Frequency Reward Vs Customer Loyalty Programs

Key Concept
Customer loyalty programs can be based on frequency rewards or customer tier benefits (e.g. special benefits when you reach a certain elite customer status). As companies try to decide which type of program is better, or if loyalty programs are even worth the trouble, new research shows a combination of both programs offer direct financial benefits, as well as better customer information for strategic decision-making.

Idea Summary
There are two basic types of loyalty programs: frequency rewards, through which customers earn points or credits to be redeemed (a free hotel room after so many stays); and customer tier programs, in which customers receive the benefits that come from climbing to a higher status of customer (e.g. accumulating enough purchases to become a diamond-level customer which gives access to diamond-level services such as upgrades). Frequency rewards are one-shot deals: the customer cashes in the points and receives a free hotel room stay (or whatever the product or service might be). Customer tier rewards are ongoing, but with an expiration time frame. A customer earns a certain status level, but needs to keep earning that status to avoid expiration.

Many companies choose one or the other type because they believe that the two programs combined will only cannibalize themselves: the customer tier program would take away customers from the frequency rewards program or vice versa.

However, new research based on an extensive analysis of a hotel chain’s customer loyalty program reveals that cannibalization does not occur. Specifically, the data showed that both frequency rewards and customer tier programs generated incremental sales.

In fact, the analysis by the research team revealed some synergy between the two components (i.e. instead of raiding each other’s customers, the combination increased the effectiveness of each individual program). While the actual synergy is minimal, at the very least, the data shows that there is no cannibalization.

The data covered the behaviour of nearly 4,000 customers who were members of the hotel chain’s loyalty program over two years, That information was integrated with pricing and occupancy rates data from 14 submarkets, such as Los Angeles airport area, in which the chain’s hotels were located. The research was conducted by a team of five researchers from four business
The research in the hotel customer loyalty programs yielded further results:

- **Both components create points pressure.** Points pressure is the term for customers who push themselves to buy something when they are getting close to reaching a reward target. While it was assumed that frequency rewards programs would generate points pressure, the research shows that customer tier programs did likewise.

- **Both components show a reward behaviour effect.** Reward behaviour relates to the increase in loyalty as a result of receiving a loyalty reward. For example, a guest who is able to cash in a free stay during a certain period, is going to be more likely to return as a guest in the following period.

- **Customers can be segmented into two types: price-oriented and service-oriented.** The price-oriented segments, who are more sensitive to price incentives, are attracted by the frequency rewards programs; service-oriented customers are less sensitive to price and more sensitive to service benefits, such as special privileges. Service-oriented customers are more likely to stay in luxury hotels. Like price-oriented customers, service-oriented customers also appreciate frequency rewards programs but for a different reason: they enjoy the upgrades. Service-oriented customers are also more attracted than price-oriented customers by the benefits that come from customer tier programs.

- **Loyalty programs with both components are going to help managers evaluate loyalty initiatives and predict future results better than if there is just one or the other component.** For example, because customer tier programs attract generally less price-sensitive customers diagnosing the impact of price-related strategies becomes more difficult.

- **While both frequency reward programs and customer tier programs increased hotel stays, frequency reward programs were more effective.** The reason, as described above, is that both price-oriented and service-oriented customers are attracted by frequency rewards.

**Business Application**

The business implication of the research is unequivocal:

1. **Companies should offer loyalty programs.** Whether involving frequency rewards or customer tiers, the programs increase incremental sales.

2. **Companies should offer both components.** Both components are going to increase incremental sales without taking sales away from the other. In addition, both components, covering all customer segments, give company executives better data for decisions on issues such as pricing and loyalty program structure.

3. **The structure of loyalty programs, such as reward requirements, involves trade-offs that must be balanced.** If rewards are earned too easily, there is not sufficient points pressure to create significant incremental sales. If earning rewards is too difficult, customers might give up easily, thus eroding any potential points pressure. Also, because there are less cash-ins, there is less rewarded behavior: customers don't get the injection of goodwill toward the company that inspired continued loyalty.

**Further Reading**


**Further Relevant Resources**

Praveen K. Kopalle's profile at Tuck School of Business at Dartmouth

Yacheng Sun’s profile at Leeds School of Business, University of Colorado

Scott A. Neslin’s profile at Tuck School of Business at Dartmouth