3. Loyalty Schemes

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
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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).

Often called the first “actual” loyalty scheme, the S&amp;H Green Stamps (not to be confused with the S&amp;H Green Shield Stamps issued by a different company in the UK) were introduced in the USA as a reward currency by the S&amp;H Company in 1896 (S&amp;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.
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.

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- 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)

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).
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 Allders 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 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.

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

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, Kralev (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:

\[
\text{Gain/Loss} = (U_\text{n}P) - (U_\text{o}P) - R - A
\]

Hereby, \(U_\text{n}\) refers to the new number of units sold (i.e. following the implementation of the program) and \(U_\text{o}\) 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.
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, Hipner 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)

**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-
acked. 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.

<table>
<thead>
<tr>
<th>Models</th>
<th>Sub-Groups</th>
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<tbody>
<tr>
<td>Single outcomes in multiple categories</td>
<td>Models of incidence outcomes</td>
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<td></td>
<td>Models capturing “whether to buy”</td>
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<td></td>
<td>Models capturing “when to buy”</td>
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<td>Models capturing bundle choice</td>
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<td>Models of brand choice outcomes</td>
<td>Models capturing correlated marketing mix sensitivities across categories</td>
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<tr>
<td>Models of quantity outcomes</td>
<td>Models capturing correlated brand preferences across categories</td>
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<tr>
<td>Multiples outcomes in multiple categories</td>
<td>Models of incidence and brand choice outcomes</td>
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<td>Models of incidence and quantity outcomes</td>
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<td></td>
<td>Models of incidence, brand choice, and quantity outcomes</td>
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</table>

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).

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

Another, slightly less straightforward 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.

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).

<table>
<thead>
<tr>
<th>General Benefits</th>
<th>Data Collection-Specific Benefits</th>
</tr>
</thead>
<tbody>
<tr>
<td>- The increase of:</td>
<td>- The ability to:</td>
</tr>
<tr>
<td>- Purchase frequency</td>
<td>- Minimize wasteful (marketing) spending</td>
</tr>
<tr>
<td>- Basket size</td>
<td>- Mass customize marketing communication to maximize the impact of the corresponding marketing activity</td>
</tr>
<tr>
<td>- Share-of-wallet</td>
<td>- Identify customer segments with similar characteristics</td>
</tr>
<tr>
<td>- Lifetime duration</td>
<td>- Engage in profitable customer acquisition by modeling expected customer potential</td>
</tr>
<tr>
<td>- Trust</td>
<td>- Increase revenues through cross- and up-selling, based on a model of the customer’s purchase likelihood of specific product sets or services</td>
</tr>
<tr>
<td>- Satisfaction</td>
<td>- Optimize store layout (e.g., product placement) following a better understanding of purchase behavior</td>
</tr>
<tr>
<td>- Commitment</td>
<td>- Promote follow-up products (e.g., razor blades for a particular razor)</td>
</tr>
<tr>
<td>Plus the:</td>
<td>- Reduce churn with predictive models that identify customers who are likely to stop patronizing the company in the future</td>
</tr>
<tr>
<td>- Buildup of exit barriers</td>
<td>- Identify customers who were recently lost and to reach them with an action plan aimed at bringing them back</td>
</tr>
<tr>
<td>- Generation of positive word-of-mouth for the company</td>
<td>- Identify track trends</td>
</tr>
<tr>
<td>- Attraction of new customers through the program itself</td>
<td>- Make qualified changes to the range of goods or services on offer</td>
</tr>
<tr>
<td>- Decrease in price-sensitivity among loyal customers</td>
<td>- Measure and evaluate the effect of marketing campaigns in a better and more efficient manner</td>
</tr>
<tr>
<td>- Decrease in costs necessary to serve loyal customers</td>
<td>- Improve the success of a necessary product recall by directly addressing affected customers</td>
</tr>
<tr>
<td>- Improvement of company, product, service, and brand image</td>
<td>- Cheaply acquire new customers for new business areas developed by the company</td>
</tr>
<tr>
<td>- Formation of a means of competitive advantage</td>
<td>- Support business decisions of various kinds (e.g., development of a new product line)</td>
</tr>
</tbody>
</table>

Figure 12: Proclaimed Benefits of Loyalty Schemes


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.
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

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 Buzscher (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 weekend 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, Haebelke (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.