

Do reward programs build loyalty for services? The moderating effect of satisfaction on type and timing of rewards

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Abstract

While reward programs have been widely used as a means to engender customer loyalty, it is not clear if the ends are justified. Some researchers argue that we do not fully understand the mechanism underlying reward programs and how it affects consumer acceptability of such programs. In this study, we examine two variables; timing (immediate vs. delayed) and type (direct vs. indirect) of rewards in two service conditions (satisfied vs. dissatisfied). We conduct the experiment in two service settings and the results indicate that when consumers are satisfied, they prefer delayed, direct rewards (of higher values) to immediate, direct rewards. However, when consumers are dissatisfied, they prefer immediate, direct rewards to delayed, direct rewards (of higher values). Interestingly, the preference for direct over indirect rewards is apparent only if the rewards are delayed (for the satisfactory service experience) or immediate (for the dissatisfactory service experience). © 2006 New York University. Published by Elsevier Inc. All rights reserved.

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Introduction

As an important component of customer relationship management (CRM), reward or loyalty programs have become an increasingly popular tool for managers to build customer loyalty (O'Brien and Jones 1995; Cigliano et al. 2000; Uncles et al. 2003). In such programs, consumers are given incentives in return for repeat business, which in turn serve as reinforcers that encourage consumers to continue their behavior. Examples of reward programs in the service industries are frequent flyer programs conducted by airlines, cash rebates from credit card companies, and redeemable gifts from banks. However, the effectiveness of reward programs has been questioned. There are divergent views on how best to structure these rewards and whether the ends justify the means (Sharp and Sharp 1997; Cigliano et al. 2000).

Given the managerial relevance of reward programs, academics have also recently begun to show interest in this topic (e.g., Kumar and Shah 2004; Magi 2003; Kivetz and Simonson 2002, 2003). In this study, we investigate how the type and timing of rewards affect customer loyalty for services. Adopting the framework proposed by Dowling and Uncles (1997), *type* refers to whether the rewards are related or unrelated to the main service in question, whereas *timing* denotes whether the rewards can be redeemed immediately or at a later time. We examine whether the effectiveness of these reward structures is moderated by customer satisfaction. Specifically, we seek to answer the following questions:

- Between redeeming an immediate reward that has lower value and redeeming a delayed reward that has higher value, which one has a stronger effect on customer loyalty?
- Similarly, how does relatedness of reward (e.g., getting a free laundry service at a Laundromat vs. getting a food coupon at a Laundromat) affect customer loyalty?

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- Does customer satisfaction moderate the relative effectiveness of these different reward configurations?

The remainder of the paper flows as follows; we first review the relevant literature on reward programs, satisfaction, and loyalty to motivate the hypotheses concerning consumer loyalty response towards various configurations of reward programs under both satisfactory and dissatisfactory conditions. We then conduct an experiment that manipulates three variables (timing, type, and satisfaction) in two service contexts (restaurant and bank). Theoretical and managerial implications are provided, and we conclude with the limitations of our study and suggest directions for future research.

Type and timing of reward programs, satisfaction and loyalty

In this section, we provide a brief theoretical overview of the four constructs of interest; type of rewards, timing of rewards, satisfaction and loyalty.

Type of rewards

Rothschild and Gaidis (1981) make a distinction between two types of promotional strategies (*primary* and *secondary*), with the key difference being that primary reinforcers have intrinsic utility (the core product or service), while secondary reinforcers (e.g., coupons and tokens) do not have such utility and need to be converted. As such, secondary reinforcers are less powerful than primary reinforcers (Rothschild and Gaidis 1981). Based on this, Dowling and Uncles (1997) classify reward programs into either *direct rewards* (gifts that support the value proposition of the product/service) or *indirect rewards* (other types of reward that have no linkage with the product/service). In a recent study, Nunes and Park (2003) investigate how bundles of direct (e.g., \$50) and indirect rewards (e.g., 5,000 frequent flyer miles) could enhance or diminish the perceived value or size of consumer spending. They advocate further research to enhance our understanding of customer preference for direct or indirect rewards – a central issue that our study addresses.

Timing of redemption

An important aspect of promotional campaigns is the decision to use *immediate* or *delayed* value promotions (Blattberg and Neslin 1990). Examples of the former category for packaged consumer goods include peel-off coupons, direct-mail coupons and price packs, while the latter category includes in-pack coupons, on-pack coupons, and contests. The meaningfulness and relevance of this distinction is supported by empirical observations of the packaged goods industry, where it has been found that immediate incentives were effective in getting consumers to switch away from competing brands

while delayed incentives retained consumers by rewarding their future purchases (Zhang et al. 2000).

In our study setting, immediate rewards refer to benefits that are experienced at the point of transaction. This can be viewed as discounts or price cuts offered to customers at the point of sale. Conversely, delayed rewards are benefits and incentives (with higher value; to be detailed later) that are obtained or redeemable at a later date from the point of sale. Previous research indicates that: (1) when given a choice between necessity and luxury rewards of similar value, higher redemption efforts shift consumer preference towards luxury rewards. Redemption effort is more salient for consumers who feel guilty about luxury consumption, and for those who relate the effort to work rather than to pleasure (Kivetz and Simonson 2002), and (2) consumers who see themselves as having effort advantage (idiosyncratic fit) with the reward program have higher perceived value of the program (Kivetz and Simonson 2003).

Satisfaction and loyalty

Researchers have conceptualized service experience satisfaction using the disconfirmation of expectation paradigm (e.g., Bitner 1990; Oliver 1997). Consumers compare their prior expectations against the service performance received to evaluate how it would or should perform. When consumers experience shortfall from their expectations, negative disconfirmation is experienced (Oliver 1997). Prior service experience, thus, shapes customer expectations and attitudes towards the firm.

There exist several definitions of loyalty in the marketing literature. Some scholars argue that behavioral loyalty (i.e., repeat purchase) alone is too simplistic and does not capture the multidimensionality of the construct of loyalty (Kumar and Shah 2004). In this respect, habitual/convenience buying as well as purchases induced primarily by promotional incentives have been termed as false or spurious loyalty (Dowling and Uncles 1997). This has been used to argue why reward programs may not really generate loyalty (Kumar and Shah 2004; Uncles et al. 2003). As such, increasingly researchers are looking at the psychological meaning of loyalty in order to distinguish it from behavioral definitions, and tend to define loyalty as a combination of commitment to the relationship and overt loyalty behaviors (Dick and Basu 1994; Oliver 1997; Ganesh et al. 2000), which is the approach that we adopt in this study.

It has been argued that satisfied and dissatisfied customers perceive reward programs loyalty in different ways, and further study is needed to verify this relationship (Dowling and Uncles 1997). Therefore, we include customer satisfaction into our model as a moderating variable. This is in contrast to Magi (2003), who studies the separate effects of satisfaction and reward programs on customer share. We develop our hypotheses by separately examining the effectiveness of the different reward configurations (type and timing) under customer satisfaction and dissatisfaction conditions. In doing

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