Loyalty Schemes in Retailing

A Comparison of Stand-alone and Multi-partner Programs

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2. Loyalty

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

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

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

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

2.1 Definition

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

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

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

2.1.1 Historical Development of the Loyalty Definition

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

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

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

2.1.2 An Attempt at Pinpointing the Terms

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

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

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

2.2 Exploring the Emergence of Loyalty

2.2.1 Classifying the Reasons for Loyalty Formation

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

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

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

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

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

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

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

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

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

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

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

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

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

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