

Loyalty Programs. Role, Structure and Potential Benefits

by

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Abstract. A loyalty program consists of an integrated system of marketing activities, aimed at increasing members' loyalty by rewarding customers according to their purchasing frequency and amount spent. Loyalty schemes, customer clubs and sales promotion techniques are the most common relationship tools used in marketing practice. To join the program and receive a card, consumers must fill in a registration form, providing demographic, behavioural or even psychographic data. Loyalty schemes and customer clubs offer long lasting benefits to participants. Sales promotion techniques can be used both as tools to attract new customers, as well as instruments to stimulate repurchase behaviour. The potential of a loyalty scheme to achieve members depends mainly on rewards value, diversity and timing. Similar, the success of clubs depends on whether customers perceive enough relational benefits according to their personal interests. Although currently, loyalty programs have become very popular, programs effectiveness and implicitly the managerial decision to implement them are determined by different factors, including: homogeneity of supply and products purchase frequency, competition and consumer demand characteristics and the internal environment of the company.

Key words: customer clubs, loyalty schemes, relationship marketing, rewards, sales promotion techniques.

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1 Introduction

A loyalty program consists of an integrated system of marketing activities, aimed at increasing members' loyalty by rewarding customers according to their purchasing frequency and amount spent. Consequently, customers must become members in order to experience the benefits of the system. By using loyalty cards, individuals are identified with each purchase occasion and customer specific transactions will be recorded.

In relationship marketing literature a great variety of loyalty programs can be found, which are usually structured into three main categories, according to their potential to create value for customers. These are loyalty schemes, customer clubs and sales promotion techniques that stimulate repurchase behaviour.

2 Loyalty schemes

Loyalty schemes are designed to stimulate behavioural loyalty, based on the principle of rewarding customers for the intensity of their purchases and the shopping value. The first programs of this type appeared in the air transportation services sector, at the initiative of

Southwest Airlines (Gilbert, 1996). The company offered travellers the opportunity to collect evidence of purchase, which could be further exploited as a free flight for a partner. However, the loyalty schemes currently used by many organizations have developed their structure starting from the frequent flyer programme launched by American Airlines in 1981 as AAdvantage. The company's goal was to benefit from the underutilized capacity by transforming it into an efficient marketing tool to boost customer loyalty (Gilbert and Karabeyekian, 1995). The premise from which the management started was that air transport companies have been facing very high fixed costs, which are not decreased whether the transport capacity is used at 35 per cent or 95 per cent level. Therefore, American Airlines managers have realized that covering empty places will have little impact on costs, but a significant impact on future customer demand. Consequently, customers who were making frequent flights were identified in the reservation system in order to be rewarded with free flights.

The model of this program has been further analyzed and imitated by companies activating in many other economic sectors, being

implemented in hotels, restaurants, gas stations, retail stores, libraries, and so on.

The operating mechanism of most of the loyalty schemes has evolved over time (Filip, 2011). If the initial emphasis was on collecting stamps or proof of purchase, card-based schemes were developed in a more advanced stage. The first cards were anonymous, without the participant's name mentioned. Then, magnetic stripe cards have been launched, followed by chip cards that in addition to recording numerous transactions and personal data, also provides a high level of security. To join the program and receive a card, consumers must fill in a registration form, providing demographic, behavioural or even psychographic information. Currently, there have been developed integrated loyalty schemes, involving the participation of various companies from different industries, usually working in complementary fields. For instance, customers of an airline company can collect flight miles by using the products and services belonging to any partner company, such as gas stations, hotels, fast food, financial and banking institutions, etc. Customers are registered within the loyalty program and receive one single card that they use to collect points from all purchase and consumption locations included in the scheme. Points can be usually converted in a wide range of products and services from the portfolio of the companies involved in the program.

To be effective, it is recommended that loyalty schemes to meet a number of conditions, needed to create value and to be favourably perceived by consumers (O'Brien and Jones, 1995).

1. To have cash value, because customers assess the monetary value of rewards related to all the expenses incurred to obtain the prize.
2. A wide range of choice regarding the rewards should be offered to the program members.
3. An aspirational value of the rewards should exist, so that consumers to have the desire or temptation to obtain it.
4. Rewards should have value in terms of their relevance or likelihood of being achieved. In other words, customers

must perceive that the rewards can be obtained and that the efforts involved are feasible. For example, how many points should be added together to obtain a durable good.

5. The operating mechanism of the program should have value in terms of convenience, customers taking also into account the scheme's ease of use.

However, the potential of a loyalty scheme to achieve members depends not only on the value associated with its rewards. It is also under the influence of timing, because customers assess the program attractiveness by the time when the specific rewards become available to them. Depending on the timing of reimbursement, the rewards can be classified into two main categories, immediate and delayed rewards (Dowling and Uncles, 1997).

Immediate rewards are usually offered in the form of discounts when purchasing certain products, while delayed rewards require customers to make efforts of repurchase. The latter can be obtained only in certain periods of time (e.g., bimonthly or monthly) provided enough points to be accumulated on the card.

In the fast moving consumer goods industry, practitioners have noticed that immediate incentives are effective in order to attract customers of competing brands, while delayed incentives have a greater role in buyers' retention, by rewarding future acquisitions. Customers tend to prefer delayed rewards at the expense of immediate incentives when the monetary value of the reward is high.

In the relationship marketing literature, an association link has been identified between customer satisfaction towards retail stores and their perception regarding the rewards received within the loyalty schemes (Dowling and Uncles, 1997). Thus, in situations where customers are dissatisfied with a particular supplier, immediate incentives may reduce their migration intentions, while delayed rewards have a high efficiency only in the case of positive consumer experiences.

Some researchers identified a number of criticisms related to the loyalty schemes, the main consisting of high costs of starting and managing such programs (Buttle, 2004).

Regarding operating costs, the loyalty schemes used by retailers for example, usually rewards the customer with a discount or a coupon, which is the equivalent of one per cent of the purchase value. These financial incentives are likely to considerably decrease the profit margin, so that a retailer, who has a profit margin of five per cent, could lose a fifth of his profits to fund the loyalty scheme.

Additional to the costs generated by the rewards that had been promised to customers, high investment in technology are needed to support the project. Promotional efforts are also involved in order to create program awareness. Criticisms are made about the potential success of loyalty schemes. In the situation when the operating mechanism of the program is based on rewarding the purchase frequency or the number of visits made by the customer, without a logical correlation with the buyer profitability, then the risk of a potential failure will exist.

Frequent fliers programs initiated few decades ago by different airline companies are relevant examples in this sense. Most loyalty schemes used in this field had implemented the principle of rewarding customers based on the flight distance and not on the fare paid. As a result, the customer who had paid a discounted price on a ticket purchased from a particular site received instead a reward equal to that of a customer who had fully paid the published tariff. The losses recorded over time by different airline companies have been the reasons of the changes that later occurred in the mechanism of the loyalty programs (Kumar and Shah, 2004).

Consequently, the rewards of the loyalty schemes began to be granted not as a function of the flight distance, measured by the number of flight miles, but depending on the price paid by the buyer. If the first is an indicator of frequency, the second can be considered an indicator of profitability. This approach can be found today in most of the loyalty schemes from other industries too. Currently, organizations are frequently using a system of awarding the bonus points depending on the amount spent by the customer (in a supermarket, for instance). Taking the case of the airline companies, they are now commonly

use loyalty schemes, which offer different point scores according with specific customer profiles. For instance, for the customer in the economic segment, the loyalty program may offer one point per mile or per monetary unit spent, the reward being progressively higher for customer in the business class and first class.

Similarly, other loyalty schemes implemented in other sectors are based on a progressive scoring mechanism, meaning that customer score will be higher for each additional unit spent. Future acquisitions have therefore an increased value for customers.

Companies that have developed loyalty schemes are also facing the difficulty of transforming these types of programs into competitive advantages.

Practice experiences show that programs that prove to be successful will be in short time imitated by competitors and this situation leads to an insufficient differentiation of the loyalty schemes implemented in a particular industry.

When customers are in the possession of many loyalty cards, belonging to several organizations in the same sector or even from the same geographical area, they will perceive increased opportunities of gaining advantages from most of the competitors, fact which will negatively affect their level of loyalty toward a certain firm. This is the example of many supermarkets and pharmacies that operate in the same area, sometimes only a few meters away. Therefore, when customers have many choices, their product or store loyalty tends to be low (Filip, 2011). In the best case, they will become loyal to a particular programme, motivated by the desire to obtain certain rewards.

3 Customer clubs

Customer clubs have many common points with loyalty schemes, noting that the emphasis is both on stimulating the repurchase behaviour, but rather on providing unique customer experiences that foster the development of an individual feeling of attachment toward the company.

Customers can become members of a certain club either free or by paying a relatively small fee, but in both cases they are required to

register by filling in specific forms. After registering, customers typically receive a loyalty card that is designed to identify the individual and to ensure his participant status.

Based on customer information, the company is able to initiate a series of interactions with customers, to learn more about their behaviour and preferences and to develop customized products and services.

The success of clubs depends on whether customers perceive enough benefits according to their personal interests. Therefore, the organization will focus its efforts on providing value added services that are tailored to segment or even individual level.

Among the most common benefits experienced by club members, can be listed (Buttle, 2004): access to product and services reserved exclusively for members, dedicated websites, newsletters and additional information about new or improved products that are planned to be introduced on the market, the opportunity to test various products before being launched, discounts received and bonuses accumulated by using loyalty cards, special offers, magazines containing subjects related to specific developments in the field and various other topics that address customer interests, invitations to special events and so on. In this way, multiple needs are met: social, status, group membership, self-fulfilment, etc.

Benefits should not be the same for all customers; they should be differentiated according to customer profitability and behavioural patterns.

The initial costs of establishing a club can be quite high, but after a certain period of time costs are usually covered and the club concept will significantly contribute to customer retention and loyalty.

4 Sales promotion techniques

Loyalty schemes and customer clubs provide long lasting benefits to participants. Sales promotion techniques can be used both as tools to attract new customers, as well as instruments to stimulate repurchase behaviour.

However, sales promotion provides only a temporary improvement in the value offered to

customers, the effects on buying behaviour being of a short duration.

The coupon for future purchases and the prizes for buying continuity are two main example of sales promotion techniques used for achieving customer retention objectives.

In the case of the coupon for future purchases, consumers buy the product and receive a voucher, which entitles them to pay a reduced price for future or additional purchases.

The prizes offered for buying continuity are designed to determine buyers to make efforts to collect evidence of purchase, which are then mailed or personally delivered to a store in exchange for a gift or a free item. Sometimes, the premium received by the customer is part of a series of collection and some buyers will be interested to get the whole set, making more future purchases.

5 Factors affecting loyalty programs effectiveness

Although currently, loyalty programs have become very popular, programs effectiveness and implicitly the managerial decision to implement them are determined by different factors, including (Leenheer and Bijmolt, 2008): the industry, competition and consumer demand characteristics and the internal environment of the company.

Industry and sector characteristics can influence a company ability to adopt loyalty programs, by taking into account two main factors, the homogeneity of supply and products purchase frequency.

Homogeneity of supply refers to the level of variability in the product portfolios of those firms operating in the same field of activity.

If product assortments are relatively similar, companies will face difficulties to distinguish in relation to each other and customers will tend to switch from one provider to another to get more promotions (Zhang *et al*, 2000). In such circumstances, loyalty programs are preferred by organizations in comparison to the use of promotional prices, because these ways are created a series of switching barriers for buyers. If product assortments are heterogeneous, they can be better tailored to the specific preferences

of different customer segments. Therefore, a relational connection may be formed, which could act as a natural barrier to reduce migration intentions.

The buying frequency in an industry is concerned with the average number of purchases made by consumers from the product and services existing in the market, at a certain period of time. Since organization-customer relationships are composed of a set of interrelated transactions, the relationship marketing approach and implicitly the loyalty programs have less applicability in areas where the purchase frequency is low, consumers buying products and services rarely or at greater time intervals.

Furthermore, the value of customer data collected by the use of loyalty cards is less significant, because of the limited number of transactions per customer. Therefore, relational instruments have greater benefits in those industries where the products purchase frequency is high.

This principle is also supported by consumer propensity to adhere to those loyalty programs, which are expected to bring benefits with each transaction, customer advantages rising along with the increasing of the buying frequency.

Competition and consumer demand characteristics are factors directly related to the market in which the company operates. These characteristics may vary even in the same field of activity, according to specific geographical areas. In addition, companies compete both with firms from the same sector, as well as with organizations from other sectors, which provides substitutes for certain product types. The level of competition depends in these circumstances on the size of the company product range and its market positioning.

In general, organizations that operate in highly competitive markets have proved to be more innovative, because they have to face a higher level of uncertainty and must continually seek new ways to attract and retain customers. Thus, loyalty objectives become a managerial priority, given the more intense risk of customer migration to competitors' offers.

When competition is high, the adoption of loyalty programs can be associated with a

defensive strategy in order to maintain the firm's competitive position.

Even if the effectiveness of a loyalty card is reduced in the context in which other competitors develop similar programs, in many cases organizations can not afford to give up these tools, because it would allow the creation of an unfavourable gap in relation to other competitors.

In markets where customer profitability varies considerably, loyalty programs are able to customize the service level according to customer value. This is possible by offering personalized rewards based on the scoring points accumulated by different customers.

A loyalty program is useful in identifying profitable customers, which are then rewarded with additional services and privileges (Bell and Lal, 2003).

Successful implementation of relational strategies is also influenced by organizational resources and competences, which characterize a company internal environment.

Loyalty programs are primarily adopted by organizations that have both the customer orientation and the technological skills needed to properly use customer information achieved through the use of loyalty cards.

The company size is also a future that might influence the adoption of loyalty programs. Although there is no established rule in this respect, it is assumed that there is a greater likelihood that loyalty programs to be implemented by large firms, compared to small ones (Leenheer and Bijmolt, 2008).

This hypothesis is argued by the resources available to large corporations in making such investments, using databases to support various marketing actions, such as those involved in the implementation of a loyalty program (Coviello *et al*, 2000). Small businesses are primarily conducting relational marketing activities by investments in those personal interactions occurring between customers and front line employees.

6 Conclusions

Whether determine or not the real loyalty, these programs certainly rewards customers for their repurchase behaviour. The accumulated bonuses

represent investments made by the customer over time, which can be perceived as switching barriers, depending on their importance for individuals. Usually, if customers are satisfied with the rewards of a program, they will have the intention to spend more in that particular store or on the products and services of a certain company, the effects being favourable in terms of firm profitability, relationship life cycle and customer share of wallet.

Additional to the positive influence on customer repurchase actions, loyalty schemes allow the accumulation of substantial amounts of information about customer behaviour, fact which is possible by scanning the cards at every purchase made by the buyer.

Therefore, the company has the opportunity to understand the needs and requirements of individual customers, their preference and their specific reactions to different promotional campaigns conducted in stores.

The information collected is stored in databases and is integrated with information from different other sources. In a later stage, the data are subject to processes of analysis in order to identify specific behavioural patterns. Further, the organization will have the opportunity to develop its product portfolio and to design its marketing campaigns according to the needs of various customer segments.

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