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## Hospitality Loyalty Program Effectiveness Evaluation Rubric

Nazia Charania

*University of Nevada, Las Vegas*

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**Hospitality Loyalty Program Effectiveness Evaluation Rubric**

**By:**

**Nazia Charania**

**Chair:**

**Dr. Clark Kincaid**

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### Abstract

This paper examines the various loyalty program strategies and design elements utilized within the hospitality industry and evaluates the implications of the various strategies on establishing and fostering loyalty among consumers within a hyper competitive industry. In order to maintain competitive parity, many programs have constantly lowered reward thresholds and increased program offerings, making such programs very costly and with little direct evaluation in their ability to stimulate true loyalty. In a society bombarded by loyalty programs in almost all industries, consumers are becoming very savvy in comparing their personal rewards to the effort and inconveniences incurred by enrolling. The success of many loyalty programs have resulted in the establishment of independent companies, while other programs struggle to stimulate revenue and true loyalty however exist due to the popularity among consumers. Relationship marketing specialists require a comprehensive tool to understand and evaluate the various elements of loyalty programs to ensure their profitability and success due to the substantial financial commitment by companies in operating such highly popular programs.

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## **Part I**

### **Introduction**

In the face growing competition, the hospitality and tourism industry adopted loyalty reward programs from the supermarket industry as a relationship marketing tool in the early 1980s. The programs were highly popular among consumers and resulted in their wide spread proliferation throughout the industry with many firms initiating replicate programs as a means to maintain competitive parity without considering the strategic implications or overall effectiveness of loyalty programs in stimulating repeat patronage. For firms merely replicating other popular programs, such initiatives can serve as major cost centers without a clear understanding of the loyalty and revenue generated directly from the program.

Evaluating the effectiveness of relationship marketing strategies is critical to a firms overall profitability, however this process is often overlooked or incorrectly completed when measuring the ability of frequent guest programs to stimulate loyalty. For example, traditional evaluation metrics, such as membership base, are not effective in evaluating the impact of the program and many fail to consider the qualitative impacts entirely. Other quantitative measures consider 'average dollar spent' of loyalty program members and compare these figures to non-members. Such metrics are inefficient due to the inability for firms to establish causation and consider whether the program members spend more due to the program or were always a more loyal customer segment. Marketing expenditures must be carefully prioritized to ensure maximum efficiency in an industry with very tight operating budgets and profit margins. The utilization of loyalty programs without strategic consideration of the product offering and customer base is a major problem facing the heavily competitive hospitality industry.

Extensive research has been conducted regarding the social phenomenon of loyalty as well as the most effective loyalty program design strategies. Such information is valuable to those establishing loyalty programs; however the vast majority of firms have existing loyalty programs which are difficult to cancel due to the popularity among consumers. Instead, firms try to incorporate all elements which are most popular among consumers to maintain competitive parity. Loyalty programs can take on many different forms and most empirical research focuses on a specific industry segments (i.e.; credit cards or frequent flyer miles) or optimal designs (i.e.; volume discount, targeted mailing) which may not be generalizable to all loyalty programs, making it extremely challenging for managers to apply specific research findings to evaluate the effectiveness of their own loyalty programs.

**Purpose.**

The purpose of this professional paper is to develop a rubric to evaluate the various structural elements which contribute to the overall effectiveness of hospitality loyalty programs.

**Objectives.**

The rubric will serve as a tool for managers to consider the critical elements of their existing loyalty program in an effort to identify areas of weakness within the program to be modified as well as determine program strengths and elements of value which can be leveraged in loyalty program marketing. The rubric will also allow managers to focus on more efficient measurement metrics in evaluating loyalty programs to ensure loyalty programs provide maximum utility to the business.

The majority of loyalty programs were created as ‘cookie cutter’ programs which quickly imitated the competition to maintain competitive parity. The objective of a Hospitality Loyalty Program Evaluation Rubric is to provide managers with a mechanism to conduct a more critical evaluation of existing program structures in order to maximize profitability. Traditional loyalty program research provides extensive information on specific dimensions of loyalty (i.e.; emotional commitment or luxury rewards) however managers must complete a comprehensive analysis. Loyalty programs, as in all business initiatives, involve a number of tradeoffs which must be carefully balanced to maximize efficiency. Managers require a tool to consider the various dimensions and trade offs in order to complete a comprehensive analysis of their specific program to be evaluated against the various options and program design available. Many companies conduct surveys and incorporate guest feedback into their loyalty programs however such feedback target specific ‘high priority areas’ for customers (usually tangible rewards) and fail to consider areas of opportunity for cost savings and value creation.

## **Research Constraints**

### **Application of existing research.**

Many types of loyalty programs exist, with the majority of hotels and airlines offering points accumulation for rewards while the food and beverage industry offering volume discounts for frequent purchases (i.e.; buy 10 get 1 free). Development of a rubric specifically for these industries and types of programs limits the utilization of existing research studies which are based on analysis of other industries (i.e.; supermarkets or credit cards). Little comprehensive research has been completed, with most studies focusing on one geographic area or market segment, limiting the overall generalizability of the statistical data. While the principles of

loyalty program research have been applied to the rubric, there is little utilization of correlation co-efficient values to measure the strength of effectiveness due to a lack of generalizability of information from other loyalty program research and geographic areas.

### **Self selection bias and lack of control group.**

A major limitation of all loyalty program research is self selection bias and the lack of a control group. Hospitality industry loyalty programs generally speaking are open to all consumers and thus, heavier users who are already more loyal (without incentive of the program) are more likely to chose to join the program. This self selection bias will result in an over estimation of the influence of a loyalty program. At the same time, it is difficult to compare members to a 'non-member control group' as those who do not enrol are usually lighter users. In addition to overestimation challenges, loyalty program members eagerly provide demographic information as part of program membership and registration; however collecting data about non-program members is almost impossible due to privacy concerns and a lack of collection tool. There is no collection mechanism to measure customer loyalty, spending and demographics before a loyalty program is established without relying on self reporting by consumers which also presents respondent biases. As a result, it is important for managers to be empowered with the knowledge and tools to critically self-evaluate their own programs without heavy reliance on feedback from customers.

### **Intervening Variables.**

Measuring loyalty and the influence of loyalty programs is especially challenging due to the limited ability to establish causation. Firms incorrectly conclude that increased loyalty via

share of wallet, percentage of purchases etc. is due to the establishment of a loyalty program.

Critics will reason that too many co-determinants of loyalty exist, including time pressures, need for variety, dynamic needs, price promotions etc. (Uncles, Dowling & Hammond, 2003), making isolation of variables in such business research practically impossible. Similarly, without comparison to a control group, it is very difficult to establish causation when researching loyalty programs. As a result, it is important to carefully plan and evaluate loyalty programs, instead of merely reacting to competition, due to limited ability to assess the program after implementation.

## **Glossary**

Loyalty programs are ‘an integrated system of marketing actions that aims to make member customers more loyal (Leenher, Heerde, Bijmolt & Smidts, 2007). While individual programs can take on multiple forms, the overall purpose of loyalty programs is to retain customers by means of both tangible and intangible benefits. Loyalty is an abstract and psychological construct within society which can take on many different levels of meaning. Loyalty within business is best defined by Oliver (1999) as a deeply held commitment to rebuy or repatronize a preferred product or service consistently in the future, despite situational influences and marketing efforts having the potential to cause switching behaviour.

The effectiveness of loyalty programs is a highly subjective and variable dimension within the industry. Many firms incorrectly utilize membership size and enrolment as measures of success as such measures do not consider profitability or the deeper objectives of loyalty programs (to produce repeat patronage). For the purpose of this report, loyalty program effectiveness is the ability of a loyalty program to elicit incremental repeat patronage that would

not have been realized without the program to generate revenues which exceed both the direct and indirect costs of operating the loyalty program.

## **Part II**

### **Literature Review**

#### **Introduction**

Marketing departments are constantly working to attract customers in order to generate revenue. Within hyper competitive industries, such as hospitality and tourism, obtaining and maintaining the attention, dollars and loyalty of consumers is a definite challenge.

Marketing strategies have shifted from focusing on individual transactions, to long-term relationship marketing, in hopes of attaining marketing's holy grail of customer loyalty and securing long term revenues and profitability (Shugan, 2005). Ehrenberg and Goodhardt's (1977) leaky bucket theory argues that traditional marketing is counterproductive; focusing on attracting new customers while existing customers are lost by means of holes in a bucket or flaws in product, service and other elements of the marketing strategy. Customer loyalty is one mechanism to plug the holes in a leaky bucket as a truly loyal customer is one who has established an emotional relationship with the product, or more importantly the brand, and continues to purchase the product or service from the firm. Continued patronage increases revenues, a major reason why loyal customers are extremely valuable to any corporation in addition to the potential positive word of mouth, which has been identified as a very valuable marketing mechanism.

Corporations work feverishly to uncover new ways of assuring and establishing customer loyalty in order to succeed. One long established tactic, which has gained considerable popularity, are loyalty programs. The goal of loyalty programs is to establish a higher level of customer retention in profitable segments by providing more satisfaction and value to certain customers (Bolton, Kannan, & Bramlett, 2000).

Loyal customers are considered a huge asset for a company however controversy exists as loyalty programs create large future liabilities (i.e.; future rewards owed for points accumulated) in order to acquire current assets (Shugan, 2005). A true asset involves investing resources today into an investment or mechanism to produce future returns. Despite such technicalities, relationship marketing tactics are supported by the variances in cost of acquiring versus retaining customers. The cost of enticing a new customer, by means of samples, price discounts and other marketing techniques, is substantially higher than the costs associated with having a current customer purchase again and estimated by some as six times the cost of retaining existing consumers (Dowling & Uncles, 1997; Wansink, 2003). Due to increased revenues and decreased cost of attracting and serving repeat guests; loyal customers are highly profitable customers.

In theory, customer loyalty is a win-win situation as corporations benefit from increased revenues, less price sensitivity, increased average cheque, and positive word of mouth, while consumers experience simplified and familiar service interactions and reduced risk (Dowling & Uncles, 1997). Critics question the underlying assumptions of loyalty programs, including whether consumers desire relationships with corporations and if the investments in such programs can stimulate an emotional bond with or whether such theories only apply to interpersonal relationships.

### **History & Growth of Loyalty Programs**

Relationship marketing began as a strategy and competitive advantage for small businesses that were able to provide individual attention and build loyal relationships among individual consumers. Larger chains, beginning in the supermarket industry, attempted to imitate

these personal relationships through the establishment of formal loyalty programs (Dowling & Uncles, 1997). Within the airline industry, loyalty programs were initiated soon after deregulation with the introduction of American Airlines' AAdvantage program in 1981, and were launched in the hotel industry by InterContinental in 1983. In the past 30 years, the AAdvantage program has grown to 57 million members as of 2009 with the airline industry loyalty program market boasting a membership base of 254 million. In comparison, hotel loyalty programs have attracted 92 million members globally (DeKay, Toh, & Raven, 2009).

The late 1990's saw some companies abandon the loyalty program concept due to high costs and lack of return on investment (i.e.; Omni Hotels), however the majority of companies continued these questionable investments due to popularity among consumers (Nunes & Dreze, 2006). Technological advancements eased the proliferation of loyalty programs which made them increasingly user friendly and more cost effective for companies. As a result, loyalty programs have re-established themselves as a critical component to maintain competitive parity within the hospitality industry. Today, nearly all hotels, restaurants and airlines offer some type of incentive to encourage loyalty and more multi-merchant collaborations are being established, growing both in strength and popularity (McCall & Voorhees, 2009; Capizzi & Ferguson, 2005).

Loyalty programs have evolved into their own industry with airlines selling 'reward miles' to other companies (i.e.; Visa) to compensate their customers for loyalty (DeKay, et al., 2009). This successful business model has allowed multiple airline loyalty programs to spin off into their own entities while parent companies struggle financially. For example, as Air Canada filed for bankruptcy protection in 2005 their independent, publicly traded loyalty program Aeroplan was valued at \$4B Cdn while American Airlines separated the loyalty program into a

wholly owned subsidiary valued at \$7.5B, 1.5 times the value of the parent company (DeKay, et al., 2009).

Loyalty programs within the global hospitality industry have hundreds of millions of members, with total US membership at 973 million members, (an average of four memberships per person) and loyalty programs continue to grow at double digit rates, 12% in 2008 (Capizzi & Ferguson, 2005; DeKay et al., 2009). Despite these growth statistics, the industry as a whole has begun experiencing signs of maturation with less positive growth and increasing competition, warranting the need for renewed creativity and diligence on the part of corporations (Capizzi & Ferguson, 2005).

### **Types of Loyalty Programs**

Historically, loyalty programs were stamp collection programs where consumers were rewarded with stamps for purchases at a specific store which could be collected and redeemed for tangible rewards. Today, loyalty programs are much more complex and automated, offering both tangible and intangible rewards. While many different types of loyalty programs exist as well as hybrid programs, Berman (2006) established four distinct loyalty program formats, three of which are ideally suited and traditionally seen in the hospitality industry. In order to establish a specific and detailed analysis of hospitality loyalty programs, the evaluation rubric will only focus on Type II, III and IV programs as outlined by Berman due to their suitability for the industry (See Appendix A – Loyalty Program Typology).

Type II programs are seen primarily in the food and beverage industry, and are based on quantity discounts and self managed by the consumer. Consumers are provided a punch for each item purchased and compensated with a reward for each ‘n<sup>th</sup>’ purchase. Type II programs are

volume discounts as consumers are rewarded for the number of items purchased and not necessarily frequency or emotional loyalty. A consumer purchasing seven coffees in a single day once a week receives the same reward as a daily patron purchasing one coffee. Such programs are cost effective and easy to administer however can be easily replicated by competitors and lack data collection and understanding of the consumer.

Type III programs are similar to those offered by most airline and hotel chains. A comprehensive database is used to track all purchases and provide points based on cumulative spending which consumers can redeem for rewards. While more expensive, such programs provide opportunity for extensive data analysis and the information collected can be strategically applied to stimulate loyalty among consumers.

Type IV programs in Berman's model focus on targeted communications and marketing via leveraging of data collected (i.e.; email newsletters and tracking of online purchases), which is a critical element of many hotel, airline and food and beverage loyalty programs whereby coupons, price promotions and new offers are sent only to specific guests making such marketing much more cost effective than traditional mass media. Such programs lack formality as many consumers consider themselves part of the newsletter or frequent shopper but lack membership cards or rewards statements.

Each program presents unique strengths and weaknesses however it is critical for managers to design and evaluate programs effectively in order to ensure program strengths are realized and weaknesses are minimized. In addition to the above programs, hybrid programs have been developed which incorporate elements of type II, III and IV programs. Such initiatives require careful and strategic planning to avoid overlapping objectives. While many

opportunities exist, the ability for firms to successfully realize such advantages is a major obstacle in ensuring overall loyalty program effectiveness.

### **Challenges Facing Hospitality Loyalty Programs**

#### **Value Creation and Competitive Advantage.**

A major source of competitive advantage within the hospitality industry is marketing the product in attempt to positively differentiate the consumer's perception of the product. Many companies quickly established loyalty programs, mimicking those of competitors to maintain competitive parity (Dowling & Uncles, 1997) without careful consideration of the strategic marketing implications. Even the most successful loyalty program strategies (i.e.; elimination of blackout dates) provide short lived competitive advantage due to the ease of replication, rendering such strategies as a large cost with short lived returns. In order to establish competitive advantage, a program must create a unique and unimitatable value for the guest. Current loyalty programs are immensely popular and enjoyed by consumers, however their ability to elicit value and influence decision making has been argued as quite limited.

Many argue that loyalty programs may serve as a short term solution to long term product differentiation problems, as seen in the increasingly commoditized hospitality industry with very low switching costs (Yesawich, 1987; Writz, Matilla & Lwin, 2007). Firms must differentiate both products and programs based on their unique customer segments or product offerings in order to generate value and brand loyalty and a source of competitive advantage, which cannot be achieved by merely replicating successful loyalty programs (Yi & Jeon, 2003).

Airlines on average only redeem 11% of miles earned with an estimated 17 trillion unredeemed miles valued at approximately \$480B (DeKay et al., 2009). Such low redemption

rates make airline loyalty programs much more profitable however limited flexibility impacts their effectiveness in creating value for guests and stimulating loyalty. From the guest perspective, airline miles are devalued due to limited and constantly reduced seat offerings, shorter redemption periods and increasing redemption levels (DeKay et al., 2009) while the purpose of loyalty programs is to maximize value for both the guest (via rewards) and company (through loyalty). Many firms have addressed this issue and eliminated blackout dates for airline redemptions however this hinders the profitability of the programs which were designed to fill otherwise empty and perishable airline seats at an average cost of only \$23 per seat (Greenberg, 2008). The creation and sharing of value must be achieved strategically to both generate revenues and maintain costs and thus profitability of the program.

Most loyalty programs look alike, in an attempt to maintain competitive parity with one another, which reduce their ability to stimulate loyalty and generate a competitive advantage for the firm. Research by Capizzi and Ferguson (2005) showed that guests could not distinguish among frequent guest programs once the branding queues (i.e.; logos and program name) were removed. When consumers do not perceive any difference among programs it is not possible to utilize loyalty programs as a source of competitive advantage.

While loyalty programs may not be a strong source of competitive advantage, they have evolved into a business necessity to maintain competitive parity. Surveys conducted by McCleary and Weaver (1991) indicated that cancelling a loyalty program would have no impact on 49.4% of guests demonstrating that loyalty programs are not instrumental in hospitality industry decision making. A survey of considerations in hotel decision making ranked loyalty programs 6<sup>th</sup> (out of 8) with an average Likert scale value of 3.17 (out of 5) (Toh, DeKay & Raven, 2008). While loyalty programs have a limited impact on almost 50% of guests, 33% of

loyalty program members indicated they would stay less often if their preferred chain cancelled the program and 13% of consumers who would switch chains all together (McCleary & Weaver, 1991). This is a large portion of a firm's guests who cannot be ignored and indicates that loyalty programs are a source of value for consumers and while ranked relatively low in decision making it is still necessary or even taken for granted. For example, items such as TVs in the room or bath soaps are not critical in decision making as they have come to be expected by guests as part of the product offering. While offering a loyalty program may not be a source of competitive advantage, not offering a competitive loyalty program would be a huge source of competitive disadvantage.

### **Reciprocity in Business.**

Relationship marketing is based on the underlying assumption that consumers desire to have an emotional bond with a service provider. The value generated for both consumers and retailers from loyalty programs is based on reciprocal action theory, which states that "actions taken by one party in an exchange relationship will be reciprocated in kind by the other party because each party anticipates the feelings of guilt if would have if it violated the norm of reciprocity" (DeWulf, Odekerken-Schroder, & Iacobucci, 2001, p. 34). Bagozzi (1995) argues that this theory traditionally applied to interpersonal relationships can be established between consumers and corporations. Despite psychological evidence supporting reciprocity, behavioural commitment theory argues that the exchange between a customer and a service provider does not compare to the interpersonal relationships necessary for reciprocal action theory to hold true. Uncles et al. (2003) argue that loyalty, attitudes and behaviours as a sociological construct which cannot be as easily applied to the buying of low risk, frequently purchased brands or when

impulse buying or variety seeking is undertaken. Loyalty research is focused on emotional commitments and relationships however for customers both emotional loyalty and the behavioural act of repurchasing are passive habits rather than serious psychological commitments (Uncles et al., 2003). At the same time, merely providing the program does not constitute the retailers' portion of relationship establishment as firms must also invest in understanding and knowing their customer in order to build an emotional bond and loyalty (Morais, Dorsch, & Backman, 2004).

Research by Toh, et al., (2008) indicated that only 29% of guests are willing to pay higher room rates for loyalty programs while 46% of guests would stop staying at a hotel if the program were eliminated. Hospitality loyalty programs traditionally do not involve any prior commitment by consumers or enrolment fees meaning the above statistics indicate consumers want more service and amenities for less money and thus do not act or feel the need for reciprocal action and desire to be rewarded for their pre-existing behaviour without any guaranteed commitment or loyalty.

### **Identifying Profitable Customers and Over Satisfying Loyal Customers.**

Many ineffectively designed loyalty programs result in over satisfying unprofitable consumers while under satisfying loyal consumers. Critical to relationship marketing is establishing that not all consumers have to be treated the same (O'Brien & Jones, 1995). Not only does preferential treatment increase loyalty via prestige and exclusivity but also maximizes a company's resources. Identifying which customers to reward best is a major task and priority for successful loyalty programs.

Loyalty programs were established based on the Pareto principle that the top 20% of customers generate 80% of total revenue. Dowling and Uncles (1997) argue the top 20% of consumers may not be the most loyal but just the largest buyer and potentially also the competitors' most profitable customers simultaneously, resulting in firms compensating consumers based on volume discounts, not loyalty to the brand. Research within hospitality has also indicated that within the hotel industry, 44% of revenue is derived from the top 10% of customers meaning the majority of revenues are generated from a larger portion of consumers, inconsistent with the Pareto principle (Dowling & Uncles, 1997). Marriott Rewards reports that their 34 million program members account for 50% of all room nights booked (Marriott, 2010), meaning their program is inconsistent with the Pareto principle. Even if companies are able to determine the precise percentage of revenues derived from top guests, such figures do not address the argument against loyalty programs that firms are merely rewarding consumers who would already have been loyal to the company without incentive.

Self selection within hospitality loyalty programs also may result in very profitable (low service cost, high revenue) consumers electing not to join loyalty program and thus less profitable consumers being rewarded (Dowling & Uncles, 1997). Psychology research has shown that loyal customers are more inclined to be loyal without further incentive via loyalty programs. Research also suggests that consumers vary in their propensity to be loyal, and the more loyalty programs one is a member of the higher the probability they will register for another (Leenher, et al., 2007), raising the issue of polygamous loyalty.

**Polygamous Loyalty.**

Despite being appreciated by consumers, membership to loyalty programs do not necessarily result in increased purchases or loyalty, as many consumers will purchase from multiple companies and brands and enrol in multiple loyalty programs. Polygamous loyalty is defined as “the act of demonstrating loyalty to several brands simultaneously” (Dowling & Uncle, 1997, p. 74). By splitting purchases, consumers are not loyal to a brand but instead establish a group of habitually bought brands, making loyalty programs a defensive mechanism in an effort for companies to become part of a consumer’s group rather than an offensive mechanism to stimulate loyalty (Uncles, et al., 2003). The focus then switches from creating an emotional and monogamous relationship with a customer to becoming part of their group of brands.

While no loyalty program will result in 100% true loyalty, reward program incentives can generate the extra incentive required when consumers make a purchase decision which is especially important in highly competitive industries such as hospitality (Koslowsky, 1999). While guests are usually part of multiple programs, they tend to focus on one program to maximize rewards and achieve goals quickly (Toh, Hu, & Withiam, 1993). Firms must strategize and ensure loyalty programs are supported by comprehensive marketing efforts (i.e.; high quality service) in order to maximize the effectiveness of loyalty programs within a society of polygamous loyalty.

Consumers in the hospitality industry have justified reasons for polygamous loyalty such as the desire for variety and the lack of flexibility of many programs and thus it is unrealistic to expect guests to become single brand loyal (Uncles, et al., 2003) Firms should instead address these underlying needs for polygamous loyalty. For example, Marriott offers a variety of brands

with multiple service levels to cater to all consumer needs and desires and thus encourage loyalty to Marriott. A business traveller may stay at Marriott properties and chose Courtyard by Marriott hotels for weekend getaways while also earning points at Marriott Vacation Club's for family holidays.

### **Dimensions of Loyalty Programs to Evaluate Effectiveness**

Extensive research has been conducted regarding the individual elements, best practices and common errors within loyalty programs over the past two decades. Loyalty programs are often misunderstood and misapplied with many firms treating rewards as short term promotions (O'Brien & Jones, 1995) and thus a deeper understanding into the various elements is needed. A thorough understanding of existing research findings is critical in establishing a successful program and to evaluate existing loyalty program structures.

#### **Strategic Implementation and Target Marketing.**

Traditionally, loyalty program membership has been open to all current and potentially interested customers. This results in large membership numbers and high proportions of inactive memberships, leading to increased administrative expenses without repeat patronage. Similar to any marketing strategy, loyalty programs must target valuable customer segments and discourage those who are less valuable to the firm (O'Brien & Jones, 1995). The reward structures of loyalty programs inherently attract price sensitive and deal savvy consumers, those who are generally less profitable and must ensure strategic design and marketing to attract the best consumers.

The goals of the business must align with the goals of the rewards program (Nunes & Dreze, 2006). Loyalty programs will only be effective if the program leverages the brands value

proposition (Dowling & Uncles, 1997) and thus it is critical to align the firm's overall strategy with that of the loyalty program. Rewards and benefits must also be in line with the company's capabilities (O'Brien & Jones, 1995). For example, discount airlines should not promise '5 star service rewards' as this is not only inconsistent with the desires of the target market but difficult to deliver based on the current capabilities of the firm. In order for a loyalty program to stimulate loyalty, the program must work together with the entire marketing and service strategy to enhance the overall value of the product offering. If firms encourage easy, online booking as a benefit, loyalty program members should also be able to ease booking with their membership number as well as simplified redemption procedures.

Other loyalty programs target heavy users to enrol, in accordance to the Pareto principle that 80% of revenues are acquired from the top 20% of customers. A major flaw in this logic is that heavy users are limited in their ability to increase usage and thus rewards are merely a form of discounting (Wansink, 2003). Light users cannot be overlooked as there is a greater opportunity to increase market share however businesses must be careful to target light consumers with cost effective rewards until they evolve into loyal and heavier users of the product.

In order to establish loyalty to the brand, the loyalty program must offer benefits that are truly valued by the brand's target segments (Matilla, 2006). While companies can have multiple target segments, it is critical to identify and target specific, profitable segments for marketing efforts, including loyalty programs. Most hospitality loyalty programs target business travellers due to higher room rates paid and price insensitivity however it is important to remember that the same business traveller is a price sensitive consumer when on pleasure trips with their family.

At the same time, this market is highly saturated with loyalty programs and thus different niche segments should be considered based on the product offering and business model.

### **Commitment and Emotional Bonds.**

A major argument against loyalty is the focus of programs on repeat purchase behaviour and not on the true essence of loyalty, as the emotional bond and relationship building with consumers. Various elements of loyalty programs foster different types of commitment which must be carefully balanced to stimulate loyalty among consumers.

#### *Affective versus Calculative Commitment.*

Commitment is the enduring desire to maintain a valued relationship (Matilla, 2006). Within loyalty and relationship building, various types of commitment exist. Most loyalty programs strive to lock customers into a longer term relationship by creating switching costs as accumulated points are worthless if one patron another company. This is a form of calculative commitment; a sense of being locked into the service provider due to the cost of leaving (Matilla, 2006). Calculative commitment is inconsistent with the goal of relationship marketing to build a connection and bond with the consumer which is affective commitment. Reward programs alone are not enough to stimulate loyalty without consumers establishing an emotional connection to the brand. Matilla (2006) argues that not only does point accumulation alone fail to influence guest loyalty, but locking customers in due to point accumulation may have a negative impact on affective commitment stimulation. Emotional attachment with a brand and other value added benefits are important predictors of behavioural loyalty (the actual act of repurchasing) and

critical to achieve the overall goals of loyalty programs however achieving affective commitment remains not well understood (Matilla, 2006).

***Resource Investment Theory.***

The accumulation of points may be the foundation of loyalty programs however resource investment theory argues that it is important to invest in relationships to build stronger, longer and more satisfying relationships (Morais, et al., 2004). Shugan (2005) argues that loyalty programs operate backwards as corporations desire consumers to trust and invest in them to provide future rewards when in fact a relationship involves mutual investments. Blau (1964) and Smith & Barclay (1997) recognize the investment of time, effort and other irrecoverable resources in a relationship to create the psychological ties that motivate parties to maintain the relationship, critical to affective commitment as seen in small businesses. However consumers may not perceive the monetary and time investments into loyalty programs as meaningful investments of resources as current programs are highly automated and leverage technology making them increasingly simple for consumers to utilize. Firms must make a conscious effort to invest elements of value to increase the perceived relationship investment such as the prized resource of time and labour. Small gestures can demonstrate such investment and importance, as seen by Marriott International (and many other major chains) which provide hand written and prepared key packets for elite guests to not only expedite check-in but demonstrate that the hotel anticipated the arrival of a valued guest.

**Loyalty Emotions and Feelings.**

Affective commitment involves an emotional bond with the product. Barsky and Nash (2002) created a national Market Metrix Hotel Index (MMHI) which identified specific emotions which induce customer loyalty and influence decision making regarding repatronage and increase willingness to pay. See Appendix B – Loyalty Emotions by Market Segment. While the specific emotions which correlated to loyalty vary across market segments, firms must match their segment and strategy and ensure both the service offering and loyalty program evoke these feelings. For example, guests of extended stay hotels are more likely to be loyal if a hotel service experience makes them feel comfortable and respected.

Guests' interactions with staff are interpersonal relationships which are critical in the establishment of loyalty and resulted in stronger, longer lasting and loyal relationships between the consumer and business (Morais, et al., 2004). Consumers desire human characteristics including care, creativity and flexibility in loyalty programs to build meaningful relationships which can only be achieved by empowering and involving employees (Hendler & Latour, 2008).

**Leveraging Data Mining and Technology.**

The most successful firms are those which best meet the needs of customers, however knowing what customers desire and value is a challenge in the hospitality industry which is characterized by highly variable and dynamic consumers. Traditionally, market research data collection was based on small samples of self reported data and required consumer cooperation and generally some form of compensation resulting in biases and limited useful information. In contrast, loyalty program data is based on large sample sizes, transactional (objective) data without active participation of members (Berman, 2006). Customer loyalty databases also

continue to build overtime and thus are longitudinal in nature, allowing for long term trend analysis (Berman, 2006). In addition to identifying what consumers want, development of database technology has made it much easier for companies to differentiate guests and identify the most profitable customers (Yi & Jeon, 2003).

Matilla (2006) reasons that one way to increase the emotional bond and better understand consumers is to carefully analyze data collected via loyalty programs. Utilizing this information and catering to customer preferences allows for corporations to indicate that they care and subsequently build loyalty. This can be achieved via highly targeted promotions (i.e.; encouraging get away the month of a wedding anniversary) or increased on-site service (i.e.; offering guest their preferred wine at dinner). While many firms have acquired the ability to analyze and store such data, the benefits will not be realized until employees utilize the data to build the emotional connection.

Despite the obvious advantages, data mining does not consider non-members and thus potential opportunities to expand the customer base. While detailed transactional data is valuable quantitative information, a major limitation is that there is no insight into the motives behind decision making in order to better understand consumers (Berman, 2006). Finally, data warehousing, input, analysis and application are very costly endeavours, generally only undertaken by major corporations. Most small businesses opt for a more intuitive approach which cannot guarantee accuracy.

Advancements in technology have facilitated the rapid growth of the loyalty program industry by providing cheaper and more powerful tools for managing consumer relationships (Kivetz & Simonson, 2002). Shifting communications and redemption online is both cheaper for

corporations and more desired by consumers however is not a form of differentiation (Capizzi & Ferguson, 2005) due to the ease of replication by most competitors.

### **Rewards and Program Structure.**

The most obvious variable factor amongst loyalty programs from the consumers' perspective is reward structure. Many times the priorities and desires of customers are the direct opposite of loyalty program objectives and thus careful analysis of the impact of various structures on consumer decision making and loyalty stimulation must be completed in evaluating the overall effectiveness of a program.

### ***High versus Low Involvement Products.***

The ability for loyalty programs to stimulate loyalty appears to be impacted greatly by the level of involvement of the product or service. When the consumer effort required is low, consumers prefer lower magnitude rewards however expectations and the need for higher magnitude rewards increase with effort (Kivetz, 2003) and thus firms must carefully determine the involvement of guests in order to reward them effectively.

Low involvement products are every day decisions that do not involve extensive information search or risk and thus warrant less loyalty among consumers. Low involvement products within the hospitality industry include fast food and coffee chains. Dowling & Uncles (1997) found that low involvement products result in value being derived from the program (deal loyalty) rather than the product (brand loyalty) and thus must be carefully managed as customers may practice brand switching as the product does not reinforce the desired behaviour. Low involvement products with loyalty to the program cannot utilize switching costs as an exit

barrier, as even with high involvement products (i.e.; hotels) frequent guest programs as an exit barrier are only ranked at 3.6 (out of 7) as a consideration in repurchasing decisions (Matilla, 2006). High involvement products require customers to actively participate in the search for information and service delivery due to a higher investment of money as well as risk. The level of involvement and effort on behalf of guests will subsequently impact the effectiveness of specific types of rewards.

### ***Direct versus Indirect Rewards.***

Naturally, high involvement products result in a deeper concern and commitment to the product or service and thus consumers derive more value from rewards directly related to the product (Dowling & Uncles, 1997). Examples of direct rewards include upgrades to first class airline seats or butler service at a hotel. Direct rewards can be both hard benefits (i.e.; free stays) and soft benefits (i.e.; priority check in) but must be related to the product offering. Corporate consumers highly value such soft, fringe benefits as they cannot be purchased or expensed and thus are more exclusive (Toh et al., 2008). Within high involvement products, direct rewards will better stimulate loyalty among consumers. Indirect rewards (i.e.; redeem points for free camping gear) are not as important to high involvement consumers who attribute their actions and behaviour to the physical product and service (Dowling & Uncles, 1997). The benefit of direct rewards is that it reinforces consistency between the behaviour and the desired reward.

Behavioural learning theory suggests that for low involvement products, consumers derive value from the reward and not the product itself (Rothschild & Gaidis, 1981). Low involvement products are generally low in price and routine purchases which result in consumers perceiving such products as a 'means to the ends' with the 'ends' being the reward. Value

perception works indirectly with the loyalty program acting as a mediator, consumers become loyal to the program before building loyalty to the product (Dowling & Uncles, 1997). As a result, indirect rewards (not related to the value proposition of the product) create stronger loyalty to the program. This creates a conflict of interests for corporations who seek consumers to build a bond and connection with the physical product, not the loyalty program. Firms can attempt to augment low involvement products into high involvement brands as a means to avoid conflicting priorities (Wansink, 2003). Exclusivity of membership and being the first to receive new information are ways to increase consumer involvement with traditionally routine products, as seen by the Godiva Chocolate Rewards Club whereby a traditionally low involvement product has been transformed into a higher involvement experience d brand.

#### ***Immediate versus Delayed Rewards.***

Another area where consumer and corporate priorities conflict is in the timing of rewards. Consumers obviously prefer to be rewarded more frequently while corporations prefer to delay rewards in an attempt to elicit as many repurchases as possible before paying a reward to minimize costs and as a mechanism to build exit barriers until the desired behaviour is observed (Yi & Jeon, 2003, O'Brien & Jones, 1995). As in all consumer relations, a careful balance must be achieved whereby consumers and corporations can share the value generated.

Reward timing has been a source of competition amongst loyalty programs in recent years. On average, consumers perceive a reward as immediate when received every 4<sup>th</sup> visit (Yi & Jeon, 2003) however the industry continues to compete and reduce reward timing thresholds. The Hyatt's Gold Passport program provided a free night after 2 nights charged to a Hyatt Mastercard and this strategy has been copied by many within the industry. Lowering rewards

thresholds has a negative impact on the long term commitment of consumers as well as profitability of the program. As rewards improve and thresholds decrease, consumers will begin to seek the ‘best deal’; the lowest price or the richest reward, which is counterproductive to the overall goal of loyalty programs (Matilla, 2006). The above are examples of price wars and the discounting death spiral that ensues from loyalty programs competing against one another based on rewards as opposed to focusing on augmenting the product offering and building relationships to stimulate loyalty (Hendler & Latour, 2008). Such campaigns do not ensure repeat business and encourage polygamous loyalty among potentially profitable consumers due to lowering of the reward thresholds in terms of reward timing.

Immediate rewards are generally associated with price promotion due to the inability to provide high cost rewards. Frequent, low value rewards (i.e.; coupons and price promotions) are a short term strategy while loyalty programs strive to establish long term relationships (Dowling & Uncles, 1997) and are likely to attract reward-price sensitive brand switchers and not loyal customers (Yi & Jeon, 2003). At the same time, loyalty programs must provide some immediate benefits as the establishment of loyalty is a multi-step process requiring successive reinforcements and immediate rewards can provide incentive for consumers to remain loyal and work towards higher valued, long term (delayed) rewards (Rothschild & Gaidis 1981). While low involvement products generally call for immediate rewards, firms must carefully balance the cost of immediate rewards and ensure frequency and repeat patronage remain a critical goal of the program. Target marketing and strategic coupons and discounts (an immediate reward) can be leveraged to build loyalty to a low involvement product. For example, coffee shops that encourage one to bring a friend for 50% off coffee not only provide immediate rewards but

expose potential future customers to the product. Immediate rewards for low involvement products are very easily replicated by competitors and thus must be carefully utilized.

Satisfaction with the service provided appears to have an impact in reward timings. Keh and Leh (2006) found that customers who were satisfied with a provider are generally content to wait for rewards (delayed) of higher value rather than receiving immediate, lower value rewards. Firms which focus on providing excellence in service and satisfying customer will be better able to delay rewards and increase profitability. Another mechanism to delay rewards without jeopardizing consumer patronage, is when rewards for high involvement products enhance the value of the product (Yi & Jeon, 2003) primarily by means of direct rewards. Consumers are more willing to wait for direct, high valued rewards when satisfied with the product because satisfaction with the experience reduces the perceived investment on the behalf of the consumer. Minimizing the perceived investment may subsequently allow the firm to minimize their investment into the physical loyalty program due to the establishment of a strong affective commitment.

#### ***Luxury versus Utilitarian Rewards.***

Kivetz and Simonson (2002) reason that the type of reward, luxurious versus utilitarian, will influence consumers' value perception of the program. Luxury rewards include massages, first class upgrades and wine while utilitarian rewards include free flights or cash back rewards. Luxury rewards have a positive impact on the perception of value due to their association with positive, hedonic experiences while utilitarian items are perceived as necessities and not as rewards but compensation.

Luxury rewards are better able to build relationships as rewards are more memorable and build positive associations with both the reward and the company. American Express designates rewards as sticky (hedonic) and slippery (utilitarian) due to the rewards ability or inability to stay in the mind of consumers and build relationships and positive connotation (Nunes & Dreze, 2006).

A loyalty program with luxury rewards can also have a stronger effect on price sensitive consumers who feel guilty about consuming luxuries (Kivetz & Simonson, 2002). Products which require increased perceived program effort on behalf of the consumer are better rewarded by luxury rewards to justify the effort and reduce the guilt associated with indulging in luxuries (Kivetz & Simonson, 2002). Perceived program effort includes any inconveniences of the program including buying at a specific store, higher prices and substitution costs (Kivetz, & Simonson, 2002). Luxury rewards can still be directly related to the product itself (i.e.; upgrade to hotel suites or first class) and thus firms should consider the involvement of the product as well as perceived cost of rewards to consumers. A consumer may perceive an upgrade to first class as a \$200 reward while the cost to the company is substantially lower. Luxury rewards must be provided carefully not only due to high costs to the business but also because luxury rewards at low points thresholds will not only decrease the perceived value of the reward and program (and subsequently the product) but also will not encourage repeat patronage.

Luxury rewards are not appropriate for all programs as the business model must be considered and the reward type must reflect the characteristic of the product (Hendler & Latour, 2008). Luxurious consumption (i.e.; casinos) must be rewarded with luxury rewards (i.e.; room upgrades or fine dining) while utilitarian consumption (i.e.; rooms at Motel 6) should be rewarded with utilitarian rewards (i.e.; cash back or free rooms) in order to augment the value

position of the product offering and reinforce consistent behaviour. For example, rewarding repeat patronage to lower service hotels with a fine dining experience will encourage the consumer to defect and stay at a higher service hotel segment in the future. Regardless of involvement and effort, the reward type must fit the needs and desires of customers in order for guests to identify with the benefits of membership, the program and ultimately the company (McCall & Voorhees, 2009). Programs with a high customer fit encourage consumers to feel part of a community among members and foster loyalty (McAlexander, Schouton & Koenig, 2002).

### ***Tiered Programs.***

Tiered programs group consumers based on historical loyalty and compensation varies accordingly. This basic loyalty program design is very effective not only in minimizing costs but also provides consumers incentive. Tiered programs look to reduce costs, based again on the Pareto principle that 80% of revenue is achieved from the top 20% of guests. Because it is difficult for hospitality loyalty programs to refuse guests membership to programs, administrative costs are reduced by focusing efforts and rewards on higher tiered members who have demonstrated loyalty in the past (McCall & Voorhees, 2009). Research by Nunes and Dreze (2009) has found that three tiers is the magic number as administrative costs (of managing multiple tiers) is kept low yet consumers are provided with substantial differentiation of importance to provide value. Elevated tiers also allow for increased prestige for truly valuable customers and allow them to better identify with the organization in order to build an affective relationship.

Kivetz, Urminsky and Zheng (2006) found that consumers increase affective commitment and accelerate desired behaviours as they approach the next tier within a program

and reward thresholds, indicating that program tiers not only reduce cost but also impact the development of loyalty and positively encourage purchase behaviour. Companies which provide reward statements outlining a customer's progress towards rewards enhance customers' psychological commitment to loyalty programs thus increasing loyalty to the company (Dowling & Uncles, 1997).

Despite the benefits of tiered programs, companies must carefully consider potential drawbacks. Multiple tiers can increase administrative expenses if too many tiers are created. For example, differentiating between Gold and Platinum guests is more costly than grouping all 'Elite Members'. Tiers also complicate programs for both consumers and employees resulting in increased marketing and training and may result in employees not maximizing usage of the program and thus customers will not acquire value, rendering programs useless. Exclusivity must also be balanced to ensure benefits of tiered programs are realized. Elite members are most satisfied when there are relatively few people in their tier, demonstrating the impact of prestige and exclusivity in building loyal relationships (McCall & Voorhees, 2009). To remain competitive, many firms have lowered the thresholds to achieve elite status (Matilla, 2006) for example; Marriott Rewards members achieve 'silver status' after 10 nights. Firms must be very careful to balance consumers' desire for prestige with the need for exclusivity which can be jeopardized by low elite status thresholds. At the same time, limiting membership can alienate (and risk potential profits) of lower tiered members. For example, Marriott's 'Silver tier' provides little differentiation from basic membership and as a result does not encourage loyalty in relation to the prestige of Gold and Platinum membership, however intermediate tiers are important as the members of these tiers are generally larger in number and critical to long term profitability. Many tiered programs are based on the number of nights stayed in a given year.

An elite guest may not reach the pre-specified threshold the following year, many times by a matter of a few nights. It is obviously detrimental to relationship building for hotels to downgrade guests' status within the program, many times via automatically generated mailings and jeopardize future business as consumers are felt to be less important.

***Prestige, Exclusivity & Service.***

Developing relationships and an emotional commitment from customers is the means to establish loyalty and the primary purpose of offering the economic benefits of loyalty programs. Psychological benefits of loyalty programs include the feeling of participation, anticipation of future rewards and a sense of belonging (Dowling & Uncles, 1997). Bowman and Narayandas (2001) found loyal customers valued interactions with service personnel more than the reward itself indicating that the loyalty program process, prestige and differentiated treatment may be more important than the physical reward.

The sociological impact of loyalty programs include supporting the human need to belong to groups via identification with the corporation, leading to loyalty. By joining loyalty programs, customers feel special, which creates affective commitment (Leenher, et al, 2007; Matilla, 2006). It is human nature to demonstrate loyalty towards groups of which we are a part, for example loyalty to an individual's school sports teams (Robbins & Judge, 2008). Program members are more likely to identify strongly with the company because their membership relates them to a group of preferred customers (Leenher, et al., 2007).

The most lucrative and generous loyalty programs will not be successful if not supported by a quality product, which in the hospitality industry is service. Jones and Sasser (1995) found that the effectiveness loyalty programs are moderated by consumer usage levels and the service

experience. While increased patronage can result in, on average, some negative or subpar service experiences, firms which consistently provide excellent service and satisfaction will generally obtain a larger share of the consumer's wallet. Customers naturally evaluate their satisfaction with both service and loyalty programs to competitors and thus programs cannot be evaluated individually and must consider (but not necessarily imitate) competitive offerings (Keaveney, 1995).

While loyal customers are most typically satisfied, satisfaction does not ensure loyalty, with 65-85% of those reporting to be 'satisfied or very satisfied' with service still defecting (Oliver, 1999). Uncles et al. (1997) argue that even repeated satisfaction will only lead to a weak commitment to the brand and companies must still work to build loyalty. While loyalty program members are said to be less sensitive to service failures, prior satisfaction with the product and service is critical in establishing loyalty (Bolton, Kannan & Bramlett, 2000). Capizzi and Ferguson (2005) stress the importance of the 'wow' factor in building loyalty. Satisfying customers is similar to loyalty programs themselves as both strategies will merely establish competitive parity while delighting the customer with unforgettable experiences is critical in building loyalty.

In satisfying consumer needs, products and services provide utilitarian benefits, while relationships with the service provider and the trust and satisfaction generated from this relationship, are higher order needs and constructs of enhancing relationship quality (De Wulf, et al., 2001). Most individuals who can afford hospitality services have well established lower order needs and thus in order to motivate individuals to purchase and establish loyalty, firms must focus on higher order needs such as building a sense of belonging and esteem as established by Maslow's Hierarchy of Needs (Robbins & Judge, 2008). Loyalty programs create a

relationship by addressing higher order needs including encouraging a sense of belonging, advancement within tiered programs and earning of rewards, which all contribute to a sense of prestige and self actualization (Dowling & Uncles, 1997). Satisfying these higher order needs motivates individuals to continue obtaining services from the company and the emotions derived build loyalty. Research on human behaviour has demonstrated that people possess a strong drive and motivation to engage in efforts directed at achieving rewards and thus working towards the accumulation of loyalty program points provides both economic and psychological benefit (Kivetz & Simonson, 2002).

Personalization is another mechanism to make loyalty program members feel important and foster relationships. Leveraging data mining is critical to ensuring personalization, an important reason guests chose to engage in relationships with service providers. DeKay et al., (2009) feel that hotels are in an even better position to personalize services and enhance loyalty to the brand and product instead of the program due to a longer service encounter, less regulation and more amenities. Personalization is another means to increase the perception of corporations as more 'human' and able to engage in meaningful relationships.

Ultimately, loyalty programs aim to make consumers feel a sense of prestige and belonging and thus satisfy their human need to work towards the ultimate goal of self-actualization. Consumer studies have shown that knowing you have been provided better value in relation to other customers will further stimulate loyal behaviour (Leenher, et al., 2007), encouraging firms to provide increased value in the forms of rewards, recognition and personalized service to build loyalty. As a result, the success of programs in establishing a sense of belonging and prestige will impact the overall success of the program's ability to stimulate loyalty.

***Flexibility & Program Procedures.***

When consumers are questioned regarding dissatisfaction with loyalty programs and reluctance to enrol, loyalty program flexibility is raised as a major issue. A survey of hotel loyalty program members found that 53% indicated they would rather receive airline miles for their hotel stays if given the choice (DeKay et al., 2009). Most major hotel chains have partnered with multiple airlines and offer an exchange program, and those airlines which have not are potentially at a competitive disadvantage. Despite the overwhelming preference, in 2004 only 30% of travellers took advantage of this flexibility option, down from 70% in 2001 (DeKay et al., 2009). A potential cause for this discrepancy may be the perceived complexities in transferring rewards points or time concerns as such transfers were historically done manually.

Consumers are motivated to establish relationships and loyalty in an attempt to reduce the perceived risk of utilizing unknown service providers. Consumers have imperfect knowledge about their future purchases which hinders the potential value of loyalty programs as consumers are unsure if they will acquire the rewards (Lewis, 2004). Increasing flexibility in collection and redemption (i.e.; loyalty program coalitions and the elimination of point expiration) are all methods to increase value by means of reducing consumer risk. Toh, et al., (2008) found that while the top reason for not enrolling in loyalty programs is that consumers feel they do not stay at hotels enough, within the top five reasons, reduction in hotel choices (an element of flexibility) and unattractive rewards are both major concerns for consumers. Consumers justify membership to multiple programs as a means to maintain flexibility (Toh et al., 2008) and thus building flexibility into loyalty programs can increase the value and attractiveness of a program. Redemption flexibility is also important to consumers. Research by Nunes and Dreze (2006) found that loyalty programs which allow members to redeem points in combination with cash

result in lowered psychological cost to consumers and an increased perceived benefit to the consumer, without any increase in costs to the company.

Partnering with credit cards is another way to incorporate flexibility into the program by allowing members to earn points for non-program product purchases. Airlines are compensated on average 1.7 cents per mile awarded by credit card companies (DeKay et al., 2009) and thus prove to be a huge revenue generating opportunity while also better serving guests. Forty percent of all Visa and MasterCard issuers now operate as rewards programs demonstrating the importance of loyalty programs rewards to other industries (Capizzi & Ferguson, 2005).

### **Effective measurement metrics**

Loyalty programs strive to create value for both the firm and customer but it is critical to ensure more value is generated than transferred to guests (O'Brien & Jones, 1995). Value is a subjective concept and thus behavioural, attitudinal and financial constructs are utilized to evaluate programs. Currently, many loyalty programs measure success based on the number of members. This is an ineffective measurement metric as it does not evaluate the ability of the program to stimulate loyalty and larger membership bases result in higher administrative costs. A more comprehensive and critical approach must be taken to measure loyalty program success.

### **Behavioural Measurements.**

Many researchers argue that behavioural measurements are the best mechanism to measure loyalty. While customer sentiments are important, such emotions and feelings are fruitless if not followed by the actual act of repurchasing. While all behavioural measurements have flaws (discussed in research limitations) a company's share of wallet is a critical

measurement of success in building loyalty and repeat patronage. Research indicates that the share of wallet measurement may experience decreased elasticity within the product category with the implementation of a loyalty program (Leenher, et al., 2007) and consumers may spend more within a given product category or be less sensitive to fluctuations in price. As a result, it is critical for firms to measure the proportion of revenue from the particular product category (share of wallet).

Logic reasons that a loyalty program will not result in consumers purchasing more than they need (Uncles, et al., 2003) and thus firms must increase average spending per visit as well as acquire market share from other firms. As a result, overall market share is another measure of loyalty program effectiveness however historically market share percentages have remained consistent, indicating a lack of competitive advantage (Dowling & Uncles, 1997). A major limitation of behavioural measures is the inability to establish causation and evaluate the ability of the program to stimulate loyalty which can be achieved through understanding the emotional commitment and drivers of consumers.

### **Attitudinal Measurements.**

While behavioural measurements are less subject to bias errors relative to attitudinal measures, the overall goal of loyalty programs is to induce behavioural loyalty via emotional commitment. Behavioural loyalty can easily be swayed by a more convenient or cost effective competitor whereas attitudinal commitments are deep rooted and more difficult to alter and thus desired by firms. Guest satisfaction surveys are important to assess success in providing excellent service and measuring consumers' emotional ties to the company. Interacting and

speaking to guests is a critical means of both establishing emotional bonds and relationships as well as measuring the firm's success in strengthening attitudinal commitment.

In addition to guest satisfaction surveys, positive word of mouth (WOM) generated is a key attitudinal measurement metric which is very challenging to measure (Dowling & Uncles, 1997). Dowling and Uncles (1997) argue that positive word of mouth is not only generated by loyalty program members but by all satisfied customers and thus a weak measurement metric however critical in building loyalty and expanding of a firm's customer base. Firms can also increase positive WOM by rewarding customers for such behaviour. For example, offering bonus points for referring a friend to the loyalty program or providing double points for bringing a friend.

### **Financial Measurements.**

It is without argument that loyalty programs are high cost endeavours, as seen by the \$15M in advertising costs incurred by Hyatt merely to inform members about changes made to their loyalty program (Edward Watkins, 1989). Loyalty programs must be analyzed utilizing financial measures. Regardless of the ability of a firm to create behavioural and attitudinal commitment, all programs are ineffective if their cost of operation exceeds the benefit derived for the company.

Individual programs have a breakeven point at which the rate of redemption times the cost of rewards redeemed is equal to the incremental revenue generated by the program (Capizzi & Ferguson, 2005). Such measurements are challenging due to the inability to measure incremental revenue generated by the program. While it may be difficult to compare break even

points across the industry, a firm can establish accounting assumptions and variables to evaluate their own loyalty program efficiency.

A complete financial evaluation of a loyalty program must also consider not only administrative costs but also the direct and indirect costs of operating the program. Direct costs include marketing, enrolment costs, IT hardware, database maintenance etc. while indirect costs include labour costs (of executing the program) and opportunity costs (if invested in other marketing initiatives) (Uncles et al., 2003).

Another critical financial measurement is the discount rate of the program. To maintain their loyalty program, InterContinental Priority Club pays program members approximately 5% of what members spend on each visit (DeKay et al., 2009). In the 2010 Financial Reports, Marriott listed the Marriott Rewards program as a liability of \$1799M (Marriott, 2010). Firms must carefully measure and evaluate the opportunity cost of such high discount rates in measuring loyalty program effectiveness over a period of time. It is difficult to compare such costs to others within the industry due to varying assumptions and accounting procedures as no standards exist and thus programs can be tracked over time to ensure cost effectiveness based on individual program budgets.

Loyalty program costs are reported to range between 3% to 6% of revenues for airlines and hotels while total advertising budgets are generally 3% of total revenue (Dowling & Uncles, 1997). Such costs need to be carefully balanced with the potential revenue generated, however research suggests that it is difficult, if not impossible to accurately quantify the payback of loyalty programs (McCleary & Weaver, 1991).

**Conclusion**

Experts remain divided regarding the ability for loyalty programs to truly stimulate loyalty. McCleary and Weaver (1991) summarized these conflicting conclusions best by suggesting that frequent guest programs are destined to linger on unless all lodging chains were to drop such programs at the same time. Few firms will risk the competitive disadvantages of not offering a loyalty program and thus steps must be taken to maximize the investments and minimize the cost of offering these incredibly popular programs. Companies must critically evaluate loyalty programs to ensure their long term sustainability and effectiveness a relationship marketing tool.

Extensive research exists outlining the most effective program structures and mechanisms to stimulate both behavioural and emotional loyalty from guests, however it is very challenging to develop best practices for the loyalty program industry due to the variances in each business. If loyalty programs are truly expected to help differentiate businesses in an increasingly commoditized industry to create a competitive advantage, the underlying strategies and objectives of loyalty programs cannot merely be duplicated. Utilizing the above summarized research findings managers can evaluate their individual circumstances and programs to maximize profitability and effectiveness.

### **Part III**

## **Hospitality Loyalty Program Effectiveness Evaluation Rubric**

### **Introduction**

In order for loyalty programs to stimulate loyalty and repeat patronage they must not only create value for the guest but also be differentiated from competing programs. This involves a careful consideration of the implications of the current loyalty program's structure, but also overall strategy for the business. Firms not only vary in business strategies and loyalty programs, but also cater to various customer segments. While each firm is in a unique situation and must carefully evaluate multiple variables in establishing a loyalty program, all firms face tradeoffs. Many of the most popular loyalty program strategies among consumers are also the most expensive. It is important to measure the effectiveness of the various loyalty program offerings and balance both the direct and indirect costs if businesses intend to build loyalty programs which go beyond maintaining competitive parity and stimulate repeat patronage. Appendix C – Hospitality Loyalty Program Effectiveness Evaluation Rubric serves as a guide to the discussion below to outline the various areas of consideration for managers.

### **Strategy and Competencies**

#### **Overall Strategy of the Business.**

Consider the objectives of the company and how the business intends to be profitable. Critical considerations include the product, customers and any unique areas of differentiation.

The product must be identified as high involvement or low involvement as well as the level of luxury of the product. Involvement refers to the level of effort and risk endured by the guest (Dowling & Uncles, 1997). Luxury products are those which can be considered

unnecessary and satisfy non-utilitarian needs. Within the hospitality industry a major component of the product offering is service and the service standards can help establish whether a product is utilitarian or luxurious. For example, hotels offering basic service and the bare necessities of a hotel room will be a utilitarian product while a full service resort with spa and dining outlets is a luxury product offering.

The identified products target a specific consumer who must be understood in order to effectively stimulate loyalty. Customer characteristics include price sensitivity, purpose of purchase (i.e.; business versus pleasure) as well as basic demographic information. Loyalty programs must also fit the needs of guests and thus understanding your consumer is critical. It is important to understand what the company does best and how one differentiates itself from the competition. All firms must have a set of core competencies which can be leveraged to develop bases of competitive advantage (Barney & Hesterly, 2009) and such competencies must be seen within the loyalty program.

It is important to clearly identify and understand the business in order to ensure the objectives of the loyalty program are consistent with the overall goals of the company. Outlining these important details initially will allow for management to ensure focus and consistency while evaluating the various elements best suited for a loyalty program.

### **Loyalty Program Strategy.**

The goal of all loyalty programs is to increase the commitment of guests however programs can focus on various dimensions of loyalty and means to stimulate repeat patronage. The various strategies utilized must not only complement the product offering but also ensure that loyalty is being stimulated and not merely rewarded.

***Loyalty Program Commitment Strategy.***

Loyalty includes both behavioural and attitudinal elements. Firms can choose to focus on encouraging behavioural loyalty, attitudinal loyalty or balancing both. Many researchers argue that true loyalty is attitudinal in nature, and an emotional commitment to the company will inevitably lead to behavioural loyalty, however programs which successfully focus on repeat patronage without establishing an emotional bond will still succeed in increasing revenues. Investments in both types of loyalty can be very costly and thus firms must identify the priorities of the business.

Behavioural loyalty is fostered utilizing rewards redemptions and frequent promotions, to entice the consumer to return. Attitudinal loyalty requires data mining and investing in time and effort to foster guest relationships, via special service and treatment by employees.

Once these priorities are established it is critical to ensure the remaining dimensions of the loyalty program support the loyalty program strategy. For example, a business focusing on attitudinal loyalty cannot consistently reduce rewards thresholds and instead must invest in relationship building. Many businesses will try to focus on both elements of loyalty however this requires very careful balance which many argue is not only challenging but unachievable. Matilla (2006) argues that focusing on behavioural elements automatically reduces attitudinal commitment as consumers are more concerned with the next deal versus relationship building. Regardless of the loyalty program strategy, it is critical for this strategy to be consistent with the goals and capabilities of the company.

### ***Loyalty Program Revenue Focus.***

The purpose of all loyalty programs is to increase revenue by one of two methods. Customers can increase revenues by means of spending more during each visit or visiting the establishment more frequently. While ideally patrons would visit more often and spend more, this is a very ambitious goal and consumer behaviour research has consistently shown that consumers will not buy more than they need on a long term basis. Businesses must focus on either acquiring higher market shares or increase average cheque. Such decisions are best based on the product being offered.

Generally speaking, consumers can be encouraged to purchase low involvement products which are more routine and at a lower price point more often. While it is difficult to encourage consumers to purchase higher involvement products more frequently than they need (i.e.; airline tickets or hotel rooms), loyalty program tactics can be utilized to spend more per visit. Both the type of loyalty program utilized and structure of the program must be strategically prioritized to ensure the loyalty program meets the established program objectives.

### **Loyalty Program Type**

Berman (2006) established a loyalty program typology, of which type II, III and IV are best suitable for the hospitality industry. A firm must chose the most suitable program type and carefully balance the strengths and minimize weaknesses of the program type to ensure it is consistent with the overall goals of the business and loyalty program. The evaluation rubric not only provides weaknesses and mechanisms to reduce such challenges but also the strengths of each program to ensure they are realized by the company. For example, volume discount

programs are traditionally a very low cost endeavour however not if operated inefficiently and as a result this strength must be evaluated to ensure it is indeed is leveraged by the firm.

### **Type II – Volume discount program.**

Type II programs are best suited for the food and beverage industry and operate as a volume discount program. Consumers are rewarded a free product for every 'n<sup>th</sup>' purchase and thus encouraged to increase loyalty and purchases in order to achieve rewards. Such programs are relatively inexpensive to operate as they are self-managed by the consumer who is responsible for bringing in a frequent guest card and thus easy to administer for the business and involve minimal employee training. While self management by consumers reduces costs, many consumers are overwhelmed by the number of loyalty programs and are reluctant to carry yet another loyalty program card.

A major limitation for type II programs is the ease of replication by competitors and a lack of data collection which limits the ability to build emotional bonds and attitudinal loyalty among consumers. While these simpler loyalty programs do not allow for complex data mining, data tracking can still provide valuable information. For example tracking the date a new punch card is issued and the date it is redeemed for a reward to measure the rate of redemption and customer patronage rates.

The structure of type II loyalty programs will greatly impact the ability to stimulate loyalty. For example, providing every 10<sup>th</sup> cup of coffee for free without restrictions will merely provide volume discounts without encouraging repeat patronage, increased average check or loyalty. Consumers may purchase 10 coffees in one day for an office party and be rewarded the

same as a loyal customer who purchases a coffee every morning. It is important to limit the number of ‘punches’ in a single day or transaction to ensure repeat patronage and loyalty.

The type of reward is also critical in stimulating loyalty within type II programs. Most food and beverage products are low involvement and thus are compensated with direct rewards; however rewards should still stimulate loyalty and create opportunities for the business. For example, providing a free muffin for every 10<sup>th</sup> cup of coffee purchased can expose the consumer to try other products and potentially entice consumers to purchase the complementary products in the future. Another alternative is providing stamps based on the dollar amount purchased instead of the number of products. For example, providing one stamp for every \$5 spent in store on any variety of items. This also encourages consumers to spend more and allows consumers to try a variety of items, meeting the human need for variety while increasing revenues.

### **Type III – Points Accumulation.**

Type III programs involve a comprehensive database which is used to compensate a consumer with points for purchases at a pre-established rate. Within the hotel industry, on average consumers are given 10 points for every \$1 spent while many airline programs compensate flyers based on the number of miles flown. Consumers can then redeem the points for a variety of rewards.

While such programs are much more complicated and expensive to operate, they provide great opportunity for data mining and understanding the needs and desires of the customer in order to better build relationships with consumers. This immense opportunity involves not only an investment in data analysis but also flexibility for the business to meet the ever changing

demands and desires of the consumer. Such programs also allow for loyalty program coalitions and more complex reward redemptions to provide incremental value to guests.

Points accumulated operate as an alternative currency which can be used to purchase rewards. Consumers wish to understand how many dollars they must spend to receive a reward and will then determine the personal value the reward (in dollars) to determine the value of the reward and subsequently the program. Many firms have created complex point collection schedules with the rates varying based on product purchased, season and membership status. Despite the ability to utilize such schemes to stimulate sales of certain products, stimulate low season sales or increase prestige for consumers, managers must be very careful to maintain the simplicity of loyalty programs as consumers are bombarded in a heavily saturated industry and can easily confuse programs.

Type III programs also involve collection of both personal information and purchase data which for many consumers raise privacy concerns. As such programs are managed by the company (and not the consumer), appropriate levels of communication, whether by phone, email or mail to ensure the consumer feels valued but at the same time is not bombarded with information. Recent security breaches by third party loyalty program database hosts such as recent as the Epsilon case in March 2011 have raised privacy concerns among consumers. Regardless of the complexity of loyalty programs, it is important for firms big and small to maintain secure databases and to ensure consumers feel safe providing personal information. Many loyalty programs include a privacy clause, assuring members that information is kept confidential and not sold to third parties or allow consumers to select the type and frequency of communication as a means to address member concerns regarding personal information and communication.

Many structural elements of loyalty programs must be established in both types of hospitality loyalty programs (i.e.; reward thresholds, rewards types etc.) and can impact the ability to stimulate loyalty, however understanding the inherent strengths and weaknesses of the program type is critical to ensure overall effectiveness.

#### **Type IV – Targeted Communications.**

A popular loyalty program type within the food and beverage industry is email newsletters and targeted mailings which deliver news updates and special promotions to consumers who provide email or mailing addresses. Such programs are inexpensive to operate but fail to encourage loyalty among consumers and function as short term promotions or more targeted flyers. The flaw in such programs is that consumers need not demonstrate loyalty to receive the promotion.

The Cheesecake Factory, a chain restaurant periodically distributes email rewards to subscribers of their e-newsletter, providing a free slice of cheesecake for every \$30 spent on food and beverage. This does not foster a long term relationship with the consumer as the reward is not based on historical loyalty but instead loyalty to the newsletter. Instead of stimulating relationships with consumers, Cheesecake Factory inherently encourages the consumer to visit the restaurant during the period of the promotion. Targeted communications are a powerful mechanism to lower marketing costs and reach a critical demographic however if not used in conjunction with type II or III loyalty programs, cannot be considered an effective loyalty program.

**Product Attributes for Evaluation**

Before evaluating a loyalty program, to ensure consistency and effectiveness in stimulating loyalty it is critical to consider both the product offering as well as the target consumer.

**Product.**

The product (identified via strategic evaluation of the business) is critical to the implementation of an effective loyalty program. The product includes both the physical product (i.e.; room, food, etc.) as well as intangible elements such as service. The product must be classified as high or low involvement. High involvement products require extensive effort on the part of the guest, including searching for information, higher price and higher risk. Hotels are considered a high involvement product as guests must carefully decide where to stay, at a relatively higher price and the consequences of staying at a bad hotel are high (i.e.; ruined vacation). Low involvement products require little effort on the part of the guest, are generally low cost and impulsive decisions which consequently present a lower risk to the consumer. Fast food is a low involvement product as consumers do not think carefully before choosing a restaurant, prices are relatively lower and due to minimum investment, the risk is also minimized.

The level of consumer involvement has major implications on the effectiveness of many reward types and structures. Generally speaking consumers are more likely to develop loyalty towards higher involvement products due to higher personal investments in the product and experience; however it is still possible to build loyalty towards lower involvement products.

One strategy is to augment a lower involvement product into a higher involvement product by means of increasing the brand value and experience for consumers, especially within the food and beverage industry. For example, Starbucks offers coffee, a traditionally low involvement product however by building brand value and associated prestige and luxury with the product Starbucks is treated as a high involvement brand to which many build loyalty. This decreases consumer price sensitivity, and increases the ability to establish loyalty among consumers.

All products cannot be clearly distinguished as high or low involvement products, but evaluating the effort invested by consumers can allow for an understanding of how loyalty is stimulated and better application of loyalty programs.

### **Consumer Fit.**

A loyalty program must be consistent with the overall strategy of the business, including the consumers which the business serves. Many loyalty programs focus on the high volume, price insensitive business traveller due to the obvious profitability of this segment however loyalty programs must look at the actual customers served and the goodness of fit of the program to the needs of the target market. Two areas of fit include the reward type (luxury versus utilitarian) and emotions derived from the product.

### ***Loyalty Emotions.***

Barsky and Nash (2002) developed a Market Matrix Hotel Index (MMHI) which identified specific emotions which induce loyalty and influence decision making, repatronage decisions and increase willingness to pay. Loyalty inducing emotions vary by market segment

within the hotel industry and thus firms should identify where their specific segment and the corresponding emotions (See Appendix B). While all consumers appreciate luxury rewards and upgrades, luxury emotions will have a limited ability to stimulate loyalty in a budget hotel market segment and thus it is important to ensure the rewards and benefits of a loyalty program are consistent with the needs of the market segment. An area for future research within the MMHI is to identify which services and amenities, especially loyalty program amenities, best evoke the identified emotions. For example, luxury brand hotels can best induce loyalty by evoking feelings of being pampered and thus luxury rewards and priority check-in would be effective loyalty program strategies.

### ***Reward Type.***

In order for guests to value the benefits of loyalty program membership and thus build loyalty, the rewards and perks of program membership must meet the needs of the guest (McCall & Voorhees, 2009). While luxury rewards are associated with positive, hedonic experiences and thus able to better stimulate loyalty, they will be ineffective in motivating consumers if lower order needs (as identified by Maslow's Hierarchy of Needs) are not met. For example, a consumer in need of basic shelter who cannot afford spa services will be better motivated by cash back rewards or complimentary room nights. Consumers whose lower order needs have been satisfied are better motivated by luxury rewards such as room upgrades and concierge access however utilitarian rewards can still stimulate desired loyalty from this consumer segment. Research suggests that those who can afford luxury services will be inclined to spend more on incidental items (i.e.; dining services, spa etc) when rewarded with a free night, and thus

the power of luxury rewards must be carefully balanced with both guest needs, desires and the functionality of utilitarian rewards.

### **Loyalty Program Dimensions**

Elements of loyalty programs vary in their ability to stimulate loyalty and must be based on the previous analysis and understanding of the product offering. Analysis of the customer and product must then lead to appropriate types of program offerings to most effectively stimulate loyalty.

#### **Direct versus Indirect Rewards.**

Consumers relate stronger to high involvement products, due to personal investment and thus are motivated and able to develop loyalty via rewards directly related to the value proposition of the product, such as free room nights or upgrades. Loyalty programs for businesses offering high involvement products should focus on direct rewards and then balance utilitarian or luxury rewards based on customer needs which can increase exposure to all products (including those priced higher) and stimulate repeat purchases.

It is difficult for consumers to develop an emotional bond with low involvement products as they are routine purchases with minimal investment on the part of consumers. As a result, indirect rewards are better able to create hedonic experiences and stimulate loyalty. Indirect rewards are not directly related to the value proposition of the product, and include household items or unrelated travel and leisure rewards. Such rewards are valued by guests however managers must be wary of guests establishing loyalty to the program and not the product as well as the risk of consumers abandoning the relationship with the product in the situation that the

reward (or the entire program) is eliminated. An important way to balance such issues is by offering a combination of direct and indirect rewards based on reward timing.

### **Immediate versus Delayed Rewards.**

It is important for businesses to balance both immediate and delayed rewards. Delayed rewards offset the reward liability until after the desired behaviour (repeat patronage) occurs however immediate rewards are critical in expediting the loyalty cycle. Loyalty programs should provide lower magnitude (and lower cost) rewards immediately and delay higher magnitude rewards until after the desired behaviour in order to motivate guests towards rewards and reduce costs as only truly loyal customers will achieve the higher cost rewards. Immediate rewards which are also direct will better build loyalty to the value of the product and increase consumer exposure to further stimulate loyalty. In a loyalty program where reward thresholds are constantly being reduced to maintain competitiveness, it is critical for businesses to not only maintain reasonable thresholds for cost purposes but also to provide prestige and value to the program.

Utilizing both the magnitude of the reward (value of the reward to the consumer) and the reward threshold, consumers establish the value they place on the reward to see if investment and membership to the program is worthwhile. For example, if a consumer must spend 10 nights to achieve a free room, the consumer must consider both the value of the free room as well as the cost and amount of time (delayed versus immediate) to achieve the reward. As stated previously, consumers on average perceive rewards awarded within 4 visits as immediate however the amount of physical time to achieve this reward will vary based on individual consumer

behaviour. Managers can utilize reward thresholds to compare the competitiveness of offerings and overall perceived value of a reward to potential members.

### **Prestige and Exclusivity.**

The perception that one has received preferential treatment can motivate consumers to engage in relationships with a business and thus the prestige and exclusivity of program membership are many times subconscious, intangible elements of the program which help foster loyalty. Various elements of the loyalty program (i.e.; enrolment, tiers and service) all contribute to the feelings of prestige and exclusivity and further stimulate loyalty among consumers. Providing a sense of prestige to many members is important to stimulate loyalty among a larger customer base however counterproductive to exclusivity which also fosters relationship building and loyalty.

### ***Enrolment.***

Most hospitality loyalty programs offer open membership in an attempt maximize membership base and not alienate customers, however this is counterproductive to the value derived from exclusivity. Firms should be careful to encourage membership selectively and strategically, while not refusing membership to those who wish to join.

Many firms provide employee bonuses based on enrolment statistics, encouraging employees to enrol as many individuals as possible, regardless of the customer's fit to the program and profitability to the business. Immediate rewards (i.e.; 25,000 bonus points for enrolling) provide a huge incentive for guests to enrol even if they have no intention to repurchase. While logic would argue that a larger membership base will lead to larger rates of

loyal customers, focusing on enrolment does not result in relationship building. Such initiatives are not only increase administrative costs but are also counterproductive in the establishment of exclusivity.

Almost all hospitality loyalty programs offer free enrolment into the program, encouraging enrolment, increasing administrative expenses and reducing exclusivity. Some of the strongest retail loyalty programs require members to pay a fee and offer augmented rewards (both immediate and delayed) and increased prestige and exclusivity. Diners Club International is an example of a loyalty program coalition whereby members pay a fee but also receive global rewards, access to a variety of restaurants as well as discounts and promotions (Diners Club International, 2011). While many successful membership fee based programs exist, the key to their success is the ability for the membership fee to be perceived as substantial lower than the value derived from membership to the program.

### ***Tiered Programs.***

Utilizing program tiers is a very effective means to offer open membership but reduce administrative expenses by focusing efforts on those guests who have historically demonstrated loyalty to the company and thus have advanced to higher tiers. The number of tiers must be high enough to provide sufficient differentiation and prestige with minimized complexity, but low enough to control administrative expenses of multiple tiers. Nunes and Dreze (2006) have researched consumer perception and loyalty program tiers and identified 3 tiers as the magic number of tiers to balance these issues however companies must consider their own membership size and program offerings. Program tiers must also provide sufficient differentiation without alienating lower tier guests and making them feel unimportant. Many loyalty programs will

inform guests that they have reached a new tier but not have any valued associated benefits, rendering the entire process nothing more than an administrative expense.

### ***Intangible Benefits.***

Research has suggested that guests derive more value from intangible elements which provide more prestige than tangible rewards (Bowman & Narayandas, 2001). The major benefit of intangible rewards, such as priority check in or remembering guest room and amenity preferences is that they generally are very low cost initiatives which stimulate the need for reciprocity and loyalty. For example, if an employee remembers a guest, asks about their family or the weather in their specific home town the guest will feel the need to reciprocate the relationship and remember the employee and thus the business. Intangible benefits must be used strategically in order to maintain their value. If loyalty program members are provided an array of intangible benefits merely for enrolling, they will depreciate in value among new members as well as truly loyal members who will no longer experience preferential treatment.

### **Program Flexibility.**

As loyalty programs become increasingly competitive, program flexibility becomes increasingly important to maintain value for consumers and reduce program switching and polygamous loyalty. However increased flexibility generally comes at a higher cost and thus understanding elements valued by consumers is critical to ensure profitable investments in flexibility.

***Convenience.***

In our increasingly convenience based society, consumers will not only undervalue but many times avoid programs which are complex to understand and inconvenient partake in. Consumers are bombarded by dozens of programs and reluctant to carry around ‘yet another loyalty card’ for a program with unsure returns and value. Loyalty programs should be kept as simple as possible in all dimensions including enrolment, utilizing rewards cards, redemption and communication of information. Consumers increasingly value electronic rewards statements and instant reward redemptions, which increase the convenience and value of the program to consumers. Firms which can retrieve membership numbers utilizing more commonly known information such as phone numbers or zip codes increase convenience and reduce the burden of carrying many cards for guests however must be careful to consider privacy concerns.

***Point Transfers & Coalitions.***

The main reason consumers practice polygamous loyalty is the human need for variety. Firms which can incorporate variety and flexibility into their program can subsequently increase loyalty and decrease polygamous loyalty. Research has suggested that over 50% of consumers prefer earning airline miles over hotel rewards points (DeKay et al., 2009), indicating the importance for coalitions among hospitality industries. While larger coalitions increase administrative costs, increased flexibility increases value for consumers. In addition to offering points transfers, such transfers must be convenient for consumers, many of which prefer automatic or electronic transfers.

***Points Expiration & Blackout Dates.***

Traditionally, loyalty program rewards points expired after a set time period, in many programs after one year. Many programs eliminated expiration dates as a means to establish a competitive advantage. Unfortunately, such strategies are easily replicated and thus lead to many firms having to eliminate expiration dates to maintain competitive parity. Expiration dates traditionally limited the accrual of future liabilities (in the form of future rewards owed) and provide incentive to members to collect and utilize loyalty program points quickly and strategically eliminate lower frequency members from the program as their points expire. It is important to remember however that high frequency guests are not necessarily the most loyal and lower frequency guests can still develop long term, profitable relationships with businesses and spread positive word of mouth to potential consumers. As a result, management must strategically consider expiration dates and the potential to be placed at a competitive disadvantage in relation to hospitality loyalty program industry standards.

Loyalty programs were initially adopted by the hospitality industry to utilize perishable inventory during low seasons, especially within the airline industry. Blackout dates, dates when rewards for free hotel stays or flights could not be redeemed, were established to ensure unused inventory would be utilized and not inventory with high demand by paying customers. Again, as a ploy to establish competitive advantages among loyalty programs, hospitality firms eliminated blackout dates. While increasing flexibility and further satisfying guests, this strategy also increases the opportunity costs of programs as customers who are willing to pay full price a product begin given as a reward to others. If management decide to eliminate blackout dates it is critical to calculate the opportunity cost of turning away customers on sell out situations. For businesses with very stable demand and limited sell out situations, eliminating blackout dates is a

very effective way to provide flexibility and value while differentiating loyalty programs from the competition.

### ***Flexible Points Collection.***

Increasing the flexibility of point collection is not only a means of providing value to guests but also increases revenue for the business. For example, firms who provide a punch for each coffee purchased are limiting loyalty stimulation to coffee purchases. Providing stamps for every \$5 spent can expose consumers to a variety of products and stimulate spending. In a similar manner, many hotels and resorts now provide 1 point per \$10 spent not only on the room but also food and beverage, spas, gift cards and other amenities encouraging individuals to spend more at the property.

Another form of flexible collection is offering points for utilizing preferred partners (i.e.; car rental companies) or reward credit cards. Parent companies on average are compensated 1.7 cents per point by credit card companies for spending on a rewards credit card and thus not only create flexibility and value for consumers in collecting points but also are a source of revenue.

### ***Flexible Rewards Redemption.***

Loyalty programs were initiated with limited technology and were mostly administered manually. With the rapid advancement in technology, consumers have high expectations for loyalty programs to operate seamlessly and instantly, especially in regards to redeeming points. Online rewards catalogues, rewards statements and even instant points redemption are all means of increasing the flexibility of reward redemption. Programs which require advance planning and long processing times for redeeming rewards will be at a disadvantage within a highly

competitive hospitality loyalty program industry. If firms do not have the technological capability to provide flexible redemptions, management should consider utilizing a more simplistic loyalty program type (i.e.; self administered punch card).

Nunes and Dreze (2006) researched the value of redemption rewards and found that consumers' perceived value of rewards is higher when they are permitted to purchase rewards for points as well as cash, allowing consumers to attain higher rewards thresholds faster, at no cost to the business. While such offerings render a loyalty program complex for businesses to administer, firms should strategically measure the incremental value obtained by guests via satisfaction surveys or focus groups.

### **Data Mining.**

Researchers remain conflicted regarding whether attitudinal loyalty (emotional commitment) is more important than the behavioural actions of repurchasing (behavioural loyalty), however all agree that all loyalty programs, regardless of structure, type, breadth and complexity are a critical source of valuable information for a business. The levels of data mining can vary and while it is important for all firms to engage in some form of data collection, businesses must analyze the costs associated and benefits derived.

Simpler, non-automated loyalty programs can still partake in data mining, for example by tracking the average turn around between issuing a rewards card and reward redemptions. Tracking postal codes of members can allow firms to analyze the areas and distances consumers travel for the product and provide valuable market demographics. Determining the number of frequent guest cards distributed can allow management to determine the retention rates of loyalty program members and evaluate effectiveness. These are all low cost initiatives which can still

provide valuable information for a business looking to make strategic marketing and operational decisions.

Large multi-national hospitality firms have invested in costly and extensive business intelligence to obtain information about consumers in an effort to render loyalty programs more effective and improve the business' relationship marketing strategy. For such firms it is important to ensure the information and data collected is transformed into action items and implemented at the property level for consumers to benefit from such relationship building tactics. For example, all hotels have the ability to track the most profitable guests however if this information is not shared with front line staff, all top tier guests will be provided with the same service standards and render data mining activities useless.

### **Measurement Metrics**

The success of various loyalty programs must be evaluated based on their ability to stimulate loyalty and repeat patronage. Three major areas of evaluation exist, behavioural, attitudinal and financial measures, all of which should be balanced and considered in evaluating loyalty programs.

#### **Behavioural Measures.**

Behavioural measures of loyalty involve considering the actions of consumers. Loyalty is an emotional commitment and while many consumers have preferences and loyal intentions, businesses rely on the behavioural outcomes of such sentiments. Many of the data mining tactics for type II loyalty programs (i.e.; punch card turnover speed, redemption rates etc) are simple behavioural metrics which can be applied to all loyalty programs. Businesses which focus on

revenue generation and monetary measures look at share of wallet and average cheque as behavioural measurements of loyalty. A discussion of various behavioural measures follows.

### ***Share of Wallet.***

A firm's share of wallet measures a consumer's level of spending at the firm in relation to the entire product category. This behavioural measure will evaluate whether consumers' are actually demonstrating increased loyalty (via increased patronage) to the specific company. It is important not to compare members' share of wallet to non-members as non-members are most probably less loyal or not heavy enough users of the product to justify loyalty program membership. Within loyalty programs, higher share of wallet figures can easily identify the most profitable loyalty program member segments.

A disadvantage of share of wallet as a loyalty measurement metric is the reliance on consumers self reporting their actual spending on the product category. To address this weakness, many firms measure fluctuations in overall market share to evaluate the impact of loyalty programs however this does not account for a wide array of intervening variables especially for larger chains operating in multiple markets.

### ***Average Cheque.***

Another behavioural gauge often utilized is average cheque. For example, Subway has found that average cheque among rewards program members is substantially higher than non-members (Nunes & Dreze, 2006). A major weakness of the average cheque metric is that loyalty program members may already have been more loyal and higher volume users of the product who are now merely being rewarded for their patronage and thus it does not measure the ability of the program to stimulate loyalty. Calculating average cheque among members is a simple

behavioural computation and important to ensure members are still profitable customers due to the increased cost of serving these customers due to the cost of rewards and program administration. Calculating average cheque also requires tracking the number of visits by members, a very important behavioural measurement metric, especially over time. Consumers who increase patronage can be identified as increasingly loyal.

### ***Active Membership.***

Membership base is not a strong behavioural metric due to issues such as polygamous loyalty and increased administrative expenses associated with larger membership bases. A high active membership ratio is a means to measure the effectiveness of programs overtime. Programs which do not maintain competitive offerings will experience decreased active memberships as consumers may have enrolled in the program, but no longer participate due to a lack of value obtained from the program.

### **Attitudinal Metrics.**

Loyalty is an emotional bond and relationship and thus researchers argue must be measured using attitudinal measures. Guest satisfaction surveys targeting loyalty program members are one way to measure not only guest satisfaction with the program but also with the overall product. Satisfaction scores can be compared to non-members to evaluate whether members truly feel a bond to the company or merely appreciate being rewarded for their patronage.

Referral programs are another means to ensure customers have established an emotional bond with the company. Many firms offer extra points and other rewards for referring a friend to

the program or provide two-for-one coupons to allow members to introduce a friend to the product offering. While many deal savvy customers are eager for the reward, sociologists would argue that consumers would not refer a friend to a product which they were not completely satisfied with. Such programs also expose future customers to the product.

Many websites, blogs and programs are established to help consumers find the best loyalty program deal to meet consumer needs and provide the quickest (and cheapest) rewards. These are excellent forms of consumer feedback with many becoming increasingly formalized. For example, the Frequent Traveler Awards allow travellers to vote for their preferred programs (The Frequent Traveller Education Foundation, 2011). Exploring such feedback and awards is a critical measure of consumers' attitudes towards not only the program but also the overall product offering.

The major weakness of attitudinal metrics is social desirability bias. Consumers will be reluctant to confess that they enrol in loyalty programs merely for the rewards with little appreciation with the product or intent to return as this violates the principles of the reciprocal action theory. Attitudinal commitment also does not necessarily translate into behavioural loyalty. Many researchers argue that while consumers may have strong feelings and sentiments towards a specific brand or product, consumers will not purchase beyond their needs, or if it is inconvenient for the guest, rendering attitudinal loyalty fruitless. For example, a loyal Hilton Honours program member would stay at a Marriott property if a full service property is not in proximity to the event they are attending.

**Financial Metrics.**

As in all business decisions, a budget for a loyalty program is critical in order to decide which strategies can be employed. The budget can be utilized as a guideline to ensure the effective utilization of marketing expenditures and ensure management do not continue investing in an unprofitable endeavour.

In evaluating loyalty programs, many unknown variables exist and assumptions must be made and as a result it is difficult to financially benchmark a loyalty program against others. It is important for firms to maintain consistency in reporting functions and keep careful financial records of the loyalty program to ensure financial stability and success over time to track any changes and fluctuations in loyalty program effectiveness overtime.

***Direct and Indirect Costs of the Program.***

It is critical to measure the overall cost of the program, however many firms merely consider the direct costs of rewards and administration of the program and fail to consider the indirect costs of the program. A major indirect cost which is often disregarded is the opportunity cost of the investment; the potential return if the money were invested in an alternative initiative such as mass media or product improvements. Also within the hospitality industry, labour is a major expense which cannot be overlooked. Many intangible and prestigious rewards are provided by employees and require time and labour cost, such as special gift bags, prepares key packets etc. and thus increased labour expense to administer programs must be considered. The overall cost of the program can be used to calculate the cost per member. It is important to ensure that the cost of serving loyalty program members does not exceed the value of their loyalty to the business in terms of incremental revenues and word of mouth advertising.

***Return on Investment.***

Utilizing the incremental share of wallet and overall cost per customer, managers can roughly estimate the return on investment per customer of the program to ensure profitability. Larger membership bases may increase revenues, however to a point of diminishing returns as the number of customers who can be made increasingly loyal is not infinite. Eventually, identifying such customers will prove to be more costly than the increased revenue realized. Minimal incremental sales from many customers may not be as valuable as focusing on fewer customers and stimulating true loyalty and significant increases in revenue. Firms must track the return on investment not only by customer but for the program as a whole to identify at which point the program has peaked in terms of targeting and rewarding loyal and profitable customers to then minimize incremental investments into the program.

***Break Even Analysis.***

Capizzi and Ferguson (2005) encourage calculating the breakeven point for a loyalty program in order to understand the effectiveness over time. Breakeven analysis establishes the maximum amount can be given to guests in order to stimulate loyalty before the program is unprofitable. Consumers have become very loyalty program savvy and managers must ensure that the cost centers within loyalty programs (administration, reward redemption and intangible benefits) remain at par (or below) the incremental revenue realized via the loyalty program and members. In order to maintain competitiveness, it is critical for managers to know how much can be invested into the project to maintain profitability. Intercontinental Hotel Groups (IHG) witnessed a 6% decrease in the breakeven point (and thus increased contribution margin) of serving members due to a higher willingness to pay (on average 7-10%) and significantly higher

tendency to utilize the cost effective website for booking (Berman, 2006). IHG has not only realized the increased revenue generating potential of loyalty program members but also the maximum increase in costs which the program can effectively bare.

Existing research provides valuable insight into effective (and ineffective) loyalty program strategies which can be applied by management, however as in all business strategies, many elements of loyalty programs are trial and error. Consequently, careful measurement and evaluation of loyalty programs is not only important but must be undertaken periodically to monitor any shifts in consumer behaviour and within the industry.

## **Conclusion**

Evaluating loyalty program effectiveness involves much more than maintaining competitive parity and reacting to the rising demands of consumers. Maintaining costs while ensuring the program is indeed fostering customer relationships are critical in ensuring loyalty programs are a strong investment decision within the highly competitive hospitality industry. Management must take a more proactive approach to understanding not only consumer needs and desires but also how the many elements of loyalty programs contribute to increasing the perceived value of a company's unique product offering.

Exploring loyalty program research as well as following trends within the industry can uncover many potential changes to be made to an existing loyalty program; however management must be careful in adopting any changes and avoid constant alterations to the program. A major drawback and customer frustration with loyalty programs is program complexity which is furthered complicated by constant changes and unappreciated by consumers, which decrease the perceived value of the program and the consequently the product.

Changes in loyalty programs are also very costly, as seen by the \$100 million investment by Southwest Airlines to revamp their frequent flyer program to maintain competitiveness among business travellers and increase the revenue generating potential of the program (Jennings Moss, 2011). The short term investment and potential displeasure of loyalty program modifications must be carefully balanced with the long term revenue generating potential of all loyalty program initiatives.

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## Appendices

### Appendix A – Loyalty Program Typology

**FIGURE I.** A Typology of Loyalty Program Types

Program Type	Characteristics of Program	Example
<b>Type 1:</b> Members receive additional discount at register	<ul style="list-style-type: none"> <li>• Membership open to all customers</li> <li>• Clerk will swipe discount card if member forgets or does not have card</li> <li>• Each member receives the same discount regardless of purchase history</li> <li>• Firm has no information base on customer name, demographics, or purchase history</li> <li>• There is no targeted communications directed at members</li> </ul>	Supermarket programs
<b>Type 2:</b> Members receive 1 free when they purchase n units	<ul style="list-style-type: none"> <li>• Membership open to all customers</li> <li>• Firm does not maintain a customer database linking purchases to specific customers</li> </ul>	Local car wash, nail salon, SuperCuts, Airport FastPark, PETCO
<b>Type 3:</b> Members receive rebates or points based on cumulative purchases	<ul style="list-style-type: none"> <li>• Seeks to get members to spend enough to receive qualifying discount</li> </ul>	Airlines, hotels, credit card programs, Staples, Office Depot
<b>Type 4:</b> Members receive targeted offers and mailings	<ul style="list-style-type: none"> <li>• Members are divided into segments based on their purchase history</li> <li>• Requires a comprehensive customer database of customer demographics and purchase history</li> </ul>	Tesco, Dorothy Lane Markets, Wakefern's ShopRite, Giant Eagle Supermarkets, Harris Teeter, Winn-Dixie, Harrah's, Hallmark

Berman, Barry. (2006, Fall). Developing an Effective Customer Loyalty Program. Diagram. *California Management Review*, 49(1), 125. Retrieved May 7<sup>th</sup>, 2011, from Academic Search Premiere.

**Appendix B - Loyalty Emotions by Market Segment**

<b>Emotion</b>	<b>Economy</b>	<b>Mid-price</b>	<b>Upscale</b>	<b>Luxury</b>	<b>Extended stay</b>
Comfortable	◆	◆	◆		◆
Content	◆				
Elegant					
Entertained					
Hip or cool					
Important			◆		
Inspired					
Pampered				◆	
Practical	◆				◆
Relaxed				◆	
Respected					◆
Secure		◆			
Sophisticated				◆	
Welcome		◆	◆		

Barskey, J., & Nash, L. (2002). Loyalty emotions by market segment. Table. *Cornell Hotel and Restaurant Administration Quarterly*, 43(1), 39. Retrieved May 7<sup>th</sup>, 2011, from Academic Search Premiere.

**Appendix C – Hospitality Loyalty Program Effectiveness Evaluation Rubric**

**Hospitality Loyalty Program Effectives Evaluation Rubric**

*Below is an evaluation rubric tool to be used to strategically analyze loyalty program offerings and to identify potential areas of improvement to further stimulate loyalty. Each businesses must consider their unique product offerings and budget concerns to balance loyalty program tradeoffs to ensure long term sustainability and profitability of the program.*

**A – Business Strategy**

Identify the overall objectives of the business and how the business intends to be profitable.

*Product Offering:*

High involvement      Vs      Low Involvement

*Is it consistent with the overall business strategy for a low involvement product to be augmented into a high involvement brand?*

Luxury              Vs      Utilitarian

*Target consumer*

Describe the ‘typical customer’

Age

Gender

Income

Purpose of patronage (i.e.; business or pleasure)

Price sensitivity (High/Low)

Core competencies of the business:

*In completing the remainder of the evaluation, consider whether the various initiatives meet the needs of the above identified customers and if the business has the capabilities to efficiently execute the chosen elements of the loyalty program.*

**B – Loyalty Program Strategy**

Loyalty program initiatives which foster:

Attitudinal loyalty (i.e.; priority check in, remember guest names)

Behavioural loyalty (i.e.; valued rewards, 2 for 1 coupons)

*Are the above initiatives contradictory?*

Revenue generating initiatives to:

Increase number of visits

OR:

Increase average cheque

What are the benefits to consumers for becoming members of the loyalty program?

*Are the initiatives above:*

- a) Able to stimulate loyalty to the business and build relationships with consumers*
- b) Are these initiatives consistent with the objectives of the business*

**C – Loyalty Program Type**

*Complete an evaluation of the strengths (to ensure they are being leveraged) and areas for potential improvement for your identified loyalty program type. Included below are only some potential solutions.*

**Type II - Volume Discount Program**

## Strengths

- Inexpensive
- Easy to administer
- Limited employee training

## Areas of improvement

- Incorporate data collection
  - Track addresses to identify key demographics
  - Turnover rate for rewards cards
- Increase exposure to business offerings
  - Provide variety of products as rewards and not merely free product which is already consumed
  - Discounts on other items for reward card members
- Limited ability to build emotional bonds and communication
  - Impose restrictions to build loyalty and not merely reward volume discounts
  - Email newsletter to support program
  - Intangible benefits for reward program members
- Compensate for total amount spent (not number of specific items) to increase consumption and product exposure

**Type III – Points Accumulation**

## Strengths

- Data Mining and application of information
- Increased reward variety which create value for guests

## Areas of improvement

- Complexity of 'points currency'
- Member security and privacy of personal information
- Employee training to leverage data collected

**Type IV – Targeted Communications**

Strengths

- Inexpensive
- Simple and convenient for guests

Areas of improvement – *must operate in conjunction with type II or III loyalty program to stimulate loyalty*

- Reward guests based on loyalty not merely short term promotions
- Mechanism to track guest patronage, not merely a newsletter
- Data collection
  - Collect email print outs to measure response rates and effectiveness of marketing campaigns

**D – Consumer Fit**

Do the benefits and rewards of the loyalty program meet the current needs of the target consumer?

Do the emotions derived from the product stimulate loyalty to the desired product category?

**E – Direct Versus Indirect Rewards**

High involvement product - direct rewards

- Direct rewards should add to the value proposition of the product
- Do rewards increase consumer exposure (and potential future spending) to the product?

Low involvement product – indirect rewards

- Do consumers value the program or the reward?
- Utilize indirect rewards as a long term loyalty strategy
- Direct rewards can be used to foster the relationship between the consumer and product

**F – Immediate versus Delayed Rewards**

List all rewards offered by the program (both tangible and intangible) and classify the reward as either immediate or delayed

*\* Consumers consider any reward provided instantly or up to the 4<sup>th</sup> visit as immediate rewards*

Reward	Immediate Reward		
	High/Low Magnitude	Reward Threshold	Perceived Value to Consumer

Reward	Delayed Rewards		
	High/Low Magnitude	Reward Threshold	Perceived Value to Consumer

Identify the magnitude of the reward as perceived by the consumer

*The perceived value of the actual reward, ideally in a dollar amount (i.e.; free room is valued at \$100 dollars) or high/low ranking for intangible rewards*

Identify the reward threshold (number of dollar or purchases to achieve reward) for the above rewards

**Evaluating the Above Tables:**

- Lower magnitude rewards should be immediate while higher magnitude rewards should be delayed
- Immediate reward thresholds should be relatively lower than delayed rewards thresholds
- Divide the value of the reward by the reward threshold to determine the perceived value of the reward to the consumer
  - o Must ensure the perceived value is a competitive offering within the product offering
  - o Perceived value must not be so low that the program and rewards are no longer motivating to consumers

**G – Prestige and Exclusivity**

## Enrolment strategy

Is enrolment open to all patrons or exclusive?

Is enrolment invitations based on consumer analysis or merely striving to increase membership base size?

Are consumers provided incentive to enrol immediately with no need to return in the future?

## Tiered Programs

Does the program offer tiers to provide additional prestige to loyal members? YES/NO

How many tiers are offered?

*Does the number of tiers adequately differentiate members yet minimize complexity and administrative expenses?*

Outline the precise differentiation among tiers

*Are these bases of differentiation of value to consumers?*

**H – Program Flexibility**

*The higher the level of flexibility incorporated into the program the more value consumers will derive from the program. The following initiatives all contribute to program flexibility.*

## Convenience

Membership card required? (Yes/No)

Can the membership number be retrieved utilizing easily recalled information?

## Points Flexibility

Ability to transfer airline and hotel points to partner companies

Coalitions allowing members to earn points at more than just one firm

Credit card program offering points for all credit card spending

No point expirations

No blackout dates (or limited blackout dates)

## Rewards Redemption

Online rewards catalogues and electronic rewards statements

Redemption time (how far in advance must members plan to utilize points)

Cash and points redemption option

## **I – Data Mining**

Do managers currently collect data?

- Demographic information
- Tracking purchase behaviour
- Member satisfaction and feedback

Is this data utilized to improve marketing initiatives?

Is this data utilized to improve operations?

Are employees empowered to utilize information to improve the customer experience?

## **J – Measurement Metrics**

### **Behavioural Measures**

- Share of wallet
- Average cheque
- Market share
- Active Membership Rate

### **Attitudinal Measures**

- Guest satisfaction surveys
- Referral programs
- Websites, blogs and loyalty program awards

### **Financial Metrics**

- Direct and indirect costs of the program
- Return on Investment of the loyalty program
- Break even analysis

*It is challenging to compare the above measurements to competitors or non-members due to variations in measurement and fundamental differences among members and non-members. It is most effective to continuously collect data and information which can be used to conduct a long term evaluation of the program.*