

LOYALTY SCHEMES

IMPACTS AND ANALYSIS

(VOLUME 1)

TANUJ AHUJA



Loyalty Schemes: Impacts and Analysis (Volume 1)

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Introduction to Customer Loyalty and Related Program

1.1 Problem Definition

Loyal customers, it is said, are worth striving for. They spread positive word-of-mouth, reduce defection rates, and amplify the purchase frequency, to name just a few examples. But what can be done to induce that loyalty? Can loyalty schemes help us to do so, and most importantly, under what circumstances, at what cost, and with what possible result?

Customer loyalty has become an increasingly important goal in retailing, as the industry in general is characterized by declining rates of consumer loyalty (Hoffmann 2008). Looking at Figure 1 listing the drivers causing these diminishing loyalty rates, it becomes clear that the proclamation of this trend is just a general assertion. Some retailers naturally do implement successful innovations (and thereby foster customer loyalty), while others fail with theirs. In any case, loyalty, at least when it goes hand in hand with profitability, is something that is always worth aiming for. For example, Reichheld & Seidensticker (2006) discovered that a 5% increase in loyalty can lead to a 25-200% boost in profits (see Chapter 2 for a more detailed view on customer loyalty).

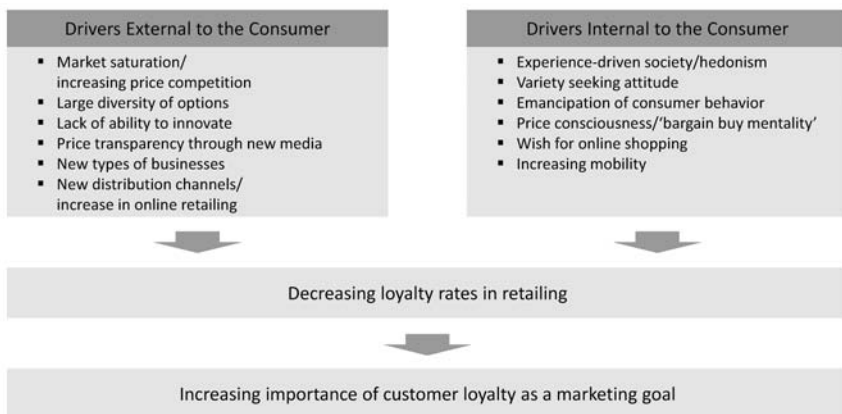


Figure 1: Drivers Causing a Decrease of Consumer Loyalty in Retailing

Source: Hoffmann (2008)

But can customer loyalty schemes, as their name suggests, really help to engender or enhance customer loyalty? Numerous retailers, service providers, and manufacturers have – some more successfully than others – attempted to establish or at least foster loyalty among their current and prospective customers with the help of such solutions. At the same time, a vast number of researchers have found interest in this topic, in an endeavor to evaluate the effects of these schemes, their effectiveness, and their efficiency. Still, customer loyalty schemes are, at least in their modern forms that enable companies to gather detailed transaction data, a comparatively recent and also constantly advancing development. Literature regarding this topic stems primarily from the second half of the 1990s and the new millennium, and while this field of research still appears to be a ‘hot topic,’ many questions remain unanswered or at least inconclusively answered.



Figure 2: Categories of Literature on Customer Loyalty Schemes

Broadly speaking, literature on loyalty programs can be distinguished into four areas: success impact, reward configuration, data capture and analysis, and general studies regarding a range of surrounding issues such as customer acceptance or usage frequency (see Figure 2). Among these groups, research on success impact appears particularly interesting, as existing studies on this subject have led to differing results. A detailed literature review of 23 publications has revealed a range of causes for this situation (see Chapter 2.3), with varying definitions of success, dissimilar program configurations in various industries, and diverse research methods allowing for the explanation of a good part of these irregularities. In summary, it may be noted that loyalty programs can indeed have a positive effect on customer behavior. The German fuel station chain Aral, for instance, attributed the rise in market share from 22.5% to 23% in the three months

following its partnership with the Payback coalition scheme in May 2006 exclusively to this decision (Payback 2007; personal communication, 21 July 2009). While it is anywhere between difficult and impossible to determine the accuracy of companies' claims regarding the success of their respective schemes from an outside perspective, it is at least noteworthy that a multitude of organizations have employed a loyalty program for an extended period of time and continue to make such favorable assertions.

Interestingly, among the 23 reviewed studies in the success research category, only one focused on the special type of program that Aral – the fuel station featured in the previous example – is also part of: loyalty coalitions. Still, no comparison with stand-alone programs was made. Up until now, academic literature has indeed neglected to deal with the question of how well these multi-partner programs really perform in comparison to stand-alone solutions. This is particularly noteworthy, as various authors have begun to praise loyalty coalitions as the next evolutionary step in customer loyalty schemes. Comments on this subject include the following:

- “According to Frequency Marketing Inc., there are 3 trends to watch for in card marketing in the new millennium: [...], and coalition programs” (Barlow 1999, p. 76)
- “Coalitions represent both the natural evolution and the future of loyalty marketing programs, both within the USA and abroad” (Capizzi & Ferguson 2005, p. 297)
- “The 22 major factors that will shape the future of customer loyalty: [...] 3. An explosion of loyalty coalitions and networks” (Clark 2006, p. 1)
- “The efficiencies inherent in coalition loyalty models [...] make coalitions the natural end-game for loyalty evolution” (Ferguson & Hlavinka 2006, p. 1 f.)

Without doubt, multi-partner solutions boast various advantages over stand-alone programs: administrative costs can be shared between the partner companies, a multitude of options for point collection and consequently faster redemption are hypothesized to result in higher customer interest, customers need to keep only one loyalty card in their wallet, the resulting pool of data is considerably richer, and moreover, large, nation-wide programs enable companies to quickly achieve a high penetration rate. On the other hand, for example, the partner companies' leeway for program design is limited, there is a danger that customers will develop loyalty towards the scheme and not the partner company, and it is also difficult to pilot such programs. For a majority of practitioners and academics, the advantages nevertheless seem to outweigh the disadvantages.

As far as the few pieces of literature on this topic are concerned, some ground is covered by studies from market research organizations (usually commissioned by coalition operators, however; e.g. TNS Emnid 2006 or GfK 2007), and in fact, some of the rare academic literature was also written by practitioners from research organizations (e.g. Capizzi & Ferguson 2005 or Ferguson & Hlavinka 2006). Next to a few current or former practitioners (e.g. Humby et al. 2008 or Clark & Clark 2009), the truly academic view on coalition schemes remains extremely limited, with only a handful of papers such as those by Sharp & Sharp (1997) or Lara & De Madariaga (2007). At best, authors with an academic background have mentioned examples of coalition schemes within studies of other aspects of loyalty schemes (e.g. Stone et al. 2004 referred to UK's Nectar coalition in a general evaluation of loyalty schemes or Rowley 2005 in a case study of Tesco's Clubcard). Scientific information on this topic is consequently scant, with unbiased, empirical evidence of the superiority of coalition schemes still outstanding.

1.2 Research Objective

Given these prophecies made with regard to the superiority of multi-partner schemes on the one hand, and the scarcity of work on this topic on the other hand, the decision was taken to primarily engage in (1) success research with (2) special focus given to the subject of coalition schemes. In addition, a general survey component will form part of this study in order to retrieve answers to a range of further questions that are expected to be relevant to practitioners.

Specifically, the following research questions have been singled out as the focus of this paper (see Figure 3 for a graphical illustration):

- How do coalition schemes perform in direct comparison with stand-alone solutions, or put in more concrete terms, what is the differential impact of these two loyalty program types (1) on a classical behavioral success indicator such as share-of-wallet and (2) on attitudinal loyalty measures?
- What dependencies and interrelationships exist between loyalty, program membership, and other variables often cited in connection with the subject (namely store satisfaction, membership in competing loyalty schemes, and effect of certain shopper characteristics)?
- What do loyalty executives think about these program types and what experiences have they gathered?
- What do members of these program types think about a whole range of questions revolving around different facets of this topic that might be relevant to practitioners (e.g. privacy concerns, exit barriers, program/reward attractiveness, redemption behavior, response to up- or cross-selling incentives, etc.)?

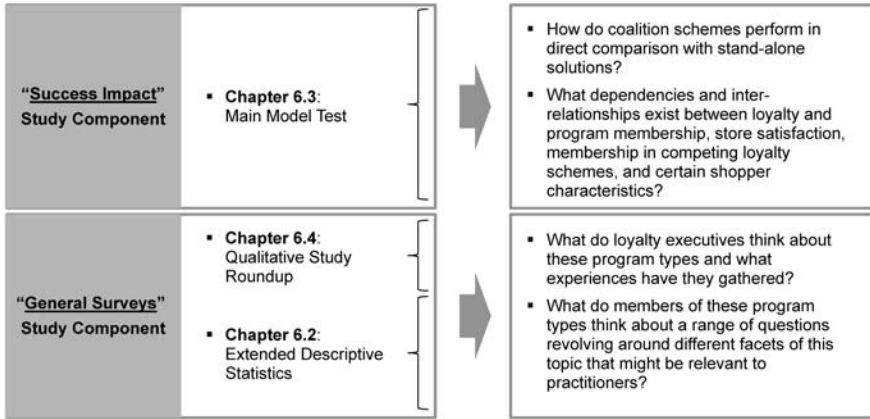


Figure 3: Research Questions and Where They are Evaluated Within This Paper

These questions shall be answered with data from a proprietary, two-pronged empirical investigation. Due to the lack of any sizable, nation-wide coalition program in Austria, Germany was selected as the place to conduct the study. To be precise, the focus will be set on the fuel retailing market, with Aral (as a partner company of *Payback* – Germany’s biggest multi-partner program) and Shell (with the nation’s major fuel station loyalty scheme *Clubsmart*) constituting two subjects of study which, being strong and similarly large competitors, ensure good comparability. This decision has been taken, following an analysis of all partner companies in Germany’s three major coalition programs and their comparable competitors with a stand-alone solution in place.

A customer survey will form the heart of this study, with questionnaires being distributed in person to participants at the point of sale, along with a postage-paid, self-addressed return envelope. In addition, explorative interviews with the management of Aral, Shell, and Loyalty Partner (the organization administrating the *Payback* coalition scheme) will precede this survey, in order to gather background information and to hear about these managers’ experiences with the two types of loyalty programs.

Finally, the comprehensive literature review preceding the empirical component is expected to give a good overview of the field of loyalty research, as well as both loyalty schemes in general and coalition schemes in particular. Next to summarizing, structuring, and critically evaluating the stream of previous publications on loyalty programs, it is the compilation of material on multi-partner programs that is expected to account for a noteworthy contribution to the body of literature.

1.3 Structure of This Paper

Chapter 1 has marked the starting point of this paper by providing a brief overview of the decision process that led to this paper's focus on loyalty scheme success research in connection with a comparison between coalition and stand-alone solutions.

Chapter 2 will primarily be dedicated to a review of the whole subject of loyalty research. A section on definitions will precede a reflection on pieces of literature dealing with the formation of loyalty, which in turn will be followed by a thorough evaluation of previous studies from the field of loyalty scheme success research.

Chapter 3 will revolve around a comprehensive overview of loyalty schemes. Beginning again with a segment on definitions, this section will also include the historical development and current spread of loyalty programs. This will be followed by a detailed illustration of the known loyalty scheme types as well as the different program characteristics that are commonly used as parameters in these categorizations. Thereafter, an excursion will be made on the value of data being generated by these programs, with a comparison of advantages and disadvantages idiosyncratic to such loyalty tools concluding this chapter.

Chapter 4 will form the end of the literature-centered segment of this paper, offering a synthesis of existing publications on coalition schemes. Hereby, a classification of multi-partner solutions will be compiled, differences to stand-alone programs exposed, and success factors relating to such operations highlighted. In addition, the limited information available on impact, spread, and customer perception will be screened and processed.

Chapter 5 will represent the opening to the empirical segment of this paper, whereby an overview of the qualitative and quantitative study components will first be given, followed by an illustration of the process of developing the study framework, corresponding hypotheses, and underlying theoretical basis. Eventually, a sub-section will be dedicated to the operationalization of the constructs used.

Chapter 6 will be dedicated to a discussion of the findings stemming from the empirical study. First, an overview of the sample and data cleansing processes will be given, followed by a section on descriptive statistics, the main model test, and a brief roundup of the qualitative component.

Chapter 7 will provide a finale to this paper by summarizing the study's most important findings, highlighting emanating managerial implications and elaborating on limitations of the study as well as suggestions for further research. Finally, a concluding, critical reflection of the research area in general will be given.

Customer Loyalty in Retail Business

“Napoleon Bonaparte, the most feared French commander of the early nineteenth century, achieved extraordinary results through the unrelenting loyalty of the soldiers under his command. Coming to the civilized world of the 21st century, we see Generals in the form of marketers striving to defend or capture market share with the help of a loyal customer base” (Kumar & Shah 2004, p. 318).

The concept of loyalty is nothing new and has received a significant amount of attention in customer research. Most examinations of loyalty tended to focus on consumer goods (brand loyalty) (Dick & Basu 1994), although the concept is of similar significance for industrial goods (vendor loyalty), services (service loyalty) and retailers (store loyalty). Since Dick & Basu’s assertion in the 1990s, the focus has broadened conspicuously, with more and more research dedicated to the latter forms of loyalty, and some even extending the view to the loyalty cards (card loyalty) themselves (Mauri 2003).

Regardless of the form of loyalty, loyal customers are certainly a valuable asset to any company, and various notable examples exist in research literature supporting this fact. It is, for instance, common marketing knowledge that winning over new customers is many times more expensive than keeping current ones. As a rule of thumb for many industries, 20% of customers are said to be responsible for 80% of the revenue (Reichheld & Sasser 1990, Reichheld 1996). Naturally then, it should be a priority for managers to prevent customers from defecting, particularly if they are important, profitable or even important *and* profitable. A more specific example discovered while exploring the connection between loyalty and growth, was that a 5% improvement of customer loyalty can lead to a 25-100% increase in profits (Reichheld & Seidensticker 2006). The authors also proved that those companies that had the highest level of customer loyalty were typically able to increase their turnover at double the rate their competitors could. Consequently, such companies exceeded their competitors’ performance at the stock market by a factor of 2.2 during the 1990s (Finnie & Randall 2002). A possible explanation for this is presented by Tellis (1988), as outlined by Oliver (1997). Using panel scanner data over a 20-week interval, Tellis (1988) explored the relative effects of advertising, brand on display, coupons, special promotions, long-term loyalty, and price on buying behavior. “Without question, loyalty is the strongest determinant of purchase behavior” (p. 142), the author concluded.

Loyalty, then, is something that makes good business sense. With some promoters of loyalty schemes claiming that they are even able to create or foster the growth of true attitudinal loyalty, this is a topic that needs to be addressed in the course of any paper dealing with the marketing instrument of loyalty programs. In the course of this chapter, a definition of loyalty will be given (Chapter 2.1) and the drivers of customer loyalty analyzed (Chapter 2.2). Following this introduction to loyalty research, the chapter will be concluded with a comprehensive review of loyalty scheme success research (Chapter 2.3).

2.1 Definition

A common theme found among most academic definition attempts is that of at least partial disaccord. Loyalty – like terms such as “emotion” or “satisfaction,” as Oliver (1997) rightfully pointed out – is easy to discuss in the course of casual conversation, but difficult to analyze for meaning in a scientific context. In the case of loyalty, Jacoby & Chestnut (1978) found 53 definitions in their analysis of the 1970s alone, with one being Jacoby & Kyner’s (1973) definition as a function of six necessary and collectively sufficient conditions. They stated that “brand loyalty is (1) the biased (i.e. nonrandom), (2) behavioral response (i.e. purchase), (3) expressed over time, (4) by some decision-making unit, (5) with respect to one or more alternative brands out of a set of such brands, and (6) is a function of psychological (decision-making, evaluative) processes” (p. 2). Despite the exclusive focus on brands, Jacoby & Kyner’s explanation contains most of the generally accepted characteristics of loyalty, but lacks the important factor of external influence. A more recent, and arguably more elegant definition is that of Oliver (1997), who suggested that “customer loyalty is 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 behavior” (p. 392).

While minor details might be added to contribute to universal applicability, this definition comes very close to what appears up-to-date in the context of today’s state of research. Based on Oliver, for the purpose of evaluating the concept of loyalty later on in this paper, the following more comprehensive definition is suggested:

Customer loyalty is a deeply held commitment to a product, service, store, or any other aspect of an organization that causes the customer to rebuy or repatronize the organization’s product, service, or store consistently in the future, despite marketing efforts or other external influences having the potential to cause switching behavior.

2.1.1 Historical Development of the Loyalty Definition

The roots of loyalty research date back to the 1920s, when Copeland (1923) first dealt with the question of brand repeat purchase behavior. Over time, the narrow focus on brands gradually shifted to a broader view on relationships between customers and companies, but models remained largely *behavioral* in nature (Homburg & Bruhn 2008). In that regard, the early 1970s marked an important turning point in loyalty research, following the contributions of Day (1969), Jacoby & Olsen (1970), and Jacoby & Kyner (1973). As Dick & Basu (1994) pointed out, brand loyalty research used to rely on behavioral measures like proportion of purchase or purchase frequency, for example. The problem with this type of measurement is that research based on pure observation of activities obviously misses out on the factors that underlie the customer's purchases. Repeat purchase of a certain brand could be influenced by a lack of choice at a store with a limited range of articles, a stock-out, or even variety seeking behavior. Behavioral measures alone, Jacoby & Chestnut (1978) criticized, were thus inadequate to explain the concept of loyalty. Loyalty was reconsidered to be more than just the simple repeated patronization of a store.

Day (1969) emphasized that it is the internal disposition of the customer that drives loyalty and proposed a shift to the combination of *behavioral and attitudinal* loyalty in loyalty research. Jacoby & Chestnut (1978) theorized that true single brand loyalty of a consumer could be present only if three conditions persisted: belief (i.e. the cognitive dimension), affection (i.e. the attitudinal aspect), and intention (i.e. the conative element). The consumer thus needed to (1) believe that the brand information he has is superior to that of competitive brands, (2) have a clearly higher degree of affective preference for the specific brand, and (3) must have the intention to purchase the brand in an upcoming buying decision (Oliver 1997).

This reorientation towards the analysis of loyalty through a more detailed description of cognitive activities manifested itself in the following decades, and loyalty was eventually accepted to be “a function of psychological (decision-making, evaluative) processes” (Jacoby & Chestnut 1978, p. 2). Today, it is widely accepted that this conclusion needs to be taken into account for any type of research focused on loyalty in its true sense.

2.1.2 An Attempt at Pinpointing the Terms

A plethora of terms surrounds the concept of customer loyalty and its management by organizations. Customer relationship management (CRM), loyalty marketing, relationship marketing, retention marketing, database marketing, micromarketing,

direct marketing, or 1-to-1 marketing are all but a few examples. Indeed, whatever term you start from, a situation parallel to that of defining loyalty arises. Focusing on relationship marketing literature, for example, Harker (1999) made out 28 definitions. Also dealing with the vast number of terms and definitions from the viewpoint of relationship marketing, Egan (2004) concluded that many of these are merely “relational variations [which] describe a particular or closely associated aspect of relationship marketing philosophy rather than necessarily a holistic concept [...]. Others are associate concepts that may be seen to overlap with relationship marketing in some way” (p. 20). While direct marketing, micromarketing, 1-to-1 marketing, and database marketing thus do mean vaguely the same thing (as a database is paramount to direct/micro/1-to-1 marketing), Egan argued that they could not be used interchangeably with the term relationship marketing, as they, despite sharing several relational strategies and tactics, are more transactional than relational in nature (see e.g. Berry 1983, Dwyer et al. 1987, Grönroos 1994, Peck et al. 1999, or Ryals 2005 for background on the development of relationship marketing as a comparatively new paradigm in the marketing sciences).

CRM, then, is a term with a heavy focus on its technological aspect as a means to executing loyalty marketing (Dowling 2002; see e.g. Anderson et al. 2007 for an overview of CRM in retailing) and retention marketing as compared to loyalty marketing is a somewhat broader term with respect to its measures towards reducing customer defection, but a narrower concept in the sense that it aims at current customers only (Oggenfuss 1992). All in all, relationship marketing and loyalty marketing are probably closest to what could be called umbrella terms. As far as the difference between these two is concerned, one could argue that relationships might exist even without loyalty (e.g. in the form of simple behavior), while loyalty marketing is oriented exclusively towards creating true psychological commitment.

Several of these terms certainly seem to give the impression that they mean the same, at least to such a large extent that it seems unnecessary to coin a new term (were it not for authors in need of a novel title for their publication). The rough distinction presented in this chapter ought to suffice for this paper, bearing in mind that the intention of virtually all these concepts is the creation or development of what is commonly referred to as loyalty in the literature on the subject (Duffy 2003). What needs to be noted, however, is that some of these concepts do not necessarily distinguish between behavioral and attitudinal loyalty.

2.2 Exploring the Emergence of Loyalty

2.2.1 Classifying the Reasons for Loyalty Formation

Numerous possible causes for repurchase behavior exist and each is characterized by a different loyalty background. To better distinguish between the two categories of behavioral and attitudinal loyalty, it is important to differentiate between the underlying factors. This chapter attempts to provide an overview of existing typologies. Few of them are explicitly founded in theory, but they are nevertheless helpful in getting accustomed to the topic of customer loyalty, as they can be considered preliminary stages of a loyalty theory (Diller 1996). Various attempts to group the numerous causes exist, with German literature providing a few notable examples.

Meyer & Oevermann (1995) made out five fundamental causes for relationships between a customer and an organization:

- Psychological factors
- Situational factors
- Legal factors
- Economic factors
- Technological factors

Among these five elements, only psychological factors are likely to include attitudinal aspects. Situational causes like convenience, stock-outs, or special promotions are much more likely to influence pure behavioral loyalty. Likewise, legal factors such as contractual obligations, economic reasons like high costs of substitution, or technological factors such as a lock-in created by the inefficient transition period during the shift to a new software vendor can hardly be viewed as a form of attitudinal loyalty. Even though it might be argued that reasons related to technology are not very different from economic causes, this basic categorization does serve the purpose of revealing the nuances underlying a repurchase decision.

In a similar approach, Hill & Alexander (2006) distinguished five variables that lead to some form of loyalty. In the following enumeration, they were sorted in degree of allegiance from low to high:

- Monopolies
- Habit
- Cost of change
- Incentives
- Commitment

At a more simplified level, Homburg & Bruhn (2008) suggested a categorization into habitual, voluntary and involuntary relationship drivers. Like other basic categorization attempts, this proposition seems theoretically sound, and one could even attempt to merge other classifications such as those distinguished by Meyer & Oevermann (1995) into them in a mutually exclusive and collectively exhaustive manner.

Diller (1996) focused on four of the numerous possible antecedents to relationships. The following examples were selected to demonstrate how a variation in the degree of these antecedents (high vs. low; plus “bought” in the case of commitment) results in different types of relationships, *despite the relationship being intense in all cases*:

- **Involvement** relates to the customer’s readiness to absorb and process information and signifies a construct fundamental to any research on customer behavior (Trommsdorff 2004). Diller (1996) argued that beyond its significant impact on purchase behavior and information handling, the extent of involvement of a customer also determines his readiness to form a relationship with a business partner. The case of an intense relationship coupled with a high level of involvement is what Diller called “hot customer relation” (i.e. a relationship characterized by enthusiasm), as opposed to “cold customer relation” (i.e. a relationship despite indifference) in the case that an intense relationship meets a low level of involvement.
- Likewise, varying degrees of **commitment** can lead to different kinds of relationship. If an intense relationship is coupled with a low level of commitment, an “involuntary relation” arises (e.g. in the case of a monopoly in a certain sector), while a “functional relation” would exist in a case where the supplier has “bought” commitment from the customer by offering a sufficient amount of value (i.e. whenever the customer voluntarily enters a business relationship, but no attitudinal loyalty is present). Eventually, if the relationship is intense and commitment is high, a “truly voluntary relation” sets in (i.e. loyalty in its attitudinal sense).
- Despite being a possible consequence of a relationship, **trust** can be viewed as a significant antecedent to relationships as well. It creates harmony and stability and helps to oppose complexity and uncertainty, to name just a few examples. When an intense relationship meets a low level of trust, Diller expected a “relation on reserve” to persist, while a “liaison” might be present in the case of a high level of trust.
- Finally, **satisfaction** is the key variable that has probably received the most attention in literature as a potential relationship driver (see e.g. Oliver 1997 or Kumar & Reinartz 2006). In an intense relationship, Diller (1996) expected

one of two outcomes: either a “hollowed-out relation” in the case of low satisfaction or an “endorsed relation” in the case of high satisfaction.

2.2.2 The S-O-R Model as a Way Out

Chapter 2.2.1 makes it evident that there is no even rudimentary consensus in literature on a structure by which to categorize the reasons for loyalty, and indeed, the whole process from influencing factors to the type of loyalty created lacks an acknowledged theory. Despite his criticism of the graphical presentation of existing models describing this process (which he called “a pipe-fitters nightmare” – a look into Howard & Osterlund 1973, for example, will clarify why), Jacoby (2002) made several noteworthy, further-reaching observations: they are arbitrary to a large extent in the way that variables are categorized, relationships drawn up, and indeed in the way that the variables are chosen in the first place. Furthermore, a clear designation to a particular category is not always clear or even possible. Most importantly, however, authors have failed to build their models on prior knowledge in the way that science is commonly understood. “At the very least, the current state of affairs makes it unnecessarily difficult to compare and contrast the various models, or to identify the unique contributions and deficiencies” (p. 53), Jacoby noted.

This needs to be kept in mind when considering the stimulus-organism-response (S-O-R) model as a way to bring some kind of structure to the multitude of models prevailing in the literature, trying to explain one aspect or another in the overall process from stimuli to output. In fact, within this paper it should be regarded as no more than a tool to structure this chapter, and not as what could be considered yet another model. Variables were chosen in a comprehensive, but nevertheless exemplary manner. The way they were assigned to the three boxes stimuli, organism, and response is not without reason, but it would be arguable that a particular variable could be placed in another, into several, or even outside these boxes. The way that relationships are drawn is based on the original S-O-R paradigm, and is thereby exposed to the prevailing criticism Jacoby highlighted. The reason it was still chosen as a model in this paper is, aside from its ability to provide a good overview (and because its purpose within this paper is limited to just that), that it is widely accepted and still firmly rooted in business curricula.

Historically, the S-O-R model emanated from a more recent form of behaviorism. In its original version, behaviorism dates back to a classic of psychological history, Watson’s (1913) “Psychology as the Behaviorist Views it,” and has roots that can be traced back even further to Ivan Petrovich Pavlov’s salivating dog.

Watson's model, and indeed most developments following up to the 1960s (including the notable works of authors such as Skinner 1938 or Hull 1966 [first published in 1943]), were simple input-output ($I \rightarrow O$) models in that they completely disregarded factors internal to the individual (Jacoby 2002). These models were then outdated by what Jacoby called 2nd generation models. Sometimes referred to as neobehaviorism, these models began to embed the organism as part of the theory, and eventually became known as the S-O-R paradigm, or S-O-R model (Houston & Rothschild 1977, Slama & Tashchian 1987). Stimulus \rightarrow organism \rightarrow response became the new mantra, expanding the old stimulus (i.e. input) \rightarrow response (i.e. output) idea.

Figure 1 provides an overview of a possible way to view the steps from influencing factors to the generation of a particular kind of loyalty as one of several possible responses emerging from the individual.

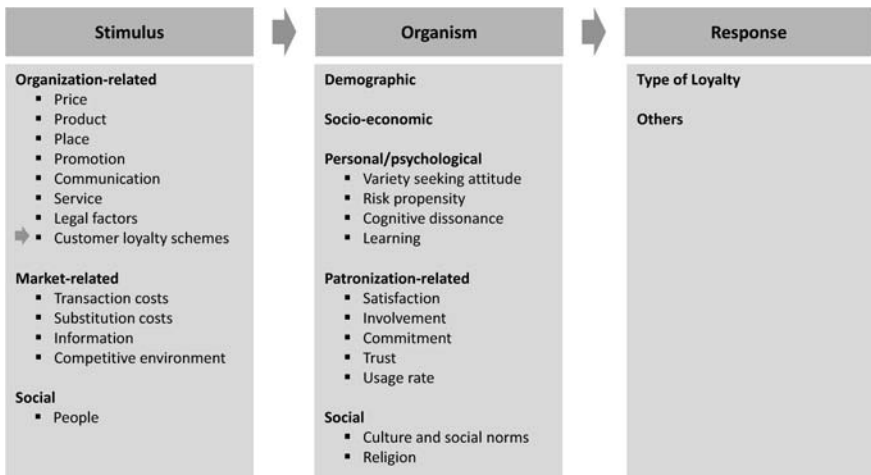


Figure 4: The S-O-R Model Applied to Customer Loyalty

Source: Howard & Osterlund (1973), Straßburger (1991), Engel et al. (1995), Meyer & Oevermann (1995), Diller (1996), Sheth et al. (1999), Jacoby (2002), Pan & Zinkhan (2006), Hill & Alexander (2006), Hoyer & MacInnis (2007), Kuß & Tomczak (2007), Homburg & Bruhn (2008)

1) Stimulus

For the purpose of this paper, stimuli were defined as influences (and consequently potential drivers of loyalty) that stem from outside the organism. A lot of classic models use a different approach by adding several factors from the organism box to the stimulus category (see e.g. Howard & Osterlund 1973, Straßburger 1991,

Hoyer & MacInnis 2007). In the case of this paper, however, it is argued that they find a more harmonious fit in the organism segment, which will be discussed in the following section.

A literature review helped to determine the various elements that were taken into account as an external stimulus by one model or the other. These were then categorized into the following three groups: organization-related (i.e. containing all factors influenced by the organization), market-related (i.e. made up of influences stemming from the market), and social (i.e. referring to variables of social nature which exert influence from outside the individual).

- Organization-related:
 - **Price** is probably one of the more obvious drivers leading to some form of loyalty.
 - **Product** refers, for example, to the quality or specific value-add that makes customers buy it.
 - **Place** concerns retail channels, geographical location, and convenience.
 - **Promotion** deals with special offers to the customer, whether or not they are price-related.
 - **Communication** relates to the quality of communication attempts of the organization with the consumer. These could include high-quality service centers, well-made direct mailings, or the opportunity for customers to be integrated into the product development process.
 - **Service** describes the quality of a performed service (as opposed to the quality of products), or that of customer service, other than that contained in the communication category.
 - **Legal factors** could, for instance, exist when a contract limits the customer in his alternative seeking behavior.
 - **Customer loyalty schemes**, the focus of this paper, are associated with the use of this marketing instrument as a driver of loyalty.
- Market-related:
 - **Transaction costs** are, according to transaction cost theory, also a driver of buying behavior.
 - **Substitution costs** have an impact on repurchase behavior, as they reduce the probability of customers defecting.
 - **Information** relates to intelligence coming from the market (e.g. product tests) that cannot be controlled by the organization.
 - **Competition** is another important factor that sways buying behavior. The presence, structure, and intensity of any competitive offering or other action will naturally have influence on customers involved in their purchase decision.

- **Social:**
 - **People** are a notable example of social influence coming from the buyer's surrounding. This kind of influence comes from outside the organism (e.g. in the form of a friend's opinion or parental advice), as opposed to culture or religion, which can be seen as being anchored within the individual.

2) *Organism*

Factors listed in the organism box are those variables associated with the individual that determine how external stimuli are processed. As mentioned before, several authors consider these to be stimuli – internal ones, but stimuli nonetheless.

It is argued that once factors such as social class, ethnicity, culture, or religion have become part of the individual, they should be considered internal to the organism. A possible explanation for the difficulty in classifying these factors as either stimulus or organism is that association with any of these categories depends on how far these factors are internalized. If, for instance, an individual becomes religious at a late stage in life (e.g. following exposure to Buddhism during a journey to Tibet), religion might at first be more of an external stimulus to behavior. If, however, a person is born into a Buddhist family, he is exposed to religion from early life and likely to have truly internalized it sooner. What makes it so hard to draw the line, is that this transition from external stimulus to internal characteristic (i.e. “true religious belief” in this case), is likely to be one marked by a more or less continuous transition.

Ascribed to the organism category are the following five categories: demographic, socioeconomic, personal/psychological, patronization-related, and social.

- **Demographic:**
 - **Demographic** variables refer to the composition and development of the population (e.g. characteristics such as age or gender).
- **Socio-economic:**
 - **Socio-economic** factors describe the relationship between economic activities and social life (e.g. income, education, or profession).
- **Personal/psychological:**
 - **Variety seeking** attitude is related to the consumer's desire for change.
 - **Risk propensity** means the individual's tendency to take chances when deviating from the proven path.
 - **Cognitive dissonance** is a state of mind that humans are theorized to be trying to avoid. Disloyalty to a product, for example, bears the risk of creating such cognitive dissonance through potential dissatisfaction.

- **Learning** refers to learnt behavior. That promise of rewards leads to conditioned behavior is a prominent example of instrumental conditioning (a form of learning that will be discussed in Chapter 5.3.4).
- Patronization-related:
 - **Satisfaction** is often considered to be the most significant driver of customer loyalty (see e.g. Oliver 1997, Homburg 2006, or Kumar & Reinartz 2006 for further information).
 - **Involvement** is commonly agreed to be a concept central to the organism. The readiness to absorb and process information has been proven crucial to the development of loyalty.
 - **Commitment** to an organization, store, product or service is also considered to impact customer behavior.
 - **Trust** is a further factor related to products, services, or stores that will sway the purchase decision process of the consumer.
 - **Usage rate** is the final patronization-related factor, resulting from customers' different needs and preferences, leading to different usage rates. A higher usage rate of a product, for example, will most likely expose its strengths and weaknesses to a greater extent, and involvement might be increased.
- Social:
 - **Culture and social norm** (i.e. the way of life for an entire society) exert influence on the decision process of an individual if internalized to a large enough degree. Otherwise, influence might persist as a pure external stimulus.
 - **Religion** can be of significance similar to that of culture and social norm, once it has become part of the individual.

3) Response

Finally, having dealt with influencing factors as well as the way consumers process them, notable examinations of the response “loyalty” shall be presented. One way of categorizing loyalty is offered by Plinke (1989), who, Diller (1996) summarized, elaborated on nine different forms of relationships by contrasting three types of relational objects (things, people, and organizations) with three kinds of commitment (only at the supplier-level, only at the customer-level, and at both levels). Another example is that of Enis & Paul (1970), who, discussing store loyalty, devised an index to capture the varying degrees of loyalty by looking at share-of-wallet allocated to the retail outlet, the amount of switching, as well as the number of opportunities to do so. With a focus on profitability, Reinartz & Kumar (2002) contrasted the duration of patronization (short- and long-term) with profitability (high and low) and came up with four types of customers that require different

managerial action: strangers (short-term customers/low profitability), butterflies (short-term customers/high profitability), barnacles (long-term customers/low profitability), and true friends (long-term customers/high profitability).

Referring to the type of loyalty that is engendered within the individual, Dick & Basu (1994) distinguished between no loyalty, latent loyalty, spurious loyalty, and loyalty in its typical sense. A final example is that of Oliver (1997), who took a somewhat different approach and came to the conclusion that the phases of cognitive, affective, conative, and action loyalty follow one another. The individual approach (including the description of possible stimuli) taken by these latter two authors in the theoretical development of these loyalty types will now be briefly elaborated on. In addition to explaining these categories of loyalty in more detail, this discussion serves the purpose of gaining a complete overview of two seminal contributions to the field of loyalty research.

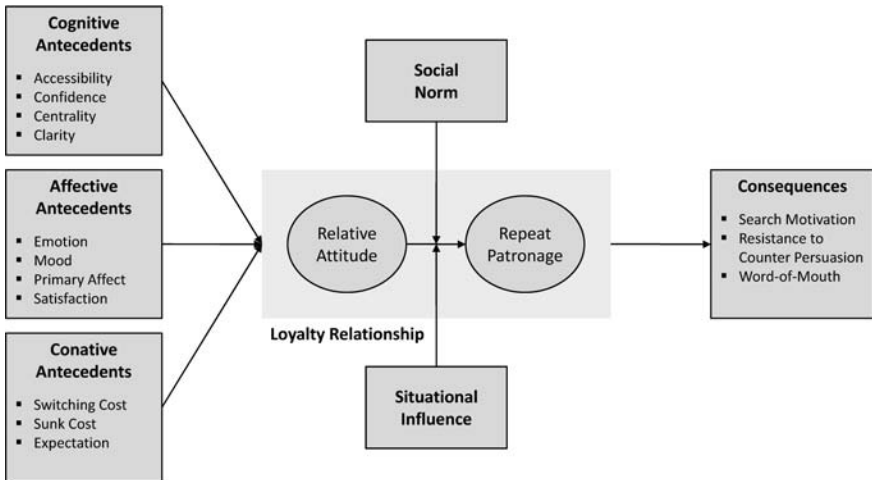


Figure 5: A Framework of Customer Loyalty

Source: Dick & Basu (1994)

Following Jacoby & Chestnut's (1978) work, it took until the 1990s for a notable progress of the loyalty literature to take place (Oliver 1997). Dick & Basu (1994) expanded the loyalty literature with the view that the customer's relative assessment of the alternatives within a set of choices would also hold high potential significance. To construct what they called an "integrated framework" for customer loyalty (see Figure 5), the authors conceptualized loyalty as a relationship between the customer's relative attitude towards an entity such as a brand, store, vendor or service provider and repeat patronage behavior, and in addition to that,

distinguished attitudinal and non-attitudinal moderators of the relationship between relative attitude and repeat patronage behavior.

In order to determine the kind of loyalty a consumer possesses, the authors used the two matrices provided in Figure 6. The left one distinguishes the level of relative attitude by cross-classifying attitude strength on the one hand and attitudinal differentiation on the other hand. Applying Ajzen & Fishbein’s (1980) notion of judging the degree of attitude by examining the position of, for instance, a particular product along a “continuum of favorability,” one can determine whether it is weak or strong. This is then put in contrast to attitudinal differentiation, asking whether the customer perceives any differentiation in his choice set. The highest relative attitude could thus be perceived if the customer has a strong attitude and there is differentiation within the focal product group. The degree of relative attitude is then placed on the y-axis of the second 2 x 2 matrix and compared to the intensity of repeat patronage, which consequently results in four specific kinds of loyalty, each characterized by a different possible background:

- No Loyalty: a low relative attitude and low repeat patronage could, for example, be due to a market with little possible differentiation or a customer who is unaware of recent product introductions.
- Latent Loyalty: non-attitudinal influences, such as subjective norms and situational effects, are likely to exert significant influence in a scenario where repeat patronage is low despite high relative attitude.
- Spurious Loyalty: this case is, similar to that of latent loyalty, characterized by non-attitudinal influences. High repeat patronage despite low relative attitude could be caused by factors such as social influence or familiarity.
- Loyalty: naturally, the state where high relative attitude meets high repeat patronage is the most desirable for an organization, as this situation signifies true loyalty.

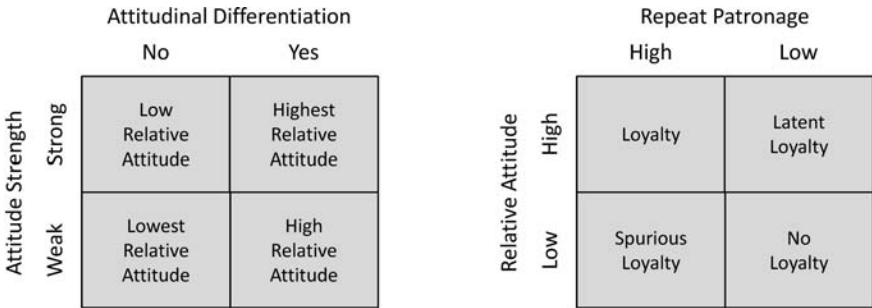


Figure 6: Modeling Different Forms of Loyalty

Source: Dick & Basu (1994)

Going back to the framework depicted in Figure 5, Dick & Basu (1994) further elaborated on cognitive, affective, and conative attitudinal antecedences influencing the loyalty relationship by building on the ideas of Jacoby & Chestnut (1978). *Cognitive* antecedents consist of the ease of accessing an attitude from memory, the level of confidence in regard to an attitude, the degree to which an attitude is central to a person's value system, and the clarity of the definition of the particular attitude. *Affective* antecedents are composed of emotion, mood, primary affect (i.e. physiological responses independent of cognitions), and satisfaction, while *conative* antecedents comprise switching costs, sunk costs, and future expectations.

Finally, the authors considered two additional non-attitudinal factors influencing repeat purchase behavior. On the one hand, social norm was seen as a moderator of loyalty in certain situations, and on the other hand, situational influences such as stock-outs or special promotions for a rival product were accounted for.

Similar to Dick & Basu (1994) and Jacoby & Chestnut (1978), Oliver (1997) differentiated between the formation of beliefs, likes and dislikes, and behavioral intention. He further theorized that these three phases are sequential in nature, meaning that customers become loyal along the information base first, upon which they develop a favorable attitude, which eventually leads to a commitment to buy. At the *first level*, consumers are simply swayed by the value that a particular service, for instance, provides to them over the offer of competitors. At the *second level*, attitude enters the picture, which, the author noted, is formed by expectations in the early phases of purchase on the one hand, and expectation disconfirmation, prior attitude, and satisfaction in the later phases on the other hand. Pointing to Eagly & Chaiken (1993), Oliver (1997) highlighted that the important attribute of affect (i.e. attitude) in this context is that it is firmly connected to overall brand evaluation as well as cognition. For that reason, affect is much less vulnerable to counter-argumentation than cognition. Marking the *third level*, behavioral intention, or commitment as it could also be called, takes affection one step further by adding the wish to take action.

These three phases fall short of achieving true loyalty, however. To solve this problem, Oliver turned to a stream of research called "action control," the study of the mechanism by which intent is converted to action (see Kuhl & Beckmann 1985 for further details), to describe a *fourth level*. In line with this theory, motivation as well as a desire to overcome obstacles is needed for intention to develop into a readiness to act (Oliver 1999). Only then, the author denoted, are all necessary requirements of loyalty accurately considered, and a state of loyalty in its true sense achieved.

2.2.3 Conclusion

It can be seen that numerous elements are expected to exert some kind of influence on the creation or development of customer loyalty. Different authors consider different ones in their models, but none of them seem to have found either final consensus or an ultimate solution. Possibly, we do not have to understand what exactly goes on within the organism, as long we can prove a connection between a stimulus and a response. A lot of these factors are interconnected, which makes them extremely difficult to model. For example, satisfaction was shown to be correlated with loyalty and is commonly considered to be a very important driver of customer retention. The link between satisfaction and retention is nonlinear, however, as Anderson & Mittal (2000) demonstrated, with the impact of satisfaction on retention being strongest on its extremes, and a flat slope (the so-called zone of indifference) spanning out in between. The shape of this curve, Kumar & Reinartz (2006) summarized, is influenced by various factors, including the competitive environment, switching costs, and the level of perceived risks. It is, for instance, not uncommon in many business sectors that aggressive competition offering desirable products lures away satisfied customers from their current brand of choice (Jones & Sasser 1995; see Chapter 5.2 for further elaboration on this topic).

This section tried to give an overview of the framework of loyalty and its status in research. As mentioned before (and indeed, as the name suggests), one of those elements argued to exert some kind of influence on customers are customer loyalty schemes. Numerous authors have investigated their ability to engender or foster loyalty and the following chapter aims at distilling their findings.

2.3 Customer Loyalty Schemes and Loyalty

“Do these programs really create extra loyalty beyond that which is derived from the relative value of the product or service? Do they encourage customers to spend more? Or do they merely bribe a customer to buy again,” Dowling & Uncles (1997, p. 71) rightfully asked themselves and their readers. In this connection it needs to be kept in mind that retailing is, as opposed to the service industry or B2B relationships, characterized by a lower level of personal contact and interdependence (O'Malley & Tynan 2000). The question came up, whether true loyalty could even exist in this sector (Uncles et al. 2003). After all, a risky investment decision certainly has a higher potential to lead to a relationship between two companies than the purchase of pickles will have for that between an organization and a regular grocery shopper. It is not certain, Dowling & Uncles (1997) accentuated, whether customers really want a relationship for low-involvement products. Somehow, one is tempted to say “probably not.”

A good part of research on loyalty programs was dedicated to answering the question of whether they are able to engender loyalty. Often focused on the behavioral aspect of loyalty, a whole range of authors has attempted to answer the question of “whether these programs actually work,” and came up with mixed results. Table 1 gives an overview of the literature reviewed in this section. The focus of this compilation was put on the context of retailing, complemented by a few notable papers from other industries. The categorization into publications employing a comparison across competitors, as opposed to those comparing across time or across consumers was suggested by Liu (2007) and has, in a slightly modified form, been adapted for the overview in Table 1 to help make sense of the heterogeneous literature. In Chapters 2.3.1 and 2.3.2, findings will then be presented in more detail in chronological order, based on these papers’ assignment to the two categories that ultimately matter most: that with either predominantly positive or predominantly negative evidence. In the course of this, all retail-related papers, but only the most noteworthy of the selected papers from other industries will be covered.

Comparison Across Competitors (comparing loyalty program impact across multiple firms; often focused on share-of-wallet)						
Authors	Industry	Geography	Data Source	Sample	Time Span	Results
Nako (1992)	Airlines	USA	Company travel reports (business travelers)	270 customers	2 months (non-consecutive)	Loyalty programs had a significant impact on airline choice; in that regard they were ranked as less important than the number of flights, the percentage of direct flights, and total travel time, but more important than fare and on-time performance
Sharp & Sharp (1997)	Retailing (coalition scheme: grocery, fuel, department stores)	Australia	Customer diaries	745 households	5 months (2 separate observations lasting 9 and 12 weeks respectively)	Two of the six brands participating in the coalition scheme that formed the basis for the study showed substantial deviations in excess loyalty; however, these deviations were observed for both members and non-members
Mägi (2003)	Retailing (grocery)	Sweden	Customer diaries, survey data	643 households	1 month	Limited support of the impact of loyalty schemes on customer behavior; while program members were found to have a larger share-of-wallet and share-of-visits at that chain, the effect did not reach significance at the store level
Xopalle & Neslin (2003)	Airlines	USA	Various databases, industry analyses and annual reports to test own model	n/a	n/a	Loyalty schemes were found to be powerful, multi-period promotions
Meyer-Waarden & Benavent (2006)	Retailing (grocery)	France	Panel data	2,476 customers (50,000 purchase acts)	6 months	Loyalty programs did not lead to a significantly higher purchase frequency or increased penetration; if all companies had a program in place, the competitive situation would remain unchanged
Meyer-Waarden (2007)	Retailing (grocery)	France	Panel data	2,476 customers (397,000 purchase acts)	36 months	Positive effects of loyalty schemes on lifetime duration and share-of-wallet at the store level; multiple program membership may reduce effect; impact of share-of-wallet on lifetime duration increases with time
Leenheer et al (2007)	Retailing (grocery)	Netherlands	Panel data	1,909 households	24 months	Small, yet positive effect (4.1 percentage points) of program membership on share-of-wallet; the effect was seven times smaller as compared to a model not taking self-selecting members into account
						Positive

	Authors	Industry	Geography	Data Source	Sample	Time Span	Results	Overall Evidence
Comparison Across Time (observation of the same consumers' behavior across time)	Dierke & Hoch (1998)	Retailing (baby products)	USA	Store data	n/a	6 months	25% rise in category sales and 7.5% in transaction size, 4% rise in overall grocery sales and 5% in store traffic	Positive
	Lal & Ball (2003)	Retailing (grocery)	USA	Store data	n/a	24 months (5 short-term programs lasting 6-8 weeks)	Loyalty programs were successful in increasing turnover in a profitable manner; substantial incremental sales to irregular shoppers offset the subsidies to already loyal customers	Positive
	Smith et al (2003)	Retailing (grocery)	United Kingdom	Customer diaries, survey data	30 customers	4 months	Average spend was far less for non-members, but no evidence was discovered that cardholders become more loyal over time	Negative
	Lewis (2004)	Retailing (grocery and drug store; internet)	USA	Store data	1,058 customers	13 months	Average number of annual orders increased from 9.98 to 10.25 and mean customer revenue increased from 634 to 647 USD	Positive
	Taylor & Nestlin (2005)	Retailing (grocery)	USA	Store data, survey data	776 households	24 months (2 short-term programs lasting 8 weeks each)	Within the duration of the program, weekly storewide sales rose by 6.1% in the first and 6.4% in the second year; overall, evidence was found for both a points pressure and a rewarded behavior effect (i.e. a significant behavior change took place both before and after reward redemption)	Positive
	Kivetz et al (2006)	Catering, internet music rating	USA	Company data, data from own experiments	949 coffee stamp cards, 108 and 65 participants in two experiments, 148 people rating music online	n/a	Shortening of inter-purchase time with progress towards goal; illusion of approaching the goal was sufficient to alter behavior; a stronger tendency to accelerate towards the reward served as a predictor of greater retention and faster reengagement with the program	Positive
	Liu (2007)	Retailing (grocery)	USA	Store data	1,000 customers	24 months	For light and moderate buyers, transaction sizes and purchase frequencies increased, and customers became more loyal to the firm	Positive
	Meyer-Waarden (2008)	Retailing (grocery)	France	Panel data	2,150 customers (475,000 purchase acts)	36 months	Loyalty schemes significantly affected purchase behavior for both market leaders and smaller retailers	Positive

	Authors	Industry	Geography	Data Source	Sample	Time Span	Results	Overall Evidence
Comparison Across Consumers (comparison of member to non-member behavior)	Bolton et al (2000)	Financial services (credit cards)	Three European countries	Company data	405 customers	12 months	In repatriation decisions, program members weigh negative evaluations of the company less than non-members; the program leads to increased revenue due to fewer cancellations and higher service usage levels	Positive
	Verhoef (2003)	Financial services (insurance)	Netherlands	Company data, survey data	1,677 customers [1st measurement], 918 customers [2nd measurement]	n/a	A loyalty scheme with economic incentives leads to greater customer retention and serves as a tool to maximize customer share	Positive
	Noordhoff et al (2004)	Retailing (grocery)	Singapore/ Netherlands	Survey data	333 customers	n/a	Impact on both attitudinal and behavioral store loyalty given if number of competitive programs is limited and customers have not become accustomed to loyalty schemes over time	Positive
Other (surveys targeting program members only, literature reviews, etc.)	Bellizzi & Bristol (2004)	Retailing (grocery)	USA	Survey data	301 customers	n/a	Loyalty programs rank very low in the list of factors which customers consider likely to be increasing their store loyalty	Negative
	Dowling & Uncles (1997)	Various	n/a	Literature review	n/a	n/a	Loyalty schemes are not serving their purpose as loyalty would be much more likely to result from other factors than the program itself; only under certain conditions can they be useful	Negative
	Liebermann (1999)	Retailing, consumer goods, leisure	Israel	Survey data	240 customers	n/a	Membership in a single program, joining the loyalty scheme on own initiative, and a high participation rate in club activities all had a positive effect on loyalty	Positive
	Wright & Sparks (1999)	Various (but heavy focus on retailing)	United Kingdom	Survey data	150 customers	n/a	Consumers were joining the programs out of rationality or greed and not to reinforce a sense of belonging; limited evidence to suggest influence on customer behavior; customers might be getting wary of LPS	Negative
	Birdson et al (2008)	Retailing (health and beauty)	Australia	Survey data	200 customers	n/a	Hard and soft reward characteristics as well as the LP overall were shown to be a significant predictor of store loyalty	Positive

Table 1: Literature Review of Loyalty Scheme Success Research

2.3.1 Predominantly Positive Evidence

First in a range of examples with “net positive evidence” comes the work of Drèze & Hoch (1998). During a six month time period, the authors observed a category destination program (i.e. a program that is similar in nature to a loyalty scheme in that it aims to encourage spending, but limited in the sense that it does so only for a single category) for baby products at all 70 outlets of ABCO Markets in the American state of Arizona. Backed by advertisements both in-store and broadcasted by radio and television, the program offered one “Baby Buck” for every USD spent on baby-related products. 100 such baby bucks could then be exchanged for a store-wide voucher of 10 USD. In terms of category sales, the program led to an overall increase of 25%, resulting from a 25% rise in the number of customers buying baby products and a 7.5% increase of the average transaction size. Overall, store traffic increased by 5% and total grocery sales by 4%.

In a preliminary study covering six small Israeli loyalty schemes across three industries (one being retail) with an average of around 15,000 members each, Liebermann (1999) conducted telephone interviews with 40 members of each program. The author discovered a significant effect of membership on word-of-mouth, while no significant effect of membership on expenditure was found, however, even though 20% of customers reported having spent significantly more due to their membership, and 32 % indicated having bought slightly more. In any case, the article nevertheless leaves a positive impression.

Using data provided to them by a supermarket chain in the mid-west of the USA, Lal & Bell (2003) analyzed the effects of five non-institutionalized short-term loyalty schemes such as a ham promotion (where vouchers for a certain amount of ham were handed out, depending on the amount spent) or the so-called “discount and turkey promotion” (coupling a store-wide voucher with a coupon for a turkey, whereby the size of the reward again depended on the amount spent). The authors concluded that the programs were successful in increasing turnover by their customers and added that interestingly, the spend of customers in the lower spending deciles was greater than that of the supermarket’s best customers. Moreover, these programs were run in a profitable manner.

Mägi (2003) gathered data on 643 households by having them keep a four week store choice diary and complete a questionnaire at the end of this period. Her results were mixed. On the one hand, the author’s hypothesis that members of a loyalty scheme of their primary store will have a larger share-of-wallet and share-of-visits at the primary *store* could not be supported. Although support was found to be slightly positive, it did not reach significant levels. On the other hand, the hypothesis that customers having a loyalty card of a chain will have a larger share-of-wallet and share-of-visits at this *chain* could be maintained. This

was only true, however, for the 35% of customers who did not possess a competitive loyalty card. Still, all in all, limited positive support for loyalty schemes was discovered.

Next to the influence of email-coupons, pricing changes and shipping fees as three other marketing efforts, Lewis (2004) presented a model of customer response to a loyalty scheme. The model included both previous behavior by looking at cumulative purchases and forward-looking elements such as loyalty rewards. To test the model, Lewis used a sample of 1,058 customers stemming from a complete 13 month data set of 30,000 customers provided by an internet retailer focused on grocery and drug store articles. Conducting both simulation and policy experiments (e.g. to test the effect of changing or removing the loyalty scheme), the author found that the loyalty program effectively increased repeat purchase rates and was indeed successful in increasing turnover for a substantial proportion of customers. Specifically, the average number of annual orders increased from 9.98 to 10.25 and the mean customer revenue increased by 13 USD from a baseline of 634 USD. Consequentially, Lewis noted, the relative fit of the dynamic model (which considered future rewards) as compared to a static model did point towards the effectiveness of loyalty schemes.

In a study with questionnaires personally administered to 333 grocery shoppers in the Netherlands and Singapore, Noordhoff et al. (2004) analyzed, among other things, inter-cultural differences in the impact of card possession on loyalty. While doing so, the authors also differentiated between behavioral and attitudinal store loyalty and came up with surprising results. While loyalty card possession yielded a significant increase in both behavioral and attitudinal loyalty in Singapore, the analyses of the Dutch sample could only confirm a link to attitudinal loyalty. Partly due to fact that the amount of loyalty was significantly higher in Singapore, the authors hypothesized that the lack of a connection between loyalty card possession and behavioral loyalty in the Netherlands could be due to the effectiveness of loyalty programs eroding with their age and the emergence of a multitude of competitive schemes. As for the particularly strong links in Singapore, Noordhoff et al. argued that this might have been due to the Asian economic crisis of the late 1990s having increased price consciousness and consequently the sensitivity to price reductions. Despite the unexpected peculiarity as regards behavioral loyalty in the Netherlands, overall support for the ability of loyalty schemes to engender loyalty remains nevertheless positive.

Taylor & Neslin (2005) examined the effect of a loyalty program on sales both in the short and in the long run. Short-term impact, they argued, is created by what they termed *points pressure*, as customers increase their purchase levels to surpass a necessary threshold for obtaining a reward. By contrast, long-term impact is hypothesized to be generated through *rewarded behavior*, where, possibly due

to the learning theory of instrumental conditioning or positive affect resulting from the reward, customers exhibit a higher than baseline level of sales in the period following the receipt of a reward. Complemented by an initial mail survey, two years of grocery shopping basket item data for close to 776 households formed the basis for the study. The reward program which offered a free turkey to customers was employed for eight weeks once every year. During their analysis, Taylor & Neslin found evidence for both the points pressure and the rewarded behavior effect. During the eight week period the program was employed, weekly storewide sales rose by 6.1% in the first year and by 6.4% in the second year. Furthermore, sales did not immediately return to pre-program levels following the redemption of the free turkey. Still, unlike one might expect, the overall impact of the rewarded behavior did not surpass that of the points pressure effect.

This points pressure effect was also proven by Kivetz et al. (2006) who (1) analyzed 949 completed ten-stamp cards at a café on a university campus promising a free coffee, (2) conducted a field experiment with 108 participants in a free coffee setting, (3) carried out a questionnaire-based experiment with 65 respondents set around free pizzas as a reward, and (4) analyzed a data set of close to 148 people participating in a program that incentivized them with Amazon vouchers for rating music on a website. The authors found that the purchase frequency accelerated while customers progressed towards receiving a free coffee. Similarly, customers visited the rating website more often, rated more songs, and persisted longer in their rating effort while approaching the reward. This was further fortified by the observation that a slowdown set in following the achievement of a reward, while eventually another phase of acceleration was noticed once a reward could be reached for the second time. Interestingly, even the illusion of approaching a goal was sufficient to alter behavior. During the coffee-experiment, certain customers were handed out cards that required 12 stamps but had 2 fields already stamped as part of a “special promotion,” while others received empty cards requiring 10 stamps. Despite the fact that the number of purchased coffees needed to receive a reward was the same in both cases, the already pre-filled cards were completed faster than the empty ones. Furthermore, the authors noted, a stronger tendency to accelerate towards the reward served as a predictor of greater retention and faster reengagement with the program.

Leenheer et al. (2007) emphasized another important aspect: loyalty programs can not automatically be considered effective if members of loyalty schemes are found to have a higher share-of-wallet than non-members. This is due to the fact that already loyal members are the ones most likely to sign up for a loyalty program, as they are benefiting most from its rewards. Taking this endogeneity into account in an analysis of seven loyalty programs of Dutch grocers, the authors found a small, yet positive effect of program membership on share-of-

wallet (which would have been seven times that large without accounting for self-selecting members). According to the authors' calculations, the programs were able to generate more additional revenue than additional cost in terms of saving and discount reward. Still, given the limitations of this study, these findings need to be put into perspective. Next to several other issues, it featured a significant flaw in that it did not incorporate any expense factors (e.g. administrative, IT, or marketing spending) other than the rewarding costs.

Using a random sample of 1,000 customers from an American convenience store chain, Liu (2007) observed the effect of the company's loyalty program over the first two years following its inception. The author found that the effect of the loyalty scheme depended on the customer's initial usage levels. For heavy spending customers, spend levels and exclusive loyalty to the store did not increase over time, while the opposite was true for light and moderate spending buyers. Their transaction sizes and purchase frequencies increased, and furthermore, they became more loyal to the store. This increase, Liu added, was most evident in the first three months of the program's creation, upon which growth decelerated to a slower pace.

In a series of two similar articles, Meyer-Waarden (2007, 2008) evaluated panel data from the French town of Angers, covering customers' purchases in five hypermarkets and two supermarkets. Over a period of 156 weeks each, and covering 397,000 purchase acts by 2,476 customers and 475,000 purchases by 2,150 customers respectively, the author concluded that loyalty schemes significantly affected purchase behavior at smaller retailers as well as market leaders. For instance, Meyer-Waarden (2007) noted, program subscription not only significantly reduced the relative risk of defection, but also increased share-of-wallet at the particular store. "Specifically, cardholders have significantly higher purchase intensities in terms of total and average shopping baskets, share-of-category purchases, purchase frequencies and inter-purchase times than do non-members over the entire three-year period and throughout the trading areas," Meyer-Waarden (2008, p. 102) summed up the results.

Bridson et al. (2008) gathered survey data from 200 customers of two stores of an Australian health and beauty retailer, and found an empirical verification for the relationship between the loyalty program, store satisfaction and store loyalty. Specifically, hard and soft reward characteristics as well as the loyalty scheme overall were shown to be significant predictors of store satisfaction. As for store satisfaction, the authors confirmed its mediating role on store loyalty, and concluded that loyalty schemes were indeed a significant predictor of store loyalty.

Positive evidence of loyalty schemes is not limited to studies set in the retailing context, however. Apart from the work of Kivetz et al. (2006) that has already been described in greater detail due to its notable findings, examples include

Nako (1992) and Kopalle & Neslin (2003) who found proof for loyalty programs' effectiveness in the airline industry, or Bolton et al. (2000) and Verhoef (2003) who ascribed a positive influence to customer loyalty schemes in the financial industry.

2.3.2 Predominantly Negative Evidence

An important part of loyalty research in the retailing context has historically been that of store loyalty. Various authors have analyzed the factors influencing store patronage (e.g. Bellenger et al. 1977, Arnold et al. 1983, Louviere & Gaeth 1987, Bellizzi & Bristol 2004), but be it product assortment, convenient location or fast check-out lines that fetch the top place as the factor with the highest impact, results in these studies tend to be similar (see East et al. 1995, Bloemer & de Ruyter 1998, or De Wulf & Odekerken-Schröder 2003 for examples with a narrower focus). Pan & Zinkhan's (2006) thorough meta-analysis of the determinants of retail patronage confirms this impression. Interestingly, none of these studies mention the role of loyalty schemes. When asked about the reason for not including loyalty programs as a driver of store choice, Yue Pan answered that the only reason he did not include them was that he did not find many articles that reported usable effect sizes for this variable (personal communication, January 22, 2008). The question still remains open, however, whether Pan & Zinkhan really had all the relevant studies at their disposal, and whether the authors of the publications reviewed in the meta-analysis even considered including the comparatively new topic of loyalty programs in their respective studies in the first place. Furthermore, inclusion in the authors' study depended on what they considered a "usable" effect size. This problem of varying opinions among authors of what effect size is to be considered "usable" or "good enough," will be discussed in greater detail in Chapter 2.3.3.

Dowling & Uncles's (1997) paper is the first in a row of publications that leave the reader with a negative impression of the effectiveness of loyalty schemes. What stands out about this work is that it is often referenced, despite a lack of its own empirical data. In fact, one might even go so far as to call the authors' work the starting point for modern research on the effectiveness of loyalty programs (next to Sharp & Sharp 1997, possibly). In a review of behavioral loyalty research as well as then current events in the business environment, Dowling & Uncles (1997) seem to have put future research on track. They found that loyalty is much more likely to come from other factors than the loyalty scheme itself. From this they concluded that most programs were not serving their purpose, despite agreeing that if properly designed, there are certain conditions under which they can be useful.

In an attempt to determine its ability to create additional loyalty for brands taking part in the program, Sharp & Sharp (1997) evaluated Australia's major coalition scheme Fly Buys. To detect a change from normal repeat purchase behavior, the authors developed Dirichlet estimates of expected repeat purchase loyalty from their own panel of 745 households, and compared them with the actual, observed behavior. They found that out of the six participating brands, only two showed substantial levels of excess loyalty, and further added that these deviations were likely to be at least partially linked to other loyalty efforts by the company, as both members and non-members exhibited the same alteration in behavior.

An example of an exploratory study relying on survey data is that of Wright & Sparks (1999). From personal interviews with 150 people entering or exiting the main shopping center of the British city of Stirling, the authors concluded that people were tiring of loyalty cards. In explanation of the reasons behind this phenomenon, Wright & Sparks stated that people no longer had space in their wallets, that they did not have the time or inclination to complete card applications, and that they would not need further cards which they were probably not going to use regularly. In addition, customers were found to join loyalty programs mostly out of rationality or greed, and not because they wanted to reinforce their sense of belonging. Furthermore, the authors retrieved only limited evidence to suggest that loyalty schemes possess the power to influence customer behavior.

Following the administration of an initial questionnaire, Smith et al. (2003) evaluated the results from a four month diary study covering 30 respondents in the United Kingdom. Despite finding that the average spend of non-cardholders equaled just slightly above 40% of what cardholders generated, the authors conceded that "there was no evidence to suggest that the cardholders were becoming more loyal over time" (p. 114). As far as the average spend is concerned, this can easily be explained by the fact that customers that are already very loyal are the ones most likely to sign up for the scheme, since they are the ones drawing the biggest benefits from their membership (Leenheer et al. 2007).

In Bellizzi & Bristol's (2004) study, respondents were, among other things, asked to assess 28 items on a five-point scale and indicate how likely each factor would be to contribute to their store loyalty. With a mean of 2.67 (5 being highest), "store offers a shopper loyalty card" landed in place 18, followed by items like "store offers automobile oil change while you shop" in place 25, or "store offers a beauty salon/barber shop inside" in the final slot. Obviously, one is tempted to say, customers placed factors such as "store offers quick-moving check-out lines," "store offers a variety of fresh produce," or "store is conveniently located" in the top positions. Also, they will naturally prefer immediate discounts over delayed ones, as indicated by the unnecessarily specific item "store does not have a loyalty card, but offers low prices in general, and has lots of two for one

sales” in place number 7. Two things are important to note in this connection: (1) letting customers judge the importance of such factors can potentially yield inaccurate results, as they might not consciously perceive, acknowledge, or admit to the psychological effects underlying certain loyalty schemes (particularly when dealing with delayed rewards) (e.g. Mägi 2003), and (2) both academics and practitioners acknowledge that the potential impact is comparatively small (see Chapter 2.3.3 for a detailed discussion of these issues).

Preceding the series of similar articles by Meyer-Waarden (2007, 2008) that were mentioned in the section on positive evidence, Meyer-Waarden & Benavent (2006) evaluated a sample of 50,000 purchases from a panel of 2,476 customers over a period of 24 weeks. Despite relying on the same panel that Meyer-Waarden (2007, 2008) used, the authors retrieved predominantly negative evidence. According to their findings, stores with a loyalty scheme were not able to develop higher purchase frequency and also, no effect on an increase in customer penetration could be observed. Interestingly, Meyer-Waarden failed to properly comment on this outcome in his latter two articles, except for referencing his earlier work with Benavent while noting that some authors “contend it is difficult to change established behavioral patterns with the type of reward systems that are prevalent today” (Meyer-Waarden 2007, p. 224 and Meyer-Waarden 2008, p. 90).

2.3.3 Possible Explanations for the Mixed Results

It could be seen that some authors provided rather positive and others rather negative evidence, while yet others came up with mixed results even within their own studies. This ambiguous situation even reaches the extent that findings leave enough discretion to be interpreted in both directions. Indeed, certain articles are sometimes cited as positive and sometimes as negative examples, depending on what the authors considered “effective.” For example, Leenheer & Bijmolt (2008) referenced Mägi (2003) in relation to loyalty schemes when stating that “existing academic research [...] provided empirical evidence of their effectiveness” (p. 429), while Demoulin & Zidda (2008) claimed that “Mägi (2003) did not show any convincing effect of loyalty cards on consumers’ shares in grocery retail chains (i.e., share-of-wallet and share-of-visits)” (p. 387). A similar example concerns the paper of Lal & Bell (2003), which was referenced by Gómez et al. (2006) following the statement that “papers focused on loyalty programs that compare the consumers’ behavior before and after enrolling themselves in these programs show that there is virtually no difference between the two states regarding to number of visits to the retailer or purchase volume” (p. 388), while Taylor & Neslin (2005) stated that the authors “found evidence for a sales increase during

the redemption period, suggesting a rewarded-behavior effect" (p. 295). Interestingly, even the same author might provide different results. For instance, Meyer-Waarden & Benavent (2006) wrote: "findings with regard to the effects of loyalty schemes on repeat purchase patterns in stationary markets are mitigated [...]. Our findings lead us therefore to reject hypothesis H1, according to which stores with loyalty schemes systematically develop higher purchase frequency" (p. 81). Working with the same source of panel data two years later, however, Meyer-Waarden (2008) noted that "our main findings show that loyalty programmes affect purchase behaviour for both market leaders and smaller retailers" (p. 101 f.).

One reason for these discrepancies could be that the authors were simply sloppy in their literature review. Evidence for this theory comes from the fact that Taylor & Neslin (2005) referenced Lal & Bell (2003) in a June 2002 edition of *Quantitative Marketing and Economics*, despite the fact that the article appeared in June 2003. Gómez et al. (2006) did no better, however. Apart from referencing the 2002 working paper instead of the published article from 2003 (which, after all, appeared a whole three years prior to their own work), they continuously misspelled the last name of poor Rajiv Lal. Still, this theory probably does not explain it all and is, moreover, a rather unkind allegation that was not meant too seriously. More likely, then, are the different interpretations due to the varying perceptions of what the authors considered to be "effective." In the course of the literature review employed in this paper, both the works of Mägi (2003) and Lal & Bell (2003) were mentioned as examples of positive evidence. If one attempts to read the corresponding statements of Demoulin & Zidda (2008) and Gómez et al. (2006) with more care, one can discover the solution to this problem in little words embedded in these sentences. When the authors claimed that the loyalty programs "did not show any *convincing* effect" or made "*virtually* no difference," they interpreted the results according to their own standards.

But what is the principal reason that explains why these papers allow for such fundamentally different interpretations in the first place? It is argued that this is due to the fact that the positive effect that can be obtained by employing a loyalty scheme is comparatively small by nature. This is particularly true for the retailing industry, as it is generally characterized by a non-contractual setting, low consumer involvement, a high level of competition, low profit margins and consequently comparatively low reward values in the industry's loyalty programs. Grocery retailing probably serves as the most prominent example for this scenario. This realization is not only supported by academics (e.g. Meyer-Waarden & Benavent 2009), but by practitioners alike. For instance, Humby et al. (2008) (the men behind Tesco's Clubcard scheme) explicitly note that these programs can only complement the marketing strategy of a retailer, after all other more important

factors are delivered on. The impact these schemes can consequently have on turnover is comparatively small expressed in percentage points, but will nevertheless result in a significant absolute number – particularly in a retail sector such as grocery retailing, which is characterized by small margins, but high rates of turnover.

A further issue that interferes with these results is the ubiquity of loyalty cards (Capizzi & Ferguson 2005). Indeed, marketers have found customers to be “cherry picking,” with multiple memberships in different competing loyalty schemes forming the basis (Passingham 1998, Wright & Sparks 1999, Bellizzi & Bristol 2004). “I have accumulated nine ‘loyalty’ cards from various stores and supermarkets. Does this make me more loyal, or less,” asks a reader in a letter to *The Times* in the UK (Wright & Sparks 1999). Usage frequency of these cards is one factor that would have to be considered in order to judge whether customers are really promiscuous at all times, or merely keep a loyalty card of a second fuel retailer in their car in case their first choice is not around. Particularly in those instances where the program is configured so that it gives immediate discounts, consumers are likely to register for the free program. Another possible scenario is what Dowling & Uncles (1997) and McGoldrick & Andre (1997) called polygamous loyalty. As opposed to brand switching on the one extreme and promiscuity on the other, polygamous loyalty describes the loyalty to a small set of brands. A possible example for this would be a variety seeking customer who purchases a specific toothpaste or breakfast cereal 80% of the time, and another one 20% of time. The “just-in-case scenario” as well as that of polygamous loyalty would thus be two possible explanations for the negative effect that having a competing loyalty card has been found to have on share-of-wallet (e.g. by Mägi 2003). What remains true, though, is that cards are often not used in the long run. During a 12 month empirical investigation of the database of one Italian supermarket outlet, Mauri (2003) discovered that a very high percentage of card holders were not loyal to their card. In fact, out of the roughly 8,300 cards issued during that year, less than 40% were still in use in the last month.

The effect of competing loyalty programs is also one of the most important points of criticism with regard to these programs’ effectiveness. Following the argumentation of Uncles (1994) and Dowling & Uncles (1997), a loyalty scheme’s effect will be cancelled out as soon as competitive offerings enter the market. Consequentially, as terminating a loyalty scheme is a problematic issue and not advisable in a setting where a competitor has already matched the program, retailers are expected to be left with additional costs, but no additional benefit. As some of the studies mentioned in Chapter 2.3.2 have shown, this is not necessarily true, particularly because quite often not all players in an industry do employ a

loyalty scheme and furthermore, because they almost always differ in their setup (e.g. their reward structure).

Another possible explanation for the varying results relates to methodological deficiencies, of which Meyer-Waarden & Benavent (2009) provide a valuable summary. While studies using aggregate panel data do not take customer heterogeneity into account and store level data fails to do so with respect to competitive information on buying behavior, declarative survey data is confronted with reliability problems. Most importantly, however, the explanatory power of virtually all existing studies is flawed in that they ignore purchase behavior prior to loyalty program membership. Unfortunately, this is a limitation that is hard to avoid. While for store-level data, purchase behavior can only be captured from the beginning of membership in a loyalty program, very few providers of panel data capture the sign-up date to a loyalty program and also what purchases the respective card has been used for. Finally, survey data might have difficulties capturing the minor changes in purchase levels or buying frequency that can be expected from loyalty program membership in certain industries. Different methodologies, data sources, sample sizes and observed time spans are just some of the issues that cause variations in the outcome, particularly because the effect that is to be measured is fairly small. Regarding the oscillating observations mentioned previously in a comparison of Meyer-Waarden & Benavent (2006) and Meyer-Waarden (2008), for example, Lars Meyer-Waarden noted during personal communication that this was influenced by the data basis covering only 24 weeks in the first case, while it spanned 156 weeks in the later article (personal communication, December 7, 2008).

Next to these two main reasons that are often cited as interfering with the determination of the “true” effect of loyalty schemes, numerous other elements are obviously involved. For example, Meyer-Waarden also highlighted the lack of proper consideration of the distorting effect of self-selecting members in his papers as well as our personal communication. Except for Leenheer et al. (2007), who calculated that 86% of the effect of being a member on share-of-wallet is explained by this endogeneity, no other study to date has launched an attempt to control for this factor. In addition, different industries and even retailing sub-sectors are likely to lead to different results and the program configuration and reward structure can also be considered a major driver of loyalty scheme effectiveness (if not the most important one). A certain variance in the outcome of these studies is thus naturally given, as their setup is never similar in all respects.

2.3.4 Reflection

It seems fair to say that studies regarding the effectiveness of loyalty schemes in generating or fostering loyalty face several limitations that need to be considered. As far as the problem of distinguishing between studies that prove and those that refute the effect of loyalty schemes is concerned, this paper does at least partly step into the same trap that other authors were criticized for falling into. The reason for the voluntary action of offering a “positive evidence chapter” and a “negative evidence chapter” is to provide an illustration for the dominance of research that leaves the reader with a positive aftertaste. Naturally there are some papers that were named in the negative category, but do not provide purely negative results (e.g. Sharp & Sharp 1997 or Smith et al. 2003). The motivation for still putting them into that group is that they are *predominantly* negative, as opposed to those in the positive category, which are at least *predominantly* positive. Overall, however, literature tends to support a small, yet positive relationship between loyalty schemes and behavioral loyalty.

But what about attitudinal loyalty, one might ask. Unsurprisingly, opinions diverge in this case as well. Kumar & Shah (2004), for example, argued that loyalty programs need to cultivate attitudinal in addition to behavioral loyalty in order to reap the benefits of some of the commonly believed effects of true loyalty (Reichheld 1996, Steyn et al. 2010):

- The costs of serving loyal customer are less.
- Loyal customers are less price-sensitive.
- Loyal customers benefit the company by passing on positive word-of-mouth.

The way in which this can be done, the authors proposed, is via a suitable configuration of the reward structure. Applicable only to pre-selected, profitable customers, this would mean targeting the customers’ higher level goals in life, such as achieving social recognition, or visiting exotic places around the world. Likewise, Hart et al. (1999) suggested that loyalty schemes need to put more focus on their relational intent. In fact, the authors even asserted that the “future success of the schemes will depend on extended relationships as well as a move away from transactional intent” (p. 557). It needs to be added, however, that Hart et al. are referring to non-grocery retailing sectors only, which might constitute a key point in this discussion. Even Kumar & Shah (2004) could only come up with examples for rewards they contended to be able to foster attitudinal loyalty, which are rather unlikely to see implementation in a food retailing setting. When credit card companies fly their elite customers around in a private jet or treat them to private time with a celebrity, one could imagine that this might work. Picturing a grocery chain doing so is disproportionally harder. In this regard, the

question that Dowling & Uncles (1997) brought up by asking whether customers really want a relationship for low-involvement products might be modified into asking whether a relationship can really be established for retail sectors characterized by low involvement. In all likelihood, it is maintained, creating attitudinal loyalty through a special loyalty scheme for the top customers in Prada stores is more probable to succeed than through a program targeting Tesco's best customers. This also supports Yi & Jeon's (2003) proposition that loyalty marketing is a better fit for high-involvement products.

While some authors thus still purport that attitudinal loyalty is a goal that is achievable, many others believe the opposite. "A classic example of a misnomer: the loyalty card" is the title of an article by the academic Steve Worthington (2000), for instance. Similarly, Wright & Sparks (1999) stated that "'loyalty card' is not perhaps the correct term to call many of the cards in use" (p. 431), and Weinstein (1999) quoted a managing partner of a retail consultancy talking about attitudinal loyalty with the words "in fact, there is one thing still lacking in frequent-shopper programs, and that is loyalty" (p. 89 f.). Indeed, even for studies that explicitly capture attitudinal loyalty (e.g. Noordhoff et al. 2004 or Gómez et al. 2006) it needs to be kept in mind that despite findings of loyalty program users being characterized by a higher level of attitudinal loyalty than non-members, a causal relationship has never been established.

Can a loyalty scheme generate loyalty? Logic would suggest that a smart shopper (i.e. well-informed and generally price-conscious consumer) will adopt such a program and adjust his behavior to his own benefit, but in practice, this will certainly not be true for all customers (Schnedlitz 2006, Liebmann et al. 2008). This question of whether a loyalty program can create loyalty has not received an ultimate answer yet, but for the effect on *behavioral loyalty*, the answer appears to be predominantly yes, though depending on industry and program structure, generally to a relatively small extent. As for *attitudinal loyalty*, the answer tends towards no, at least for a large part of the retailing landscape and again dependant on program and particularly reward configuration.

Concept of Loyalty Scheme and its Types

Chapter 3 will be dedicated to a comprehensive discussion of loyalty schemes. Again, a section on definitions will mark the beginning of this overview (Chapter 3.1), after which the historical development and the current spread of loyalty programs in a sample selection of countries will briefly be touched upon (Chapter 3.2). Thereafter, the different types of loyalty schemes will be discussed (Chapter 3.3), the aspect of data collection broached (Chapter 3.4), and finally, the positive as well as the negative aspects commonly associated with these programs summarized (Chapter 3.5).

3.1 Definition

A chapter on definitions always seems to be a somewhat German endeavor and consequently, this work relies at least partly on German literature. By summing up the essential characteristics that the name alone does not always transmit, definitions certainly have an important role to play in any academic paper. In the case of loyalty schemes, this role is even more important, as the features that are commonly ascribed to such a scheme have changed somewhat in the recent past. Possibly due to that reason, a generally accepted definition of loyalty programs is still lacking.

“A customer club can be defined as an at least communicative union of people or organizations, which is initiated and operated by an organization in order to contact these members directly on a regular basis and offer them a benefit package with a high perceived value, with the goal of activating them and increasing their loyalty by creating an emotional relationship,” Butscher (2002, p. 5) noted. Similarly, Diller (1997) defined customer clubs as an “association of actual and potential customers with a certain organizational degree, initiated, organized, or at least supported by one or more organizations” (p. 33, translated), and Poth & Poth (1999) as “the association of users of certain products or services,” whereby these clubs “are founded by producers, but particularly retailers and primarily serve the purpose of [engendering] customer loyalty” (p. 214, translated).

Following a review of classic German marketing handbooks, Holz (1997) added three further properties that characterize a loyalty scheme: (1) it needs to

be seen as a marketing instrument, (2) it unites only a part of all current and potential customers, and (3) it implies an activity by the customer in order to become a member of the club. Furthermore, Liebmann et al. (2008) added, these schemes are used to develop loyalty particularly among customers “who have either identified themselves with the company or its products to a larger degree [than others] in the past, or those that are considered desired customers due to their turnover potential or their function as opinion leaders” (p. 630, translated).

While most of the characteristics mentioned by these authors are certainly correct, the constituting element of engenderment of true loyalty which, for instance, Poth & Poth (1999) or Butscher (2002) imply, is mostly considered outdated. The plain stimulation of continued patronage among customers is its basic goal, which companies attempt to achieve through discounts, cash, free goods, or other special features and services (Berman 2006; see Chapter 3.5 for further information on goals of loyalty schemes). Direct, customized communication and a range of useful analyses made possible through extensive customer databases is the essential foundation for companies with sophisticated programs. “The effective use of loyalty card data is arguably the most significant benefit of scheme implementation,” Byrom (2001, p. 334) noted.

The role of loyalty schemes is nowadays largely considered to be basically twofold, meaning (1) the programs’ ability to generate data and (2) their function as a marketing tool which might be promotional in nature, though featuring unique characteristics (see e.g. Sharp & Sharp 1997).

3.2 Historical Development and Current Spread

There are numerous points in the past to go back to in search of the roots of loyalty programs, depending on how closely one believes historic examples need to resemble today’s loyalty schemes in order to be considered a historic example in the first place. It is probably due to that reason (and hopefully not bad research) that different dates marking the beginning of these schemes appear in the literature.

Generally speaking, frequency schemes reward loyal customers with a diverse range of monetary or non-financial benefits, expecting an overall positive impact on business. Did salesmen in the Middle Ages, ancient Rome, ancient Egypt, or even in times before that employ such practices in one form or another? Most probably, one is tempted to say, they did. Still, the earliest concrete date mentioned in relevant literature is 1844. In that year, the Rochdale Society of Equitable Pioneers, one of the first consumers’ cooperatives, was founded in Rochdale, England by William Cooper, Charles Howarth, and another 26 Lancashire weavers (Reeves 1944). Reportedly encouraged by a lecture by George

Holyoake (a short-time lecturer at the Birmingham Mechanics Institute, greatly influenced by the ideas of the Welsh socialist Robert Owen) on self-help, the “Equitable Pioneers” opened a small grocery shop (Cannon 2004). The underlying rules, which endured as the basic structure of consumers’ cooperatives, encompassed two things: a fixed interest on invested capital as well as a distribution of profits depending on the amount purchased (Reeves 1944). Run by its members, the shop was initially open on only two evenings a week. By 1851, however, this modest upstart had served as an inspiration for a total of 130 similar outlets, reaching an impressive 450 cooperative enterprises by 1862 (Cannon 2004) and serving as the basis for the foundation of a cooperative factory and a textile mill (Reeves 1944).

The basic element found in both this consumer cooperative as well as modern loyalty schemes is, of course, that of giving something back to the consumer based on his contribution to sales. What is arguably different, however, is the underlying motive. While customers in today’s loyalty programs are rewarded for their patronage with the actual aim of increasing overall profit, the dominant idea of the Rochdale Society was simply to provide groceries without paying the additional profit margin to the retailer (in return for which the members of the society had to contribute their labor).



Figure 7: S&H Green Stamp

Source: Wikipedia

Often called the first “actual” loyalty scheme, the S&H Green Stamps (not to be confused with the S&H Green Shield Stamps issued by a different company in the UK) were introduced in the USA as a reward currency by the S&H Company in 1896 (S&H 2009). Founded by Thomas Sperry and Shelly Hutchinson, the company sold these stamps to a whole range of supermarkets, fuel stations, and

other retailers, which distributed them as a bonus to customers based on the amount purchased. Shoppers could then collect these stamps in collectors' books provided by S&H free of charge and eventually exchange filled in books for a variety of premiums and consumer products offered at local Green Stamps stores or via a special catalogue. According to the company's own declaration, by 1964 this catalogue had become the single largest publication in the USA, with S&H printing three times as many stamps as the US Post Office. In the past decades, however, the popularity of the program has decreased steadily. In 2000, following two changes in ownership, the firm launched an electronic version of the Green Stamps, the greenpoints, with a supermarket chain in New York and New Jersey. By 2003, the greenpoints were used by a self-reported 3 million customers of three grocery chains in eleven US states, but have certainly failed to live up to their predecessor's glory.

Departing from the stamp-idea, American Airlines is often accredited with the initiation of the modern loyalty scheme. Following industry deregulation in 1979, the AAdvantage Program was introduced in 1981, converting unused capacity into a loyalty marketing tool (Gilbert 1996, O'Malley 1998). Only a few weeks later, United Airlines launched a similar program and today, many carriers have their own frequent flyer scheme in place.

Following an overview of the historical development, a few facts and figures about the current spread of loyalty programs will be given. This section is deliberately kept comparatively short, as these numbers change rapidly. Companies start up new programs, other schemes are shut down – large numbers of customers enroll in recently introduced programs in certain industries of particular countries, while somewhere else saturation and lethargy unfurl. Consequently, it needs to be kept in mind that the following selection of findings from a range of studies permits only a rough estimation of today's true geographic and industry-specific spread of loyalty schemes, as well as their customer penetration. The following numbers have been collected for the USA:

- By the end of the 1990s, more than 30% of the supermarkets in the US had a program in place, with an additional 30% planning their implementation (Weinstein 1999). Mostly due to the emergence of computers, scanners, and other efficient ways of capturing, storing and analyzing customer purchase data, card-based loyalty programs have strongly increased their presence since the 1990s (Bellizzi & Bristol 2004).
- Total US loyalty memberships have increased from 973 million in 2000 to 1,319 million in 2006 (Ferguson & Hlavinka 2007). Figure 8 depicts the 2006 distribution of these memberships by industry.
- Calculating with a generous 80% of the United States' roughly 300 million inhabitants, this would translate to around 5.5 loyalty memberships per person.

- Gartner analyst Adam Sarner calculated that US companies spent 1.2 billion USD on loyalty programs in 2003 (Kumar 2008).
- Regarding the current state of affairs, Capizzi & Ferguson (2005) cannot help but describe loyalty schemes as ubiquitous. For example, the US Food Marketing Institute FMI (n.d.) revealed that approximately 75% of grocery retail customers in the US participate in a program of some sort, and indeed, some retailers disclosed that more than 95% of their total sales were generated by members of their loyalty scheme. Around five years earlier, Cigliano et al. (2000a) had found that only 53% of US grocery shoppers were enrolled in a loyalty program.

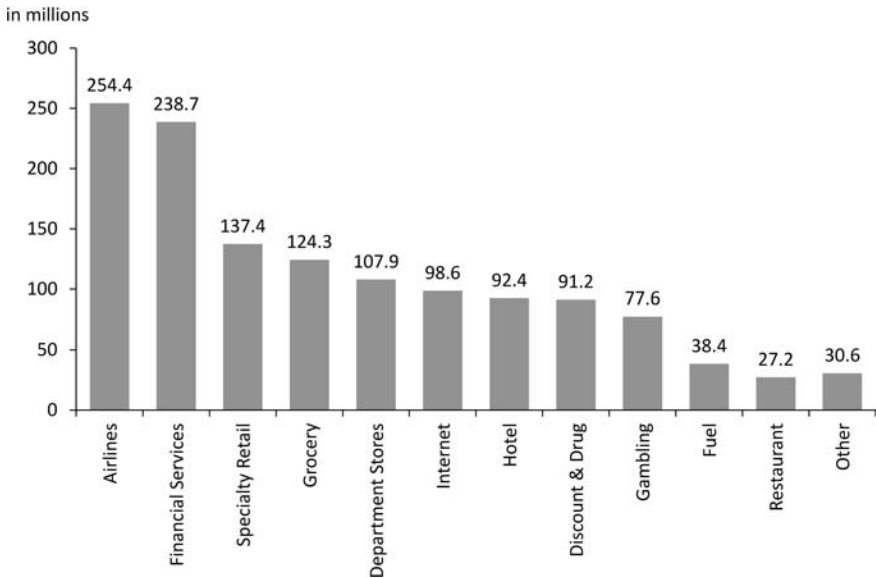


Figure 8: Number of US Loyalty Program Memberships by Industry (2006)

Source: Ferguson & Hlavinka (2007)

Comparable enumerations could be assembled for many countries in the world. For instance, Capizzi & Ferguson (2005) reported that more than 70% of Canadian households participated in at least one loyalty program. Similarly, to name a European example, Pressetext Austria (2006) announced that close to 80% of Austrian consumers were members of at least one loyalty program, following a 6% increase from the previous year.

Not everything seems to be home and dry, however. As previously mentioned, these numbers are all characterized by high volatility. To illustrate these

rapid changes, one just needs to consider the developments in the British grocery retail market in the past decades. In the United Kingdom, probably the world's most mature market for loyalty programs, four out of the five biggest food retailers (Tesco, Sainsbury's, Safeway [acquired by Morrisons in 2003], ASDA, and Morrisons) had at some point employed a loyalty scheme. Today, Tesco remains as the only company still running its own program. Around the turn of the century, both Wal-Mart's subsidiary ASDA, as well as Safeway abandoned their trials or running schemes and pronounced them a failure (Humby et al. 2008). Eventually, Sainsbury's gave up its own loyalty program in 2002, joining the British coalition scheme Nectar (Thompson 2004).

The customer penetration of loyalty programs changes constantly and as far as predictions are concerned, one should never forget to distinguish between different geographical markets and different industries (see e.g. Demoulin & Zidda 2009 for drivers of customers' adoption and adoption timing, which could, in line with Venkatesh et al.'s 2003 concept, possibly also be explained with a technology acceptance model). Despite some authors having augured a saturation in certain industries (e.g. Wright & Sparks 1999 with a focus on retailing in the UK), the tendency in many areas still seems to be that of further growth (see e.g. Ferguson & Hlavinka 2007 for more detailed sector-specific growth estimates for the US).

Following this introduction to the history and current spread of loyalty schemes, a comprehensive overview of the diverse types of programs will be given.

3.3 Types of Loyalty Schemes

Interestingly, particularly German literature seems preoccupied with the urge to classify the various types of loyalty schemes into as many groups as possible. Next to the classic loyalty program, Holz (1997) and Butscher (2002), for instance, differentiated between the following types of clubs:

- Book and music clubs: a meanwhile increasingly outdated form of distribution used particularly by book and music catalogue retailers. Hereby, customers are lured into the "club" by special offers, upon which the new members are obliged to buy a specific number of products in a given period of time.
- Fan clubs: clubs initiated and often run by consumers themselves, such as fan clubs of a particular soccer team, car brand or actress.
- Club companies: clubs that do not serve as a marketing instrument for a company, but that form the actual basis of the organization (e.g. the American Automobile Association in the US).

- Warehouse clubs: a form of retailing where customers pay an annual fee for the club membership, enabling them to shop at the corresponding retail store, which usually offers no-frills settings and wholesale quantities for competitive prices (e.g. Costco or Sam's Club in the US).
- Rebate clubs: clubs based entirely on price discounts, whereby the payment of the membership fee entitles customers to a specific rebate for a particular period of time (e.g. the BahnCard of Deutsche Bahn, the German railway company; one available variation of this card, the BahnCard 25, can at the time of writing be purchased for 57 EUR and entitles its owner to a discount of 25% on all railway tickets in second class purchased within a year).
- Business-2-Business Clubs: marketing instruments similar to regular customer loyalty schemes, but aimed at partners in B2B transactions.

Categorization attempts go even further than that, however. In addition to the special variations mentioned above, Holz (1997) and Butscher (2002) tried to further distinguish between "customer clubs," "customer cards," and even "frequency programs." This categorization can still be found in modern retailing literature in the German-speaking area (e.g. Liebmann et al. 2008). From these authors' works, the following explanations could be distilled:

- Customer clubs: the main characteristic of this type of club, which might also distribute cards as a sign of club membership, is supposed to be the lack of price discounts as well as a payment function of the card. Club benefits are thereby reduced to things like special service, a club magazine, invitations to special events, or an exclusive product selection available to members (e.g. the Family Club of the Swedish furniture retailer Ikea).
- Customer cards: according to these authors' definitions, customer cards, as opposed to customer clubs, are loyalty programs that offer price discounts and/or a payment function of the card. Particularly with regard to price discounts, this category could probably be called the classic loyalty scheme of today's business environment.
- Frequency programs: the single differentiating feature of this type of program is their foundation on the collection of some form of bonus points.

As will be seen in the course of this chapter, there are numerous variations of loyalty programs in existence. Keeping that in mind, any categorization such as that into customer clubs, customer cards and frequency programs, appears random. Various possible categorizations are thinkable – consistent with the MECE principle (i.e. the categorization is mutually exclusive and collectively exhausted) and accurate, but quite frankly, all just more or less random. Furthermore, another point of criticism needs to be added with regard to Holz (1997), Butscher (2002), and Liebmann et al. (2008): giving these three categories names that are commonly

known, but not commonly agreed upon, is highly problematic. In fact, a lot of people use these terms interchangeably, and who is to decide that a loyalty card giving its bearer 5% off the total purchase is a “customer card,” while the loyalty card that does not is in fact an outflow of a “customer club” and should be referred to as such. Holz (1997) himself noted that a clear distinction of the terms “customer club” and “customer card” does not exist in literature and is problematic in practice. Is dialogue-oriented communication more dominant in this type of program and do the money- and payment-related advantages outweigh regular club benefits in that type of program? Not only does no clear-cut categorization spring from these variables, but the distinction is also superfluous. For the reasons stated above, it is thus believed that this discussion takes things too far.

The contributions of Holz (1997) and Butscher (2002) were, however, valuable in that they highlighted certain forms of customer clubs that are not to be mixed up with the various types of loyalty schemes that form the basis of this work. To be precise, book and music clubs, fan clubs, club companies, and warehouse clubs will not be further touched upon in this paper. As opposed to these four variations, the rebate clubs the authors referred to, possess all classical features of loyalty schemes. Likewise, B2B clubs are a form of loyalty scheme, despite being targeted at a different audience. In the course of this paper, the terms customer club, customer card, and frequency club will be considered synonyms together with other common names such as loyalty program, bonus program, frequency program, or reward program. For each of these, not the name, but a description of the program’s particular configuration (e.g. the target group, cost of membership, etc.) will allow the reader to differentiate.

Finally, a few other examples of classifications will be presented here. None of these individually might be the one and only correct answer, but at least they do evade a previous point of criticism: the naming issue. For instance, Berman (2006) suggested the following typology of loyalty program types:

- Type 1: members receive additional discount at the register
- Type 2: members receive 1 free when they purchase n units
- Type 3: members receive rebates or points based on cumulative purchases
- Type 4: members receive targeted offers and mailings

Numbering the different kinds of loyalty schemes from Type 1 to Type 4 and sorting them by the level of sophistication from low to high, is arguably a much more elegant solution than that pursued by Holz (1997), Butscher (2002), and Liebmann et al. (2008). Hereby, Type 1 programs are nothing more than electronic coupons, while the other three types rely on psychological mechanisms that attempt to increase the customers’ purchases by specifying a particular threshold that needs to be exceeded. Type 2, then, is a simple variation of that kind,

while Type 3 programs demand a higher level of administrative effort. Finally, Type 4 solutions resemble the most refined form of reward programs. In addition to using the program as a different form of promotional tool, the company can analyze the generated data and use it to improve various aspects of the program as well as other parts of the organization.

A further example of categorization is that of Dowling & Uncles (1997). The authors, no strangers to the field of loyalty program research, proposed a fundamentally different approach: a classification according to the timing of the reward on the one hand and the reward's support of the product or service value proposition on the other hand. By contrasting two variations of timing (immediate vs. delayed) with two variations of the type of reward (direct support of the product's value proposition vs. other indirect types of reward) on a 2 by 2 matrix, the authors ended up with four kinds of reward schemes:

- Retailer/brand manufacturer promotions: direct support of the product's value proposition coupled with an immediate reward (e.g. price promotions).
- Airline frequent-flyer clubs, coupons, and tokens: direct support of the product's value proposition coupled with a delayed reward (e.g. the GM card, allowing the card holder to accumulate a discount redeemable towards the purchase of a new General Motors vehicle).
- Competitions and lotteries: other indirect types of reward coupled with an immediate benefit (e.g. instant scratches).
- Multiproduct frequent-buyer clubs: other indirect types of reward coupled with a delayed benefit (e.g. the Australian coalition scheme Fly Buys).

Rowley (2004) took yet another path by presenting the following categorization:

- Retailer schemes: operated by or on behalf of individual retailers. These might also include shared schemes such as the Tesco Clubcard in the UK (see Chapter 3.3.2 for a distinction of program types by operating company).
- Coalition schemes: program management is independent from any of the partners.
- Financial services schemes: typically associated with credit or debit cards.
- Online schemes: seek to cultivate loyalty among online consumers.
- Frequent flyer or frequent travel schemes: reward frequent users of travel-related services for their patronage.
- Geographically based schemes: rest upon repeated patronage of related outlets in a particular geographic area (e.g. shopping center or airport loyalty cards).

Unfortunately, Rowley's classification follows no clear pattern. Next to retailers and financial services, the author mentioned another very broad group (travel), which includes various components such as airlines (transportation) or hotels

(accommodation), a special category for all online schemes (including retailers, service providers, etc.), one group based on the program's organizational structure (coalition schemes; while stand-alone and possibly also shared schemes are thrown into the group of retailer schemes), and finally one group that almost seems like it received its own category only because it did not fit anywhere else (the geographically based schemes).

It can be seen that many different categorizations and typologies are thinkable. None of them are necessarily incorrect (even though some provoke criticism more than others), but neither do any appear to be the ultimate answer either. In the following sub-chapters, a comprehensive overview of the range of options a company has when determining the structure of its loyalty program will be presented.

3.3.1 B2C vs. B2B

A fairly evident distinction of loyalty schemes is that into programs targeted at the individual end consumer and those aimed at business partners in B2B transactions. Possibly due to their less extensive spread, B2B programs have received far less attention in the literature and remain understudied. Professional users, companies purchasing goods for their own production, or resellers could all be the target of a B2B scheme (Butscher 2002, Lacey & Morgan 2009). An example would be the Preferred Partner Program of the electronics manufacturer Toshiba. Retailers can enroll in this scheme to receive benefits such as increased rebates, demonstration units to be tested by their customers, or an option to register for special deal periods which allot additional rebate to the retailer if such is able to sell a particular amount of specified products within a given timeframe. Incentivizing a retailer with, say, a 5% additional rebate if more than 50 of the manufacturer's laptops are sold within the next month, is not so very different from rewarding the individual customer with a 5% discount on yearly turnover upon reaching a threshold of 2,500 EUR at the same chain.

As far as B2C clubs are concerned, one can distinguish between retailer, manufacturer, and service provider schemes. Compared with B2B programs, consumer schemes certainly remain the dominating force both in research and practical application and are also the main focus of this paper.

3.3.2 Stand-Alone vs. Shared vs. Coalition

Any company developing a loyalty scheme faces the question of whether to finance and administrate it alone or to get partners on board. Furthermore, if the

decision is taken in favor of partners, the initiating organization has the option of being the dominant sponsor who runs the scheme or to be one of many equals in a coalition, in which case the program is usually administrated by a specialized third party (see Chapter 4 for a detailed description of coalition schemes).

Describing what they considered the basic scheme options among which companies have to take their decision in the creation of a program, Stone et al. (2004) presented the following alternatives:

- None
- Solus: stand-alone programs (e.g. Safeway Club Card in the US)
- Shared: the main company lets customers collect points at a range of partner companies as well (e.g. Tesco Clubcard in the UK)
- Consortium: coalition schemes where an organization outside the circle of sponsors usually sets up and runs the program (e.g. Payback in Germany)

While the differentiation into stand-alone and coalition schemes is a very common one, the category of shared loyalty schemes is not so clear cut. Partnerships are generally defined by the ability to *earn* points with each partner. Whether they can be *spent* at these partners or for other companies' products or services does not play any role in this case. Stone et al. defined a coalition as a scheme where a third party sets up and runs the program. Reinartz (2006), on the contrary, suggested that all multi-firm variations may be run either by the dominant partner, any other partner, or a third party. Theoretically, Reinartz is certainly right in that coalitions need not necessarily be run by a third party as it is at least thinkable that a company in the circle of partners takes on this task (if data protection policies allow), but this is still usually the case in practice.

It is argued that the defining element is more likely to be that of the degree of dominance of the principal firm. As for shared schemes, for example, Stone et al. (2004) mentioned the Tesco Clubcard, because customers are able to collect points at other partner companies such as the UK department store Alders or the electricity giant E.ON. Indeed, becoming a partner in a strong loyalty scheme brand is also an option. It needs to be added, however, that in the case of Tesco, the percentage of points accrued via partner organizations is still comparatively small. For that reason, as well as due to the fact that certain companies allow their program members to collect points with other loyalty programs (e.g. many hotel groups give customers the option of either accruing points with their own scheme or air miles with some airline's frequent traveler program), classification might seem a bit difficult. While categorizations that are not guided by clear rules are generally problematic, this just might be the next best thing in this case. It does not matter who runs the loyalty scheme: a shared program will be given when a partnership is clearly dominated by a single firm (as is the case with the

Tesco Clubcard), while a coalition scheme is present when the parties to the program are regarded as equal partners (as is the case with Payback in Germany, despite the fact that some of the partners in the scheme are naturally larger than others).

3.3.3 Within Sector vs. Across Sector

This question relates to partnerships (i.e. shared or coalition schemes) only. Any partnership might include firms from the same sector or only companies from different sectors (Reinartz 2006). Alliances encompassing various airlines within one frequent flyer scheme are famous examples of intra-sector partnerships. As far as retailing is concerned, however, most shared and coalition schemes include different non-competing sub-sectors. A typical coalition scheme might thus include a grocery, a fuel, and a sporting goods retailer, but not two competing food retailers.

3.3.4 In-House vs. Outsourced Administration

As far as program administration is concerned, there are generally two options for stand-alone loyalty schemes: running it in-house or outsourcing it to a specialized company. For shared schemes, the options are threefold: having it run by the dominant firm, any other partner, or a third party. Finally, companies employing a coalition scheme can decide whether the program is to be administered by one of the partners or by a specialized company. As mentioned previously, shared programs tend to be run by the dominant company, while, probably for both data protection reasons as well as the aim of creating an equal atmosphere among the partners, coalition schemes are usually run by a third party.

3.3.5 Target Group

Deciding on the target group of the loyalty scheme involves two basic questions: (1) should the program target all or only specific groups of current customers and (2) should it aim only at the current customers or at potential new customers as well?

Butscher (2002) accurately pointed out that any decision on the target group within the range of current customers naturally depends on the underlying goal of the loyalty scheme. If, for instance, the goal is to develop a comprehensive customer database in order to be able to reap the benefits of direct marketing, the target group will have to be very broad. If, however, the objective of the whole

undertaking is to secure or intensify relations with the top customers, the target group needs to be adapted accordingly. Most importantly, the overall program structure and particularly the reward structure, needs to be matched with the strategic goals of the company. Eventually, it needs to be kept in mind that these goals that were mentioned merely as examples do not necessarily exclude each other. A program might, for instance, allow for points collection among the whole range of customers and at the same time offer special events to top customers only.

An interesting point in this discussion is the fact that both researchers and practitioners tend to focus on the logical target of heavy users. Why would it not make sense to put more effort into maintaining a relationship with those 20% of customers that generate 80% of the firm's revenues (as has been shown to be the case in many industries), as opposed to investing too much energy in sporadic customers who do not spend much? Pointing into that direction is research focused on coupling loyalty programs with a measure of profitability (e.g. Reinartz & Kumar 2002, Kumar & Shah 2004). Other authors take it for granted that "in order to maximize loyalty and profitability, a company must give its best value to its best customers" (O'Brien & Jones 1995, p. 76) or that "the primary target group of your customer loyalty programme should be your most important customers, those who constitute the major portion of your business" (Butscher 2002, p. 6). Still, many organizations, including the best practice example Tesco (see Humby et al. 2008), have quite successfully employed the principle of treating all customers equally (despite having previously experimented with a different approach). In this respect, Wansink (2003) presented an interesting piece of research, featuring results from interviews with 41 managers of loyalty programs, as well as two surveys of 132 brand managers and 643 customers respectively. 80% of the brand managers thought that heavy users would be the most profitable user segment to target, while only 18% opted for the light users. Results from the customer survey showed that light users might even be an overlooked segment. In fact, implementing a high rewards program among heavy users was shown to be the least cost-effective in the scenario employed by the author. Instead, low and moderate reward programs targeting light customers may generate higher incremental sales and may be more profitable than initially expected. Still, authors like Wansink or Kumar & Shah (2004) do have one thing in common: they suggest a loyalty program targeted at different user segments simultaneously, but tailored in terms of their reward values. Even though it will depend on the individual situation of the company, this seems like a sound suggestion, as long as it can be implemented in a profitable manner. In addition to that, a loyalty scheme can help to identify the valuable and the not so valuable customers in the first place!

As far as the question of whether the program should be aimed at current or new customers is concerned, Tomczak et al. (2008) made the point that customer

relationship management demands a concentration of activities on the existing customer base. For Tomczak and his colleagues, new customers are consequently nothing but a positive side-effect. If one were to go with the strict meaning of the words, that is probably true. After all, one can only foster a relationship with existing consumers, while winning new ones is a different story. This might be true, but winning over new customers is always part of the project, be it that they are lured through positive word-of-mouth by current members or that they got wind of the benefits that await them in any other way. Not without reason is the acquisition of new customers usually part of success evaluation (e.g. at American Express, as O'Brien & Jones 1995 explained) or part of the program development process (see e.g. Kumar & Shah 2004). The amount of research on the effectiveness of programs to acquire new customers is still fairly small and mostly forms part of studies dealing with the effectiveness of loyalty programs overall, such as those reviewed in Chapter 2.3. To give just one example, in their study determining the effect of loyalty programs on repeat purchase behavior, Meyer-Waarden & Benavent (2006) found they had "little effect on recruiting new customers" (p. 81). They supported this conclusion with the insight that 88% of the program members in their sample were already customers before subscribing. However, this still leaves 12% of the sample that were not customers before joining the loyalty program. This is certainly not the majority, but a number that feels fairly considerable nevertheless. As the authors also pointed out, the reward structure naturally drives the impact that loyalty schemes can have on the acquisition of new customers. While programs that are mostly used as promotional tools giving discounts on promotional items have a higher ability to attract new customers, things might look different when a large amount of points needs to be collected in order to receive a reward. Further information on customers' word-of-mouth behavior can, for instance, be found in Reinartz & Kumar's (2002) or Ferguson & Hlavinka's (2009) work.

3.3.6 Open vs. Closed

Customer loyalty schemes can be distinguished into open and closed programs. While open programs welcome any customer to the club, closed programs usually require a financial commitment in the form of an admission or membership fee, and/or particular customer-specific characteristics in order to participate. Thus, by setting up other preconditions for membership as well, creators of closed programs might actually be going one step further than just asking whether the scheme should be free or come at a cost.

As for their actual prevalence, open clubs have clearly gotten the upper hand, bringing with them large numbers of members, but also negative side-effects

such as scattering loss through inactive members, for instance. What is important to note is that closed programs can naturally create a much tighter fit with the target group. Particularly with regard to the overall appearance and reward structure, closed schemes are much easier to tailor to customer preferences. By contrast, members of open programs will feature much more heterogeneous preferences (Hoffmann 2008). As for advantages and disadvantages of closed programs, Hoffmann extracted two notable points from Felser's (1997) and De Wulf et al.'s (2003) contributions: on the one hand, the creation of access barriers could create an impression of exclusivity and consequently fulfill a function of prestige for members, while on the other hand, high membership fees could deter otherwise valuable customers. What could be added to the negative aspects is that not just the fees, but also the simple existence of an exclusive circle from which they are excluded, could alienate customers. Furthermore, a smaller number of members does not necessarily help to make the program cost-efficient. On the upside, however, membership fees obviously help to cover the costs of closed clubs.

As is the case with many of the aspects revolving around decisions on program structure, the choice to operate either an open or a closed club is similarly guided by the strategic goal of the club. There are many variables interfering with this decision and Butscher (2002) presented a set of guidelines that may be useful to reflect upon. He summarized that open customer loyalty schemes tend to be the better choice for companies who

- possess little knowledge about their current and potential future customers
- prefer a rather general approach
- have a big, long-term budget at their disposal
- operate on unsegmented markets
- are set in consumer goods markets
- are retailing commodity products

On the contrary, closed programs tend to be better for organizations who

- primarily try to approach their top customers
- prefer a rather focused approach
- command a smaller budget
- operate in clearly segmented markets
- are not set in consumer goods markets
- have a relatively homogeneous target group

Keeping advantages and disadvantages in mind, these guidelines can certainly help, but are not free from criticism either. Would not a relatively homogeneous target group (similar to a clearly segmented market) speak for an open program as well, since standardized rewards are likely to meet rather homogeneous prefe-

rences? Furthermore, why, without considering its capabilities, should it matter whether the company prefers a general or a focused approach? Should not the actual situation determine the appropriate approach?

3.3.7 Member Limit

As for this point it should be mentioned that it is rather theoretical by nature and finds practical application in extremely rare cases only. The reason why it is still discussed here is that it might in certain exceptional constellations be an interesting option to introduce a member limit to a loyalty program. In fact, it might even have the potential to introduce some element of novelty to what Capizzi & Ferguson (2005) called a loyalty trend of the 21st century: today's ubiquity of loyalty cards.

3.3.8 Reward Structure

Last, but certainly not least, the reward structure is probably the element most critical to the success of a loyalty program. Found to be the most important among the different elements of the operative structure of a loyalty scheme, Lara & De Madariaga (2007) added that rewards were even considered more important among non-users than among loyalty scheme members. For the company, deciding on the reward structure is always a trade-off between what customers want and what the company can provide at a reasonable expense. From the customer perspective, there are five elements that determine a program's value (O'Brien & Jones 1995):

- Cash value: the value of the reward in percent of the spending amount necessary to achieve the reward. For example, if a customer has to spend 2,000 EUR at a fuel station to earn enough points to trade in for a can of engine oil worth 20 EUR, this would equal a cash value of 1%.
- Choice of redemption options: the variety of rewards a customer can choose from. For instance, members of Lufthansa's Miles & More frequent flyer program can redeem their miles not only for airline tickets, but for a whole range of goods from wallets to designer garden furniture.
- Aspirational value: the desirability of the reward. For example, a top customer who is rewarded with a Ferrari for a weekend or a chance to meet the shoe designer Manolo Blahnik during a special off-hours shopping evening in an upscale department store might perceive this as more desirable than a simple voucher worth 3 % of annual spending at the store – despite the fact that the cost of the reward might be the same in both cases.

- **Relevance:** the ability of a program to be valuable to a customer in the first place. For instance, a program that lets members collect only air miles towards a long-haul flight is likely to be irrelevant to all but heavy customers of the organization, as it will probably take the majority of customers a very long time to accumulate enough air miles for the flight. A study by Sneed (2005) highlighted the importance of this factor by showing that 69% of those customers who stopped participating in a loyalty program cited the long time it took to receive a reward as the main reason for doing so.
- **Convenience:** the scheme's ease of use. For example, members of the loyalty program of the Austrian hypermarket chain Merkur can optionally use their bank card as a membership card, freeing up space in their wallets. Furthermore, the fact that most Austrians carry a bank card in their wallet at all times, makes this program very convenient to use.

Parker & Worthington (2000) contributed to this discussion by noting that customers' loyalty towards a program is influenced by five things: (1) the degree of satisfaction the customer feels towards the rewards, (2) the offering of competitive loyalty schemes, (3) other customers' feelings towards the program, (4) the media, and (5) the social norms. Similarly, Stauss et al. (2005) noted in their study on customer frustration with loyalty schemes that programs should provide genuine value to the consumer and added that it should be possible to claim these benefits at any time and without additional effort.

Essentially, customers' wants need to be balanced with the cost of the rewards to the company. Deciding on the type of reward is only the first step, however. Should more important customers receive bigger rewards? Should customers receive them immediately or in the future? Should psychological mechanisms be exploited that take effect when customers need to reach a certain barrier to receive the reward? Should the company focus on financial benefits to the consumer or provide other non-financial benefits to its program members? The following sections will lead the way through the different elements that need to be considered when dealing with a program's reward structure.

1) Financial vs. Tangible vs. Intangible

Generally, rewards can be differentiated into so-called hard (i.e. tangible) and soft (i.e. intangible) rewards. Reinartz (2006) proposed that the first category consists of all financial and other tangible rewards, while the other contains rewards that are based on psychological or emotional benefits. Consequently, rebates, vouchers, free products, special promotions, and other non-financial benefits such as late check-out at the hotel, access to a special lounge at the airport, or a special check-out queue at the supermarket would all be considered hard re-

wards. Reinartz’s very narrow definition of soft rewards thus only referred to what the author called the “badge effect:” the psychological benefit of receiving special treatment or a special status (e.g. becoming a “Gold Customer” and later a “Platinum Customer” in a loyalty scheme). This, the author pointed out, usually comes in a package with actual tangible rewards, such as the access to a special lounge at the airport mentioned previously. Furthermore, Reinartz argued, soft rewards can become more important than hard rewards in cases where the buyer shows high involvement with the product or product category (e.g. members of Harley Davidson’s owners group HOG enjoy the sense of being part of a community, but do not receive many hard rewards).

Reinartz’s categorization is certainly an interesting one, but leads to a single dominant and heterogeneous group (i.e. that of hard rewards). To further dissolve this category into more homogeneous segments, the classification depicted in Table 2 is proposed.

Category	Variations	Examples
Financial	–	Price promotions available to members, electronic coupons, money-off vouchers
Tangible	Utilitarian	Products or vouchers for products catering to basic needs (e.g. basic household, personal, or food items)
	Amusement/Luxury	Airline tickets, theater tickets, jewelry, an evening at a high-end restaurant
Intangible	Service	Special hotline, exclusive check-out line at the supermarket, preferential treatment, late hotel check-out, airport lounge access, payment function of the card
	Information	Early notice of upcoming promotions, customer magazine giving background information on products and services
	Social	The psychological benefit of receiving special treatment (the “badge effect”), sense of belonging, feeling of participation
	Charity	Support of disadvantaged third parties such as the donation of accumulated points to an NGO
	Environment	Support benefiting the environment such as the donation of points to green projects

Table 2: Classification of Reward Types

The first category depicted in Table 2 concerns all kinds of financial rewards. The customer might receive 5% off his purchase at the cashier or in the form of a voucher mailed at the end of the year (covering 5% of the customer’s total annual purchases). Other examples of financial rewards would be special promotions for program members, special electronic coupons stored on the customer loyalty card, or promotional money-off vouchers sent via direct mailings. The second category of rewards refers to all tangible benefits the customer might receive,

such as tickets to an amusement park or a free product. The distinction into utilitarian and amusement/luxury rewards was made as this has important implications for customer acceptance (see e.g. O'Brien & Jones's 1995 criteria of aspirational value in the opening paragraph of Chapter 3.3.8). In fact, Reinartz (2006) even considered the hedonic value of rewards as a separate criterion along which the reward structure can be described. A noteworthy contribution to this topic comes from Kivetz & Simonson (2002). The authors investigated the impact of the level of effort loyalty program members had to invest to receive the reward on their preference for specific reward types. In a series of studies, they found that higher program requirements caused a shift in preference towards luxury rewards. In a way, customers felt like they earned the right to indulge. In addition to that, the authors added, this effect was even stronger among customers who tend to feel guilty about consuming luxury products and services. In the context of a loyalty scheme, that would mean that shoppers who need 30 instead of 15 shopping trips to obtain the reward are more likely to prefer a reward with hedonic value (for further information on this topic, see e.g. Hirschman & Holbrook 1982, Berry 1994, Dhar & Wertenbroch 2000, or, for research in a service setting, Daryanto et al. 2010).

Finally, loyalty programs can provide various kinds of intangible rewards to the customer. What Reinartz (2006) subsumed at least partly under the category of "*hard* rewards" (which arguably feels wrong when talking about an *intangible* reward), might involve special service or information, as well as social benefits such as those described by the author as soft rewards. As mentioned before, social benefits are often coupled with services or other types of rewards and might be considered a by-product of hard reward types. The two variations of charitable and environmental reward types are a comparatively recent trend. For example, members of Lufthansa's Miles & More frequent flyer program can donate 20,000 miles to the SOS children's village, in return for which Lufthansa will cover the (unspecified) costs of enabling one young African to attend secondary school or of a vocational training center for a period of two months. Alternatively, miles can be donated to support projects that conserve endangered species, replant forests, or conserve habitats. It remains unknown, however, how many customers have already donated 10,000 of their hard-earned miles to mark and consequently protect one Chinese snow crane or to plant and protect five trees in South Africa.

2) *Firm-Related vs. Non-Firm-Related vs. Mixed*

Some discussion has been going on among researchers as to whether rewards should be linked to the products or services supplied by the firm, or whether they

should be unrelated or, indeed, mixed. Frequent flyer programs, for instance, allow customers to collect miles and trade them in for an airline ticket or a business-class upgrade. Thereby, the airline directly supports the value proposition of its products. Several airlines have decided to offer a greater choice of redemption options to their customers, allowing for miles to be exchanged for other products like alcohol, perfume, or clothing. By doing so, Lufthansa falls into the mixed rewards category. Another example would be that of a supermarket that gives away points to be redeemed for an airline ticket. For obvious reasons, this type of reward cannot be considered to be supporting the value proposition of the company's products.

Dowling & Uncles (1997) referred to these two options as offering either direct or indirect rewards (which he also used as classification criteria: see the beginning of Chapter 3.3) and suggested that rewards which directly support the value proposition of the product or service were preferable to indirect rewards. They arrived at this judgment after considering the findings of a previous study by Rothschild & Gaidis (1981). Relating to something similar to what Mauri (2003) described as card loyalty, Rothschild & Gaidis (1981) referred to what might be dubbed "deal loyalty." Leaning on behavioral learning theory, the authors pointed out that deals can lead to brand switching as "the deal is more likely to be reinforcing than the product" (p. 74). This can be particularly problematic for low-involvement products, where, as opposed to the product itself, the reward might become the primary incentive to purchase the product. The issue with this situation is, Dowling & Uncles (1997) summarized, that once the incentive is taken away or copied by a competitor, the primary reason to buy the product disappears. That, then, is also the reason why many companies find themselves in a vicious cycle of ongoing promotions. By contrast, high-involvement products are often accompanied by a small incentive, but bought primarily because of the product. Consequently, the authors argued, direct (i.e. firm-related) rewards are preferable to indirect (i.e. non-firm-related) ones.

Yi & Jeon (2003) followed this argument and further underlined that the concept of Dowling & Uncles (1997) really is very similar to that employed by Rothschild & Gaidis (1981). In fact, Yi & Jeon (2003) argued that the direct and indirect rewards that Dowling & Uncles (1997) mentioned were conceptually consistent with Rothschild & Gaidis' (1981) "primary and secondary enforcers." According to Rothschild & Gaidis' definition, primary enforcers such as the product, provide intrinsic utility to the customer, while secondary enforcers like coupons or loyalty program stamps need to be converted first. In other words, while the authors would advise a company to focus on promotions for products with 10% more content for a limited period of time (as opposed to handing out vouchers), Dowling & Uncles (1997) would recommend letting customers exchange their points

from ten purchases of a product against yet another product. It is probably unfair to claim that Dowling & Uncles simply applied this idea from the field of promotions to that of loyalty schemes and gave it a different name. The difference lies in the fact that the determining element in the case of Rothschild & Gaidis (1981) was that of “redemption” – which was only true for secondary enforcers. In Dowling & Uncles’ (1997) view on loyalty schemes, redemption always takes place, with the only question being *for* what type of reward (a direct firm-/product-/service-related reward or an indirect non-firm-/product-/service-related one).

Either way, the praise of firm-related rewards has found other followers as well. Wansink & Seed (2001) or Reinartz (2006), for instance, also concurred with Dowling & Uncles (1997). Additionally, based on a contribution by Lobb (1997), Wansink & Seed (2001) reminded their readers of the possible extension of the view from the product to the brand. Their example is that of a beverage company rewarding consumers with sports gear. While this might at first sight oppose Dowling & Uncles’ (1997) proposition, it might not entirely. It would, namely, not be true if this type of reward was chosen as part of a brand-building effort trying to establish a sportive brand image. This issue was also discussed by Roehm et al. (2002), who found that incentives that overlap with brand associations can help post-incentive loyalty. Thus, even rewards supporting the brand can be considered beneficial to the company.

Still, the reality is everything but consistent with these authors’ views. Most, particularly point-based programs indeed offer mixed rewards in terms of their support of the value proposition of the product or service. Even the often-cited best practice example Tesco has concluded that the benefits of satisfying customers with a larger choice of redemption options outweigh the disadvantages of not offering direct rewards (Humby et al. 2008). Obviously, more simple forms of loyalty schemes such as the buy-n-get-1-free type or those programs that are functionally reduced to a simple form of price promotion (e.g. handing out store-wide vouchers worth a certain percentage of annual purchases by the customer) rely on the proposed rule. Nevertheless, thorough empirical proof of whether this is applicable to all forms of loyalty schemes and whether it is really preferable to offering more choice to consumers is still outstanding. There are, after all, also authors who see the future in offering a large amount of reward options, made possible through partnerships and alliances (e.g. Kumar & Shah 2004).

3) *Intrinsic vs. Extrinsic*

An issue that is fairly similar to that described in the previous section on the rewards’ relation to the firm, is that of offering either rewards intrinsic or extrinsic

for the consumer. Hereby, the critical question is whether the rewards create a good fit with the customer's natural purchase motivation (Meyer-Waarden & Benavent 2008). An example that Meyer-Waarden & Benavent gave was that of financial rewards: these would be considered intrinsic for a person who bases purchase decisions on price and extrinsic for a consumer whose main motivation to shop is pleasure. Consequently, the authors argued that extrinsic rewards would only buy the customer's loyalty for one transaction – or even worse, reduce the person's intrinsic motivation to make the purchase. Instead, intrinsic rewards would be considered valuable by the consumer and reinforce natural shopping behavior.

In a way, this question goes one step further than the previous section in taking the customer's perspective into account. For example, handing out vouchers to be exchanged at the supermarket where the underlying revenue was generated would be considered firm-related rewards, while offering free flights to customers of the supermarket would count as non-firm-related. However, both types of rewards could be intrinsic or extrinsic to a specific customer in that they reflect or do not reflect his actual buying motivation.

One problem with Meyer-Waarden & Benavent's assertion is that offering only intrinsic rewards will impede any endeavor to cultivate cross-selling. This is also the reason why Tesco has decided to mail out customized vouchers partly valid for products that are part of the customer's regular buying behavior and partly for other products (e.g. in neighboring categories) that have never appeared on that customer's record of previous transactions (Humby et al. 2008). Following Meyer-Waarden & Benavent's (2008) line of thought, the latter type of vouchers would be classified as extrinsic rewards. At the same time it is undisputed that these rewards are effective in establishing long-term purchase motivation in respect of the new product in at least some of the recipients. Thus, this just might be another one of those questions where neither extreme is desirable. Instead, a healthy mix of intrinsic and extrinsic rewards might best serve the purpose of providing both immediate value to the customer and the possibility to engage in successful cross-selling.

4) Rate of Rewards

A company developing a loyalty scheme must, as briefly touched upon in the section on reward types (financial, tangible, or intangible), also decide on the actual value of the reward. Thereby, the rate of rewards refers to its monetary value as a percentage of the sales volume necessary to receive it. In other words, the rate of rewards describes how much a customer gets in return for his purchases (Reinartz 2006). Naturally, the rewards are a big cost factor for the company and

offering a rate of reward of 2% instead of 1% can have a big impact, particularly in low-margin industries. Certainly, the company will want to make sure that an increase in loyalty can be attained with these measures to a larger degree than the associated costs. One advantage for the company is that the price to end consumers is generally perceived as the value of the reward by the customer, while the direct reward cost of handing out a 10 EUR voucher redeemable at a supermarket's own chain resembles only the wholesale price of the items purchased with it (not taking other overhead costs into account). In this regard, an interesting point needs to be kept in mind: the cost component that lies behind these loyalty programs differs quite significantly between industries. For example, airlines employing a frequent flyer program can simply fill their otherwise empty seats with passengers redeeming their miles. In an article of the Financial Times (2002), an associate principal at McKinsey revealed that in 2000, *sales* of frequent flyer miles by the five biggest US airlines to retailers, hotel chains, credit card companies, and other organizations for use in their respective loyalty schemes totaled around 2 billion USD and accounted for an astonishing 40% of these airlines' combined operating profits. In a more recent example published in the Washington Post, Kraleov (2009) reported that United Airlines sold miles *worth* around 1 billion USD to the US consumer and commercial bank Chase, its credit card partner, in 2008. In contrast to airlines, however, rebates on merchandise or other rewards that retailers offer their program members directly affect their profits.

Still, the basic question that companies face is that of deciding on the optimal rate of rewards. What rate do customers still perceive as valuable enough to influence their behavior, while it is at the same time not too costly for the company? For instance, would a change in the rate of rewards from 1% to 2% make sense for a supermarket? The answer is, yet again, that no universal answer can be given.

In a study investigating the rate of rewards of the later abandoned ABC Card of the former British supermarket chain Safeway (which has meanwhile been acquired and renamed Morrisons), Parker & Worthington (2000) detected that the program did not operate in what they defined as a fair and equitable manner. This conclusion was primarily based on the finding that points reflected less value, the more a customer had to redeem for a product. In other words, the best-value products were available after a few visits. Furthermore, the authors showed that the value of a point was more than twice as much for the best offers than it was for the worst offers. This meant that the rate of rewards fluctuated between around 1% and 2%. By comparison, at the same time, the value of a point offered by the Advantage Card of the British chemist Boots was significantly higher at over 4%. While pointing out a structural problem that might be considered unfair by certain customers, Parker & Worthington also failed to provide an answer as to what the appropriate rate of reward would have been.

What may be noticed, however, is that different industries can afford to provide different reward rates. The main reasons behind this are probably the particular margin structure in the different industries, as well as the differing costs associated with the rewards. Thus, while Safeway offered a reward rate of around 1-2% in value to its customers, Boots could afford to give away over 4%. At the same time, a sandwich shop that gives away a free sandwich after the customer has already purchased 10 of them, is effectively handing out a discount of roughly 9.1%.

To test customer reactions towards different reward rates, Wansink & Seed (2001) conducted a survey study comparing programs with high, moderate, and low reward characteristics. The *high-reward* program featured a monthly booklet with information as well as a voucher worth 1 USD to be used for the purchase of any product in the product line. Additionally, sending in 10 proofs of purchase of a product in the product line (e.g. a coffee mug) would entitle the customer to a free product of that kind. By contrast, the *moderate-reward* program gave away quarterly booklets with vouchers worth 0.5 USD and the opportunity to exchange 20 proofs of purchase for a free product, while in the *low-reward* program only a quarterly one-page newsletter would be sent out, containing a 0.25 USD coupon and the option to mail in 20 proofs of purchase for a free product, which would, however, cost the customer an additional 5 USD in shipping and handling fees. Keeping in mind that the survey participants consisted of only 153 people (who were members of the not further specified “Brand Revitalization Consumer Panel”), the authors discovered that loyalty schemes offering moderate reward value had the most cost-effective impact on increasing purchases. One can learn from this, then, is that very generous loyalty programs may have trouble remaining profitable, while those providing too little reward value to the customer may be ineffective in fostering an optimal amount of behavior change among their program members. Again, this rule certainly does not have universal application, as companies operating in different settings and different industries are likely to arrive at unequal estimations of variables such as reward cost or sales uplift.

At the most basic level, Wansink & Seed reminded their reader, the program will be profitable if the following function turns out positive:

$$\text{Gain/Loss} = (U_n P) - (U_o P) - R - A$$

Hereby, U_n refers to the new number of units sold (i.e. following the implementation of the program) and U_o to the old number of units sold (i.e. prior to the implementation of the program). Furthermore, P describes the price, R the cost of the rewards, and A the administrative expenses (please note a change to Wan-

sink & Seed's formula: the authors did not put the actual cost of the rewards into their calculation, but the "dollar amount of coupons or other incentives used" (p. 216); in most cases, however, the dollar amount would not be an accurate reflection of the underlying costs).

5) *Tiered vs. Non-Tiered*

Contrary to what Parker & Worthington (2000) found that Safeway had practiced, companies who believe in rewarding their heaviest spending customers will provide them with more valuable rewards than their light spending customers. Briefly discussed in relation to the decision on the target group of the program (see Chapter 3.3.5), tiering was favored by a large amount of authors (e.g. O'Brien & Jones 1995, Butscher 2002, Kumar & Shah 2004), but not always employed in real life. Tesco, for instance, decided that treating all customers equally was the way to go, despite having experimented with a tiered reward structure (Humby et al. 2008). There are, however, also numerous examples of companies that successfully operate a tiered reward structure. Lufthansa's Miles & More program, for instance, consists of four tiers: basic members, frequent travelers, senators, and HON circle members – with tier-membership depending upon accumulating a specific number of miles in a certain period of time. Hereby, benefits range from a bonus of 25% on future miles collection (until the status is lost again after a while) to additional baggage weight allowances and access to lounges and special check-in counters. Naturally, benefits increase level by level. While frequent travelers can enter only business class lounges, HON circle members are allowed into first class lounges when traveling with a Lufthansa ticket of any fare class. Another goody granted to the heavy user group of HON circle members is that they are picked up with a luxury limousine at the airplane if their flight is not assigned a gate dock. Another famous example stems from the retail setting. At the time of writing, the InCircle program of the US upscale department store Neiman Marcus featured six tiers. If accumulated points are redeemed for gift cards, the rate of return equals 2% for the first four tiers and 5% for the last two tiers. To move up from the first to the second tier requires an annual turnover of at least 2,500 USD, while the shift from the fifth to the final tier (the so-called "chairman's circle") is dependent upon purchases valuing over 600,000 USD per year. In addition to the higher rate of return mentioned previously, other perks include off-peak shopping hours or special shopping events from tier 5 upwards, or unique experiences like a visit to the offices of Vogue including a glimpse into the magazine's famed fashion closet exclusively for members of the chairman's circle. "How will the customer get to the Vogue

offices?” one might ask. Possibly by driving the new Lexus the InCircle member had previously traded in 1.5 million points for (Sherman 2007).

In what they considered the way of the 21st century, Kumar & Shah (2004) developed a noteworthy conceptual framework for building and sustaining customer loyalty. Incorporating different behavioral and attitudinal analyses via surveys, transaction data, profile data, and a measure for customer lifetime value, the authors proposed a two-tiered reward structure to operationalize the framework. Specifically, a simple and explicit baseline should be provided to all customers, ensuring general awareness and the ability to record a comprehensive set of transaction data. In addition to that, the authors suggested selectively awarding highly differentiated rewards at the individual customer level.

Apart from making heavy customers happy with special perks, tiering has a second major effect. Described in Chapter 2.3.1, Taylor & Neslin (2005) found proof for the existence of what they termed “points pressure.” Further examined by Kivetz et al. (2006), this effect describes a change in the behavior of loyalty program members due to the existence of a certain barrier that needs to be overcome to reach the reward. For instance, this effect caused customers to increase their purchase frequency the closer they came to the barrier. The authors did not explicitly investigate this impact in relation to a whole range of loyalty program tiers, but a similar effect is likely to exist.

In practice, companies employ both tiered and non-tiered loyalty schemes quite successfully (see e.g. Drèze & Nunes 2009 for further details on the effect of program structure on the customers’ perception of status). Nevertheless, all evidence considered, it seems that tiering might very well provide more advantages (e.g. being able to record transaction data on a broad basis while still giving special treatment to the most valuable customers) than disadvantages (e.g. higher reward and administrative costs). Which one to pursue, though, will again have to be determined based on the specific situation and the strategic goals of the company.

6) *Immediate vs. Delayed*

A further decision to be made in the context of reward structure is that on the timing of rewards. On the one hand, consumers naturally prefer immediate rewards or at least short accumulation periods. On the other hand, the company tends to prefer long accumulation periods, as they work as a switching barrier (Reinartz 2006). Customers who are building up points and accumulating turnover to reach a certain barrier thus, in addition to other possible changes in behavior (e.g. increased purchase frequencies), also find themselves in a form of lock-in (Kim et al. 2001). The reward that awaits them encourages customers to do busi-

ness with the firm. Unfortunately for the company, Dowling & Uncles (1997) highlighted, research had proposed that delayed rewards were less powerful. The authors added that companies often try to mitigate this problem by sending out regular mailings that remind the member of the aspirational value of the rewards. Taking a strong customer perspective, Dowling & Uncles eventually suggested that immediate rewards were preferable to delayed ones.

Certainly, humans often place more value on short-term than on long-term desires (Soman 1998). The reasons why the future is often discounted in such a disproportionate manner are not fully understood (Ebert & Prelec 2003). Ebert & Prelec illustrated that in the first half of the 19th century, Rae (1905, originally published in 1834) had already suggested that people perceive the distant future as pallid and remote as opposed to a more vivid and predictable near future. More recently, to name just one example, Becker & Mulligan (1998) went a step further and analyzed how wealth, mortality, addictions, uncertainty, and other variables affected how consumers discount on future utilities. So while it is proven that this effect exists, is it worth foregoing the benefits of a delayed reward structure?

Interestingly, conducting research in a service setting, Keh & Lee (2006) found a moderating effect of satisfaction on the timing of rewards. In fact, delayed rewards were discovered to work better than immediate ones if the service experience was satisfactory. Studying promotion options in general, Zhang et al. (2000) noticed that the sales impact and the sales on discount were always higher for immediate (or what they called front-loaded) promotional initiatives. At the same time, they showed in their two published empirical studies that rear-loaded (i.e. delayed) promotions may be the more profitable option under certain circumstances. The authors demonstrated that in markets characterized by high variety seeking behavior, delayed measures will be preferable, while the opposite will be true only for markets with high inertia.

To sum up, it is not fully understood how customers react differently to delayed as opposed to immediate rewards. Individual studies have identified particular situations in which one approach is preferable over the other, but no piece of research was able to give a well-grounded more general recommendation. What is known, however, are the advantages and disadvantages of each approach. Using immediate rewards might be preferred by consumers and result in higher redemption rates, but will not make use of valuable psychological effects resulting from points pressure or lock-in. Furthermore, one could theorize that customers have gotten increasingly used to being rewarded with delayed benefits, which in turn results in higher acceptance and appreciation of this reward type.

7) *Proactive vs. Reactive*

This differentiation of loyalty rewards is a rather new one, rooted in the work of Kumar & Shah (2004). The authors criticized the common practice of rewarding customers based on their purchase history (reactive) and instead suggested that rewards should at least to some extent be distributed based on the customers' future value (proactive). As an illustration, one of the authors talked about a personal experience with the frequent traveler program of an airline, which he had been patronizing for 17 years. In unrelated communication, both the author and his spouse received a letter offering a chance to upgrade to the next status tier, despite missing the requirements by a few thousand miles each. From this the authors concluded that the airline must have been selectively choosing valuable members from the database and furthermore, that the airline seemed to be "systematically targeting customers based on future revenue potential from the customer and not tenure or other considerations" (p. 324). While it generally seems to be an interesting notion to hand out rewards in a more proactive manner, this example suffers from a few deficiencies. Given that the author had been a member of that airline for 17 years, it appears a bit audacious to claim that tenure had nothing to do with his selection. Moreover, it is probably fair to say that any member who has fallen only a few thousand miles short of the highest status tier, is a valuable customer who deserves this upgrade, even if evaluated based upon his past purchase behavior alone. Maybe a better example would be that of a frequent business traveler who shifts jobs from a company in Germany to a new employer in the United States. Given that he will be in a similar position that requires a lot of national air travel, he will have to pick a new carrier with a new frequent traveler program. If, then, right when this person starts traveling on its planes for the first time, the US airline awarded him with an elite status upgrade (as the company knows his future value), this could really be considered a proactive distribution of rewards. In this rather extreme example, the only way for the airline to know about the customer's actual value would probably be to get access to information situated outside the company. At best, the company might choose to rely on the customer's self-assessment, but overall, this does not sound like a very reliable option. All that is left then, is to base decisions in that regard on the (albeit limited) transaction history of the customer.

Another example Kumar & Shah use is that of the Wyndham hotel chain in the US which might surprise a high-value member of their loyalty scheme with a free round of golf upon arrival (given that the person noted golf as a leisure activity of interest). The question really is whether that customer was classified as high-value due to a future-looking exercise, because only then could the round of golf be considered proactive. In this respect, the difficulty of incorporating fu-

ture-oriented variables is the fundamental issue. Kumar & Shah approached this problem by applying an estimation of customer lifetime value (CLV), currently probably the most promising solution (see e.g. Gupta et al. 2006 for a thorough information basis on CLV). Customer lifetime value models, however, have clear limitations, making it hard to implement a truly proactive reward system. The need to estimate different variables such as purchase frequency or profit margin is just one (though the bigger) part of the challenge. In addition to that, the different available models themselves might lead to values that can vary quite significantly. Diller et al. (2008) called attention to this problem in a comparison of three CLV models (i.e. those by Dwyer 1997, Reinartz & Kumar 2003, and Venkatesan & Kumar 2004), whereby the authors calculated the value for each model using a comprehensive data set from a German retailer of sporting goods. Surprisingly, the results for the average CLV per customer turned out at 128, 184, and 244 EUR respectively. Accordingly, another crucial step in determining a correct (or more suitable) CLV for use in the context of loyalty schemes is the choice of an appropriate CLV model.

In the end, due to its difficult practical application, this undoubtedly intriguing approach by Kumar & Shah (2004) is possibly something that is sufficiently taken into account when simply kept in mind. It would certainly be a preferable approach, but it is simply not easy to implement in practice. Furthermore, Reinartz & Kumar (2002) have highlighted that just because a customer was profitable in the past, does not mean that he will be profitable in the future. Thus, if there is evidence that a customer will probably be worth more in the future than he has been in the past, or likewise, that a customer will not be as profitable in the future as compared to the past, the company can and should attempt to find a way to adequately reflect this in its loyalty program (and indeed, its marketing spend).

3.4 The Value of Data

Next to all other advantages that are commonly named in relation to customer loyalty schemes, the value of data is definitely among the most significant ones today. Not without reason did Schoenbachler et al. (1997) call it a major trend in consumer marketing or did Ferguson & Hlavinka (2006) label the power of data one of the three loyalty trends for 2006 and beyond. Loyalty programs allow for highly detailed information on individual customers to be collected and thereby benefit various aspects of the company. Analyzing the available information generates the ability to take strategic, knowledge-driven decisions. Companies eventually have the opportunity to achieve what only mom-and-pop stores were

able to do: to know their customers. In this chapter, the value of this source of knowledge will be elaborated on and several examples for its use in the business arena provided. An introduction to data mining will then be given (supplemented by an exemplary description of the data mining process in Chapter 3.4.1), and eventually the section closed with an excursion on retailing and shopping basket analysis (Chapter 3.4.2).

So what are the potential benefits of data analysis? The following points should serve as examples to demonstrate the power and business value of data (Clayton-Smith 1996, Hippner et al. 2001, Berman 2006, Kumar & Reinartz 2006, Humby et al. 2008):

- The ability to minimize wasteful (marketing) spending.
- The ability to mass customize marketing communication to maximize the impact of the according marketing activity.
- The ability to identify customer segments with similar characteristics.
- The ability to engage in profitable customer acquisition by modeling expected customer potential.
- The ability to increase revenues through cross- and up-selling, based on a model of the customer's purchase likelihood of specific product sets or services.
- The ability to optimize store layout (e.g. product placement) following a better understanding of purchase behavior.
- The ability to promote follow-up products (e.g. razor blades for a particular razor).
- The ability to reduce churn with predictive models that identify customers who are likely to stop patronizing the company in the future.
- The ability to identify customers who were recently lost and to reach them with an action plan aimed at bringing them back.
- The ability to identify the profitability of the company's customers.
- The ability to identify and track trends.
- The ability to make qualified changes to the range of goods or services on offer.
- The ability to measure and evaluate the effect of marketing campaigns in a better and more efficient manner.
- The ability to improve the success of a necessary product recall by directly addressing affected customers.
- The ability to cheaply acquire new customers for new business areas developed by the company.
- The ability to support business decisions of various kinds (e.g. development of a new product line).

Previously, companies could only rely on market research to facilitate at least some of the things mentioned above. However, market research is also costly, particularly when compared to the benefit yielded from the small sample sizes and imprecise results. Furthermore, market research can only answer particular questions and it falls short of offering the same potential benefits that the analysis of loyalty program data could provide. "...these data are exact: they are not based on a small-scale study, a focus group or instinct – they're actually what is happening. [...] In itself the data can become a high-value asset, as Tesco has proved," Humby et al. (2008, p. 12) summarized getting to the core of the matter. "The effective use of loyalty card data is arguably the most significant benefit of scheme implementation," Byrom (2001, p. 334) concluded – an opinion that many academics and practitioners share.

3.4.1 Data Mining

Unlike the manager of the mom-and-pop store, the CEO of a major retailer will not be able to store the knowledge about the company's customers in his head and draw any useful conclusions from it. The company needs to data mine the information stored in its databases. Customer cards with a magnetic stripe, bar code, chip, and the like, allow the company to capture the individual purchase transactions upon their use, usually during payment of the products or services. Consequently, statistical and other data analysis methods, often coupled with sophisticated reporting platforms (Kumar & Reinartz 2006), allow the company to access this information and use the newly-won insights when taking business decisions. In essence, then, data mining describes the extraction of meaningful and actionable knowledge from a large amount of data through the application of traditional statistics, coupled with modern algorithms (Ravi et al. 2006, Reutterer et al. 2007).

Managing and analyzing the mountain of data is not easy. At the beginning of the 1990s, Blattberg et al. (1994) had pointed out that many companies will not be suffering from a lack of data anymore, but from its abundance instead. One only needs to imagine a major retailer, where 75% of customers regularly use their loyalty card when they make a purchase. That means that if the data were to be recorded, every single transaction of a good part of the customers' turnover would have to be saved down to the level of the individual article. Naturally, that would result in the accumulation of an enormous amount of raw data, minute by minute. A famous example of a company that failed to face this challenge is that of the former British grocery chain Safeway. When the company abandoned its ABC card in May 2000, executives noted that making sense of all the data was like drinking from a fire hose (Humby et al. 2008). Similarly, Humby et al.

noted, the British supermarket chain Waitrose commented on the problem of the exuberant amount of data when it gave up its loyalty program attempt: “trying to analyse all the data is madness” (p. 6), the company was quoted. It certainly is a challenging task, but there are also notable examples of companies (such as Tesco, for instance) that were up to it.

So what does the data-mining process look like? A general overview is provided by Kumar & Reinartz (2006) in Figure 9.

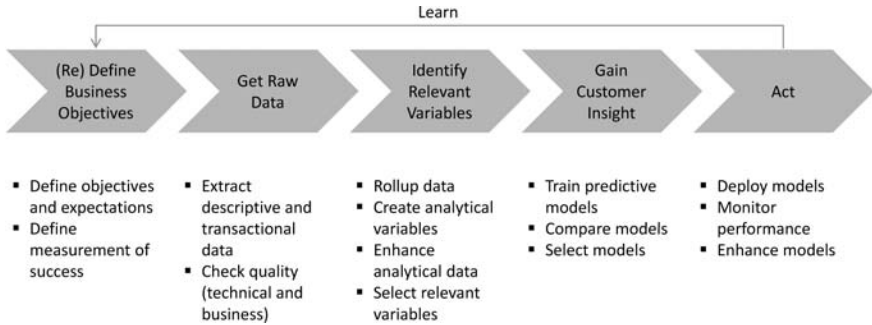


Figure 9: The Data-Mining Process

Source: Kumar & Reinartz (2006)

1) (Re) Define Business Objectives

Let us imagine the simple example where a grocery retailer wants to increase turnover through targeted promotions. Different approaches exist to resolve this issue (see e.g. Reutterer et al. 2006 for a possible solution), but for now the process described by Kumar & Reinartz (2006) will serve the purpose of illustrating a general path. As the retailer in this example has closed a deal with a manufacturer of products in the near-water category (e.g. mineral water flavored with an exotic fruit), the question is who to target with a coupon for this product. A straight-forward option might be to target those customers who purchase either still or sparkling water on a regular basis. Moreover, as the advertised product from the near-water category is an expensive, high-quality branded product, the target set could be further narrowed down to customers who regularly purchase up-market branded water. In addition to that, if a high turnout is the aim despite lower absolute numbers, one could even exclude all those water-buyers that have never had (exotic) fruit juices in their shopping basket.

As for the project management, in a more formalized setting, another task would include the setup of a project plan, including the determination of delivery dates for the final model and dates for the start and end of the supported cam-

paign. Kumar & Reinartz emphasized that it is important to carefully define the chosen experimental setup for the campaign. That might include forming two groups to enable success tracking: one control group with randomly selected (i.e. average) customers and another group with the customers selected by the model. Eventually, expected costs need to be compared with expected revenue gains and criteria for evaluating the success of the campaign defined. If high purchase rates are the goal, the measure of success could be “percentage of customers who redeemed voucher,” while it could be “absolute number of flavored mineral water bottles sold during the campaign” if the increase in turnover is the most important aim. Additionally, it might be interesting to compare the success of the campaign based on a predictive model with that of past campaigns which had relied on traditional target measures (taking the different market settings, product offerings, etc. into account).

2) Get Raw Data

After objectives and expectations have been set and a measure of success agreed upon, the raw data needs to be gathered. Kumar & Reinartz differentiated this phase into three sub-steps: (1) looking for data sources, (2) loading the data, and (3) checking data quality. In the mineral water example, the food retailer will own the corresponding data if a loyalty program that saves purchase transactions is employed. At first, it might be a good idea to start with the extraction of a small sample to make sure that the data fulfills the requirements. Then, the whole set of data necessary to answer open questions will be retrieved in a previously designed format (e.g. its native format or in XML/text format) from the company's databases and consolidated into an analytical database (often referred to as analytical data mart). Finally, data quality needs to be checked to ensure that business decisions remain unaffected by bad data quality. This check might concern problems such as duplicate records, missing values, conflicting entries (e.g. if the data is put together from various databases running in parallel), outdated information (e.g. addresses) or wrong information (e.g. incorrect information such as a customer's birth year entered as 2952 instead of 1952).

3) Identify Relevant Variables

Consequently, relevant predictive variables need to be identified. In the first phase, this will include a procedure which Kumar & Reinartz called flattening the data. The basic idea is that the sourced data is transformed from its relational format into a customer-oriented one. In a flattened view, all data related to an individual will be contained in one observation (e.g. one row in the data table). From this data, descriptive statistics such as averages, medians, sums, etc. can be

calculated. In our example one could, for instance, calculate the average monthly revenue generated in the mineral water category by each customer.

Following the flattening of the data, analytical variables might have to be created. This is the case when the variables generated in the previous data flattening step do not suffice. Possible examples would include interaction terms (e.g. variables resulting from the combination of values such as age and income), transformed variables (e.g. dates of each customer's transaction transformed into the number of days lying between them), or categorized variables (e.g. five defined income brackets from low to high). Finally, predictive variables need to be selected. As it is likely that the data set is now filled with a whole range of variables with different predictive capabilities, variables need to be sieved. For instance, salary might be a more important factor affecting the likelihood to purchase high-priced near-water brands than gender. To determine what variables show little correlation with the target value, Kumar & Reinartz suggested carrying out tests such as linear correlation analyses, pair-wise chi-square tests, or pair-wise simple linear regressions, and proposed supporting the variable exclusion process with histograms, scatter plots, box plots, and frequency tables. What can definitely be excluded are variables that take on only one value, such as name, customer ID, or home address. In addition to that, variables where the level of missing values exceeds a certain threshold might be excluded. In either case, however, it is important to keep in mind that variables deemed unnecessary for the analysis should not be erased from the table, but instead marked as unnecessary. Name, customer ID, and address, for example, are not going to be needed for the analytic process, but will certainly be required to carry out the campaign later on.

4) Gain Customer Insight

Following this step, it is time to actually gain the customer insight. In case of the mineral water example, it would be useful to build the predictive model on a predefined test set which contains customers that have already bought the flavored mineral water. In the course of model construction, one would then try to estimate the purchase likelihood for all the selected customers (who are not yet buying the new product) in the analytical model. To find the best way of doing so, one might try out different approaches in order to arrive at the model with the highest predictive power. For instance, one could apply different statistical tests such as linear or logistic regression, neural networks, factor analysis, or clustering. After doing so, the alternative models are compared by looking at the misclassification rates resulting from their application on the test set and eventually, the best one will be chosen. The final decision down to which level of purchase likelihood customers will be targeted by the flavored mineral water campaign, however, is another business decision to be made, Kumar & Reinartz pointed out.

5) *Act*

The ultimate step in the data mining process is an obvious one: to act on its results. The grocery retailer would proceed with his direct marketing campaign, mailing out vouchers for a specific brand of flavored mineral water to the selected customers. In addition to that, the company would monitor its campaign and learn from its evaluation. Furthermore, the outcome of the data mining process needs to be fed back into the company databases, with all results properly archived. As Kumar & Reinartz highlighted, possible information that requires documentation for future use or reference could include the following:

- Raw data used
- Transformations for each variable
- Formulas for creating derived variables
- Train, test, and score data sets
- Target variable calculation
- Models and their parameterizations
- Score threshold levels
- Final customer target selections

Needless to say, Kumar & Reinartz are not the only authors to write about data mining, but their work was chosen as one good example illustrating a general data mining process. In this regard, Reutterer et al. (2007) provided a helpful, compact literature overview, despite their actual focus on basket analysis. Fayyad et al.'s (1996) or Berry & Linoff's (2004; originally published in 1997) contributions, for instance, are two established pieces of literature that should not go unmentioned. Alternatively, authors such as Tan et al. (2006), Chiu & Tavella (2008), Hastie et al. (2008), or Olson & Delen (2008) offered more recent publications.

Still, what needs to be added in relation to the data mining process described by Kumar & Reinartz (2006) is that it is often automated. Discussing the future of decision support systems in the marketing environment, Bucklin et al. (1998) made a staunch pledge for automation on the basis of increasing both efficiency and effectiveness. The two variables determining the possible degree of automation are the novelty of the product and the stability of the market, whereby existing products and stable markets would consequently allow for full automation. One only needs to picture all the information the grocery retailer from our example will have access to following interpretation of the loyalty program data. The decision about who to target in a single direct marketing campaign is certainly only one among many decisions the company needs to take, and most importantly, only one of numerous interesting possible analyses that also happen on a frequent basis. Indeed, setting up a formal project for every single analysis really does not

seem like a very efficient approach. For that reason, it will definitely make sense to automate a good part of the analyses.

3.4.2 A Look at Retailing and Market Basket Analysis

Having established the use of data in general, the chapter on the value of data will now be concluded with a closer look at retailing, as this industry is the most prominent user of loyalty programs. Interestingly, findings show that retailing is also the industry which can draw the biggest benefit from its loyalty program data due to the large amount of information that is potentially available to these companies (Wood 2003). Wood reported findings from a telephone and email survey among marketing professionals of UK's top 1,000 companies, concluding that retailers were able to gain the biggest commercial value from their customer and prospect databases. Focused on local marketing initiatives, Byrom (2001) and Byrom et al. (2001) similarly praised the value of loyalty program data.

Among the different possible analyses that a retailer might undertake with the data of its loyalty program, a dominant part of that can be subsumed under the term basket analysis. While the company might also possess other information such as demographic or psychographic data perhaps, a good part of the value of the loyalty program lies in its ability to provide the company with transaction data for every single shopping incident of its members (i.e. information about their shopping basket). For that reason, a brief introduction to the research field of basket analysis will be given.

The basic idea is that the selection of products from different categories is based on related decisions. Understanding these can naturally be of great support to any marketing decision. Russell et al. (1999), for instance, highlighted the importance of including the influence from other products on the consumer's choice decision in the then possibly oversimplified consumer choice models. As far as basket analysis models are concerned, a whole range has been developed over time, trying to grasp the relationships among products and product categories. Referencing an early contribution by Agrawal et al. (1993) from the association rules category (see Table 4), Chen et al. (2005) exemplarily summarized a possible process as follows: between two individual product categories X and Y , an association rule such as $X \rightarrow Y$ would indicate a pattern where Y is bought by the customer when X is purchased. The authors described "support" and "confidence" as the two selection measures for the association rule. In this context, support signifies how often both X and Y are recorded in the database, while confidence refers to the number of consumer shopping baskets comprising both X and Y , as compared to those with only product category X . In other words, confidence works as a measure of accuracy for the rule.

As mentioned before, several different models have been developed in order to better understand these patterns. Notable introductions to and overviews of these models include those by Russell et al. (1999), Seetharaman et al. (2005), and, in German-speaking literature, Boztu & Silberhorn (2006). As usual, the applied categorization method varies among these papers. Russell et al. (1999) can be considered as a sort of starting base. The authors began by defining “category” in the first place and went on to explore different types of choice dependence, which they used to develop a research agenda. Understandably, Russell et al. argued that it would be necessary to understand the goals driving consumers in order to be able to develop adequate models. While the authors discussed cross-category consideration, cross-category learning (i.e. from earlier choices), and product bundling as the three types of cross-category choice dependence, Boztu & Silberhorn (2006) found the three factors of complementarity, heterogeneity, and coincidence to be driving cross-category choices.

	Models	Sub-Groups
Single outcomes in multiple categories	Models of incidence outcomes	Models capturing “whether to buy”
		Models capturing “when to buy”
		Models capturing bundle choice
	Models of brand choice outcomes	Models capturing correlated marketing mix sensitivities across categories
		Models capturing correlated brand preferences across categories
Multiple outcomes in multiple categories	Models of quantity outcomes	—
	Models of incidence and brand choice outcomes	—
	Models of incidence and quantity outcomes	—
	Models of incidence, brand choice, and quantity outcomes	—

Table 3: Multi-Category Models of Consumer Purchasing

Source: Seetharaman et al. (2005); illustration adapted

Probably inspired by Russell et al.’s (1999) suggestion to advance from single-category models to multi-category models, Seetharaman et al. (2005) undertook a literature review of these multi-category models in order to establish a status-quo. As depicted in Table 3, the authors distinguished the models by the number of outcomes that were modeled: either one of the three purchase decisions inci-

dence, brand choice, or quantity, a combination of two of them (i.e. incidence and brand choice or incidence and quantity), or all three.

Based on the methodological approach employed rather than the modeled element of consumer purchasing, Boztu & Silberhorn (2006) adopted the categorization illustrated in Table 4. As for the examples in literature as well as the explanations, the contributions by Mild & Reutterer (2003) and Reutterer et al. (2007) were used to complement the elaborations of Boztu & Silberhorn (2006).

	Method	Example References	Explanation
Exploratory	Pair-wise associations	Dickinson et al. (1992), Julander (1992)	Use of a 2 x 2 matrix to determine pair-wise measures of association
	Association rules	Agrawal & Srikant (1994), Chen et al. (2005)	Calculation of correlations between two or more items
	Cluster analysis/vector quantization	Schnedlitz et al. (2001), Decker (2005)	Clustering of products or product groups based upon them being purchased together
	Autologistic model	Moon & Russell (2004)	Mapping of customers according to their common preferences
	Collaborative filtering	Breese et al. (1998), Mild & Reutterer (2003)	Prediction of a new customer's behavior based on the behavior of known customers
	Multidimensional scaling	Böcker (1978), Merkle (1981)	Visualization of meaningful underlying dimensions that enable an explanation of similarities and dissimilarities in data
Explanatory	Logit models	Hruschka et al. (1999), Russell & Petersen (2000)	Modeling of inter-category choice decisions following utility theory
	Probit models	Ainslie & Rossi (1998), Manchanda et al. (1999)	Modeling of inter-category choice decisions according to utility theory, but in contrast to logit models with correlated disturbance variables

Table 4: Approaches to Basket Analysis

Source: Boztu & Silberhorn (2006), supplemented by Mild & Reutterer (2003) and Reutterer et al. (2007); illustration adapted

Based on Mild & Reutterer (2003), Boztu & Silberhorn (2006) differentiated between explanatory and exploratory models in their detailed, though not exhaustive overview. As Mild & Reutterer (2003) explained, exploratory models are focused on exposing the relationship patterns that exist among multiple product categories. By contrast, explanatory models try to discover and measure inter-category choice effects caused by the company's marketing efforts (e.g.

price or promotions), thereby considering external variables interfering with the customer's purchase decisions.

Comparing the contributions of Russell et al. (1999), Seetharaman et al. (2005), and Boztu & Silberhorn (2006), it seems fair to say that they almost perfectly complement each other. The first one gave a good introduction to the topic, outlining issues that needed to be resolved, while the second one gave a solid overview of the different approaches to solving these problems, categorizing them according to *what* the models try to capture. Eventually, the third contribution supplemented the previous works by looking at *how* the models worked, classifying them by their methodological approach.

3.5 Characteristics of Loyalty Schemes

It is relatively clear why customers join and patronize a loyalty program. Predominantly, they join to receive different types of rewards, such as discounts, increased status, or increased service (see e.g. Smith & Sparks 2009). To make this decision, they weigh these benefits (more or less consciously) against the membership's disadvantages directly affecting them (e.g. usage of wallet space for the new loyalty card, privacy issues, etc.). The company does so in a similar, though (hopefully) more conscious and structured manner. Just like the consumer, the organization also tries to reach its respective goals by exploiting the characteristics (i.e. advantages) of customer loyalty programs. At the same time, the firm has to consider the disadvantages and dangers and make a trade-off with the expected positive effects. In this chapter, the goals the organization is commonly trying to achieve with its loyalty scheme will briefly be discussed by reviewing two established frameworks (found in the current section), upon which the commonly claimed positive effects (Chapter 3.5.1) as well as the negative effects and problems associated with loyalty schemes will be covered from the company perspective (Chapter 3.5.2).

As depicted in Figure 10, Butscher (2002) categorized the companies' goals into three hierarchical levels: core goals, primary goals, and secondary goals. Most importantly, the author argued, the company is interested in increasing its turnover, profit, or market share. This can be achieved in the medium to long run by realizing the goals from the lower hierarchical levels.

Butscher's rather self-explanatory model begs two comments: firstly, it is (as ever so often in these cases) unclear why these particular goals were chosen and arranged in this specific way. Why, for instance, is the increase of purchase frequency a secondary goal, while it is actually an *outcome* of customer loyalty (which is, however, placed at a higher hierarchical level)? At the same time, other secondary goals really are a target in their own right, as they are not linked to the fulfill-

ment of a previous objective (e.g. the support of the company’s public relations). Secondly, Butscher equalized the goal of customer loyalty with the aim of developing a relationship with the customer. It was established in Chapter 2, however, that the ability of customer loyalty schemes to establish true, possibly life-long relationships (as the author describes them) is rather unlikely. At best, an average retailing loyalty scheme can alter behavioral loyalty to a certain extent, manifesting itself in a change of purchase frequencies, basket sizes, share-of-wallet, etc.

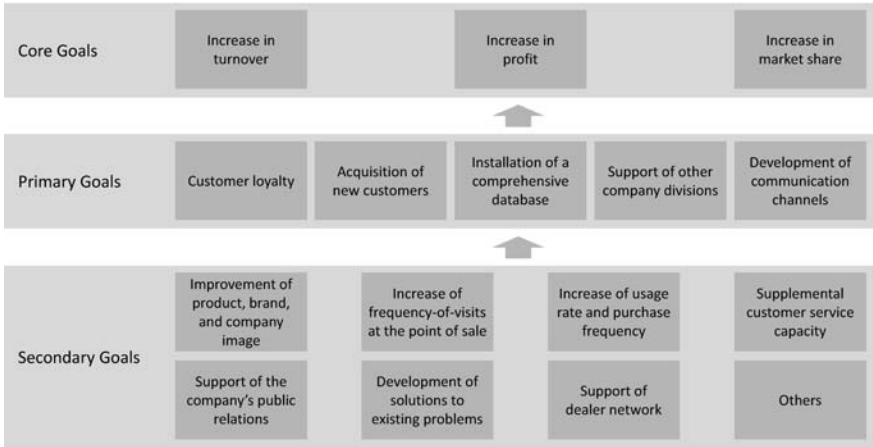


Figure 10: Loyalty Program Goals – Framework 1

Source: Butscher (2002); illustration adapted

Another, slightly less straight-forward framework is that suggested by Diller (1997). As seen in Figure 11, the author has also applied some form of hierarchy to his version. Following Diller’s line of thought, the customer loyalty program creates different types of effects via its rewards. Interestingly, three of the effects mentioned by the author (i.e. customer selection, knowledge, and interaction/integration) mean roughly the same thing. By signing up to the scheme, customer selection takes place in the sense that the members are now known by name and can be targeted individually. The company possesses information about areas such as personal data or shopping behavior, which it uses to improve interaction with the customer to better integrate him with the organization. All these things, including improved image, then lead to the realization of strategic goals such as the identification of the customer with the company, increased commitment, satisfaction, and trust, as well as positive word-of-mouth. In the end, then, these effects impact turnover and protect the company from disloyal customers and

competitive action (the security aspect), which in combination with the cost factor, results in improved profits and secures the organization overall.

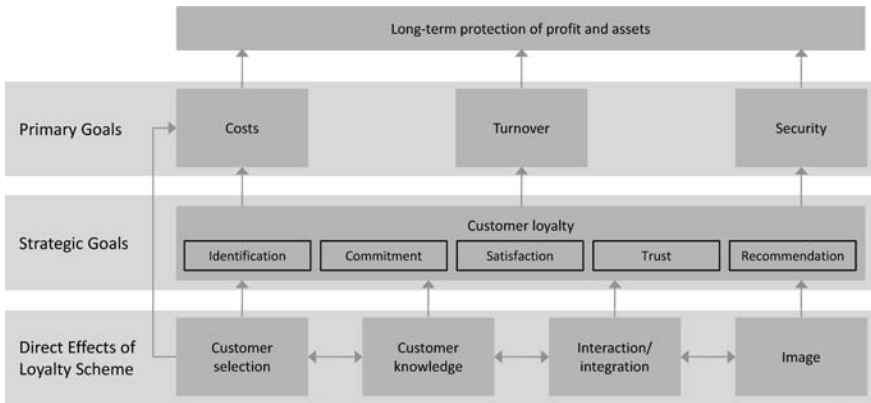


Figure 11: Loyalty Program Goals – Framework 2

Source: Diller (1997); illustration adapted

It seems fair to say that, apart from the inclusion of costs, Diller's framework appears more homogeneous than Butscher's (2002). This is probably due to the fact that Diller (1997) refrained from including the actual drivers of turnover increase, such as the aforementioned changes to purchase frequencies and the like. Moreover, it is appealing that the author made profitability the final stage in his model, anticipating the outcry of authors such as Reinartz & Kumar (2002) or Kumar & Shah (2004) who found the issue of profitability neglected in relation to loyalty schemes.

Certainly, different illustrations of this framework are possible, and despite some criticism, these two examples hopefully helped to provide an interesting introduction particularly to the following summary of positive effects, but also negative effects and issues commonly associated with loyalty programs.

3.5.1 Benefits

Several of the advantages have already been named, be it in relation to the value of data, the goals that companies try to achieve with loyalty schemes, or in other chapters of this paper. Those already cited benefits will be repeated and integrated into the following list. The aim of this section is to provide an extensive, though not necessarily exclusive laundry list of positive effects commonly attributed to loyalty programs, followed by a critical reflection, as some of these positive effects have been criticized and were shown not to apply in every setting (to

name just one example, Frisou & Yildiz 2011 demonstrated how program effectiveness is dependent on consumer learning).

General Benefits	Data Collection-Specific Benefits
<p>The increase of:</p> <ul style="list-style-type: none"> ▪ Purchase frequency ▪ Basket size ▪ Share-of-wallet ▪ Lifetime duration ▪ Trust ▪ Satisfaction ▪ Commitment <p>Plus the:</p> <ul style="list-style-type: none"> ▪ Buildup of exit barriers ▪ Generation of positive word-of-mouth for the company ▪ Attraction of new customers through the program itself ▪ Decrease in price-sensitivity among loyal customers ▪ Decrease in costs necessary to serve loyal customers ▪ Improvement of company, product, service, and brand image ▪ Formation of a means of competitive advantage 	<p>The ability to:</p> <ul style="list-style-type: none"> ▪ Minimize wasteful (marketing) spending ▪ Mass customize marketing communication to maximize the impact of the corresponding marketing activity ▪ Identify customer segments with similar characteristics ▪ Engage in profitable customer acquisition by modeling expected customer potential ▪ Increase revenues through cross- and up-selling, based on a model of the customer's purchase likelihood of specific product sets or services ▪ Optimize store layout (e.g. product placement) following a better understanding of purchase behavior ▪ Promote follow-up products (e.g. razor blades for a particular razor) ▪ Reduce churn with predictive models that identify customers who are likely to stop patronizing the company in the future ▪ Identify customers who were recently lost and to reach them with an action plan aimed at bringing them back ▪ Identify the profitability of the company's customers ▪ Identify and track trends ▪ Make qualified changes to the range of goods or services on offer ▪ Measure and evaluate the effect of marketing campaigns in a better and more efficient manner ▪ Improve the success of a necessary product recall by directly addressing affected customers ▪ Cheaply acquire new customers for new business areas developed by the company ▪ Support business decisions of various kinds (e.g. development of a new product line)

Figure 12: Proclaimed Benefits of Loyalty Schemes

Source: Clayton-Smith 1996, Diller 1997, Hippner et al. 2001, Butscher 2002, Berman 2006, Kumar & Reinartz 2006, Humby et al. 2008, Mimouni-Chaabane & Volle 2010, Morrisson & Huppertz 2010

As the relationships between these different points are not always clear, the list of generally claimed benefits in Figure 12 was presented in an unspecified order. The enumeration does, however, encompass a good part of the characteristics that are commonly claimed to be positive effects of loyalty schemes. Still, it should be noted that some of these effects have found themselves subject to criticism. In particular, the following associations with loyal customers have been increasingly called into question:

- The decrease in costs necessary to serve loyal customers
- The decrease in price-sensitivity among loyal customers
- The generation of positive word-of-mouth for the company

Going back to a series of publications by Frederick F. Reichheld (see e.g. Reichheld et al. 2000), director at the management consultancy Bain & Company, these claims have essentially been criticized for not being *universally* applicable. Building on a discussion set off by Dowling & Uncles (1997), today's best-known critics that need to be named in this regard are probably Reinartz & Kumar (2002). Studying company data of a US high-tech corporate service provider, a US mail-order company, a French food retailer, and a German direct brokerage house, the authors analyzed the shopping behavior, revenue streams, and profitability of over 16,000 individual and corporate customers over a period of four years.

Firstly, the authors found *no evidence for the claim that it costs less to serve loyal customers*. At best, they concluded, this link between loyalty and lower cost was industry-specific. The idea that gave rise to the claim for the existence of this link was that the initial customer acquisition cost could be distributed over a longer retention period in case of loyal customers. Furthermore, these customers were expected to incur a lower amount of service costs as they were more experienced with the product (and consequently with the trouble-shooting necessary). This, the idea went, would also cause customers to use cheaper communication channels, such as the internet instead of calls to the service center. Reinartz & Kumar found that in none of the four companies analyzed were long-term (i.e. loyal) customers cheaper to serve than short-term customers throughout the observed time period. For instance, experienced customers of the mail-order company who did actually use the internet instead of another more expensive channel to place their orders expected lower prices in that channel in return (thereby neutralizing any cost savings). In case of the high-tech corporate service provider, costs to serve loyal customers were even higher than those associated with short-term customers due to higher price pressure by the big and loyal corporate customers as well as increased costs for dedicated service teams.

Secondly, Reinartz & Kumar discovered that *loyal customers were not paying higher prices*. While it might sound reasonable that loyal customers are more likely to pay higher prices as they face higher switching costs or a switching barrier due to the associated uncertainty (e.g. as far as product or service quality is concerned), this was not found to be the case in practice. Loyal customers of the corporate service provider as well as the other three companies serving consumer markets were all demanding a tangible return for their loyalty or, in the best case, expected the same as short-term customers. In fact, long-term customers of the corporate service provider paid between 5-7% lower prices than short-

term customers, with loyal customers of the mail-order company paying up to 9% less in a specific product category. As for the grocer and the brokerage house, the prices charged to each type of customer were equal. Possibly due to the loyal customers' better knowledge of the product and its value, the authors concluded that these consumers are actually more price-sensitive and not the other way around.

Thirdly, the authors highlighted that *measuring behavioral loyalty alone was not sufficient to judge the effect on positive word-of-mouth*. They did not necessarily prove the claim wrong that loyal customers speak more positively about the company, but pointed out that only behavioral loyalty combined with attitudinal loyalty is truly helpful in generating new customers. This conclusion was drawn from a separate study with a sample of customers from the French food retailer, where both the passive and active word-of-mouth behavior was tested with two questions. In this study, customers were first asked to recommend a particular food retailer (i.e. to test passive word-of-mouth) upon which they were asked whether they ever tell friends or family about positive experiences with the French grocer under review (i.e. to capture active word-of-mouth). In addition to that, their actual behavioral loyalty was looked up in the company database and finally, their attitudinal loyalty captured through a telephone survey. Interestingly, customers who exposed high levels of both attitudinal and behavioral loyalty were 54% more likely to engage in active and 33% more likely to participate in passive word-of-mouth behavior (for a more recent and detailed investigation of word-of-mouth activity among reward program participants see e.g. Ferguson & Hlavinka 2009).

As mentioned in the introduction to Reinartz & Kumar's (2002) elaborations, it is important to keep in mind that the truth of these claims is clearly dependent on the industry and the individual customer or customer segment. For instance, industries where loyal customers tend to pay more certainly do exist. An example would be a highly competitive market for mobile telephone services such as that in Austria. The different providers are constantly creating and advertising new, cheaper phone plans to attract new customers. Old customers, then, very soon find themselves paying for a more expensive phone plan than all the new customers have access to. Kumar & Reinartz (2006) later added that the case where customers become more profitable over time is when a contractual relationship is given, while it would not hold true in a non-contractual setting. In the case of the mobile phone services market, however, the contractual obligation is often not the only factor causing customers to stick to the more expensive phone plan. Next to being affected by the minimum period of contract duration (usually 18-24 months in Austria), they often simply show too little involvement or fear uncertainties with regard to things like network coverage or service quality to

switch to a new provider with better offers. Furthermore, providers in many countries often do not give customers the option to transfer their old phone number to a new provider (Austrian legislation has enabled this procedure since 2004, Germany since around two years earlier), which might pose an additional, significant exit barrier. Thus, even if they are not contractually bound, loyal customers in certain industries might very well find themselves paying more than new customers.

Apart from the industry, profitability also varies by the individual customer or customer segment. For instance, Reinartz & Kumar (2002) found that long-term customer segments who were only marginally profitable actually made up between 15% and 21% of the four analyzed companies' customers, while around the same percentage were highly profitable, though short-term customers. For that reason, the correlation between customer lifetime duration and profitability was only found to be weak to moderate.

It was already determined that it depends on the industry and the individual customer whether loyal patrons are cheaper to serve than short-term customers. Similarly, it is difficult to generalize in the case of price-sensitivity, although it is certainly less common that loyal customers can (and perhaps should) be exploited by the company in that regard. Eventually, the last point of criticism will be addressed. It was concluded in the end of Chapter 2 that despite an ultimate answer being outstanding, retailing loyalty programs, dependent on industry and program configuration, are generally not able to create or foster attitudinal loyalty. At least within a retail setting it seems safe to say, then, that the true power of positive word-of-mouth (which comes from a combination of both behavioral and attitudinal loyalty) cannot fully be capitalized on. In other words, the increase in positive word-of-mouth caused by loyalty schemes will be visible, but is not expected to be very big.

3.5.2 Drawbacks

Next to the positive effects associated with loyalty schemes, there are, of course, also a range of alleged negative effects and general problems associated with such programs. The following enumeration in Figure 13, like that in the previous chapter, is not characterized by a specific order.

Drawbacks

- Loyalty schemes merely bribe customers to patronize the company
- Customers would prefer generally lower prices over a loyalty scheme
- Loyalty programs are often easy to reproduce, eliminating any competitive advantage and leaving behind an industry with lower margins
- Handling and analyzing all the data generated from such a program is like drinking from a fire hose
- Customers are concerned by privacy issues
- Following an initially visible sales bump, it is difficult for the company to measure the ongoing success of the program
- Common rewards worth around 0.5 - 3% of sales are not enough to sway customer behavior
- Once the loyalty program is started, the company will be committed, as it is extremely difficult to take it away from customers
- In most programs where customers accrue points, it takes them far too long to achieve a desirable reward
- Customers often hold multiple cards from competing firms, allowing them to engage in cherry picking
- Competing loyalty schemes are often similarly structured, resulting in too little differentiation to be effective in a competitive setting
- Customers' wallet space is limited, making it impossible to carry a membership card of every store around at all times
- A good part of the rewards goes to customers who were already loyal to the company in the past and would have remained loyal even without the program

Figure 13: Proclaimed Drawbacks of Loyalty Schemes

Source: Dowling & Uncles 1997, Passingham 1998, Wright & Sparks 1999, Parker & Worthington 2000, Dowling 2002, Berman 2006, Leenheer et al. 2007, Meyer-Waarden 2007, Humby et al. 2008, Lacey 2009, Cedrola & Memmo 2010

These points will now be elaborated on one after another. Firstly, it was claimed by some authors that loyalty schemes merely *bribe customers*. For instance, Humby et al. (2008) reported that the chairman of the British grocery chain ASDA was a renowned advocate of this view (the Wal-Mart subsidiary had abandoned the four-year pilot trial of its loyalty scheme around the turn of the century). The authors further highlighted that it was not uncommon to find a magazine comparing the rewards of different competing loyalty schemes almost like mobile phone plans, which contributes to the confirmation of this belief. Humby et al. did not go on to fundamentally refute this argument, but indicated that this does not mean that loyalty schemes were unable to generate loyalty in an emotional and not simply logical sense (such as the reaction towards bribery). It was determined previously that it is very difficult for loyalty schemes to generate attitudinal loyalty, implying that this point of criticism might essentially be cor-

rect. The question is, however, whether this is a bad thing. After all, any marketing action advertising special discounts or other types of promotion could be called bribery. The reward part, then, might well be considered another form of such bribery, without affecting the actual strengths of the loyalty scheme mentioned in the previous chapter.

Is it true that *customers prefer generally lower prices* over a loyalty scheme? This was the primary reason the aforementioned British grocer ASDA brought forward when abandoning its loyalty program pilots. Following an Every Day Low Pricing (EDLP) strategy, the company reasoned that the money would be better spent on a reduction of prices than on a loyalty scheme. Next to the overall strategy the company follows, other factors such as competitive actions or the characteristics of the industry will certainly affect this lower prices vs. loyalty program decision. Essentially, however, one factor will have the greatest influence: how cost-effective the loyalty program can be operated. Let us imagine a company facing two options: (1) to take 20 million EUR and invest the money in a loyalty scheme or (2) to decrease prices to an equal extent. Given that the loyalty scheme is profitable (i.e. it produces an increase in like-for-like sales which contribute to profit in excess of the costs of the program), the company has made a good investment. Similarly, if the decrease in prices leads to an increase in volume large enough to outbalance the turnover lost through this decrease, the company has made a good decision as well (other consequences of either move left aside). In the end, then, it will depend on the specific situation which one of these two options is the better one, or in other words, it cannot be generally stated that either one way is the right one (Tsao et al. 2010 take this one step further by discussing how a company should distribute its marketing budget between promotions and its loyalty program). Especially because while it might be true that all customers want low prices, only some of them shop exclusively on that basis (Humby et al. 2008). Furthermore, Humby et al. added, the loyalty scheme helped the company to minimize the cost of price cutting while maximizing competitive impact at the same time.

Parker & Worthington (2000) attested that the most common cause of failure is the ease with which *competitors can imitate the loyalty scheme* – something, that will inevitably happen to good programs in a competitive market. This would result in a return to the initial situation before the introduction of the first scheme, but with increased marketing costs for everyone (Meyer-Waarden 2007). Is the key, then, to have a differentiated program that cannot be easily copied? Would a sophisticated program characterized by high costs serve as an entry barrier for competition and conserve that program's competitive advantage? Let us consider Tesco's Clubcard, for instance. This loyalty scheme has helped to build up a considerable amount of know-how since its launch in 1995 (and the

start of trials some time earlier), which undoubtedly makes it extremely difficult to copy. In fact, for precisely that reason the US grocery chain Kroger decided to hire dunnhumby, the company that devised and still manages Tesco's loyalty scheme, when it attempted to set up its own program. This point of criticism consequently only applies to simple programs – the ones which are used as nothing more than a plain promotional tool. Similar to how any competitor can easily start sending out promotional leaflets or give 5% discount on all frozen pizzas to copy his competitor's move, it will be possible to imitate such a basic loyalty scheme. This is true, but no different with respect to any other promotional action.

The problem of handling and making sense of the *large amount of data* available to many companies, particularly in the retailing industry, has already been discussed in Chapter 3.4.1. This definitely is a challenging task, but one that many companies have successfully faced. In addition to that, the number of external service providers willing to assist companies in this endeavor is growing continuously.

"Food retailing loyalty schemes – and the Orwellian Millennium," Evans (1999) titled his article on the *privacy issue* associated with loyalty programs. Schemes that capture each customer's purchase history give the company access to detailed information about the shopping behavior of every person using his loyalty card. As many customers have a fear of this intrusion into their privacy, sometimes even coupled with an uncertainty about whether this data will be sold to a third party, this factor does play an important role for some customers in their decision to opt for a loyalty card. For example, using focus groups and semi-structured, qualitative interviews, Noble & Phillips (2004) discovered two different types of concern among the study participants: fraudulent use of the data (e.g. going as far as "identity theft" by someone inside or outside the company) or just simply the emergence of a "big brother is watching" feeling (see e.g. Sayre & Horne 2000 for further information on this topic). Apart from the extreme case of a misuse of data, the fact that companies are able to monitor behavior was in itself considered intrusive by some respondents. It needs to be kept in mind, however, that this matter is to a large extent strictly regulated by data protection laws, limiting the leeway given to companies. Still, organizations need to make sure that they communicate clearly to customers about this issue and adhere to their statements. Examples of problems include that of the US pharmacy chain CVS, where a lack of password protection enabled anyone with the membership number (which could, for example, be retrieved from old sales slips which the number was printed on), zip code and last name to have online access to that person's possibly sensitive purchase history. Another example was disclosed by Humby et al. (2008) in relation to Tesco's UK Clubcard. In this case, an upset woman complained about the company promoting condoms in the

targeted mailing she had received, stating that this must be a mistake as neither she nor her husband had ever purchased such an item. In reality, the husband must have done so, of course, but the call center agent reportedly acted in a sensitive manner and blamed it on a defect of the computer system. In either case, at least at a theoretical level, the potential for intrusion and infringement of privacy or possibly even manipulation is considerable, Rowley (2004) highlighted. Even though some of the advice may be taking things a little too far, a set of guidelines for companies to consider can be found in a publication by the US Food Marketing Institute (FMI n.d.).

Another problem that companies are facing is that of *measuring the effectiveness* of their loyalty scheme. Stating that it was impossible following the sales bump caused by the launch of the program is not entirely correct. Given that the scheme captures transaction data, the company can at least track things like purchase frequency or turnover development on a customer level, and also, new promotional activities associated with the program can be analyzed without much difficulty. Ziliani (2005), for instance, offered an interesting way to measure the effectiveness of promotions with the help of a loyalty scheme. At the same time, it is naturally difficult to separate the contribution of the loyalty program to the development of an indicator of success (e.g. turnover) from that of other interfering variables. A possible solution would be a comparison with a control group of non-members, which is tracked from program launch onwards. As Butscher (2002) suggested, this comparison would ideally be based on both quantitative and qualitative indicators which were selected to best judge the achievement of one or a set of previously determined goals the company was aiming to achieve with the help of its loyalty program. At the same time, it is important not to forget to take other positive effects into account that are not captured by these indicators.

A voucher worth 2% on annual sales of 500 USD might not be deemed worth much in absolute terms, particularly not if compared with the 25% to 40% discounts which are not uncommon in retailing promotions, Cigliano et al. (2000b) noted. This might sound logical, but nevertheless, a large number of retailers successfully runs a loyalty scheme offering even less *reward value* than this 2%. Despite these low percentages, certain customers still seem to respond to them – particularly, but not only, if the industry competitors do not offer their own scheme. It needs to be added, however, that focusing exclusively on monetary rewards is not necessarily a good thing (see Chapter 3.3.8 for a discussion of reward types and the rate of reward). Berman (2006), for instance, called a focus on financial rewards a potential pitfall of loyalty schemes. This is even more important as customers might perceive non-financial rewards to be of much greater value than they actually are expressed in monetary terms (i.e. stated as the under-

lying cost to the company). All in all, it can be said that numerous loyalty programs even with such low reward values have in fact been successful in practice.

It is true that loyalty schemes are *not particularly easy to cancel* or cut back on, as customers seem to perceive the receipt of rewards almost as their given right a while after the program is launched. Thus, apart from the sunk cost associated with the scheme, the company has to cope with the reaction of the customers when abandoning their program. Still, many companies have “successfully shut down” their programs. Consequently, it is certainly a point that managers will need to consider before committing to a loyalty scheme, but at the same time it is not one that cannot be overcome if the program really needs to be shut down at some point in time.

Some critics argue that *it takes far too long for customers to achieve a truly desirable reward* in most loyalty schemes where a specific number of points or amount of turnover needs to be reached in order to redeem that reward. Companies naturally are limited in the degree of reward value they can hand out to each customer. It is obvious that even if, for instance, a consumer pools all his fuel expenses at a particular retailer (e.g. 1,500 EUR per year, arising from an average distance of 18,750 km [11,650 miles] traveled with a vehicle consuming 8 liters per 100 km [29.4 miles per gallon] and a theoretical fuel price of around 1 EUR per liter [3.8 EUR per gallon]), he will not be receiving a holiday week-end in Paris as a reward every year. To illustrate the time it takes to achieve a reward worth 50 EUR, the strategy consultancy Roland Berger (2003) compared four German reward programs (Lufthansa’s Miles & More scheme, the coalition program Payback, the then still active stand-alone scheme of the fuel retailer Aral, and the loyalty program of the shoe retailer Görtz), based upon average usage frequencies and sales. Achieving that 50 EUR reward took Lufthansa frequent flyers 6.5 months, Payback users 11 months, Aral customers 12.5 months, and Görtz patrons a whopping 6.5 years. In a way, this discussion is linked to the choice of reward type and reward rate. As was previously established, companies have a wide range of options when it comes to rewards and should strive to optimize impact. Practice has shown that customers also find low-value rewards desirable and these do not always have to be monetary either. As far as rewards resembling a bigger value are concerned, multi-partner schemes can serve as a way out. In Roland Berger’s study, for example, the two programs with the shortest time to reward redemption were coalition schemes (Lufthansa’s Miles & More and the German Payback program), allowing customers to collect points at a range of partners, leading to a quicker accumulation of the reward currency.

“I have accumulated nine ‘loyalty’ cards from various stores and supermarkets. Does this make me more loyal, or less,” asked a reader in a letter to the UK

newspaper The Times cited by Wright & Sparks (1999, p. 429). Indeed, many customers, even within the same industry, are members of multiple loyalty programs (Dowling & Uncles 1997, Passingham 1998, Bellizzi & Bristol 2004, Liu & Yang 2009). To name just one example, Haeberle (2004) quoted a study by Forrester Research, according to which 54% of grocery shoppers were members of two competing loyalty schemes, 15% had joined three different programs, and 4% held membership cards of four or five food retailers. Altogether, that leaves only 27% of respondents who were members of only one program. Multiple card-ownership certainly does not have a positive influence on the effectiveness of the individual retailer's loyalty program. For instance, Mägi (2003) discovered that having a competing loyalty card had a negative impact on share-of-wallet and Meyer-Waarden (2007) found that multiple memberships of geographically close retailers lead to a reduction of lifetime duration. This problem has already been touched in Chapter 2.3.3, with the naturally given presence of polygamous loyalty through variety seeking customers or the "just-in-case scenario" (i.e. customers possess a competing loyalty card to take advantage of that program just in case they are once in a while unable to patronize their preferred company) named as possible explanations. Nevertheless, it can never be excluded that certain customers are members of competing schemes only to engage in cherry picking. This is a disadvantage that just needs to be accepted, but one whose effects can at least be mitigated by differentiating the program from competitive offerings and applying a more effective reward structure. In addition to that, a first mover advantage such as that often quoted in relation to the introduction of new products or the entry of new geographical markets might exist as well. Despite the lack of empirical proof for this effect in relation to the introduction of loyalty schemes, this scenario is not unlikely if a reward structure creating a barrier of exit is present. Once the customer has advanced to a higher tier of the program or is half way into the collection of points for a desired reward, it is less likely that the customer significantly redistributes his share-of-wallet.

The claim that *programs are often similarly structured and consequently ineffective in a competitive setting* might apply to certain industries in particular countries, but cannot be considered generally true. Many companies, such as the ever so often named best practice case Tesco, have indeed managed to differentiate themselves from competition and created a competitive advantage. The following passage stems from a research report issued by the investment bank JP Morgan Cazenove on August 31, 2005 (quoted by Humby et al. 2008, p. 271): "contrary to popular belief, Tesco's most significant competitive advantage in the UK is not its scale. We believe Clubcard, which conveys an array of material benefits across virtually every discipline of its business, is Tesco's most potent weapon in the ongoing battle for market share." The wide range of options avail-

able to structure a loyalty program enables every company to optimally match such to its own, the given industry's, and the customers' characteristics and demands. Particularly if the organization has a lead on its competitors in doing so, it will be less likely to end up ineffective in the competitive arena.

Another point of concern is that *customers' wallet space is limited*, while the number of loyalty cards available to stick into these wallets seems to be just the opposite. This is definitely an, interestingly often underestimated problem that loyalty programs face. There are, however, various ways around this issue. For instance, some companies optionally offer key fobs (e.g. UK's grocery retailer Tesco), others provide stickers with the bar code to be stuck on whatever the customer wants (e.g. the US textile retailer American Eagle Outfitters), while again others enable the loyalty program to be stored on the chip of any national bank card (e.g. the Austrian grocery chains Billa and Merkur). Alternatively, companies often allow for the customer to be looked up in the firm's database, making it unnecessary to bring the card along, but increasing the time (and thus the cost) of the payment or service process for the company. A final example is that where organizations have arranged for the customer service centers to issue a temporary card with a validity of, say, one day, in case the customer has forgotten the original (e.g. the Austrian department store Kastner & Öhler). All in all, it can be seen that this is certainly an issue that can be resolved with an according portion of creativity. Furthermore, as will be discussed in Chapter 4.2.1, coalition schemes can also serve as a mean to reduce the number of loyalty cards in customers' wallets.

As far as the problem of *rewarding already loyal customers* who would have continued to patronize the company even without the loyalty program is concerned, the critics seem to have a point. Interestingly, with very few exceptions such as Leenheer et al. (2007), authors who attempted to empirically measure the effectiveness of loyalty schemes have not taken the effect of such self-selecting members into account. Customers who are already heavy spending and loyal customers of the organizations, critics argue, are the ones who would derive the greatest benefit of a loyalty program membership. Consequently, these are the ones who are most likely to sign up for the scheme. In an analysis of seven loyalty programs of Dutch food retailers, Leenheer et al. discovered a small, yet positive influence of the loyalty scheme on share-of-wallet and added that this effect would have been seven times as large had they not accounted for this endogeneity in program membership. Nevertheless, the overall impact of the program remained positive. In light of this problem, simple, promotion-like loyalty schemes do face the same difficulty as any other form of untargeted promotion would encounter. Sophisticated loyalty schemes, however, can compensate for this in that they allow the company to develop each customer individually – even the ones who were al-

ready considered loyal. Be it that they are successfully influenced by a cross-selling incentive or that they improve the coupon redemption rate among loyal customers: the concern regarding self-selecting members is not always justified.

All in all, it can be said that most of these presumed problems or negative effects of loyalty schemes will not always be applicable. In fact, it will depend on the specific internal and external factors acting on the company whether these downsides have to be perceived as an issue in the first place. Particularly sophisticated programs can provide significant benefits to an organization and it will be up to its leaders to judge whether these outweigh expected costs and other disadvantages. Furthermore, if these problems really are encountered, there will be numerous ways to approach them available to the organization.

Concept of Coalition Scheme and its Types

“Coalitions represent both the natural evolution and the future of loyalty marketing programs, both within the USA and abroad” (Capizzi & Ferguson 2005, p. 76).

“The efficiencies inherent in coalition loyalty models [...] make coalitions the natural end-game for loyalty evolution” (Ferguson & Hlavinka 2006, p. 297).

“According to Frequency Marketing Inc., there are 3 trends to watch for in card marketing in the new millennium: [...], and 3. coalition programs” (Barlow 1999, p. 1).

“The 22 major factors that will shape the future of customer loyalty: [...] 3. An explosion of loyalty coalitions and networks” (Clark 2006, p. 1 f.).

Weighing the advantages that characterize coalition schemes against their disadvantages, several practitioners and academics have proclaimed that multi-partner programs are an ongoing trend, and indeed, the next evolutionary step of loyalty schemes. Loyalty coalitions are, as compared to stand-alone programs, a relatively recent development. While the latter have existed at least since 1896 with the origination of the S&H Green Stamps (S&H 2009), it is possibly the founding of Air Miles in the United Kingdom in 1988 that marked the birth of coalition schemes operating on a grand scale (Air Miles 2009). Since then, several other programs have been introduced in different parts of the world, ranging from the United States and the United Kingdom to South Africa and South Korea. Still, several countries well penetrated with stand-alone programs and other regional or otherwise differentiated schemes (e.g. the US) have yet to witness the development of a strong nation-wide coalition.

This chapter will offer an overview of the different scheme types (Chapter 4.1), advantages and disadvantages associated with coalitions (Chapter 4.2), notable success factors relating to these programs (Chapter 4.3), as well as studies on impact, spread and customer perceptions (Chapter 4.4). Finally, Chapter 4.5 will bridge the way to the empirical section of this paper, in which further questions concerning these schemes will be elaborated on.

4.1 Scheme Types

As far as a possible classification of coalition schemes is concerned, different approaches can be taken. One option would be the categorization into sector-exclusive schemes on the one hand and non-sector-exclusive programs on the other hand. Another possibility would be to differentiate by geographical spread (e.g. international vs. national vs. regional), possibly supplemented by an indicator of size to capture the “true presence” of the scheme. Furthermore, one could classify schemes by reward type offered (e.g. UK’s Air Miles focusing on flight rewards only vs. UK’s Nectar offering a whole range of rewards), by the underlying goal of the scheme (e.g. Nectar offering benefits only to consumers, while the regional SmartTown Alliance in the USA is aimed at benefiting both the consumer and a non-profit organization of choice), or by whether the scheme is internet-based or a “regular” program. Just as well, however, existing programs could be grouped by industry (e.g. retailing, airlines, etc.).

Among the numerous forms of coalition schemes, the following two sub-chapters will be centered on the most common variations: multi-partner programs focused on retailing and airline alliances. Finally, a brief overview of other special types of coalitions will be given in the third sub-chapter.

4.1.1 Retail-Oriented Coalitions

For obvious reasons, the number of national coalition programs a market can accommodate is a lot smaller than that of stand-alone programs. Possibly because of the ability of retailing partners to generate the volume required for the customer to maintain interest in the scheme, retail-oriented, typically sector-exclusive coalitions represent a good proportion of the already limited number of coalitions in existence. At least for strong, national programs, it is a plain necessity to get one of the biggest retailers of each of the most important sub-sectors on board. In particular a big grocery retailer will be necessary to guarantee these short purchase frequencies that keep the customer involved with the program.

It needs to be added, however, that these coalitions do not rely exclusively on retail partners. In fact, next to being able to collect points at, say, a grocery, fuel, clothing, and book retailer, customers can often beef up their point balance by generating turnover at a bank, insurance company, travel agency, car rental company, or electricity provider – to name just a few examples. The partner mix is obviously different in every scheme, but as a general rule, it seems fair to say that despite including partners from other industries, these schemes remain retail-oriented. Table 5 shows a sample list of a number of more or less well known programs falling into that group.

Category	Program	Geographical Presence	Website
Regular Retail-Oriented Schemes	BonusLink	Malaysia	www.bonuslink.com.my
	DeutschlandCard	Germany	www.deutschlandcard.de
	Dotz	Brasil	www.dotz.com.br
	eBucks	South Africa	www.ebucks.com
	FlyBuys/ Fly Buys	Australia New Zealand	www.flybuys.com.au www.flybuys.co.nz
	HappyPoints	Germany	www.happypoints.net
	i-mint	India	www.imintpoints.com
	Malina	Russia	www.malina.ru
	Nectar	UK	www.nectar.com
	OKCashbag	South Korea	www.okcashbag.com
	Payback	Germany	www.payback.de
	Premium Club	Poland	www.premiumclub.pl
	R&R	Kenya	www.rr.co.ke
	s'miles	France	www.smiles.fr
Retail-Oriented Schemes Focused on Travel Rewards	SuperShop	Hungary	www.supershop.hu
	Aeroplan	Canada	www.aeroplan.com
	Air Miles/Travel Club	UK Canada Spain Netherlands UAE, Qatar, Bahrain	www.airmiles.co.uk www.airmiles.ca www.travelclub.es www.airmiles.nl www.airmilesme.com
Regional Retail-Oriented Schemes	Kärnten Power Card	Austria	www.kaernten-power-card.at
	Powercard	USA	www.powercard.com
	S&H greenpoints	USA	www.greenpoints.com
	SelektPoints	Lebanon	www.selektpoints.com
	SmartClub	China	www.smartclub.com.cn
	Thank You	USA	www.thankyou.com
Retail-Oriented Internet Schemes	Wedge	UK	www.wedgecard.co.uk
	Maximiles	UK	www.maximiles.co.uk

Table 5: Retail-Oriented Coalition Schemes

It needs to be kept in mind that this list is by no means exhaustive. In particular the group of regional schemes is, for obvious reasons, just a brief selection. Nevertheless, this enumeration hopefully provides a good pool of examples to examine in further detail if interest has been sparked. Some of them are more dominant in terms of size, while others were created on a smaller scale. Especially the United States is an example of a loyalty card market where no truly big, national scheme managed to strike root. S&H greenpoints and the Thank You program are mentioned as two examples of regional brands, which despite boast-

ing a notable presence (in contrast to the Powercard in the US, for example), have not reached a significant nation-wide presence comparable to, say, the Nectar scheme in the UK.

As far as the categorization in Table 5 is concerned, four sub-categories of retail-oriented coalitions emanated: (1) “regular” schemes, making up the majority of this coalition type, (2) programs with a focus on travel-related rewards (i.e. a slightly different form of “regular” schemes), (3) regional programs with limited geographical reach and/or only small program sponsors, and (4) internet schemes focused exclusively on points collection with online retailers. In particular the second group might require some further explanation. The idiosyncrasy of this kind of coalition is probably best explained with an example. Air Miles, a type of franchise present in various countries of the world, was wholly-owned ever since soon after its launch in the UK in 1988 by British Airways (British Airways 2008). As discussed in the fourth sub-section of Chapter 3.3.8, airlines have a clear cost advantage over regular retail-oriented schemes, as they can simply fill their otherwise empty seats with passengers travelling on redeemed miles. The additional variable cost incurred by such a passenger is likely to stand in no relation to the value of the reward as perceived by the customer. Naturally, this constellation only works if the airline owns the program, because otherwise the frequent flyer miles need to be purchased from the airlines – eating up at least part of the cost savings. On the downside, the target group of potential customers will be smaller with such travel-reward-oriented schemes, as not everyone is attracted by this type of reward. In addition to that, a wider choice of rewards is preferred by all customers – even by those who like to travel.

4.1.2 Airline Coalitions

Airline coalitions are, as opposed to most retail-oriented programs, not sector exclusive. While several small alliances exist as well, three coalitions dominate the airline industry (see Table 6). Of course, these alliances comprise much more than just loyalty programs which allow customers to collect and redeem miles with all the different member airlines. An extended network through code sharing agreements or cost advantages through common booking systems or sales offices are a few notable examples.

Still, the loyalty scheme is a significant part of these alliances, with the distinctive feature of these coalitions being that most of these alliance members operate their own, branded loyalty scheme. At the same time, the alliance is advertised to certain degree. This naturally makes for a few differences in terms of the advantages and disadvantages commonly associated with retail-oriented

loyalty coalitions. The airlines Austrian and Lufthansa are two of the rare exceptions in the industry which use the same loyalty scheme brand (i.e. Miles & More). Since September 2009, Austrian has also been owned by the German Lufthansa, but the decision to adopt the same loyalty scheme in addition to being in the same alliance was implemented long before. It can thus be seen that different alliance governance structures are thinkable (see e.g. Gudmundsson et al. 2002 for further information on this topic).

Category	Program	Member Airlines ¹	Website
Airline Schemes	Oneworld	American Airlines, British Airways, Cathay Pacific, Finnair, Iberia, Japan Airlines (JAL), LAN, Malév, Mexicana, Quantas, Royal Jordanian, S7 Airlines	www.oneworld.com
	SkyTeam	Aeroflot, Aeromexico, Air Europa, Air France, Alitalia, China Southern Airlines, Czech Airlines, Delta Air Lines, Kenya Airways, KLM, Korean Air, TAROM, Vietnam Airlines	www.skyteam.com
	Star Alliance	Adria Airways, Aegean, Air Canada, Air China, Air New Zealand, ANA, Asiana Airlines, Austrian, Blue1, bmi, Brussels Airlines, Continental Airlines, Croatia Airlines, Egyptair, LOT Polish Airlines, Lufthansa, Scandinavian Airlines, Singapore Airlines, South African Airways, Spanair, Swiss, TAM, TAP Portugal, Thai, Turkish Airlines, United, US Airways	www.staralliance.com

1 As of February 2011

Table 6: Airline Coalitions

Source: Company Websites

4.1.3 Other Variations

While no large retail-based scheme has gained a foothold in the US to date, other smaller, creative programs managed to do so. Generally, these schemes are characterized by a set up similar to that of their larger archetypes. Customers receive a discount on their turnover or collect some form of points at a range of retailers, restaurants, financial service providers, and other partner companies. What is

special about these programs is, however, what these savings are used for. In case of college saving schemes, any discount or accumulated points will be used to pay for college tuition. BabyMint, for instance, offers members one dollar off tuition expenses for every reward dollar earned at around 175 colleges and universities across the US. Similar to BabyMint, Upromise also allows for a transfer of accumulated rewards to a college saving plan of the customer's choice (these so-called "529 college savings plans" are tax-free in the US and can be opened at a range of financial service providers).

Another interesting variation is that of schemes supporting non-profit organizations. In case of the SmartTown Alliance, for example, customers can choose a non-profit organization they want to support from a list provided. Any savings made with participating program sponsors are then split between the customer and the selected non-profit organization. Lastly, Stockback is an example of a program putting these rewards savings into an investment plan, while the Canadian Futura Rewards scheme represents a coalition allowing the customer to choose between several of these options. In this case, program members can use the rewards for education savings, retirement savings, charity, or cash payouts.

Somehow one is tempted to ask whether these programs are not simply regular retail-oriented schemes with a different range of reward options. In a way they are, but at the same time their different range of rewards goes hand in hand with such a fundamentally different positioning of the program, that it seems justified to set them apart in a special category.

Category	Program	Geographical Presence	Website
College Saving Schemes	BabyMint	USA	www.babymint.com
	Upromise	USA	www.upromise.com
Schemes Benefiting Non-profits	Rainbow Rewards	USA	www.rainbowrewards.com
	SmartTown Alliance	USA	www.smarttownalliance.com
Variable Schemes and Others	Futura Rewards	Canada	www.futurarewards.ca
	Stockback	USA	www.stockback.com

Table 7: Other Coalition Types

4.2 Differences to Stand-Alone Programs

4.2.1 Advantages

Coalition schemes offer several distinct advantages over their single-sponsor counterpart to both companies and consumers. Given the lack of literature on this topic, Clark & Clark (2009) have provided a useful basis, which has been re-structured and further supplemented:

▪ **Lower cost:**

- Instead of having to bear the cost of constructing and maintaining a program by themselves, the partner companies can share the development, promotion, communication, and other administrative costs. As far as development costs are concerned, Clark & Clark added that these are in practice sometimes covered by the third-party operator of the program (possibly with the support of a venture capitalist, as it was the case with Nectar in the UK), increasing the operator's freedom from the partner companies, but decreasing the degree of commitment by coalition members. With regard to the lower individual promotional costs it can be added that this constellation allows for more frequent and coherent promotional activities.
- In addition to that, having a third party develop the scheme will prevent the capacity of existing partner company staff from being consumed.
- Finally, these generally larger programs are often able to exploit economies of scale when purchasing the rewards that are to be distributed to consumers. Passing this benefit on to the customer can naturally help to increase the perceived value of the rewards.

▪ **Card more likely to be carried:**

- As only one card needs to be carried for use at several different companies, the often-cited problem of limited wallet space becomes less of an issue.
- This is even more important as cards carried in the wallet are more likely (if not a precondition) to be used. In this regard, In-Store (2008) reported results from a study finding that over a third of customers felt they had too many cards to carry, with another 27% plagued by regularly carrying the wrong card when making a purchase. In Germany, for example, TNS Emnid (2006) found that the Payback coalition card was carried by 32% of Germans in their wallet at all times, coming only behind a bank card and the health insurance card (and thus, together with a credit card at tied third place). By comparison, the stand-alone card carried by the highest percentage of respondents was that of a major food retailer, the REWE Haushaltskarte with 9%.

▪ **Better and faster rewards for the customer:**

- Due to the possibility of collecting points at different companies, coalition schemes allow for faster points accrual. Consequently, it becomes easier for customers to earn enough points for a bigger, more aspirational reward. While the regular purchase behavior would, for instance, amount to a total of four small rewards at the patronized grocery, fuel, sporting goods, and drug retail chains if they each operate a separate scheme, pooling these expenses with a single multi-partner program could add up to one big reward for the customer.
- Furthermore, as compared to a single stand-alone program, the time it takes until the reward can be redeemed will be significantly lower when several partners of a coalition scheme are patronized.
- Since coalitions are usually much bigger in size than stand-alone programs, they can offer a greater choice of rewards to the consumer. When selected according to the product assortment of the program partners, a broader selection of rewards might even satisfy both the customer's desire for variety and at the same time exploit the often-mentioned positive effects of offering firm-related rewards (in this case at least within the circle of partners). Dowling & Uncles (1997), for example, argued that handing out rewards unrelated to the firm could become a problem for low involvement products, as the reward might turn into the primary incentive to buy the product. Once the reward was copied by a competitor or simply taken away, the main purchase reason would disappear. In the case of coalition schemes, however, companies could offer rewards related to any of the coalition members' products or services, with the program offering protection to the firms from competitive moves.

▪ **Improved pool of data:**

- Limited by national data protection legislation as well as data protection agreements among program sponsors, the operating company of a coalition has access to a much broader and richer data set than that of a stand-alone program, due to the availability of a purchase history which covers different retail sectors. Consequently, it might, for instance, be possible to segment customers not only by what they bought at the grocery store, but by their purchase behavior displayed in a whole range of retail sectors.
- Moreover, the database is more likely to be run by dedicated professionals, as data management and analysis is a core element of the coalition operator's business. While that, of course, does not mean that the same level of professional standards could not be found in a firm running a stand-alone scheme, it is simply less likely to be the case.

- **Ability to increase the customer base of every program sponsor:**

- As loyalty coalitions are usually made up of a range of prominent representatives from different retailing sub-sectors, customers might be persuaded to redirect their share-of-wallet to the chain of a program member, after previously having collected points at some of the other sponsors.
- This effect could be supported by special coalition marketing campaigns. Clark & Clark (2009) reported an example from the Canadian franchise of Air Miles, which had once offered a 50% reduction in miles required for a free flight to every customer who had collected points with at least five coalition sponsors.

- **Higher penetration rate:**

Coalitions can often boast a quick achievement of a high customer penetration rate through broad appeal, a generally higher media presence, as well as the other advantages benefiting customers. For example, Clark & Clark highlighted that UK's Nectar had signed up more than 11 million members within 12 months and 13 million within 18 months following its launch (which corresponds to a penetration rate of around 21%, given a *total* population of roughly 61 million people). By comparison, Germany's Payback (2001) reported 10 million active cards 16 months after launch (equating to a 12% penetration rate based on a *total* population of around 82 million). Apart from coalitions, such high numbers can really only be achieved by very large and long-standing stand-alone programs.

- **Generation of appeal for a wider range of companies:**

Particularly firms offering products characterized by a low purchase frequency might be more successful participating in a coalition program than operating a stand-alone scheme. While it might become a problem that customers will not maintain interest in a stand-alone scheme, this issue would likely be mitigated in the case of a coalition. In addition to that, Clark & Clark (2009) noted, customers used to collecting low point volumes often look forward to scoring a big chunk of points at once.

- **Firm-related benefits through industry exclusivity:**

Another point that makes coalitions appealing to organizations is the possibility of keeping the program sector-exclusive. This practice is employed by most retailing coalition schemes, giving the first firm to enter exclusivity within its sub-sector. Once the program reaches a high level of penetration, this could even act as a source of competitive advantage.

- **Greater simplicity for the customer:**

Due the fact that only one account needs to be tracked and taken care of, complexity for the customer is reduced to some extent.

4.2.2 Disadvantages

Coalition schemes boast several advantages, but this does not mean that they are free from disadvantages. Naturally, there are downsides associated with these schemes as well. The following list aims to cover the most important ones (Humby et al. 2008, Clark & Clark 2009):

- **Issues regarding ownership of data:**

Similar to consumers, partner companies of coalition schemes might also be concerned by privacy issues. In this case, the concern revolves around company-related data being handled by a third party. Adding up to this is the fact that each company's data is pooled together with that of other companies. Within every loyalty coalition, there will be contracts dealing with the topic of data ownership. Clark & Clark reported that for retailers, article-level basket data is typically both held and owned by the partner companies. Therefore, coalition operators would only hold customer information and data on the number of points collected by location and date. In practice, however, it differs from case to case whether coalitions really do not have access to detailed purchase histories, particularly to undertake valuable inter-industry customer segmentations based upon buying behavior. At any rate, the issue of data ownership is definitely a significant one. For instance, Nicolai (2003) reported that the negotiations between Shell Germany and the coalition scheme Payback failed because the fuel retailer did not want to leave control over customer data to a third party. It needs to be added, however, that Shell was at that time operating its own loyalty scheme and that negotiations only took place because Shell took over the German DEA chain, which was then part of the Payback coalition. Given this scenario, it might be argued that the outcome was predetermined to a certain extent. In addition to that, Nicolai wrote, Shell was unwilling to give up the flexibility that only its own scheme could provide.

- **Target of customers' loyalty unclear:**

In case of coalition schemes, the question remains whether customers are actually becoming loyal to the partner company or to the program instead. In other words, it is unclear whether the link between customer and program sponsor is strengthened at all. An interesting report on this problem comes from Humby et al. (2008), who described the switch of the UK's grocery retailer Sainsbury's from the long-established Air Miles coalition to the then new Nectar coalition in 2002. Upon this change, Tesco decided to take Sainsbury's space in Air Miles and allowed for a conversion of its own Clubcard points to Air Miles. A week into the new partnership, Tesco claimed to have experienced a 450% increase in the use of its online store finder and a 300% increase in enquiries about home shopping. Furthermore, Tesco de-

clared that one million new Clubcards were distributed. Ultimately, Humby et al. (2008) pointed out, Sainsbury's attributed a loss of 1% of sales volume to the decision to leave Air Miles – equal to what the authors calculated to be around 60,000 valuable customers lost to Tesco. On the one hand, this shows that coalition schemes really do work in creating lock-in with a range of customers, but on the other hand it also shows that for some consumers this lock-in relates to the program and not the company. What is particular about this situation is that the change was not from one existing to another existing coalition, but one from an existing to a new one. In such a constellation, there is no opportunity to immediately replace the lost customers with members from the new coalition. Still, since its launch, Nectar has long overtaken Air Miles in terms of the number of collectors and it can very well be argued, that Sainsbury's has meanwhile had a chance to compensate for this loss (Johnson 2002 reported that Air Miles had 6.5 million members in 2002; by contrast, Clark & Clark 2009 stated that Nectar had signed up 11 million members within a year from its launch). In fact, Loyalty Management UK, the company administrating the Nectar scheme, reported that it overtook Air Miles in terms of active cardholders within four weeks from its launch (Voyle 2002).

▪ **Loss of control for program sponsors:**

Naturally, every company joining a coalition scheme as a partner will have to give up some control. Humby et al. (2008) highlighted that this will reduce the chance to quickly introduce tactical marketing initiatives and limit innovation, because all decisions have to be agreed on by the program sponsors. While this might be of particular concern for program-wide changes or marketing campaigns, this will be less significant for individual, company-specific promotions. Still, as far as program-specific activities are concerned, the different sponsors will have to cooperate even when their agendas and priorities differ. In addition to that, involvement in the general program design will also be limited and the ability to “bind the program in to the business,” which Humby et al. considered to be such an important feature for Tesco, constrained.

▪ **Imbalance concerning partner contribution:**

One problem that might arise is that some of the program partners will become net contributors to the program, while others become net beneficiaries. In other words, some companies might distribute more point value than customers spend at their outlets, while the opposite situation might be given for other program sponsors. While this is a fairly natural situation, it can be expected that coalition operators have measures in place to adjust for this imbalance.

- **Coalitions virtually impossible to pilot:**

Due to specificities inherent to program structure, coalitions are pretty much impossible to pilot on a small scale. In order to work properly, multi-partner schemes require a certain size and, in case of retailing programs, sector coverage.

- **Bad experiences with program attributed to sponsors:**

When a customer encounters a problem with the coalition scheme that is located within the scope of the operator (e.g. points were not accredited, long waiting time in the customer service hotline, etc.), these negative experiences might be attributed to the program sponsors.

- **Expanding grocers limit space for new partners:**

A final point brought forward by Clark & Clark (2009) is that grocers in many countries have started to expand their activities not just into the retailing of other non-food items, but also into other non-retailing sectors such as financial services. Since, however, a food retailer is essential to any retailing coalition as it brings the necessary purchase frequencies with it, this might (together with the usually present exclusivity agreement) restrict the coalition in terms of the other partners it can select.

4.3 Success Factors

As with all other aspects of coalition schemes, research is scarce on this subject. Despite lacking empirical proof, Clark & Clark's (2009) list of four success factors associated particularly with coalition schemes shall nevertheless be reproduced here as it still represents a valuable contribution (see also Furinto et al. 2009 for a different approach to the subject). Certainly, there are other variables contributing to success as well, but the ones mentioned here might serve as a basic guideline.

Firstly, operators of a coalition scheme need to make sure that a high rate of penetration is reached fairly quickly. Most of the big programs have adhered to this principle and made sure that a major player from each key sector in retailing and possibly also financial services was on board to build up turnover right from the beginning. Furthermore, details were usually kept secret during the planning phase, possibly with a few bits of information leaking out towards launch date to build momentum. The launch itself, then, was accompanied by a massive media campaign to create awareness and immediately sign up a large number of new members.

Secondly, particularly in the case of coalition schemes, being first is a significant advantage. Not only will the second player in the market have lost his chance to sign up the most suitable partners (i.e. generally each sector's market leader), but in addition to that, customers will already have started to patronize one

scheme and might have become locked in or be unwilling to join a second scheme. For instance, Payback was launched as Germany's first coalition in March 2000. The second biggest player on the market today is HappyPoints, which was introduced as the loyalty program of the telecom provider Deutsche Telekom in October 2001 and expanded into a comparable, classic retail-oriented coalition in the years thereafter. Possibly the lack of first mover advantage combined with the lack of a big launch with many partners right from the beginning were what has kept the program in second place ever since. According to a study by GfK (2007) covering 8,000 households, in September 2007 60.8% of German households held a Payback card, while only 41.8% possessed a HappyPoints card.

Thirdly, coalitions need to make sure that they offer aspirational rewards that can be earned in a reasonable amount of time. As was mentioned before, this factor is one of the big advantages of multi-partner programs and its operators should make sure not to give that edge away.

Finally, coalitions need to emphasize the right choice and a suitable standard of communication channels. Pooling all program-related communication at the operator creates cost advantages, but at the same time, any negative experiences at the operator's customer touch points might fall back on the partner companies.

4.4 Impact, Spread, and Customer Perception

The number of academic papers on this subject is fairly limited. Out of the 23 studies on the success impact of loyalty schemes that were reviewed in Chapter 2.3, only one dealt with a coalition scheme. In their evaluation of the Australian FlyBuys coalition, Sharp & Sharp (1997) observed a trend towards a weak level of excess loyalty, although the expected deviation was not consistently observed for all program sponsors under review. In fact, only two of the six participant brands showed substantial excess loyalty deviations and even this variance in repeat-purchase loyalty was observed for both members and non-members of the coalition. The authors explained these findings at least partly as the result of other loyalty efforts. In the end, then, Sharp & Sharp's study can be categorized as one supporting those who claim that it is very difficult for loyalty schemes to alter customers' purchase patterns. The overall majority of evidence points in the opposite direction, however. As was previously discussed, it is clearly possible for loyalty programs to alter purchase behavior, at least to a small degree. Ultimately, it probably boils down to the same problem observed with other studies on the effectiveness of loyalty schemes: the definition of success. Sharp & Sharp themselves noted that "... the results are mixed" and that "the markets [...] remain *close to* 'normal' repeat purchase markets after the introduction of the

loyalty program” (p. 483). Things did not look the same before and after program launch, but were observed to be “close to” normal. Without changing the content of this statement, one could easily rephrase this to resemble the conclusion drawn in Chapter 2.3: the loyalty programs caused change, but on average only to a small extent.

Moore & Sekhon (2005) conducted a more recent study of coalition schemes by administering a survey of 153 members of the UK’s Nectar program. The authors posed a range of general questions relating to a wide range of topics such as customers’ scheme-related knowledge or use of the card, and attempted to draw conclusions on the program’s success in influencing behavior. Due to the similarity of this study’s goals at least to the general questionnaire part of the present work, findings will be reviewed in greater detail. The following points were discovered by the authors:

- Customers were generally satisfied, found the scheme easy to understand, convenient and easy to use, reliable, and trustworthy (although the level of trust remained at a basic level), and were happy with the service.
- Respondents preferred financial rewards when asked directly, though particularly aspirational rewards created high levels of involvement, resulting in customers taking on what the authors described as “a role of planners,” saving 2-3 times more points than people with low involvement.
- Program members valued the fact that they were able to collect more points at a quicker rate.
- Contact between the program and its members was found to be limited, with communication being confusing, complicated, and thereby discouraging attention.
- Despite a high level of targeted communication, respondents still felt that their expectations were not met in that regard.
- Customers found no differentiation between Nectar and its competitors.
- Except for the major retailer (i.e. most likely the grocery chain Sainsbury’s), consumers exhibited a clear lack of awareness as far as other program sponsors are concerned. This resulted in many customers perceiving the scheme to be that of the lead retailer.
- 97% have never had problems with the program.
- No special treatment as a result of being a program member was experienced by customers.
- The card was used with the majority of transactions with the two biggest retailers, while usage figures were clearly lower with the other coalition sponsors.

- The rate of redemption for acquired points was described as low by the authors (and not further defined).
- Customers usually carried competitive cards as well and appeared to be using the scheme out of habit and not so much because of a preference for the program.

Apart from a few exceptions such as that of poor communication, use out of habit, or a lack of knowledge of program sponsors, it seems fair to say that the outcome is generally what can be expected from coalition schemes. A good part of this study's abstract nevertheless leaves the reader with a rather grim feeling about coalitions. At the same time, however, the authors titled their article "Multi-Brand Loyalty Cards: A Good Idea" and closed their summary stating that "... there is evidence to suggest consumers perceive real benefits in coalition schemes and that there is a willingness to alter their behavior if the motivation is sufficient" (p. 625).

The importance of rewards as a motivator has already been discussed in previous sections of this paper, with its last point of mention in Chapter 4.3 on success factors associated with coalition schemes. Lara & De Madariaga (2007) dealt with this topic in a study focused exclusively on multi-sponsor programs. In their telephone survey of 521 members and 540 non-members of Spanish coalition schemes, the authors attempted to shed some new light on the research subject of loyalty rewards. Among a range of different elements associated with coalition schemes (e.g. number of participating companies, effort, exclusiveness, etc.), rewards were singled out as the most important factor by both members and non-members. As far as the type of reward is concerned, an association of satisfaction with intangible amusement rewards (e.g. games, raffles, etc.) and services was noticed for non-members and one with discounts and intangible amusement rewards for members. Particularly ecology and charitable rewards were found to be a very attractive element of the reward structure, which has long been disregarded in practice. Furthermore, the authors highlighted the importance of tailoring reward types to consumers and the goal the company tries to achieve. For instance, Lara & De Madariaga found that intangible amusement rewards would be particularly useful to acquire new participants, while rewards relating to benefits such as exclusiveness or special preference could help to strengthen the present member base.

Next to academic papers, studies by market research specialists serve as another source of information on coalition schemes. A notable contribution in this category comes from TNS Emnid (2006), which posed a range of general questions to a sample of 1,000 consumers. Despite having been commissioned by the German Payback coalition and therefore calling for a healthy bit of caution (particularly

in relation to what questions were asked and how the outcome is presented), the findings might nevertheless be useful:

- When respondents were asked about the type of cards carried in their wallet at all times, the bank card finished first with a penetration rate of 82%, followed by the health insurance card with 77%, and the Payback card together with a credit card tied at third place with 32%. The card of the second largest German coalition HappyPoints was carried by 15% of people, with cards of stand-alone programs failing to surpass the 10% mark.
- Consumers were further confronted with a list of loyalty program names and asked which ones they know by name. 80% answered that they had heard of Payback, 50% were familiar with HappyPoints, 41% with the Family card of the Swedish furniture retailer Ikea, and 39% with the Lufthansa Miles & More frequent flyer program. With the exception of Ikea's Family card, no stand-alone program managed to surpass the 35% mark.
- Requested to judge the importance of a range of loyalty scheme features, 76% found the ability to use the card at different shops to be either very or rather important. That it offers services, special offers, or advantages the customer does not have access to without the card followed with 63% and that it offers coupons which provide savings and advantages upon purchase as well as access to a wide range of reward types followed with a tied 51%. Having access to a reward within a short amount of time was judged very or rather important by 46% of survey respondents, the card being usable for online shopping by 43%, that rewards exclusive to the program are available by 38%, that the card offers a payment function by 22%, and that it offers a credit card function by 12%.
- Asked directly whether their purchase behavior has changed since they became a member of the respective loyalty scheme, 34% said they buy/book more flights and 38% that they are more likely to buy/book flights since joining Miles & More. The values for Payback in these two categories ("buy/book more" and "buy/book more likely") came in at 26% and 32%, these for the program of the perfumery chain Douglas at 25% and 35%, for HappyPoints at 20% and 30%, for the Haushaltskarte of the grocery retailer REWE at 20% and 26%, and for the Ikea Family card at 9% and 18%.
- Finally, respondents were questioned as to which one of the nine programs presented in a list gave them the biggest personal benefit. Payback came in a clear first with 34%, followed by HappyPoints with 7% and the Ikea Family card, Miles & More, as well as bahn.comfort (a point-based frequent traveler scheme of the German railway company Deutsche Bahn) with 6% each. Four other stand-alone programs attracted the favor of between 1% and 5% of respondents,

complemented by 12% stating that none of the programs would give them personal benefit and 18% saying that they do not know.

Within the range of findings presented by TNS Emnid, Payback scored a conspicuously high number of first and second places. Given that the study was commissioned by Payback's operator Loyalty Partner, it seems fair to challenge the survey's outcome in a few regards. A very obvious point is the question asking people to judge the importance of a range of loyalty scheme features. Coming even before items such as the program's ability to provide savings and benefits, the possibility to use the card at different shops took a surprising first place (and this characteristic is, after all, a great advantage of Payback). Leaving aside the issue of whether respondents might have been confused as to whether the question really meant different companies or simply different stores from the same chain, this ranking is most likely explained by the fact that both the answer category "very important" and "rather important" were combined in generating it. In other words, it is not unlikely that, as opposed to the ability to use the card at different shops, a much bigger percentage of respondents judged the rebate function to be very important. In addition to that, it remains unclear why this specific range of programs was chosen for the list to be presented to respondents and whether the findings presented were not simply a flattering selection. Nevertheless, given an appropriate sense of caution, these findings still provide a few interesting insights, for instance, supporting the general view that multi-partner schemes are able to reach a much higher penetration rate than stand-alone programs.

This fact is also supported by further research on behalf of the Payback operator Loyalty Partner. GfK (2007) investigated the possession and use of loyalty cards in Germany by surveying 8,000 households. As mentioned in Chapter 4.3, in September 2007 60.8% of Germany's 34.3 million households held a Payback card. By comparison, 41.8% possessed a HappyPoints card, 11.7% a Shell Clubsmart card, and 8.7% a Lufthansa Miles & More card. As far as the use of these loyalty programs is concerned, 56.5% of respondents stated that they always use their Payback card, while 32.4% did so with their HappyPoints, 44.7% with their Clubsmart, and 30.9% with their Miles & More card. In addition to that, another 38.5% used the Payback card occasionally, 54.7% did so with their HappyPoints card, 38.7% with their Clubsmart, and 49.7% with their Lufthansa Miles & More card. What remains unclear is whether these usage rates refer to category spending or simply use with the program operators or, in case of coalitions, their partners. After all, a rate of only around 31% showing their Miles & More card on every flight taken with Lufthansa seems very low. By contrast, it seems more likely that Miles & More members were using their card on virtually every flight with Lufthansa, but that they selected this airline for only 31% of

their flights. Further background information on this issue is not provided, but one thing is in any case certain: among the programs surveyed, customers of Germany's largest coalition Payback showed the highest rates of both possession and usage.

4.5 The Next Evolutionary Step?

As was mentioned in the introduction to this Chapter 4, several academics and practitioners consider coalition schemes to be some sort of evolutionary step. Naturally, this program type has drawbacks as well, but overall, advantages were often found to outweigh.

What is so striking, then, is the blatant deficit of literature on this topic. Some ground is covered by studies from market research organizations (usually commissioned by coalition operators, however; e.g. TNS Emnid 2006 or GfK 2007) and in fact, some of the academic literature has also been written by practitioners from research organizations (e.g. Capizzi & Ferguson 2005 or Ferguson & Hlavinka 2006). Next to a few current or former practitioners (e.g. Humby et al. 2008 or Clark & Clark 2009), the truly academic view on coalition schemes remains extremely limited (and includes only a handful of publications such as those by Sharp & Sharp 1997 or Lara & De Madariaga 2007). At best, authors from an academic background have mentioned examples of coalition schemes in the course of a study on a different aspect of loyalty schemes (e.g. Stone et al. 2004 referring to UK's Nectar coalition in a general evaluation of loyalty schemes or Rowley 2005 in a case study of Tesco's Clubcard).

Scientific information on this topic is consequently still scarce, with unbiased, empirical evidence of the purported superiority of coalition schemes still outstanding. For that reason, this paper will attempt to contribute another, much-needed piece to this puzzle with the following empirical section.