How Effective are Loyalty Reward Programs in Driving Share of Wallet?

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Many markets, especially as competition stiffens during an economic slowdown, are a battleground for a share of the customer’s wallet. Marketers, in the hope of retaining customer loyalty, have embarked on loyalty reward programs.

Customer Benefits of Loyalty Programs

There are variations of reward programs around but they essentially focus on patronage. The more a customer uses the brand, the more s/he will be rewarded once past a minimum level of patronage. Gindaco, the Japanese chain selling takoyaki at Ion’s Food Opera, has a loyalty card where a stamp is rewarded for every $4.80 spent. After the 14th stamp, the loyal Gindaco customer can redeem a food item. Watsons recently introduced card membership where points are earned for $5 spent for redemption of cash rebates. Banks also have reward programs for the credit cards they issue to persuade their card holders to use their bank’s card more than their competitors’.

Airlines and hotels were among the first to introduce loyalty programs. Singapore Airlines has its Krisflyer where not only air tickets can be redeemed but also preferential treatment. Taj Hotels, Hilton, Marriott, and Hyatt have their respective customer loyalty programs.

In addition to the economic benefits (discounts or free gifts), loyal consumers also enjoy emotional benefits (a sense of belonging), prestige or recognition, as well as access to an exclusive treatment or service such as SIA’s special lounges for its PPS Club members.

Firm Benefits of Loyalty Programs

The assumption behind focusing not only loyal customers but loyal customers who have achieved a minimum level of patronage is that this set of customers is profitable to the firm. Their continued loyalty suggests that they are satisfied with the brand, will continue buying the brand and even more so in the future. Hence, their lifetime value with the firm is likely to be enhanced. Additionally, being satisfied customers, they are more predisposed to communicate favourable word of mouth to their friends regarding the brand. All in, firms want to protect the revenues from their high spending customers and hence, embarking on a customer loyalty reward program helps to enhance relationship between the firm and the customer.

Reward programs are also effective in increasing customer perceptions of switching costs. If they switch to competing brand, especially just before they accumulate the necessary credits for a reward, they forego all that they have accumulated. Hence, reward programs motivate customers to carry on with the firm till at least a reward is redeemed.

Particularly for service firms where their offerings are generally undifferentiated from one to another, reward programs are a means to tie customers to them and build a relationship.

However, consumers can be a member of several competing loyalty reward programs. What would make a consumer spend a larger share of his/her wallet on Brand A, and less on Brands B and C when s/he is a member of all three?

At the NUS Business School, we engaged in a study to address these questions. First, the attractiveness of a reward program is paramount. An attractive reward program gets a larger share of the customer wallet (i.e., behavioural loyalty or “share of
wallet”) than a less attractive programs, regardless of how loyal the customer is to the brand in terms of attitudinal loyalty (also called “share of heart”).

More interestingly, when the reward program is attractive, customers who are not too psychologically attached to a brand (i.e., have a low attitudinal loyalty) will still spend a larger portion of their wallet on that brand, especially if they perceive the switching costs between loyalty programs to be high. That is, perceived switching costs of programs are highly effective in driving share of wallet in combination with an attractive program. However, if consumers are already more psychologically committed to the brand (i.e. have high attitudinal loyalty), switching costs become less and less relevant in driving purchases. Perhaps this is because with such customers, they are unlikely to switch in the first place.

What do these findings suggest for marketers embarking or contemplating embarking on loyalty programs? If a firm is in an industry where the offerings are largely undifferentiated (say, credit cards), then it is easy for customers to switch from one card to another even at the point of sale when they have several cards in their wallet. Under these circumstances, firms should consider implementing attractive reward programs to differentiate themselves and/or raise switching costs related to the program.

We suggest offering a mix of soft rewards (e.g., sense of belonging, special treatment and appreciation) and hard rewards (e.g., point accruals and discounts,) and higher tier service levels and customisation to increase their reward program’s attractiveness and at the same time increase switching costs as all these benefits would be lost if a customer switched.

Finally, with the myriad of reward programs available, it may do well for a firm to let customers choose among several reward options to account for idiosyncratic preferences and tie customers closer to the brand.

The full article relating to this contribution plus a free book chapter on Managing Customer Loyalty can be downloaded from www.jochenwirtz.com.

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