

# THE EFFECT OF LOYALTY PROGRAMS ON CUSTOMER LOYALTY IN THE HOSPITALITY INDUSTRY

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**Abstract:** Loyalty programs have been extensively used to enhance customer loyalty. Despite the rapid growth of the programs, its effectiveness in boosting customer loyalty is still questionable. By employing meta-analysis technique, nine empirical studies in hospitality businesses are reviewed. Result shows that loyalty programs do not have a significant effect on increasing customer loyalty. The programs are only able to encourage customers to repeatedly purchase without having emotional attachment and personal relationship to the companies.

**Keywords:** Loyalty Program, customer loyalty, hotel, airlines, restaurant, hospitality industry.

In today's more competitive market, management is no longer focusing their marketing goal merely on gaining new customers. The cost to gain a new customer can be five times more expensive than to retain one (McIlroy and Barnett, 2000). Hence, in many industries, the emphasis of marketing objective now has shifted from customer acquisition to customer retention or customer loyalty (Shoemaker and Lewis, 1998). In his research in 1990, Reichheld points out that the benefits of retaining customers have direct impacts on company's profitability. The costs associated with taking care of loyal customers decline over time, while at the same time, sales from loyal buyers increase as a consequence of their loyal patronage behaviour. Further, loyal customers will also present partnership actions such as spread a positive word of mouth to their friends and relatives (quoted in Bowen and Shoemaker, 1998).

Loyalty programs have been extensively used in many industries as a tool to build customer loyalty. It was initially introduced by American Airlines in 1981, as its response towards deregulation in the US' airline industry. Similar programs then have since spread rapidly across the world through retail, car rental, hotel, financial services industries, and among many others (Palmer, et.al., 2000; O'Malley, 1998).

However, despite the rapid growth of loyalty programs, many questions rise about the effectiveness of the programs to truly enhance customer loyalty. While it requires a huge amount of money to run the programs, facts indicate that many organizations have failed to increase customer loyalty through the implementation of the programs. O'Brien and Jones (2000) urge that in practice, loyalty programs are widely misunderstood and often misapplied. Many companies treat loyalty programs as short-term

promotional tools for their customers. As a result, customers become loyal to the programs rather than to the company.

This study therefore examines the effect of loyalty programs on enhancing customer loyalty in the context of hospitality industry. By applying meta-analysis technique, nine previous empirical studies will be analyzed to draw general conclusions regarding the effect of the implementation of loyalty programs on customer loyalty.

## LITERATURE REVIEW

### Customer Loyalty

It is not easy to define customer loyalty, as many people and even managers perceive customer loyalty is equal to repeat purchase behaviour of the customers. According to Kotler, Bowen and Makens, customer loyalty is "*how likely customers are to return and their willingness to perform partnership activities for the organization*" (1999, p. 351). Partnership activities include the customers' willingness to spend more while on a property, give positive referrals to others and tell management when problems occur.

Similarly, in defining customer loyalty, Griffin urges that two factors are critical for loyalty to grow. The first factor is customer's emotional attachment toward one certain product or service. The second factor is customer's repeat purchase (quoted in Shoemaker and Lewis, 1998).

Moreover, Backman and Crompton depict customer loyalty based on two dimensions, which are the degree of repurchase (behavioural) and the degree of attachment (attitude). It can be seen on the figure 1 below:

		Attitude	
		Low	High
Degree of repurchase	High	Spurious/ Inertia Loyalty	Premium/ True Loyalty
	Low	No/Low Loyalty	Latent Loyalty

\* Source: Backman & Crompton (1991)

**Figure 1. Loyalty Typology Based on Attitude and Behaviour**

From the two dimensions above, there are four types of loyalty, they are: (1) *Premium loyalty* or *true loyalty*, which occurs when a customer has a high level of attachment and performs high repeat visits. (2) *Inertia loyalty* or *spurious loyalty* which occurs when a customer has a high repeat of purchase but has no emotional attachment to the company. (3) *Latent loyalty*, which occurs when a customer has a strong emotional attachment to the company but purchases less, and (4) *No loyalty* or *low loyalty* which means there are no emotional attachment and repeat purchase performed by the customer.

*Premium or true loyalty* is most resistant to competitor's offerings, thus, in implementing loyalty programs as an instrument to build customer loyalty, this type of loyalty should become the goal pursued by the companies. By contrast, *spurious* or *inertia loyalty* is considered as the most susceptible to competitor's offerings. Once the competitors offer more attractive marketing strategies including more valuable loyalty programs, the customers will easily switch to them (cited in Baloglu, 2002).

### Loyalty Programs

There is no exact definition of customer loyalty programs given by both marketing experts and researchers in academic and journals literatures. Nevertheless, the basic meaning of loyalty programs can be defined based on its objectives. According to Shoemaker and Lewis (1998), loyalty programs are the programs offered to the customers in order to build an emotional attachment to the brand. Thus, loyalty programs are not merely set to encourage customers to repurchase. Likewise, Butscher states "a customer loyalty program's primary purpose is to build a relationship with the customers that turns them into long-term loyal customers, who ideally will obtain their lifetime demand for specific product or service from the company sponsoring the loyalty programme" (2002, p. 39).

There are a lot of different names given for these programs. For instance, in the hotel industry, the loyalty program is often named as *Guest Frequent Program*; while in the airline industry, it is called *Frequent Flyer Program*. In other industries, it is also named as *Bonus Program*, *Customer Club*, *Customer Card*, *Fly Buys* and so forth. However, as stated by Butscher (2002, p.51), those different names basically do not differentiate one program from the others. The key differentiators are the types and the benefits offered by the programs.

Moreover, in terms of membership, there are two types of customer loyalty programs, namely *limited* and *open*. A limited loyalty program cannot be joined by just everybody. There is a formal procedure to become a member of the program such as paying joining fees and sometimes there are certain criteria in order to be eligible as a member such as certain purchase volume and minimum income. On the other hand, an open loyalty program can be joined by every individual and usually does not have formal criteria and application procedures.

Additionally, in terms of the benefits offered, there are two types of benefits namely *hard* or *financial* and *soft benefits*. Hard benefits are tangible benefits which are immediately recognizable by all members and lead to savings in some form or another. In most cases, hard benefits are financial benefits, for example discounts, rebates or coupons. These benefits can be easily imitated by competitors. Soft benefits are the special offers, the value-added services, the special treatment, the recognition and reward that the customer is looking for. It is mostly intangible, company and product related and less copied by competitors (Butscher, 2002, p.56).

### Hospitality Industry

Hospitality industry has been defined in many ways in the literature. *Webster's Ninth New Collegiate Dictionary* characterizes hospitality industry as "those businesses which practices the act of being hospitable; those businesses which are characterized by generosity and friendliness to guests" (cited in Brymer, 1995, p. 3). Based on that definition, it can be said that hospitality industry is an umbrella industry for businesses which the main goal is to please guests. There are four large areas that encompass the major segments of the industry, they are: food service, lodging, travel and tourism, and meeting and convention planning.

By referring on the definition above, the scope of hospitality industry used within this study will include hotel, restaurant and airline industries.

## METHODOLOGY

### Selecting Criteria

For the purpose of the study, there are two major criteria in selecting the articles which are going to be examined.

1. Only empirical studies will be chosen. The theoretical and anecdotal studies will only be used to support the analysis and discussion within this paper.
2. The articles selected should have the same dependent and independent variables. The dependent variable is customer loyalty, whereas the independent variable is loyalty programs.

### Variables and Operational Definition of the Variables

#### Dependent Variable

The dependent variable in this study is customer loyalty. It is operationally defined as “*the likelihood of a customer to repurchase and to have a high level of emotional attachment to the company*”. For the purpose of the study, customer loyalty then will be measured based on two factors, namely customer repeat purchase and emotional attachment. Emotional attachment includes the willingness to give positive recommendations to others, to spend more and to be loyal to the company even though there is no loyalty program offered.

#### Independent Variable

The independent variable within this study is loyalty programs. It is operationally defined as “*all programs which are offered to the customers in order to build a personal relationship and emotional attachment to the company*”. Although there are a lot of different names of loyalty programs applied across different industries, but basically they are the same as they offer similar benefits to the customers.

### Unit of Measurement

Most of the nine studies selected utilized regression analysis for measuring the effect of loyalty programs on customer loyalty. Results of all those studies then will be examined using meta-analysis technique. Meta-analysis is “*a way of statistically combining and comparing the results of different studies on the certain issue*” (Lynn, 2001). By doing so, it would allow stronger and more generalizable conclusion about the nature of the effect of loyalty programs on customer loyalty, than any of the individual studies could do so.

However, as this study does not attempt to statistically meta-analyze the results of each empirical research examined, the regression coefficient will not be measured in a quantitative way. Rather, it will only be assessed as influence or not influence. Influence means loyalty programs implemented have an effect on enhancing customer repurchase behaviour and emotional attachment to the company; and vice versa.

## FINDINGS

Table 1 below provides major results found in investigating each study chosen. It does not only describe the relationship between the dependent and independent variables, but also depicts various loyalty programs offered and a brief overview of the respondents' characteristics within each study.

There are three important points revealed which distinguish the findings of one study of the others. **First**, all studies above indicate that loyalty programs do not have a significant effect on increasing customer loyalty. Rather, they only create a *spurious loyalty*, which means that the programs influence customers to repurchase without having emotional attachment to the company. Most customers make repeat purchases in order to accumulate the benefits and then redeem the rewards provided.

**Second**, three studies on the hotel industry (study number 1-3) illustrate that there is no association at all of loyalty programs with customer loyalty. Thus, the program does not influence customers either to repurchase or have emotional bonding with the hotels. Customers are loyal to the companies not because of the programs offered. Although they belong to the program and get bonus points or discounts from it, they do not care about the loyalty program and benefits provided. Instead, they reveal that their loyalty to the companies is built up by other factors such as satisfaction and service quality. Thus, there is no correlation between loyalty programs and customer loyalty.

**Third**, among those nine studies, four studies (study number 5, 6, 7, and 8) clearly illustrate that most customers belong to multiple loyalty programs. Customers concentrate on one program and are loyal to one company until the rewards have been redeemed. Once they gain it, they will switch to another loyalty program. Therefore, they are loyal toward the programs, not toward the company. Based on the operational definition given for customer loyalty, this type of customer loyalty cannot be considered as customer loyalty.

The summary of the findings can be seen at table 2 below. It shows that the implementation of loyalty programs in three different industries investigated do not significantly help companies to reach out their goal to build customer loyalty.

Table 1. Major Findings of the Studies Selected

No.	Article, Author, Date	Industry	Name of Loyalty Programs/ Type of Membership	Types of Benefits	Profiles of the Target Group	Effect of Loyalty Programs on Building Customer Loyalty
1.	Loyalty: A Strategic Commitment Bowen, J.T. & Shoemaker, S. (1998)	Hotel	Reward Cards/Open membership	Bonus Point Discount Free purchase	Business travelers with high income	Reward cards <u>appeal strongly only to small percentage</u> of business travelers in luxury hotel. Most guests are <u>loyal to the hotel not because of the loyalty programs</u> offered.
2.	Are Frequent- Guest Programs Effective? McCleary, K.W. & Weaver, P.A. (1991)	Hotel	Frequent Guest Program/ Open Membership	Bonus points Discount Free purchase	Executive business travelers with high income	The effect of loyalty program is <u>insignificant</u> to make customer loyal to the company.  Customers will <u>keep loyal although there is no loyalty programs</u> offered.
3	Frequent Guest Programs: Do They Fly?  Toh, R.S., Rivers, M. & Withiam, G. (1991)	Hotel	Frequent Guest Program/ Open membership	Bonus points Discount Free purchase	Business travelers with middle income	Frequent Guest Program <u>does not have correlation at all</u> with guest loyalty.  Guests stay at the hotel <u>not because of the program</u> .
4.	Building Customer Relationship: Do Discount Cards Work?  Mc Ilroy, A. & Barnett, S. (2000)	Hotel	Gold Card/ Limited membership	Discount	Hotel customers (mostly new customers)  Local residents Middle income	Discount card <u>does not appear to increase customer loyalty</u> . Customers perceived the program to be good value for money only. They <u>will not repurchase if the card is expired</u> (means their membership to the program is finished).
5.	Service: The Key to Frequent Guest Programs  Toh, R.S., Hu, M.Y. & Withiam, G. (1991)	Hotel	Frequent Guest Program/ Open membership	Bonus points Discount Free purchase	Business travelers with high income  Belongs to multiple programs	Loyalty program is considered <u>able to increase repurchase behaviour</u> .  But it indicates that the <u>guests are loyal to the programs rather than to the hotel</u> . They are mostly concentrate on a single program at a hotel at a time until they have redeemed the rewards.
6.	Loyalty Marketing and Frequent Flyer Programs: Attitude and Attributes of Corporate Travelers Whyte, R. (2002)	Airlines	Frequent Flyer Program/ Open Membership	Bonus points Club member benefits	Business travelers with high income  Double membership	Most respondents feel more tied to the programs/rewards rather than to the company.  Thus, loyalty program <u>leads to a spurious loyalty</u> .
7.	Frequent Flyer Programs: The Australian Experience Browne, W.G., Toh, R.S. & Yu, M.Y. (1995)	Airlines	Frequent Flyer Program/ Open membership	Bonus points	Business travelers with high income Dual membership	Most respondents are price insensitive.  Frequent-flyer program <u>is not considered as important which affects their loyalty</u> to the company.
8.	Frequent Flyer Programs: The Beginning of the End?  Beaver, A. (1996)	Airlines	Frequent Flyer Program/ Open membership	Bonus points	Business travelers Most travelers belong to two/three schemes.	Loyalty program <u>does not appear to enhance</u> customer loyalty.  <u>They are loyal to the program</u> , not to the company.
9.	Coupon Promotions in Quick-Service Restaurants Taylor, G.A. & Long-Tolbert, S. (2002)	Restaurant	Coupon/  Open membership	Discount coupons	College students	Coupon redemption indicates a <u>negative association with customer loyalty</u> .  It <u>only influences customers to repeatedly purchase</u> the products.

**Table 2. Summary of the Effect of Independent Variable on Dependent Variable**

Independent Variable	Scope of Industry	Dependent Variable: Loyalty Programs	
		Influence	Not influence
Customer Loyalty	Hotel	5 studies	
	Airline	3 studies	
	Restaurant	1 study	

## DISCUSSIONS

The result of meta-analysis has shown that loyalty programs which are implemented in the hospitality industry do not have a strong effect on building customer loyalty. It therefore gives several important insights which need to be considered by marketing managers in planning their loyalty programs.

**First**, nine studies investigated apparently illustrate that building customer loyalty through the implementation of loyalty programs is not an easy task for managers. It offers financial rewards only, as management perceives that offering financial benefits throughout the program will attract customers to repeatedly purchase and make them loyal to the company. In fact, repurchase behaviour does not guarantee their loyalty toward the organizations. As stated by Mattila (2001), customer loyalty must go beyond racking up points and even beyond repeat purchases.

Moreover, customer loyalty which is built based on repeat patronage will not create true loyalty. This kind of loyalty will bring a short-term effect on company's profitability. The loyalty program might well stimulate sales for the duration of the program, and as a result, the company will gain higher revenue as many customers make repeat purchases, but the motivation to do so is not because they have such of commitment with the company, instead, to accumulate the points. Once they get the rewards, they might stop purchasing and switch to another company (Baloglu, 2002; Dowling and Uncles, 1997). An example can be seen from study number 4, where most respondents in the study state that they will not repeatedly stay at the hotel or make a purchase at the other hotel's facilities such as restaurant and bar if their membership of the hotel's loyalty program (*Gold Card*) is expired.

Similarly, Butscher (2002, p. 56) points out that too many programs are founded on discounts and rebates alone. Although most customers enjoy the prospect of savings and low prices, the value of further savings alone is limited. Consumers may become immune to bargains. It can be seen from the studies on the airline industry which launch *Frequent*

*Flyer Programs* (see study number 6, 7, and 8). Nearly all carriers in these studies offer the same benefits (points), and form the same partnerships with hotels, rental car companies, and restaurants. While most of the flyers are members of several *Frequent Flyer Programs*, hence, they focus their flight activities on one airline until they have reached enough miles for free flight or for other rewards. As a result, loyalty program encourages customers become loyal toward the programs, not to the company.

**Second**, it is important to consider consumer involvement in purchasing hospitality products and services, as this aspect plays a significant role in influencing consumer behaviour. Dowling and Uncles (1997) state that the level of customer involvement should become an important consideration in launching the loyalty program. For high-involvement products and services, the product and not the incentive is the primary reward, while for low-involvement products, the incentive and not the product can become the primary reward. Additionally, for low-involvement products, consumers often buy the products as a habitual behaviour, whereas for high-involvement products, consumers tend to form a personal relationship with the company or service providers.

Therefore, since the level of customer involvement in purchasing hospitality and tourism products is relatively high, it might give the reason why loyalty programs offered in most of the studies examined show an insignificant effect on building customer loyalty. As clearly indicated by study number 1, 2, and 3, most of guests in the hotels state that they do not care about the loyalty programs with which they belong to. Although there is no loyalty program provided, they will remain loyal to repeatedly stay at the same hotels. Further they state that instead of loyalty programs from the hotels, other factors such as service quality and facilities are more important to be considered when choosing a hotel they want to stay in.

**Third**, the results also reveal that there is a different characteristic of the target group especially in terms of occupation. This factor might play an important role in influencing the effectiveness of the program especially in the way customers respond to the loyalty programs offered. For instance, studies conducted in the hotel and airline industries show that the majority of the target groups are business travelers of high-level of income. Business travelers are a price insensitive group, hence, price will not become a main consideration when they purchase a product or service. Moreover, their employers generally pay their travel costs. As a consequence, they are not

really attracted by the discounts offered in the loyalty programs or even consider it in their buying decisions.

On the other hand, study no. 9 which was conducted in the restaurant industry, targeted the group of students of middle-income level. This group is relatively more sensitive toward better value of price such as discounts, coupon and rebates. Results of study number 9 shows that the students respond more positively toward the loyalty programs offered, specifically in exhibiting repurchase behaviour.

## LIMITATIONS

The analysis within this study should be viewed under some limitations. First, the number of empirical studies conducted under related topic is very limited, in particular, empirical research in the hospitality industry which investigate the effect of loyalty programs on increasing customer loyalty. During searching process throughout the databases, it is found that most of journal articles written on the related topic are theoretical and anecdotal ones. It is very difficult to find the empirical research which is the most appropriate for this study.

Second, the time to conduct this meta-analysis is also very limited, which is less than three months, thus, it might lead to the limitation to obtain appropriate numbers of empirical research.

Third, this study does not explore the aspect of loyalty program membership, which can be classified into two types, namely open and limited membership. This aspect might give a contribution to the way customers react toward the loyalty program offered. For instance, customers who join a limited membership loyalty program might be more loyal toward the company as they have to follow a formal procedure to become a member of the program such as paying joining fees, even sometimes there are certain criteria in order to be eligible as a member such as certain purchase volume and minimum income.

Fourth, all research of nine articles examined were conducted in Western countries which are United States of America, Australia, New Zealand, Germany and the United Kingdom. There is no one empirical research found conducted in Asian or African countries on the related topic, where consumers in these regions might exhibit different behaviour responding loyalty programs, as socio-economic and culture in these countries are different compared to most of Western countries. According to Kotler, Bowen, Makens, socio-economic and cultural factors play great roles in affecting consumers make

buying decisions, from the time when they collect the information about the products, consume the product, to the way they evaluate the product purchased (1999, p.181). Moreover, Crotts and Erdmann in their research highlight the influence of national culture on consumer evaluations of travel services and their willingness to repeat purchase and recommend the services to others. They contend that there is a strong positive correlation among customer satisfaction, repeat buying behaviour and positive word of mouth (2000).

## CONCLUSION

Building customer loyalty will never be an easy task for marketing managers. Customers are very vulnerable and easily switch to other brands or companies as they have a lot of options to choose. Thus, managers should fully understand that making customers loyal to the company means not only to encourage them to make repeat purchases, but also to build customers' emotional attachment to the company. In effort to do so, the use of loyalty programs as a tool to enhance customer loyalty therefore should be planned carefully.

Results of this meta-analysis study show that all of the studies indicate that loyalty programs do not have a significant effect on building customer loyalty. The programs are able to persuade customers to repeatedly purchase the products and services, but this is not the real customer loyalty pursued. Customers make repeat purchases without having an emotional attachment and personal relationship to the companies. Most customers even belong to more than one loyalty programs membership. They are loyal to the programs as they attempt to redeem the financial rewards.

The results also reveal that there are two other factors which might affect the effectiveness of loyalty programs on building customer loyalty particularly in the hospitality industry. The first factor is customer involvement with the product. The level of customer involvement in purchasing hospitality and tourism products is relatively high. For high-involvement products and services, the company and not the incentive is the primary reward or major consideration for customers in making their buying decision as well as their trust to the company. The second factor is the characteristic of the groups targeted. Different target groups will react differently toward the programs and the benefits offered. Hence, it is recommended that managers should creatively design the most suitable benefits depending upon which group of customers they target.

In conclusion, although this meta-analysis study is done under some limitations and does not provide solutions to the whole problems, it is believed that it has answered the research questioned purposed and achieved the objectives of the study. It has attempted to provide important information for marketing managers in offering more effective loyalty programs so as to build the real customer loyalty specifically in the hospitality businesses. It also has tried to give recommendations for future research to investigate more about the aspect of culture and the type of loyalty program membership.

### RECOMMENDATIONS

The result of this meta-analysis study reveals that most of the programs offer similar benefits for the customers. In other words, there is no differentiation among loyalty programs from one company to the others. Therefore, it is recommended that marketing managers should provide soft benefits rather than merely rewarding financial benefits for the customers. It is believed that soft benefits which provide extraordinary benefits for customers such as value-added services, special treatment and personal reward will be able to build personal relationship between customers and the organization. This issue becomes more crucial especially in the hospitality industry where the level of interaction between company and customers is quite intensive. Hotel, airline and restaurant businesses are people businesses where customers and employees are directly interact and participate in the service delivery process. Thus, customer's personal recognition is very important to build.

Secondly, as has been mentioned in the discussion section that the level of customer involvement with the product might influence the customer responds toward the loyalty programs. Therefore, it is recommended that management should consider the contribution of this aspect as well. In planning loyalty programs, particularly in the hospitality industry, managers should be aware that customer involvement for purchasing hospitality products and services is quite high. Psychological factors such as beliefs, trust, and perception, as well as rational factors such as value of money and risks certainly influence customer's decision-making. Hence, having an understanding that by offering merely financial incentives to attract customers and make them loyal toward the organizations might not be appropriate.

Finally, in order to make loyalty program more significantly influence customer loyalty, it is very important to understand which group are targeted,

because different groups will respond differently toward the programs where in turn impact on their loyalty towards the companies. Hence, managers should carefully design the most suitable benefits depending upon which group of customers they target. For instance, if a hotel wants to build the loyalty of their high-level income business travelers, thus, loyalty program which offers financial benefits will not be effective. On the other hand, if the middle-income guests are targeted, frequent guest programs with discounts and free purchase benefits might work effectively although it is still needed to offer other additional benefits so as not to create spurious loyalty.

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