

Do Loyalty Program Membership and Status Levels affect Service Customers' Choices?

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Abstract

This paper examines the effects of loyalty program membership as such, and impending upgrade or downgrade to a different status level, on customer brand preferences for flights and hotels. The results show that members have a significantly higher brand preference for their respective airline or hotel group than non-members, and those close to a change in status level have an even stronger brand preference compared to those who are not, which is also reflected in their willingness to pay. The empirical findings illustrates the ability of frequent traveller programs to affect purchase choices if the customer fears that earned status benefits are about to be lost.

Introduction

Loyalty programs, such as frequent flyer programs and hotel loyalty programs, aim to increase sales by encouraging higher purchase frequency and purchase volume, and are successful where participants of programs show indeed higher repeat purchase behaviour than non-participants (Gómez, Arranz and Cillán, 2006; Meyer-Waarden and Benavent, 2006; Uncles, Dowling and Hammond, 2003). However, some research (Bolton, Kannan and Bramlett, 2000) does not confirm the link between loyalty program membership and increasing loyalty, questioning the value of such programs. The literature offers a range of explanations for a weak or missing link between loyalty programs and loyalty.

Firstly, the underlying cause for a potentially higher behavioural loyalty is not necessarily an indication of higher loyalty towards the firm. Instead members may be loyal to the program rather than loyal to the firm (Dowling and Uncles, 1997; Whyte, 2002). In fact, airline frequent flyer members could display 'loyal' repurchase behaviour because they fear forfeiting already accumulated points towards award bookings and membership benefits, not because they are truly loyal to the airline (Whyte, 2002). This phenomenon is in line with the viewpoint that loyalty programs are a liability to firms offering the programs, as customers are promised future benefits in return for current revenues (Kearney, 1990; Shugan, 2005). Members feel tied to the firm because they are afraid of surrendering earned benefits, a special case of financial switching cost which reduces customers' likelihood to leave an incumbent provider (Burnham, Frels and Mahajan, 2003). Carlsson and Löfgren's (2006) research further supports the notion that frequent flyer programs contribute considerably to the switching cost of airline passengers.

Secondly, although the purchase behaviour of loyalty program members differs from that of non-members, some argue that these programs do not change the behaviour of participating customers compared to their purchase patterns prior to joining the program (Gómez, Arranz and Cillán, 2006; Sharp and Sharp, 1997). O'Malley (1998) provides an explanation for this and argues that loyalty programs are useful in dealing with customers who are not or spuriously loyal, but are less suitable for customers who show latent or sustainable loyalty.

As a result, airlines and hotels generally structure their frequent traveller (i.e., loyalty) programs to include an award points scheme and to offer different membership status levels based on travel or points volume. The status levels reflect customers' lifetime values to the firm and commonly result from previous purchase volumes. Status-specific membership benefits are additional economic incentives beyond point redemption to stay with the same airline or hotel group because they improve noticeably with increasing status levels.

Thirdly, the success of loyalty programs in creating behavioural loyalty depends on their ability to create additional value for the customer. Five different elements determine the value of a loyalty program (O'Brien and Jones, 1995), namely cash value of rewards relative to required spending, choice of redemption options, aspirational value of rewards, achievability of rewards, and convenience of participating in the scheme. The ability of these elements to create value grows with higher status or recognition levels. Premium members often earn extra bonus points compared to basic members, and therefore achieve higher cash value from their program membership. Similarly, the extent to which reward bookings become achievable and the range of redemption options also improves for premium level membership. Status-specific benefits, such as lounge access and priority check-in, may also have high aspirational value, given that loyalty program members want to receive special treatment (Mathies and Gudergan, 2007, forthcoming).

This paper explores the question of whether the threat of losing a status level because the annual point threshold has not been reached, or the prospect of gaining a better status level, affects the behaviour of frequent traveller program members in the airline and hotel industry. In particular, the aim of this research is (a) to seek reconfirmation of existing research and determine whether members of frequent traveller programs show a higher brand preference than non-members; and (b) to examine how far brand preference and willingness to pay for travel within the airline or hotel group running the program changes if an upgrade or downgrade to the next membership level is looming.

Methodology

Stated choice experiments were conducted with 465 airline passengers and 446 hotel customers to study the purchase choices in light of loyalty program membership. The sample included an equal number of non-members and members across a range of frequent traveller programs. The data analysis focuses on the Oneworld airline alliance and the Hilton HHonors programs due to the limited sub-sample size for other programs.

Congruent unlabelled discrete choice experiments for hotels and airlines were designed to describe each hotel/flight alternative and selected frequent traveller program features. A 32-profile fractional experimental within-subject design was obtained by selecting 32 profiles from the $4^7 \times 2^3$ complete factorial based on an orthogonal main effects design (Sloane, 2006). The respondents chose their most preferred flight from Australia to Bangkok, or most preferred hotel option for a stay in Sydney or Melbourne respectively, from each of the 32 choice sets. The choices were analysed using McFadden's logit model where choice is a function of attributes describing the alternatives (McFadden, 1976). Potential scale effects between the different sub-samples were found to be absent.

Results and Discussion

First, we compared the choices of members of a particular frequent traveller program with those of non-members or members of competing programs, in order to evaluate any potential differences in behaviour loyalty between the two groups. The results are exemplified with the Oneworld/Qantas (airlines) and Hilton HHonors (hotels) programs and selected preference estimates from the total 19 parameters are summarised in Tables 1 and 2. The 19 parameters correspond to the effects-coded ten product and frequent traveller program features described earlier. In the airline data, members of the Oneworld program have a significantly higher brand preference for their respective airline group ($\beta=.120813$), compared to members of other programs or no programs who show a negative brand preference for Oneworld ($\beta=-.0303558$). This also translates into a higher willingness-to-pay, where Oneworld members are prepared to pay a \$127 price premium to book a flight with their preferred alliance, which equals 11.5% given the average airfare. The hotel study revealed a similar pattern, where Hilton HHonors members significantly prefer to stay within the Hilton group and overall are less price-sensitive. They are willing to pay an extra \$39, or 15.6% of the average room rate, for a Hilton room. In summary, the findings support the argument that loyalty program members differ in their purchase choices and willingness to pay from non-members, but does not deliver insights into the potential causal effect.

Table 1: Selected Preference Parameter Estimates for Oneworld Frequent Flyer Program

	Oneworld members	Oneworld non-members
<i>N</i>	<i>141</i>	<i>324</i>
Price	-.0018 ¹	-.0024 ¹
Program Oneworld	.1208 ¹	-.0304 ²
Program Star Alliance	.0132	.0349 ²
(...)	(...)	(...)
\$50 program membership fee	-.0528 ¹	-.0903 ¹

Table 2: Selected Preference Parameter Estimates for Hilton HHonors Hotel Loyalty Program

	Hilton	Hilton non-members
<i>N</i>	57	389
Price	-.0037 ¹	-.0065 ¹
Program IHG	-.0845 ²	.0040
Program Hilton	.1218 ¹	.0015
Program Marriott	-.0278	.0268 ²
(...)	(...)	(...)
\$50 program membership fee	-.0205	-.0907 ¹

¹ significant at $p < .05$

² significant at $p < .1$

The second part of the analysis focuses on the potential effect of loyalty program members' status level on their purchase decisions, in order to assess the effects of potentially gaining or losing membership benefits. Regarding the effect of a potential upgrade or downgrade to the next status level, we analysed brand preference estimates and willingness to pay of members whose current levels of accumulated points are close to a change in status level in either direction, separate for imminent upgrade or downgrade, or neither.

Oneworld members facing a status change have a higher brand preference than members with an established status level. The threat of a downgrade has a particularly strong effect ($\beta = .7586528$) compared to the prospect of an upgrade ($\beta = .1681082$). Moreover, the practice of charging membership fees only significantly decreases the utility for loyalty program members not threatened by a status change. Similarly, the willingness to pay estimates increase from \$69 (neither) to \$166 (upgrade) to \$277 (downgrade).

Table 3: Preference Parameter Estimates for Oneworld by Status Level

	neither	Up/downgrade	upgrade	downgrade
<i>N</i>	111	27	21	6
<i>Pseudo R</i> ²	.09	.13	.11	.30
Price	-.0017 ¹	-.0025 ¹	-.0021 ¹	-.0055 ¹
Program Oneworld	.0952 ¹	.2753 ¹	.1681 ¹	.7587 ¹
Program Star Alliance	-.0027	.0520	.0316	.1746
Program Velocity	-.0208	-.0535	-.0256	-.1785
(...)	(...)	(...)	(...)	(...)
\$50 program membership fee	-.0740 ¹	.0026	.0347	-.1418

The results from the hotel study (see Table 4) are less compelling, but suggest a similar effect. A significant brand preference was only found for members close to an up- or downgrade, but not for members with an established status level. The size of the downgrade sub-sample (N=6, resulting in 768 observations) was not sufficient for model estimations. Members close to a change in recognition level are willing to pay \$37 more for a Hilton room.

Table 4: Preference Parameter Estimates for Hilton HHonors by Status Level

	neither	up or downgrade	upgrade
<i>N</i>	43	14	12
<i>Pseudo R</i> ²	.07	.07	.08
Price	-.0050 ¹	-.0037 ¹	-.0024 ¹
Program IHG	-.0618	-.2162 ¹	-.1806 ²
Program Hilton	.0843	.1512 ²	.1112
Program Marriott	-.0438	.0495	.0312
(...)	(...)	(...)	(...)

The results indicate that the prospect of gaining or losing a membership status level and the associated benefits influence customers' choices. This means that the prospect of gaining

additional membership benefits by passing a point threshold boosts customers' likelihood to repurchase a product from their airline or hotel group. A possible explanation for this is that a higher status level increases the perceived value of a loyalty program. For example, Qantas offers silver and gold frequent flyers 25% and 50% bonus points, which adds to the value of the frequent flyer scheme twofold: it improves the cash value of point redemption as a proportion of spend, and rewards become more achievable (O'Brien and Jones, 1995). The aspirational value of higher-level membership benefits such as lounge access, priority check-in, extra baggage allowance, etc. may further contribute to the perceived value of being a loyalty program member. This would mean that in the case of imminent membership upgrade, the value of the loyalty program rather than the loyalty to the firm's products is the key driver of customers' choices. Hotels and airlines need to assess whether the higher willingness to pay and brand preference achieved through the tiered program structure outweigh the cost of providing additional membership benefits. An improvement of product attributes may create more genuine behavioural loyalty.

Individuals threatened by a status downgrade may have different grounds for their remarkably strong brand preference. It has been established that point redemptions are delayed gratification for purchases that the customer has already made, and are therefore often viewed as an earned right rather than a bonus for loyal customers (Shugan, 2005). Loyalty program members who have previously enjoyed the privileges of belonging to a higher recognition level may however perceive these status benefits in much the same way. As a result, the looming loss of status benefits prompt members to purchase from their regular provider wherever possible. A potential loss of status privileges also exacerbate switching cost and further advance behavioural loyalty. While this seems a desirable effect for hotel and airlines offering frequent traveller programs, it is important to understand that the rationale underlying these customers' purchase decisions should not be mistaken as true loyalty.

Conclusion

The empirical findings support existing research that loyalty program members are more likely to purchase the program's brand, be it due to true loyalty or loyalty towards the reward program. Members' higher willingness to pay indicates that they perceive some switching cost or loss if they divert their purchase to a different provider. The remarkably high brand preference and willingness to pay of members facing the loss of their status level illustrates the ability of frequent traveller programs to change purchase choices if the customer fears that status benefits which were earned through past purchases are about to be lost. These findings support reference dependence theoretic conjectures. However, in order to draw more generalisable conclusion a larger sample size is recommended.

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