LOYALTY PROGRAMS: HOW TO MEASURE CUSTOMER LOYALTY?

Associate Professor Simona-Silvana MĂRGINEAN
"Petru Maior" University of Tg. Mureș, Romania
Email: simona.marginean@gmail.com

Abstract: Loyalty programs are designed to change the way customers interact with companies in terms of purchasing value, retention and repetition. The monetary perspective lays at the foundation of every loyalty system, designated to measure the transactional side of the client's loyalty. However, the serious decline in retention rates and low customer commitment due to lack of relevance and value pushes today's loyalty marketing into anachronism. Our approach to loyalty programs will analyze the emotional side of customer loyalty, in today's Internet driven social platforms environment, which is set to generate a switch in paradigm. Customer loyalty models need to focus on brand values and interaction, on meaningful brand experiences worth sharing. Loyalty metrics should focus on creating and inspiring more valuable customers, willing to share their seamless experiences with others. We will analyze the impact of transactional operated loyalty programs against loyalty programs built upon customer expectations, inin order to identify meaningful loyalty models generating brand attachment in tomorrow's economic environment. Our focus will be on assimilating the loyalty performance model into a new transparent loyalty paradigm, built upon brand values, customer insight, innovative contribution to brand growth and ethics, as opposed to bargain hunting, promotions and retention metrics.
Keywords: loyalty, transaction, retention, content, brand, consumer.
JEL Classification: M 31.

1. Theoretical Framework

While many scholars and practitioners agree to the premise that generating sustainable growth and designing appropriate business strategies lies in the deciphering of customer lifetime value, the business practice attept to asses the optimal combination of client acquisition and retention cost against a background of increased criticism. Companies strive to identify the preferred customer opportunities while the influence of Internet and social media upon customer behavior weights supreme. Is transactional loyalty obsolete? Would emotional loyalty and customer insights replace the retention strategies and bring value to companies? Or can we continue to advocate a loyalty paradigm based upon customer lifetime value and customer engagement?

Relationship marketing refers to broader organizational efforts involving personnel across organizations (Zineldin, 2000). Its main focus is at establishing, developing and maintaining customer loyalty and stimulating repeated purchase over (Wu & Tseng, 2015). Relationship marketing is based on the idea of treating each customer in an individualiyed way, the foundation of one-to-one marketing (Moon, 1999) and one of the pillars of customer satisfaction. The new relationship marketing paradigm uses Internet as an interaction point between companies and customers in the on-line environment, meant to collect customer data, used for its ability to understand customer behavior and as a feedback environment, allowing a one-to-one communication between the company and its customers.

Customer satisfaction is a concept translated in an accumulated and experience-based attitude. It is a feeling subject to evaluation, the result of customers' comparison between the expected and actual performance of a product or service. Kotler (1996) pointed at the relation between perceived performance and expectation. Therefore, customer satisfaction resides at the level of delight or dissapointment deriving from the comparison between perception over the characteristics or performances of a product and personal anticipations. As a response, Wei (2002) provided a simple approach to increasing customer satisfaction: to identify the needs of customers and satisfy them. In other words, to understand customers' expectations of a company, its products or its employees, manage to meet the

expectations earlier than the competitors and improve weaknesses through constant evaluations from customer's perspectives. That is the path to win customers' trust and lifetime loyalty. Wu and Tseng (2015), conclude that customer satisfaction is the result of consumer evaluation based on the pre-purchase expectations and post-purchase experiences.

In the service quality model (Storbacka, Strandvick and Gronroos, 1994), customer satisfaction is based on a recent experience of the product or service, depending on prior expectations of overall quality compared to the actual performance received. If the recent experience exceeds prior expectations, customer satisfaction is likely to be high. This would also be the case with mediocre performance quality, if the customer expectations are low, or if the persormance provides value (low price). In general, a customer can be dissatisfied with the service and still perceive the overall quality to be good, when the quality service is priced high and the transaction provides little value.

Customer loyalty marketing is an approach to marketing based upon strategic management principles. The concept residing in growing and retaining existing customers through incentives, developed and changed the way consumers interact with companies and how much they spend. The earliest premium and marketing programs (Reichheld, 1996) built on the concept of increasing loyalty and retention while encouragind spending are known as early as the 1891(USA, Blue Stamp Trading System), and developed with promotional systems such as: boxtops (1929, Betty Crocker, coupons), prizes (promotional items such as small toys, games, trading cards), tobacco inserts (1886, Allan and Ginter, first tobacco company to print cards with sports illustrations), and inserts in modern packaged food (1912, Cracker Jack popcorn, followed by Kellogg with prizes in the cereal boxes). Over time, consumers in the USA and Europe became accustomed to the rewards and incentives. The most popular are the memberships for an airline, hotel or car rental program.

An empirical study of *loyalty as a marketing concept* started with Brown (1952), who associated loyalty with repeated purchase behavior of customers while Jones and Sasser (1995) identified two types of customer loyalty: long-term loyalty (where customers are not easily influenced by external factors to change their view about a product or service) and short-term loyalty (may vanish easily when customers find a better choice). In addition, Frederick (1996) concluded that creating customer value is the fundamental approach to corporate success, because increased customer value leads to higher loyalty, which generates in turn higher growth for the company, profit and customer value. Based upon the extensive research, Wu and Tseng (2015) define customer loyalty as „the degree to which consumers feel satisfied with a webside, product or service and show the support for it, in attitudinal, behavioral and general aspects".

The development of the loyalty systems and the constant competition for high income customers led to the rise of another marketing concept, „*customer advocacy marketing*", meant to replace, in some cases, the „customer loyalty marketing".

The loyalty marketing author Fred Reichheld (2011) is the first to claim the existance of a strong link betweekn customer loyalty marketing and customer referral. Reichheld details the value to customer referral on the growth and financial performance of a growing number of US companies, having an unique measurement in the word-of-mouth influence of company advocates, promoters, as the single measurement correlation between customers and corporate performance. Moloney (2006) enhances the concept of customer advocacy marketing by enhancing the magnetic value generated by promoting and measuring customer referrals and advocacy via research and marketing.

The customer referral influence is also reflected in the „*service quality model*" (Storbacka, Strandvick & Gronroos, 1994), concluding that customer loyalty is determined

by three factors: relationship strenghth, perceived alternatives and critical episodes. As such, the relation can terminate if: (1) the cusomer moves away from the company's service area, (2) the customer no longer has a need for the company's product or service, (3) more suitable alternative providers become available, (4) the relationship strenghts has weakened, (5) the company handles a critical episode poorly, (6) unexplainable change in price of the service provided. According to an UK study (Teng and Laroche, 2006), customers consider three general criteria, above all aspects, when evaluating a loyalty program: (1) price, seen as the value to customer, (2) quality of products and (3) service to customers.

The key to loyalty marketing, according to Reichheld (2011), is the *effect of cusomer loyalty on profitability*. The fundamental assumption by Reichheld and Sasser (1990) is that keeping existing customers is less expensive than aquiring new ones. The authors claim that a 5% improvement in customer retention can cause an increase in profitability between 25% and 85% (in terms of net present value), depending upon history.

Employee loyalty is another pillar of the basic customer loyalty model (Schlessinger and Heskett, 1991) linking the employees' ability to provide superior service to customers to a „cycle of success", given the effort spent in selecting and training employees and creating a corporate culture in which they are empowered can lead to increased employee satisfaction and employee competence. This would likely result in superior service delivery and customer satisfaction.

Reichheld (1996) expanded the loyalty business model beyond customers and employees, looking at the benefits of obtaining the loyalty of suppliers, employees, bankers, customers, distributors, shareholders and the board of directors.

Internet and loyalty

Internet is a strategic tool to help companies increase customer satisfaction, retain customers and acquire customer loyalty (Ab Hamid, McGrath, 2005). Internet technologies allow companies to access tools that facilitate an up-to-date relationship to changing customer needs and could be used to secure economic, strategic and competitive advantages. This comes as an advantage to companies under the tremendous cost pressures of traditional customer relationship models. At the same time, using Internet-based services allows firms to disseminate information, to enhance customer value, to improve customer satisfaction, to increase customer attachment and build feedback platforms that will, in turns, generate customer attachment and increase loyalty. All these advantages, over time, will be reflected in a better profitability and expanded market share (Ab Hamid and McGrath, 2005).

It is more cost-effective for any company to serve loyal customers, by building trust in a relationship that is imperative for business profitability. In order to remain competitive in an age dominated by relationship and instant communication, companies must understand the factors that are relevant in relationship building. AbHamid and McGrath (2005) have identified the factors that lead to a strategic advantage for a long term business:

- The quality of customer support, translated in the ability to respond promptly to customer inquiries;
- The quality delivery;
- Web site content, relevance and navigational traits;
- Integration of marketing channels, translated in the flexibilitya and convenience of one-channel-serves-it-all";
- Generating attractive rewards, as a means to enhance customer engagement

- Gaining consumer trust, related to enhancing the security measures as to the customer's personal data;
- Personalized service;
- Flexibility.

In conclusion, the Internet customer assesses the „real" performance of a firm given it's reliability, efficiency and flexibility. The following approach is to evaluate company performance against their own expectations: either below, within or beyond consumers' expectations.

2. Research Method

In this study, we compare the classic transactional loyalty model against the customer advocacy marketing, opposing two Loyalty programs developed in diferent industries. We will refer to the loyalty programs unde scrutiny by using the following abreviations: (CC), a loyalty program launched in 2012, by Caparol Romania, a building materials producer, and (DL), a loyalty platform launched in 2015, by Dalin Furniture, Romania, upholstered furniture producer. In view of the sensitive nature of the data analyzed, the following clarifications are necessary: our usage of company data will refer to public information for the purpose of improving the level of knowledge in the field of marketing loyalty, for academic and operational purposes.

Given the intimate knowlegde of the concept and development of the subsequent loyalty systems, the method selected for the evaluation of loyalty programs and the customer engagement paradigm is a case study. Rather than using a rigid protocol that examines limited number of variables (Yin, 2013), or using samples, case study allows a more thorough in-depth examination of the phenomenon of a real-life loyalty program.

Research hypothesis 1: Can **transactional patterns** improve with the increase of the increase of the rewards buget?

Research hypothesis 2: Is **customer engagement** influenced by the possibility of chosing the desired rewards?

Research hypothesis 3: Is company communication with members determinant for the customer engagement, feedback and **brand attachment**?

3. Analysis and results

We have analyzed data collected over a 4 years interval from two perspectives:

o Transactional patterns. We have chosen database analysis, for the two loyalty programs, (CC) and (DL) allowing us to draw conclusions related to the cost and benefits of the loyalty programs under scrutiny, and their impact over the company's turnover, the degree of retention and the value opportunities generated by the programs.

o Customer engagement, using documents and direct observation, in order to report over behavioural events

o Customer feedback and brand attachment, by use of direct observation, internet activity and customer relationship;

In the following sections, we will provide insight of the main results applied to our context.

3.1 Transactional Analysis

The evaluation of the intricate relationship between customer value, customer satisfaction and customer loyalty, from the point of view of a transactional aspect is a complex attempt to investigate. For the CC loyalty program, we have analyzed the results of the program over an interval of 5 years, in relation to the: evolution of the program

members, evolution of the rewards in cost and quantity, evolution of program costs and benefits. In addition, we can evaluate empirically the members's contribution to brand awareness and consolidation of brand values.

In terms of the evolution of membership, we can estimate a program life cycle reaching maturity in 2015, after four years of deployment, whith a medium customer base increase of 50% in the first two years and 20% in the third year. Starting with the fourth year, the program recorded lower enrollment rates, but has managed to report a 65% participation rate, while comparative programs hardly manage to surpass 40%. The same trend was noted in the evolution of the turnover generated by the CC loyalty program, that increased by 22.5% after the second year, determined by the program's reaching maturity, while in the third and fourth year, the increase rates have not exceeded 11 – 15%. We can associate the financial succes of the CC loyalty program with a thorough analysis of the customer base, with the identification of customer segment and personification of the program according to customer needs (as recommended by the research of Long and Schiffman, 2000).

As to the evolution of rewards bugdet, we can identify a relation between the reward buget that decreased from 3.95% in the first year, to 1.30% in the fifth year, as an attempt to limit the costs of the programs generated by both the increase in program members and in operational costs of the overall program. However, as the rewards budget dropped by more than 50%, the turnover of the program has significantlly increased. In our opinion, a relation between the abrupt drop in the amount of the rewards buget did not significantly influence the CC program roll-out, given the attepts to diversification of the rewards base.

As to the members's contribution to brand awareness and consolidation of brand values, we can empirically evaluate the contribution of the CC Loyalty Program. We noted an increase in the number of clients that were referred to the CC Stores, by word-of-mouth. In addition, noting that the company's promotional efforts decreased by over 70% at the launch of the CC Loyalty Program, we can therefore parallel the relationship between the company's turnover and the deployment of a loyalty program with a high participation rate as extremely positive to both the company's financial evolution as well as client referrals.

As opposed to the CC Loyalty Program, the DL Program focused on a fix rewards buget calculated at 1% of the program turnover. However, the allocation of rewards bonuses was generated in relation to an analysis of cusomer priorities and expectations (Oliver, 1999) as customers were offered three online platforms for points redemption. In our opinion, the redemtion method has generated superior interest and participation to the DL Program, confirmed by the 96% participation rate after the second year. Another significant difference was in the turnover per participant, that increased by 17% in the second year, translated in a superior loyalty rate and interest in participating to the program.

3.2 Customer engagement

In terms of customer engagement evaluation, in the case of CC Loyalty Program, we were able to identify direct evidence of customer communication through the company's events as well as by means of direct mailing campaigns for the Program Members, disseminating technical up-to-date information related to company's newest products, services and events. We also noted the absence of company preoccupations to open online communication channels with the participants, and the absence of a operational loyalty data management center, that would allow further interaction, interrogation of bonus and increase participation rates.

For the DL Program, we noted that one of the main objectives was to promote a constant communication with the program members, through an on-line based loyalty

platform generating both insights (for the members as well as for the company). The loyalty platform was added a discussion Forum, enhancing bidirectional communication, in addition the the News section which disseminated the company's instances of communication.

3.3 Customer feedback and brand attachment

Referring to the CC Loyalty program, we are able to evaluate it only by its transactional side, given the limited instances of interaction provided by the company, through the operational setting of the loyalty platform. Although presented as a „community", the theoretical intenions were not materialized in generating one-to-one communication and feedback, which will limit the program's influence for the future. The program's capacity to function as the company's spokesperson is reduces, given that the only on-line evidence as to the existence of the program is the company's web page and a Facebook page. Given the extensive research on the importance of feedback and relevant communication while encouraging consumers to participate to brand development through relevant insights, we conclude the limitation identified is a major threat to the program that could limit its life cycle evolution and participant interest.

As for the DL Program, we noted that both the News and Forum sections of the interactive Loyalty platform provide valuable information for both parts, as they contribute to generating feedback, contribute to improving company's products and services based upon consumer and third party suggestions as well as generate a community engagement and provide recognition to customer's innovative contributions and valuable word-of-mouth recommendations.

4. Conclusions and recommendations

The extensive research in the loyalty marketing has introduces various theories, models and recipes, that would enhance customer loyalty and increase profitability, in B2B or B2C equally. However, while past studies concentrate on developing models, we believe that the variable related to **geographical determinants**, to culture and economic develeopment will determine whether a specific loyalty model can function or not. In addition, a thourough **segmentation and targeting of the customer base**, will allow companies to develop effective loyalty programs to serve their purposes.

Another essential aspect, relies on the **participative culture of a specific demographic**, related especially to it's online activity, that will positively influence brand awareness and contributions with valuable insights to the **brand growth and consolidation of brand values**.

Depending upon the economic development, we consider that businesses located in countries with a rich history of loyalty programs, will need to refine their marketing programs, in relation to the profile of the targeted audience and the industry's background. Quite the opposite, in countries with limited knowlegde of loyalty business models, companies will need to implement basic loyalty models and develop them over time.

Our research using a case study model over two different loyalty programs functioning in Romania, in different industries (building materials and upholstered furniture) has revealed relevant data concerning loyalty and setting up long-term programs meant to consolidate and increase customer loyalty and therefore generate relevant turnover to the companies. We have structured our conclusions relative to two facets of loyalty: the pragmatic goal at increasing profitability while evaluating the transactional side of the process and the emotional side, revealing the link between a increade customer loyalty and customer advocacy, word-of-mouth and brand engagement.

4.1 Transactional evaluation, aimed at evaluating the impact of Customer Loyalty on profitability

Every loyalty program should have a strong operational infrastructed, that encourages transparency and feedback. The setting up of in-house loyalty platforms that limits interaction and customer acces to own information and loyalty history is not only ineffective but also limitative. While most researchers admit that few loyalty programs survive their first year and even few are able to deliver value to customers (Taylor, 2016), the companies should witness the consumers' shift in expectations and mirror it with their own shift in values and set up efficient loyalty programs that manage to etsblish value for both consumer and company. While consumers patience is diminishing, their expectations are no longer set by the comparison with other loyalty programs (that are turning into disloyalty programs given the low participation rates, according to Schrage, 2015) but by companies opperating in the on-line environment, sunt as Google or Amazon. In countries with a short term history in loyalty marketing as Romania, companies may consider the emotional side of a loyalty transaction as less relevant, as compared to the transactional side.

However, the loyelty programs are build for the future, with the aim at establishing a long-term relationship with the customer and this relationship must be equally developed and nurtured. Building a loyalty program should start with the consumer's point of view, measure expectations and build a new approach to loyalty that is puts brand values in the center. According to Schrage (2015), loyalty is essentially reduces to the process of communicating brand values to people. The more options they have, the more will consumers relate to brand that speak to their beliefs and priorities, generating content relevant for the consumer, not brand-centered. Because brand values will attract customers with similar beliefs and values (according to Jutkowitz, 2015), which is set to generate increased genuine enthusiasm for the company's products.

This leads us back to the transactional loyalty programs, that aparently manage to improve the loyalty of bargain hunters while retaining customers that care more about monetary transactions. Because „loyalty is an emotion, not a transaction" (Taylor, 2016). Focusing on loyalty from the point of view of traditional measures, such as the customer purchasing value and the retention measured in repetition can send the entire loyalty concept fall into anachronism

4.2 Customer Advocacy Marketing

If we envision loyalty from the customer's point of view, at the customer advocacy marketing research is prompting us to to (Reichheld, 2011), what would loyalty look like today? Jutkowits (2015) aimes at the means of consolidating the brand relationship with the customer, considering that „brands should be, not bribe customers". In modern times, we witness the rise of the Internet driven social platforms where consumer comments influence hundreds of prospects, around the world. Therefore, what is more valuable? Customer repetition measured by the transactional side of loyalty, or customer's comments? Schrage (2015) demonstrates in a study of airline loyalty, that customers who spend more are more valuable than customers who fly more. That generates another question: what kind of loyalty works for both customer and brand?

According to Schrage (2015), companies are set to identity the loyal behavior that the most deserves recognition, reward and investment, depending on industry, repetition and instances of communication desirable and available.

In our oponion, if a „best practices" loyalty model were to be set, in tomorow's marketing environment, its content should include:

(1) <u>Seting a set of values</u> that each brand would guide its communication upon. These values are meant to attract the targeted audiences, through encouraging empathy, participation and feedback. Over time, customer suggestion cand help enrich brand values as well as save money in insights. Constantly strive to <u>consolidate brand positioning, reinforce participation opportunities and encourage word-of-mouth</u>. Even negative insight cand provide a source of empathy and engagement, if properly approached and resolved.

(2) <u>Create on-line and off-line communities</u> by generating engagement and affiliation. The corporate social responsability department should participate in engaging the brand, according to its values and targeting, into relevant projects that build awareness. Consumers are interested to engage in positive instances, rather that expect only empty benefits, brom their trusted brands.

(3) <u>Transactional aspects should become transparent and flexible</u>, giving customers the possibility to earn and redeem points across multiple channels. That would function both ways, through increasing participation and identification of the customers' meaningful experiences. Through strategic alliences, companies can create loyalty that goes beyond being recognized as a member. Analyze types of loyalty, benchmarch the competition and study the metrics of their own program should be a continuous process generating insights and change. Our environment, communication and relations change constantly. So should our marketing programes, even at a faster pace.

5. Future analysis

Starting with the year 2012, I became interested in customer loyalty marketing, as an approach to marketing based upon strategic management principles. Since, I could hardly identify during myloyalty research, a loyalty concept oriented towards the customer's point of view and the roll-out of a customer targeted loyalty system, based upon segmentation analysis, thorough insight into customer needs and desires. These will be future areas of development for our study, in an attempt to increase customer participation and customer perspective, in relation to Internet customer advocacy trends and models.

References

1. Zineldin, M., 2000. *Beyond relationship marketing: technologilaship marketing*. Journal of Marketing Intelligence and Planning, 18(1), pp.9-23.
2. Wu, M.Y. and Tseng, L.H., 2015. *Customer satisfaction and Loyalty in an Online Shop: An Excperiential Marketing Perspective*. International Journal of Business and Management, 10(1).
3. Moon, Y., 1999. *Interactive technologies and relationship marketing strategies*. Harvard Business Review, 9(599), pp.1-12.
4. Kotler, P., 1996. *Marketing management: an Asian perspective*. NY: Prentice Hall.
5. Wei, N.Y., 2002. *Viewpoints on customer satisfaction. Sunchao Culture. Taipei.* Taiwan.
6. Hamid, N.R.A. and McGrath, M., 2005. *The Diffusion of Internet Interactivity on retail Web Sites: A Customer Relationship Model*. Communications of the IIMA, 5(2). Article 4.
7. Yin, R.K., 2013. *Case study research: Design and methods*. Sage Publications.
8. Storbacka, K., Strandvick, T. and Gronroos, C., 1994. *Managing customer relationship for profit.* International Journal of Service Industry Management, 5(5), pp.21-28.

9. Reichheld, F. and Sasser, W., 1990. *Zero defection: quality comes to services*. Harvard Business Review, sept-oct/1990, pp.105-111.
10. Schlessinger, L. and Heskett, J., 1991. Breaking the cycle of failure in service. Sloan Management Review, Spring 1991, pp.17-28.
11. Reichheld, F., 1996. *The Loyalty Effect*. Boston: Harward Business School Press.
12. Reichheld, Fred., 2011. *The ultimate Question: Driving Good profits and true Growth*. Boston Mass: Harvard Business School Press.
13. Moloney, C., 2006. *Winning Your Customer's Loyalty: the Best Tools, Techniques and Practices*. San Diego: AMA Workshop.
14. Brown, G.H., 1952. *Brand Loyalty: Fact or Fiction?* Advertising Age 23, pp.52-55.
15. Jones, T.O. and Sasser Jr., W.E., 1995. *Why satisfied Customers Defect?* Harvard Business Review, 73(6), pp.88-99.
16. Frederick, F.R., 1996. *Learning from Customer Defections*. Harvard Business Review, 74(2), pp.57-69.
17. Teng, L. and Laroche, M., 2006. *Interactive Effects of Cultural Differences, Argument Strength and Competition on Consumer Purchase Behavior*. Journal of International Marketing, 14(4), pp.110-128.
18. Long, M.M. and Schiffman, L.G., 2000. *Consumption values and relationships segmenting the market for frequency programs*. Journal of Consumer Marketing, 17(3), pp.214-232.
19. Oliver, R.L., 1999. *Hence Consumer Loyalty*? Journal of Marketing, 63, pp.33-34.
20. Taylor, M., 2016. *Loyalty is an Emotion, Not a Transaction*. Advertising and Marketing. February 2016.
21. Schrage, M., 2015. *Why Your Loyalty Program isn't Working*? Harvard Business review. March 2015.
22. Jutkowitz, A., 2015. *Marketing is Dead and Loyalty Killed It*. Harward Business Review. February 2015.