3. Third, we delineate how the delivery of rewards varies their impact on loyalty program performance. By showing that the effects of loyalty programs on both target and bystander customers are either emphasized or diminished depending on reward delivery, we highlight the importance of companies' design decisions.
4. Fourth, we establish a "battery" of positive and negative forces linking loyalty programs to performance outcomes. Whereas gratitude and superior status build target customer loyalty, inferior status and unfairness destroy bystander customer loyalty. When assessing their loyalty programs, managers should take these psychological mechanisms into account.

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