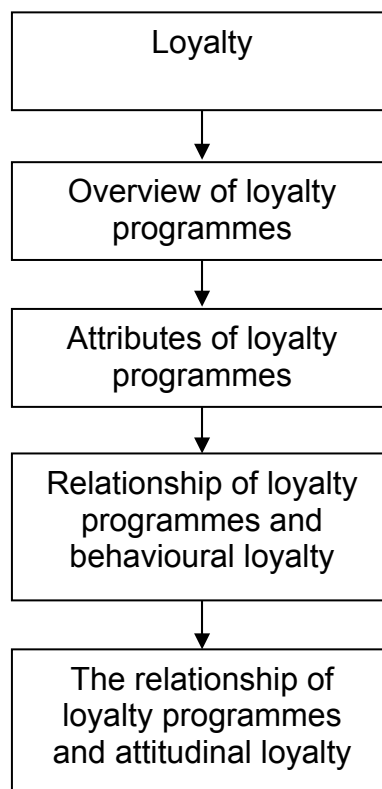


## CHAPTER 2: LITERATURE REVIEW

This chapter will review the literature and journals that are related to customer loyalty and loyalty programmes, including a review of loyalty, loyalty programmes overview and benefits and the relationships between loyalty programmes with behavioural and attitudinal loyalty.

**Figure 2:** *The organization of the literature review*



### **2.1 Loyalty**

According to Oliver (1999, p. 34), loyalty is defined as:

*“A deeply held commitment to rebuy or repatronize a preferred product/service consistently in the future, thereby causing repetitive same-brand or same brand-set purchasing, despite situational*

*influences and marketing efforts having the potential to cause switching behavior”*

These behaviours induce repeat purchases of the consumers despite the situational influences and competitors' marketing efforts, the main objective of which is to encourage the switching behaviour of consumers (Oliver, 1999). However, previous research conducted by Jacoby and Chestnet (1978) distinguished loyalty from behavioural definitions by exploring the psychological meaning of loyalty. According to their analysis, consistent buying behaviour of the consumer should not be treated as the indicator of loyalty as happenstance buying or a preference for convenience could mask loyalty if consumers are multi brand loyal (Jacoby and Chestnet, 1978).

To better explain the “loyalty” theory, Oliver (1999) categorized the loyalty phases as cognitive loyalty, affective loyalty, conative loyalty and action loyalty.

**Cognitive loyalty** is the first phase of loyalty in which consumers' loyalty is based on brand belief only (Oliver 1999). **Cognitive loyalty** occurs when the brand attribute information available to the consumers indicates that one brand is preferable compared to its alternatives (Oliver 1999). **Affective loyalty** is the second phase of loyalty in which consumers develop a liking attitude towards the brand. However, this stage of loyalty remains subject to brand switching (Oliver 1999). The third phase of loyalty is **conative loyalty**. Conative loyalty implies a greater brand-specific commitment, and consumers at this stage will develop a good intention to purchase the brand (Oliver 1999).

Finally, **action loyalty** is the loyalty where consumers will commit to the action of buying (Oliver, 1999). From the above, we can categorize cognitive loyalty and affective loyalty as attitudinal loyalty, and conative loyalty and action loyalty as behavioural loyalty.

Besides Oliver (1999), Chaudhuri and Holbrook (2001) also examined the two (2) aspects of brand loyalty – behavioural loyalty and attitudinal loyalty. Behavioural loyalty is defined as the loyalty comprising repeated purchases of the brand, whereas attitudinal loyalty is described as the degree of dispositional commitment due to some unique or favourable values associated with the brand. Brand loyalty (behavioural and attitudinal loyalty) can be better enhanced if the variables of brand affect and brand trust are developed (Chaudhuri and Holbrook, 2001).

Understanding brand loyalty is essential as consumers' brand loyalty leads to various advantages to the retailers in operating their business. Brand loyal consumers indirectly reduce the marketing cost of the retailers as they are familiar with the brand, these consumers require less information as they know which products of the brand will be more suitable for them, hence, less services are needed (Chaudhuri and Holbrook, 2001). In addition, brand loyal consumers will sometimes serve as the brand's part-time sales associates by creating positive word of mouth and recommending the brand to others (Gable et al., (2008), thus, bringing in more new consumers and creating favourable word of mouth for the retailers (Chaudhuri and Holbrook, 2001). Besides being cost effective, brand loyal consumers will also drive brand

profitability, this is because brand loyal consumers are willing to pay a premium price as they perceive their preferred brand is unique and not replaceable by other alternatives (Chaudhuri and Holbrook, 2001). Hence, retailers will be able to enjoy greater trade leverage, and, most important of all, create resistance among loyal consumers towards competitors' strategies (Chaudhuri and Holbrook, 2001).

Consumer loyalty is a by-product of consumer satisfaction (Gable, et al., 2008). Therefore, it is important to ensure consumer satisfaction when developing consumer loyalty. Seymour and Rikin, (1998) indicated that consumer loyalty is difficult to achieve without consumer satisfaction. Loyalty is developed through a stream of experiences, therefore, it is difficult to achieve within a short time. Hence, to create consumer satisfaction and loyalty, retailers will normally practice three things in their business implementation: (1) develop brand or business strong core values (for instance, outstanding product quality and colour combination for its targeted consumers); (2) develop an overall consumer focus strategy; and (3) develop a loyalty programme that enables consumers to "build a relationship" with their preferred brands and retailers (Gable et al., 2008).

Retailers' ultimate goals are to establish brand loyalty and profitable consumers, which will drive profitability and result in the longevity of their business. According to Dowling and Uncle (1997), marketing managers generally believe that loyalty programmes are able to create loyal consumers. This is further supported by Gomez et al (2006). Their study implies that

loyalty programmes are able to develop true loyalty (Gomez et al., 2006). As consumers who participate in loyalty programmes are entitled to receive rewards and benefits such as monetary discounts, organizational newsletters, or prizes and qualify for membership of the consumers' clubs. Hence, loyalty programmes that act as a consumer loyalty enhancement tool in the first place are able to induce consumers' attitudinal loyalty while at the same time develop behavioural loyalty in accordance with the favourable feelings cultivated from the benefits offered (Gomez et al., 2006; Dowling and Uncles, 1997).

## **2.2 Overview of Loyalty Programmes**

Loyalty programmes have become widespread since American Airlines launched its frequent flyer programme (AAdvantage) in 1981 (Barlow, 1996). The AAdvantage program offered the airline's consumers free travel in exchange for some level of loyalty. Subsequently, loyalty programmes have blossomed and expanded into various industries (Duffy, 1998; Liu, 2007). In recent years, the use of loyalty programmes has spread among retailers across industries as most retailers believe that loyalty programmes are able increase consumers retention, which will lead to a significant increase in profitability (Sharp and Sharp, 1997).

Generally, there are several groups of loyalty programmes or schemes offered to consumers, including retailer loyalty schemes, financial service loyalty schemes, online reward schemes, frequent flyers and other travel reward programmes, geographically based loyalty schemes, and coalition

loyalty schemes (Rowley, 2007). Furthermore, as listed below, Berman (2006) also categorized loyalty programmes into four (4) types based on their characteristics.

- Type 1: Members receive additional discount at cash register. This is similar to electronic coupons where all consumers receive similar discounts regardless of their past purchases.
- Type 2: Members receive 1 free service or product when they purchase the required number of units at full price (example, Coffee Bean).
- Type 3: Members receive rebates or points based on cumulative purchases.
- Type 4: Members receive targeted offers or mailings as well as rewards from the retailers based on the demographic and behavioural information gathered. This type of loyalty programme enables marketers to apply target marketing efficiently.

Among the loyalty programmes listed above, type four (4), the loyalty programme leads to higher consumer commitment, as it requires comprehensive information for consumers' relationship management. This type of loyalty programme offers individual members specialized communications, promotions, and rewards based on their purchase history. Hence, loyalty can be built throughout the loyalty programmes' members (Berman, 2006).

Loyalty programmes are developed with different objectives including rewarding loyal consumers, generating information, manipulating consumer behaviour and acting as a defensive measure to combat competing schemes (O'Malley, 1998). Therefore, loyalty programmes are treated as one of the defensive marketing strategies that enable retailers to develop and enhance their consumer brand loyalty by developing a personalized relationship with them. The personalized relationship can be built, as the loyalty programme is able to collect and gather information concerning demographic information and consumers' behavioural information (purchase behaviour, brand preference, etc). Subsequently, retailers are able to identify their loyal consumers and determine the most attractive or effective loyalty programme in operating their retail business (Yi & Jeon, 2003). This information enables retailers to serve as the discrimination and individualization instruments of the marketing strategies to create personalized services and products for their targeted markets (Meyer-Waarden, 2008). Loyalty programmes can induce consumers' feelings of intelligence and pride for receiving special treatment, for instance, paying the retailers a discounted price for the merchandise (Kivetz and Simonson, 2002). In other words, the implementation of loyalty programmes enables retailers to create differentiation from their competitors (Yi & Jeon, 2003; Waarden, 2008).

According to Liu (2007, p. 20),

*“Loyalty program is defined as a program that allows consumers to accumulate free rewards when they make repeated purchases with a firm. Such a program rarely benefits consumers in one purchase but is*

*intended to foster consumer loyalty over time. Thus, promotions that work as “one-shot deals,” such as instant scratch cards, are not considered loyalty program here. This exclusion is appropriate because these one-time promotions do not create the same consumer lock-in as true loyalty program.”*

Unlike the non-members, consumers who enrol in loyalty programmes are entitled to benefits such as monetary discounts, membership of consumers club, and to receive free newsletters, prizes (Rosenbaum et al., 2005), cash rebates through the accumulation of points or other benefits. Thus, through the benefits provided, retailers are able to attract new consumers, increase consumers' retention rate (due to switching cost), enhance repeat purchase behaviour and consequently increase the profitability of the retailers (Meyer-Waarden, 2006; Sharp and Sharp, 1997).

Therefore, retailers are willing to further invest in loyalty programmes because it enables them to target the selected group of consumers who contribute most of the profit margin to the company (Gable et al., 2008). This group of consumers are often those who are more wealthy, up-scale and discerning who appreciate a personalized service, higher merchandise quality and variety (Gable et al., 2008). Therefore, instead of targeting the mass market at a higher cost, targeting the “right group” of consumers will enable the company to achieve better results in its business operations. Furthermore, this group of consumers, when they became the members of the retailer's loyalty programme, are likely to relate themselves more strongly with the retailer (Oliver, 1999).



Hence, relationship marketing with consumers is very important, as it provides guidelines for retailers to focus their marketing activities through building a long-term business relationship with their consumers (Gronroos, 1995) and, eventually, develop their own group of consumers that contributes most of the profit margin of the company (Gable et al., 2008).

It can be concluded from the studies conducted that researchers have successfully proved that there is a positive relationship between loyalty programmes and consumer loyalty (Bolton et al., 2000). Previous research also indicated that the success of loyalty programmes is mainly determined by factors such as (1) the reward timing (when will the members enjoy the rewards, the time lapse between the purchase period and reward period), (2) the ease of use of the loyalty programme, (3) the operational efficiency and attractiveness of the loyalty programme based on the membership database, (4) easiness of redemption of the rewards, (5) the compatibility of the rewards with the brand image, and (6) consumer perception of the value placed on the rewards given (Rosenbaum et al., 2005). By understanding these factors, retailers will be able to develop, monitor or operate loyalty programmes to suit the consumers' expectations.

### **2.3 *Benefits of Loyalty Programmes***

Barlow (1996) indicated that the attributes of loyalty programmes can be categorized into “soft” and “hard” benefits. Soft benefits are the benefits that aim to cultivate consumers' loyalty. The soft benefits of loyalty programmes can be communicated to the consumers through the mailing of printed

catalogues or mailers to a select group of consumers (loyalty programme members) to bestow upon these consumers a sense of appreciation and unique status through special treatment, special access and special deals (Barlow, 1996). On the other hand, hard benefits are the tangible rewards that are given to a select group of consumers (loyalty programme members), which, most of the time, encourages or stimulates consumer purchase behaviour (Barlow, 1996).

Barlow's (1996) statement on the categorization of "soft" and "hard" benefits are supported by several researchers in their studies (Gable et al. 2008; Bridson et al. 2008). Gable et al. (2008) implied that the "soft" and "hard" benefits offered also determine the attractiveness and efficacy of the loyalty programme. Hard benefits, as described by Gable et al. (2008), are the "economic" benefits that the loyalty programme offers its consumers, for example, special discounts, rebates and savings for consumers. On the other hand, soft benefits are the benefits that go beyond the economic or financial components. Soft benefits focus on providing special convenience or information that facilitate business transactions between the consumers and retailers (for example, special invitations to corporate events). Compared to hard benefits, soft benefits are more difficult to implement, however, soft benefits are the benefits that are most valued by the consumers and are not easily copied by their competitors. As such, soft benefits serve as an emotional tie that binds the consumers to the retailers (Gable et al., 2008).

However, the study presented by Mimouni-Chaabane and Volle, (2009), further classified the “hard benefits” and “soft benefits” of the loyalty programme into utilitarian benefits (monetary savings), hedonic benefits (exploration and entertainment), and symbolic benefits (recognition and social benefits). Together, these benefits indicate the consumer’s perceived values attached to their exposure (e.g. the knowledge that after a certain number of purchases, the consumer receives a coupon), usage (e.g. redeeming the coupon) and experience with the programme (Mimouni-Chaabane and Volle, 2009).

### ***2.3.1 Utilitarian Benefits***

Utilitarian benefits, which are also referred to as functional benefits (Hawkins et al. 2007) serve as a basic motivation that usually corresponds to the tangible attributes (monetary saving) of the loyalty programme (Mimouni-Chaabane and Volle, 2009; Bolton et al., 2004; Johnson, 1999). Monetary savings from the loyalty programme encourage consumer purchase behaviour and condition them to continue doing business with the firm (Sheth and Parvatiyar, 1995). The monetary savings benefit can be achieved through cash rebates, discounts and cut off coupons offered by the retailers (Berry, 2006). The rewards and discount schemes (monetary saving) incorporated into most loyalty programmes are to attract consumers to make repeat purchases (O’Malley, 1998). Through these reward schemes, consumers are motivated to participate in the retailers’ loyalty programme as, fundamentally, most people like to get something for nothing (Uncles, 1994).

### **2.3.2 Hedonic Benefits**

According to Mimouni-Chaabane and Volle, (2009), Hedonic benefits in loyalty programmes can be described in two dimensions: exploration and entertainment. Direct mail, catalogues offered by the retailer, will be able to satisfy consumers' exploration needs as these tools provide the consumers with the latest news of the retailer's products and promotional activities (Mimouni-Chaabane and Volle, 2009). In addition, loyalty programmes also enable consumers to participate or enjoy unique experiences (such as private events, exclusive functions) that are offered exclusively to its members. The entertainment dimension of the loyalty programme is achieved through the joy that the consumers experience through collecting redemption points. Johnson (1999) indicated that loyalty programmes attract consumers because of the pleasure associated with collecting and redeeming points. Liu (2007), also stated that collecting points has an important psychological meaning for consumers, this action not only increases the value perception of the loyalty programme, but also increases the likelihood of the consumers staying in the relationship. In this scenario, consumers act like players experiencing a feeling of entertainment.

### **2.3.3 Symbolic Benefits**

Symbolic benefits are the benefits developed through recognition and the sense of belonging (Mimouni-Chaabane and Volle, 2009). Loyalty programmes enable retailers to establish a consumers' database and compile information, therefore, it offers retailers the opportunity to provide differentiation and personalized services to their consumers (Leenheer and

Bijmolt, 2007) who perceive differentiation and personalized services as a sign of respect or distinctiveness (Gordon et al., 1998). Consumers eventually experience recognition benefits as a member of the loyalty programme through better services and treatment from the retailers (Mimouni-Chaabane and Volle, 2009). In addition, loyalty programmes also develop the consumers' social benefits by identifying them as belonging to a group and developing emotional connections with people who share the same values, experiences and beliefs concerning the respective retailers (Mimouni-Chaabane and Volle, 2009; Rosenbaun et al 2005).

Retailers who have a better understanding of consumers' perceptions of value and experience, and subsequently leverage this knowledge into consumer experience will create consumer satisfaction (Dunlap, 2004). Through loyalty programmes, retailers are able to provide assurance to their loyal consumers and continuously reward their consumers to meet their expectations. Together, these create a positive relationship between the retailer and their loyal consumers (Gable et al., 2008). Once a positive relationship is built, retailers are able to protect their consumers from competitors' attempts to attract their existing consumers. In addition, this relationship will enable the retailers to establish a switching cost and barriers, thereby preventing the loss of their existing consumers to their competitors (Gable et al., 2008).

## ***2.4 The Relationship between Loyalty Programmes and Behavioural Loyalty***

The effects of loyalty programmes are similar to the effects of long-term promotion as it can lead to substantial gains in market penetration (number of consumers) and a small increase in the average purchase frequency or repeat purchase behaviour (Ehrenberg et al., 1990). An increase in repeat purchase behaviour may allow for the formation of closer relationships between the retailers and their consumers. These relationships, allow the retailers to better understand the needs and wants of their consumers. Hence, loyalty programmes cultivate consumer behavioural loyalty. In addition, marketing costs are reduced as the retailers spend less in convincing consumers to return. Furthermore, the closer relationship will also raise barriers to competitors' entry into the market, hence, lessening the chance of future competitive threats (Sharp & Sharp, 1997). The research conducted by Sharp and Sharp supports the argument that changing the fundamental repeat purchase patterns of the market is very difficult, however, there are still ways to possibly alter the repeat purchase patterns, and loyalty programmes are the only marketing tool that will enable the change (Sharp & Sharp, 1997).

Since 1990, retailers have encouraged consumers to participate in their loyalty programmes through which incentives and rewards are given to the consumers in exchange for repeat business (Roehm et al., 2002). Sharp and Sharp (1997) stated that loyalty programmes are marketing efforts that are structured with rewards, hence, loyalty programmes cultivate consumer behaviour loyalty that benefits the retailers. The encouragement from the

loyalty programmes will lead to behavioural changes and these can be easily seen from the changes in consumers repeat purchase behaviour when compared to non members. Consumers who participate in the loyalty programmes are known to be valuable consumers to the retailers because they will increase their repeat purchase rate and usage frequency of the retailers' products (Sharp & Sharp, 1997).

Loyalty programmes are one of the marketing programmes that reward consumers and encourage loyal consumers to engage in repeat purchase behaviour (Sharp and Sharp, 1997). Through consumer dialog and the development of customized services that stimulate repeat purchase and cross-buying behaviour, retailers are able to attract and retain their consumers, thereby leading to a higher profit margin (Stauss et al., 2005). Furthermore, through the use of loyalty programmes, retailers are able to create switching costs, and rewards for cumulative buying with the aim of developing behavioural loyalty (Meyer-Waarden, 2006). For instance, points accumulated from previous purchases will be forfeited if the consumer stops purchasing from the retailer. Moreover, psychological, sociological and relational drivers that enhance consumers' trust, affective commitment and attachment to the retailer will thereby entail higher switching costs (Morgan and Hunt, 1994).

The research conducted by Liu (2007) stated that loyalty programmes have a positive effect on light and moderate buyers purchase frequencies and transaction size, meaning that the repeat purchase behaviour of these

consumers will increase. The initial change in these two segments of consumers is most apparent when they first join the loyalty programme with the subsequent growth continuing at a steady but slower pace in the later stages (Liu 2007). Loyalty programmes are one-to-one programmes in which the level of benefits that a consumer can enjoy is dependent on their “investment” in the relationship with the retailers (Liu 2007). Liu’s (2007) research also changed the general public perception that low usage level consumers are less-than-ideal targets for loyalty, as from the research it shows that consumers with low usage level change their behaviour as much as, or more than moderate and heavy buyers. This is because, in order to claim a higher portion of rewards, these segments of consumers will gradually “invest” more in the retailers (Liu 2007). Through these measures, the opportunity for these consumers to benefit from the loyalty programme increases and, thus, further leads to consumer behavioural loyalty (Liu 2007).

Consumers’ behavioural loyalty is very important to the retailers. Therefore, retailers invest their efforts and capital to create consumer behavioural loyalty, so that their consumers will purchase or shop in their stores. This is because the success of the retail business is very much dependent on the repeat business from their consumers (Gable et al., 2008). As such, most retailers will then use loyalty programmes as a tool to create or maintain a positive relationship with their regular and loyal consumers, who will repeatedly purchase from them without considering or being disrupted by the marketing efforts of competitors (Dixon et al., 2005).



Consumers with behavioural loyalty are a large group of high potential consumers who wish to be involved in a relationship with those retailers from which they normally make their purchases. Among these loyal consumers, there are consumers who are only loyal and make purchases from one particular brand (Dowling and Uncle, 1997). These consumers are very important and valuable to the retailers as they are frequent buyers or heavy users of the retailer, which contributes high profitability to the retailer's business. In addition, O'Brien and Jones (1995) also stated that loyalty programmes are able to enhance the consumer loyalty lifecycle. Once consumer loyalty is gained, these consumers will become the retailer's most profitable consumers as well as their business builders (O'Brien and Jones, 1995). These loyal consumers purchase more, are willing to pay premium prices, and also act as the retailer's best and most persuasive referrals by bringing in more consumers (O'Brien and Jones, 1995).

From the review of the literature mentioned earlier, loyalty programmes encourage purchase behaviour as well as repeat purchase from their consumers. From the loyalty programmes, the relationship between consumers and retailers is built. The purchase behaviour of the consumers is cultivated because the benefits offered by the loyalty programme "reward" consumers who invest "heavily" in their relationship. Furthermore, the benefits offered, indirectly create a "switching cost" to the consumers, thus, to continue enjoying the benefits and "rewards" offered by the retailer, consumers will then develop their behavioural loyalty towards those brands whose loyalty

programmes they had participated in. Therefore, the following proposition is developed:

***Hypothesis 1: Loyalty programme benefits have a significant impact on behavioural loyalty***

Ultimately, the benefits of the loyalty programmes play an important role in affecting the behavioural loyalty, thus,

*H1a: Utilitarian benefits of loyalty programmes have a significant impact on behavioural loyalty*

*H1b: Hedonic benefits of loyalty programmes have a significant impact on behavioural loyalty*

*H1c: Symbolic benefits of loyalty programmes have a significant impact on behavioural loyalty*

## **2.5 The Relationship of Loyalty Programmes and Attitudinal Loyalty**

Previous research indicates that attitudinal loyalty occurs when consumer liking, trust and commitment are developed (Chaudhuri and Holbrook, 2001; Oliver, 1999). Loyalty programmes are able to cultivate attitudinal loyalty because they instil psychological, sociological and relational drivers through newsletters, exclusive invitations and members' workshops that enhance consumer trust, affective commitment and attachment towards the retailer (Meyer-Waarden, 2006).

According to Stauss et al., (2001), the perceived benefits that are associated with the loyalty programme (such as price advantages or special treatment as a member) will enable the consumers to feel a stronger identification and implant a sense of appreciation to those conferring the reward of being a special and valued consumer with the corporation and are, therefore, willing to be more loyal (Strauss et al., 2001; Kivetz and Simonson, 2002). These consumers are especially important to retailers whose product differentiation is low (Meyer-Waarden, 2006).

Indirect attitudinal loyalty can be achieved through data analysis of the database of consumers by providing more individual services to fulfil consumers' needs and wants (Stauss et al., 2001). Furthermore, retailers can reinforce the loyalty of these consumers by certain marketing strategies, namely, the "loyalty ladder" technique (Dowling and Uncle, 1997). The "loyalty ladder" technique can be applied effectively through the consumers loyalty programme as the retailers can utilize the consumers' database technology and information to move the consumers' loyalty to a higher level on the "loyalty ladder" (Dowling and Uncle, 1997).

Macintosh and Lockshin (1997) suggested that once the consumer-retailer relationship is built through the loyalty programme, the feeling of trust is built. Meyer-Waarden (2008) further supported this idea by indicating that loyalty programmes cause switching costs to consumers as a result of rewards offered to them and costs arising from the evolution of the relationship established with the retailer. The increase in the number of contacts between

both parties due to the loyalty programmes also leads to an improvement in the information flow, thereby enhancing the knowledge of the consumers, and hence, consumers' trust is cultivated and enhanced (Gomez et al., 2006).

Besides behavioural loyalty, loyalty programmes encourage attitudinal loyalty within their consumers. This is because the benefits offered, such as Utilitarian benefits, Hedonic benefits, as well as Symbolic benefits enable consumers to develop a feeling of "liking" and "trust" towards the brand. Thus, consumers' preferences are built. Consequently, the following hypothesis is developed:

***Hypothesis 2: Loyalty programme benefits have a significant impact on attitudinal loyalty***

Similarly, the benefits of loyalty programmes are believed to improve consumers' attitudinal loyalty, thus,

*H2a: Utilitarian benefits of loyalty programmes have a significant impact on attitudinal loyalty*

*H2b: Hedonic benefits of loyalty programmes have a significant impact on attitudinal loyalty*

*H2c: Symbolic benefits of loyalty programmes have a significant impact on attitudinal loyalty.*

## **2.6 Conclusion**

This chapter has gathered the related literature for conducting this research. The next chapter will present the research methodology.