Perspectives on Customer Demotion in Loyalty Programs

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Abstract

Loyalty programs are an important aspect of consumer engagement in US, European and Asian markets. While significant attention has been devoted to the evaluation of loyalty programs, research on an important element of these programs, customer demotion, is limited to a few pioneering studies. This article examines these studies with the objective of identifying areas for further research. These areas include different loyalty contexts, customer segments, types of benefits, moderating variables, and cross-cultural analysis. Finally, this article seeks to offer some recommendations regarding the role of customer demotion in loyalty programs.

1. Introduction

Since the introduction of S&H Green Stamps over a century ago, loyalty programs have grown tremendously in terms of number and sophistication (Lach, 2000). Loyalty programs now permeate the consumer scene with firms across industries constantly developing new variations and additional offerings. According to Colloquy's Loyalty Census (Berry, 2015), from 2012 to 2014 American rewards programs grew by 26% to 3.3 billion memberships. As consumers continue to eagerly sign up, the loyalty industry shows no signs of slowing down (Berry, 2015).

Loyalty programs reward customers based on the frequency and value of purchases. In return for continued patronage, customers are offered different degrees of price discounts or access to additional benefits at no extra cost (Bolton et al., 2000). Loyalty, the basis of these
programs, is described as having attitudinal and behavioral components. While attitudinal loyalty does not always result in behavioral loyalty, consumers that are favorably disposed towards a brand are more likely to buy it. Alternatively, they might frequently buy the brand but not have an emotional affinity towards it. Loyalty programs address attitudinal and behavioral components. By developing both elements of loyalty, they strive to create long-lasting and profitable customer relationships (Zeithaml et al., 2013).

Research has addressed many different aspects of loyalty programs. However, an area of research which has not received a great deal of scholarly attention is that of customer demotion. Customer demotion basically addresses the effects of lowering customers’ status within hierarchical loyalty programs. This may occur because customers fail to meet spending or behavioral goals set by organizations, or because firms decide to raise program requirements. As a result of these demotions, customers typically lose benefits which may have negative effects on the customer relationship (Van Berlo et al., 2014).

The purpose of this exploratory piece is to briefly review some important studies on customer demotion, highlight a series of issues, and lastly suggest some future directions for this emerging field of research. The authors believe it is important to carefully evaluate the research conducted to date in an effort to determine the most fruitful areas for further investigation.

2. Customer Demotion

Customer demotion is a relatively new phenomenon. Only a small number of empirical studies address the topic. Wagner, Hennig-Thurau and Rudolph (2009), use prospect and emotion theory to show that customer demotion negatively affects customer relationships. Their findings indicate that lowering customers’ status for failing to meet program targets decreases their loyalty below the levels exhibited before being elevated to their preferred status. Similar arguments were made by Pfeffer (1981) and Trice and Beyer (1984), though in the context of organizational behavior. Wagner et al. (2009) further argue that demoted customers show lower loyalty intentions than customers not elevated to the preferred level. The customers' disappointment substantially reduces loyalty intentions.

Van Berlo et al. (2014) also empirically address customer demotion. Their study confirms that demotion results in a loss of trust, commitment and loyalty, though their research is particularly interesting because they address the moderating effect of locus of causality.
The authors found that the negative effects of demotion are most pronounced for customers with external loci of causality. However, demotion's negative effects were not as strong with a situational locus of causality, and weakest with internal loci of causality. These findings suggest that customer demotion is a more complex process than previously thought, because it is impacted by a series of moderating factors.

3. Study Issues

These studies provide important insights on the customer demotion phenomenon, and their limitations suggest future areas for customer demotion research. For example, Wagner et al. (2009) develop their conclusions through empirical testing and comparing frequent flyer and department store loyalty programs. While this testing and comparison of different industry/loyalty programs provides macro-level contributions, this approach has limitations. Loyalty programs, while conceptually similar, are not necessarily the same across industries. Programs, mechanics, participants, and resultant demotion reactions likely differ from industry to industry. To illustrate, airline customers make relatively large and sporadic purchases with significant benefits. In contrast, department store customers make relatively small, but more frequent purchases with lesser benefits. It is thus difficult to combine results from two fundamentally different types of loyalty programs and use these results to formulate general conclusions on customer demotion.

Even within the same context, loyalty and customer demotion research results have limitations such as the difference between European airline loyalty programs and their US counterparts. Not only were these European loyalty programs developed later, but their mechanics reflect a fundamentally different industry/market with a unique mix of regulations, competing carriers, route structures, and customer cultures. Addressing changes in customer attitudes/behaviors produced by demotion across different loyalty program types is a research area worthy of attention.

In regards to research design, Van Berlo et al. (2014) rely on scenarios as the basis for their experiments. While this approach is viable, it is nevertheless hypothetical. Results would be more realistic if scenarios were matched to the samples being studied, such as samples made up of customers who have already experienced the scenarios at hand, or at least similar ones.

Studies such as Van Berlo et al. (2014) place considerable emphasis on the benefits that participants allegedly loose as a consequence of demotion.
Understandably, most research focuses on material/financial aspects. Since these factors are more tangible, they are easier to operationalize. However, loyalty programs typically offer heterogeneous reward mixes including intangible benefits neglected by research. For example, Wagner et al. (2009) do not really address important benefits such as convenience and recognition. Customer types such as airline business travelers may find these intangible benefits more important than material rewards such as fare discounts. As loyalty programs continue to develop partnerships and extend rewards beyond those immediately offered by their organizations, the effects of losing different reward types as a consequence of demotion is another research area requiring careful attention.

There are other research issues associated with the samples used in the research studies. Wagner et al. (2009) use undergraduate participants to produce a snowball sample of frequent flyer program members. While the procedure obtained a good number of participants, there is little information on the quality of respondents such as what controls prevent students from gaming the process. How many participants are eliminated for not being members of a plan? Similarly, Van Berlo et al.’s (2014) study raises questions about the experience of respondents, hence their ability to provide solid demotion data. The researchers use a sample of graduate and undergraduate Dutch business school students averaging 20 years of age. While the overall work is commendable, and results are insightful, how do the pilot sample and the student sample relate? Are they both student samples? More importantly, what is the degree of students’ experience with loyalty programs, and customer demotion? There is a need to address whether different sampling frames used in various studies bias study results.

Finally, in regards to generalizability, Wagner et al. (2009) use US loyalty programs and respondents while Van Berlo et al. (2014) use Dutch loyalty programs and respondents. Both studies contribute to the customer demotion literature. However, the cultures and experiences of US and Dutch customers are different, and their reactions to demotion are also likely different. In a similar fashion, customer demotion reactions in Asia and the Middle East may also differ. Hence it is difficult to generalize about loyalty programs across cultures based on customer samples from single countries. Obviously, there is also a need to incorporate cross-cultural dimensions into future customer demotion research in an effort to promote the generalizability of findings. Cross-cultural approaches to customer demotion which have an intercontinental or country focus may offer contributions to our knowledge of this research area.
Studies that examine differences across national regions, ethnic minorities, and immigrant populations may also have a role in promoting our understanding of customer demotion.

4. Other Research Directions

Future customer demotion research may also develop in three other directions. One direction is to address the loyalty industry’s changing structure. As technology permeates consumer behavior, in particular mobile technologies, a new generation of virtual loyalty programs is emerging. Consisting of daily deals and point aggregators of different sorts, these new programs already account for 13% of total loyalty memberships and are rapidly growing (Berry, 2015). Unlike conventional loyalty programs which strive to build brand equity, these new entrants transcend brands and instead focus on consumption. To illustrate, Expedia aggregates travel options across airlines, hotels and car rental brands. Customer engagement, hence loyalty, is thus transferred away from the branded providers and redirected towards the aggregator’s rewards program. These virtual entrants are fundamentally changing the loyalty industry’s structure by commoditizing conventional rewards programs. By presenting a variety of similar options, branding’s impact is reduced and the purchasing decision is based on pricing.

Another major change within the loyalty industry’s structure is the recent reemergence of coalition rewards programs in the US (Reuters, 2015). Like their virtual counterparts, they also allow customers to earn rewards from an array of merchants across categories. However, they are more moderate in that they do not cannibalize sectors but typically offer just one provider in each. Ironically, these ‘new’ programs revert back to the general model offered by S&H Green Stamps over a century ago. However, these coalition reward programs foster the transference of customer loyalty from the participating brands to the actual programs. There are thus ample opportunities to undertake research on customer demotion in these new types of programs versus more traditional ones.

A second area of demotion research is customers themselves. Loyalty initiatives generally assume that members are all alike. Hence, providers tend to offer one-size-fit-all programs (Berry, 2015). However, customers in reality are quite heterogeneous. They now cluster into a variety of segments each with its unique characteristics and requirements. A well-developed research program must examine these characteristics and requirements as well as the effects of monetary, in-kind and social rewards upon segments.
Depending on their affinity for the different types of benefits, the reaction of different market segments to demotion is likely to vary.

Future demotion research also needs to study customer reactions based on usage, demographic and psychographic characteristics. This entails cross-referencing loyalty program data such as membership length (short vs. long), membership level (low vs. high), and purchase behavior (frequency, amount, etc.), demographic variables such as gender, age cohort (boomers vs. millennials), and location (urban vs. rural); and psychographic variables such as values, technological affinity (high vs. low), and lifestyle, among others. By approaching demotion using an IDIC framework (Peppers and Rogers, 2000) it is possible to make better decisions. Customers could be better understood if firms interacted with them on a more regular basis at the individual level using the power of social media. Such interaction would provide valuable insights as to why spending levels decrease, whether changes are temporary, and if spending levels rebound or continue to fall. Research in this area may help formulate useful rules for customer demotion procedure.

A third area of future research may examine the nature and importance of the different moderating customer’s effects. Beyond the myriad of possible external factors, a central issue to consider is how the demotion is internally conducted. This is arguably just as important as the demotion act itself. Van Berlo et al. (2014) found location of causality to mitigate demotion effects. Customer reactions are less severe when they acknowledge the fault as mostly theirs, opposed to being circumstantial or worse yet, traceable to the company. With this in mind, the negative effects of demotion may be reduced if supported by appropriate program structures.

If program terms are easily understandable and frequently transmitted, demotion is based on objective and widely-known criteria. Under such circumstances, customers assume more of the responsibility and this should lessen negative effects. Furthermore, it is critically important for firms to proactively advise customers of their status. Customers need to know where they stand at all times and what they can do to maintain, and ideally increase, their loyalty status. This not only avoids any unpleasant surprises, it also reinforces customers’ responsibility to avoid demotion. Beyond the constant information, customers also need positive reinforcement on a regular basis to stimulate their loyalty. This positive reinforcement also strengthens the firm-customer relationship, and in the case of a demotion, further mitigates negative effects.
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Negative effects can be softened by appropriate demotion procedures. Besides proactively advising customers of their inactivity and impending demotion, there is also a need for firms to offer customers a set of reasonable alternatives. These alternatives mitigate the bad news, reduce customer stress, and further position the firm as an ally (Wagner et al., 2009). One alternative is a bridging strategy which enables customers to temporarily retain their status in spite of missing program goals. Bridging strategies may also be monetized, e.g. some airlines give customers the opportunity to buy qualifying miles or other mechanisms such as additional time. Bridging strategies do consume the resources of loyalty programs but they are also an opportunity for incremental revenue since customers are often forced to commit resources to stay in the bridging structure. There are still many questions requiring empirical evidence regarding the effects of bridging programs in adverting customer demotion.

If customers are not interested in bridging options, the company must then decide whether to demote the customer or to postpone that action. Wagner et al. (2009) found that demoted department store customers showed immediate and substantial expenditure reductions. These results suggest interesting asymmetrical effects worth further research. The study suggests that companies should abstain from demoting customers too quickly, especially those in elevated and more profitable tiers. Despite having earned a demotion, temporarily maintaining customer status entails a small cost and hence is a viable alternative. Postponing demotion allows customers more time to potentially return to their old spending patterns. Postponement is also an opportunity to strengthen the customer relationship in areas such as trust. Future research should also address under what circumstances, and for how long customers' status might be maintained.

When demotion does become necessary, firms must recognize the importance of doing it tactfully so as to minimize negative effects. Demotions done unexpectedly, devoid of justifications, and delivered in a cold and mechanical manner generate ill feelings. These demotions negatively impact sales and long-term patronage, and generate bad word of mouth. Such demotions have potentially devastating consequences in today's social-media dominated environment. However, if the demotion is done in a sincere, tactful and empathetic way, supported by a solid explanation and apology (Kellogg and Cunningham, 2014) and when appropriate with some sort of compensation, it is possible to mitigate the negative effects of demotion. How demotions might be best delivered constitutes another area of future research.

In sum, the authors call for further demotion research associated, though not limited to five basic areas: First, the different loyalty contexts, such as program types, given the varied and
rapidly changing loyalty industry; second, the different and more narrowly defined customer segments, each with their particular needs and preferences; third, the different types of benefits that customers stand to lose, particularly intangible ones; fourth, the different effects of moderating variables, especially internally controlled ones; and fifth, all of the above, but in a cross-cultural context to better understand global consumers. The study of each of these areas might be approached through hypothesized models seeking to explain how and why customers behave in circumstances of demotion. Of course smaller, incremental studies may help to lay the foundations to build more complex models.

5. Some Closing Thoughts

The fundamental assumption supporting loyalty programs is that they indeed increase business. This assertion is worth discussing in more detail. Wagner et al. (2009) found that department store customers who reached the gold level did not incrementally increase their spending and that their transactions plateaued after reaching this benchmark. Furthermore, the recent Loyalty Census (Berry, 2015) found that loyalty program members are not that loyal. On average, American households belong to a staggering 29 loyalty programs. Less than half of members (42%) actually participate in the programs they belong to. Activity levels have steadily declined over the last several years, down from 44% in 2012 and 46% in 2010 (Berry, 2015). These statistics demonstrate the commoditized nature of loyalty programs. Rewards no longer sway purchase decisions. The statistics also show how vulnerable companies have become to competition, neglect, and disenrollment by customers despite the best efforts of loyalty programs (Blank-Fasig, 2015). More fundamentally, they raise questions about the overall effectiveness of rewards programs. This observation is consistent with Henderson, Beck and Palmatier (2011), among others.

This data indicates that loyalty programs are not working as well as they should. Firms may need to reinvent their programs to regain competitiveness. Instead of merely focusing on the quantity of memberships, firms need to concentrate on the quality of customer engagement. This entails, on the one hand, determining which customer segments are currently most lucrative, which ones have the highest potential, and then restructuring loyalty programs to primarily satisfy these two groups.

This requires customized and more personally-relevant customer experience and reward which engage the customer at a deeper level and builds solid long-term relationships (Berry, 2015).
Program restructuring also entails demoting less-profitable program members. Participants who are not loyal, much less active are arguably a waste of resources. There is nothing wrong with firms, like customers, being more selective. Loyalty programs, like any brand or product, need clear positioning. This means moving away from trying to be everything to everybody. Such a redefinition is also beneficial at the strategic level as it supports the overall brand and value proposition. Customer demotion is thus potentially a vehicle for strategic customer alignment.
References


