

# Do Frequent Flyer Programs Build True Loyalty for Airline Companies? -The moderating effect of satisfaction on loyalty programs-

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## ✧ **Abstract**

Frequent Flyer Programs (FFPs) is the first loyalty program which was applied in most airline companies to build and keep good relationship with their customers. However, FFPs do not seem to bring so many benefits to airline companies as expected before. Airline companies tend to justify which are loyal customers by how frequent customers used their airlines. They presume that those heavy users must be loyal to their airline companies, and believe that it should give more rewards to keep those customers.

The failure can be concluded that airline companies do not distinguish the “program loyalty” and “customer loyalty”. However, there is scant research on which variables affect the relationship between the loyalty program and customer loyalty. Also, despite the prevalence of FFPs worldwide, little research has been done on the actual effectiveness of FFPs. Moreover, although previous research has found the positive effects of customer satisfaction and loyalty, there is relatively little empirical research concerning the mechanisms by which the FFPs operate.

Based on the contingency approach to loyalty represented by Uncles et al. (2003), this study employs customer satisfaction as a moderating variable (low satisfaction & high satisfaction) to testify the effectiveness of FFPs (direct rewards & indirect rewards), perceived value of FFPs, as well as the distinguish between program loyalty and customer loyalty by reviewing prior researches. At last, some hypotheses will be induced for the future empirical study.

## ✧ **Keywords**

Airline Service, Frequent Flyer Program, Perceived Value, Customer Satisfaction, Loyalty

## ✧ **Research Proposal**

### **1. Introduction**

The marketing of airlines has evolved dramatically throughout the past 50 years. Since earliest times the aviation industry has been a cyclical business. It is affected by recessions and other economic conditions and because of political intercession has been the subject of cartels, protectionism and hidden subsidies (*Gilbert, 1996*). Also, airline industry is the

industry which practiced loyalty program firstly by rewarding the high-mileage traveler free flights.

Unfortunately, although airline industry introduced loyalty programs earlier than other industries, loyalty programs do not seem to bring airline companies numerous profitable and loyal customers as companies expected. This is because loyalty programs are often misunderstood and misapplied, such as frequent flyer programs which are practiced in most airline companies. Frequent flyer programs treat rewards as short-term promotional giveaways (O'Brien and Jones, 1995), justify so called "loyalty customer" in the same standardization—how often customers use their service, and presume customer satisfactions are all in the same level. Hence, although airline companies openly discuss all the benefits of frequent flyer programs, their decision to launch a program is often motivated by fears of competitive parity in reality (Dowling and Uncles, 1997).

This present study draws on Uncles's et al. (2003) contingency approach of loyalty to explore effectiveness, perceived value of frequent flyer programs and when customers are "program loyalty" and when customer are "brand loyalty". The contingency variable employed in the study is customer satisfaction which is in two situations—low and high. As Dowling and Uncles (1997) claimed that it is not enough to discuss loyalty and program loyalty in only condition—customers are very satisfied. In the event of low-satisfied service experience, the literature strongly advocates that service recovery be carried out (Bitner et al., 1990). This study discusses whether frequent flyer program will induce customer's "True Loyalty" in two situations---high satisfaction and low satisfaction. In detail, this study seeks to clarify the following research questions:

**RQ1:** Does the frequent flyer program indeed increase customer loyalty?

**RQ2:** What aspects of the frequent flyer program are important in enhancing customers' evaluations of the program?

**RQ3:** Does customer's value perception of the program truly affect brand loyalty?

## **2. Theoretical Background**

The effectiveness of loyalty programs can be discussed from two aspects which are the conception of loyalty and competitive strategy (Minami, 2006, pp.86). The conception of loyalty highlights how to approach customer loyalty. According to prior researches, there are three approaches to loyalty generally---behavior approach, attitude approach and behavior vs. attitude approach. On the other hand, from the perspective of competitive strategy, the tendency of prior researches is how to make loyalty program effectively, in other words, how

to keep good relationship with customers through loyalty programs.

Traditionally, customer loyalty has been defined as a behavioral measure. These measures include proportion of purchase (*Cunningham, 1966*), probability of purchase (*Farley, 1964; Massey, Montgomery, & Morrison, 1970*), probability of product repurchase (*Lipstein, 1959*), purchase frequency (*Brody & Cunningham, 1968*), repeat purchase behavior (*Brown, 1952*), purchase sequence (*Kahn, Kalwani, & Morrison, 1986*), and multiple aspects of purchase behavior (*Ehrenberg, 1988; DuWors & Haines, 1990*). Based on this perspective, many researchers and managers believe that loyal customers should be the one who repeat to purchase products or services from the same suppliers. Just as *Henning-Thurau et al. (2002)* suggested that customer loyalty is always conceptualized as a customer's repeat purchase behavior which is triggered by a marketer's activities. Nevertheless, approaching customer loyalty may too simple, because those studies neglected the characteristics of product and purchase behavior---high involvement or low involvement. Then, it is cannot get a conclusions that the frequent customer buy, the loyalty customer are.

Besides the definition from behavior, attitude is another important measure about how customers are loyal to their products or services suppliers. From this perspective, "Attitude" has been defined as a psychological tendency that is expressed by evaluating a particular entity with some degree of favor or disfavor (*Eagly & Chaiken, 1993*). In another word, attitude loyalty represents a higher-order, or long-term, commitment of a customer to the organization that cannot be inferred by merely observing customer repeat purchase behavior (*Shankar, Smith, & Rangaswamy, 2000*). *Liddy (2000)* emphasizes the importance of attitudinal loyalty, as he suggests that only loyalty based on attitude, the likelihood of future usage can be expected. *Reichheld (2003)* also supports the importance and reasonability to define customer loyalty from attitude. He points out that attitude loyalty can induce positive behavior, such as recommend and repeated purchase. However, the attitude approach is no empirical research testified customers who have affective to a product or service suppliers must have loyalty to this suppliers, which is keeping repurchase in the same supplier. In *Dick and Basu's (1994)* research, having a high relative attitude with a low repeat patronage is called latent loyalty which is a serious concern for marketers. Then, it cannot say that the affective customers express, the loyalty customers are.

In recent decades, instead of approaching loyalty by only behavior or attitude, more and more researchers tend to suggest approaching loyalty by both behavior and attitude measurement. *Day (1969)* firstly proposed loyalty indexes based on composites of attitudinal and behavioral measures in his paper. Strong vs. weak attitudes toward the object, paired

with high vs. low repeat behavior, span the classic grid with four types of loyalty: true, latent, spurious, and low loyalty.

However, which one is the domain of loyalty---behavior or attitude? If repeat purchase behavior is seemed as the domain of loyalty, it may merely reflect happenstance; whereas, if affective to brand is seemed as the domain of loyalty, it may hard to be testified by empirical research. Furthermore, is the behavior-attitude definition applier into all situations? For example, loyalty to low-involvement products or services is significant different with high-involvement products or services. Then the avoidance of searching alternatives is difficult to be explained. In this point, *Uncles et al. (2003)* argued that the best conceptualization of loyalty is to allow the relationship between attitude and behavior to be moderated by contingency variables such as the individual's current circumstances, their characteristics, and/or the purchase situation faced. In conclusion, behavior-attitude approach only considering two aspects of customer loyalty, but not considering the mechanism and relationship between behavior and attitude is not enough. Furthermore, are affective feelings to a product or service the feelings of how customers are satisfied with their purchase? If so, is satisfaction included in loyalty completely? If not, what is the inter-relationship between customer satisfaction and loyalty? Is satisfaction the antecedent of loyalty or is satisfaction the result of loyalty? There are not seemed to have a clear answer in this literature (*Oliver, 1999*).

### **3. Frequent Flyer Programs (FFPs) as research object**

Frequent flyer programs are the first loyalty programs introduced for keeping a strong relationship with customers and aiming to achieve high profit. FFPs have been practiced by almost all airline companies now with various rewarding forms, such as discount travel tickets, free tour, discount shopping card etc. Most business travelers claim that they are enrolling in FFPs, because some rewards are attractive to them. On the other hand, airline companies take FFPs in a critical position and profess that they keep investing in FFPs not only for customer retention, but also for customer individual information which are thought to be very great assets for company using for proposing marketing strategy in future.

In this point, FFPs play an essential role in airline companies which cannot be ignored. However, although FFPs help airline companies to retain customers and collect customer individual information, airline companies do not avoid suffering management crises and struggling in the deficit financing. This study selects Frequent Flyer Programs as research objects have several reasons. First, loyalty programs' effectiveness is significant stronger in

high-involved service than low-involved service such as ATM and some repair services, therefore, it is expected to testify how FFPs' effectiveness and perceived value for customers. Second, as most airline users claim that they are enrolling in at least one FFP, it is expected to clarify how customers evaluate FFPs. Third, as the same reason as the second one, it is expected to distinguish the difference between airline loyalty and FFPs loyalty which are treated as one of critical literatures in loyalty research and relationship management (*Dowling and Uncles, 1997*).

#### **4. Hypotheses Development**

##### **4-1. Inter-relationship between satisfaction and loyalty---the moderating effect of satisfaction**

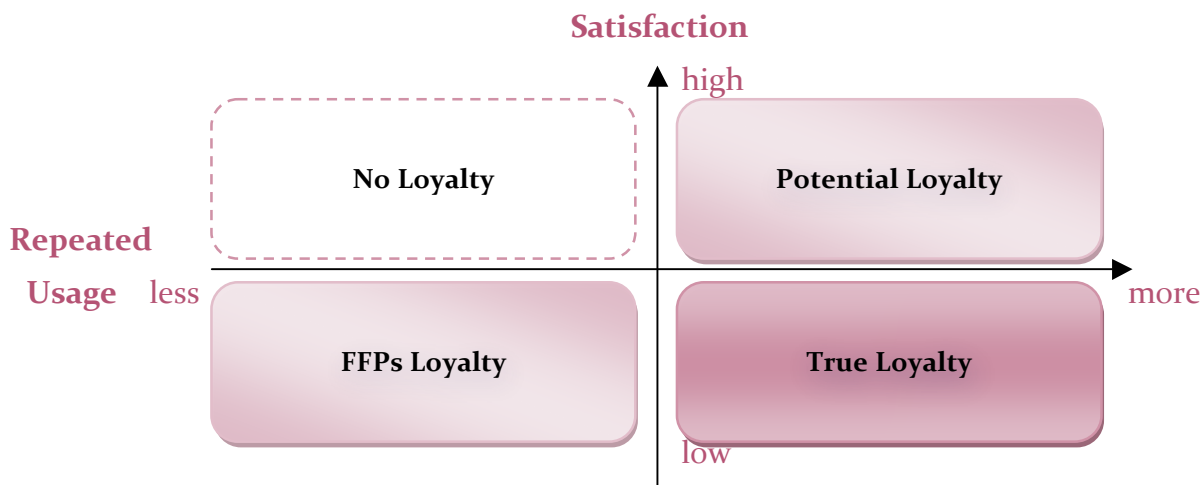
According the behavior & attitude approach, the "True Loyalty" can be approached. However, it still cannot be seemed as the best approach that distinguish program loyalty and brand loyalty, because it ignored satisfaction, in other words, how customer satisfied with their purchase or loyalty programs is a crucial variable. Numerous studies have showed that satisfaction is necessary antecedent of loyalty, in other words, loyalty is formed based on customer satisfaction. Then, satisfaction can be seemed as the attitude aspect of loyalty, if customers are not satisfied with their purchases but keep purchasing the same product or service because of avoiding high alternative risk or high switching cost, this behavior is called by spurious loyalty (*Dick and Basu, 1994*). It is clear that the customers who are not satisfied, they will not have the "true loyalty" to companies. Therefore, dissatisfied customers might continue to make purchase in the same place because reward program is attractive to them. Furthermore, it is expected that customers with different level of satisfaction (such as high satisfaction & low satisfaction) will make purchase by different motivations. Then, level of satisfaction can be seemed as an important variable to distinguish program loyalty and brand loyalty.

Another important literature is how to evaluate the effectiveness of loyalty program. Prior studies tend to discuss the effectiveness of loyalty program in the presupposition (*Dowling and Uncles, 1997; Magi, 2003; Keh and Lee, 2006*). However, 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*). In this point, the perceived value of loyalty program, and the effectiveness of loyalty program are expected different in high satisfied customers and low satisfied customers.

In this study, customer satisfaction is employed into the model as a moderating variable.

The author develops hypotheses by separately examining the effectiveness of the different reward configurations (direct and indirect reward)<sup>1</sup> under customer high customer satisfaction and low customer satisfaction conditions. In doing so, the author demonstrates that the specific interplay between reward type and reward timing is different between high satisfactory and low satisfactory service experiences, that is, a two-way interaction involving reward type (direct and indirect), and customer satisfaction (high and low) is proposed to clarify the perceived value and the effectiveness of FFPs, customers' program loyalty and brand loyalty (see Figure 1).

➤ **Figure 5: Modified Airline Loyalty Framework**



#### 4-2 Frequent Flyer Programs when customers are high satisfied

Numerous studies show that the customers who are affective to the service or product they currently use tend to show commitment to the companies which supply service or product. High satisfactory customers are delight to accept rewards but not mind which type rewards (direct or indirect) they will receive. Affective feelings to companies drive customers are willing to make commitment, and reward programs make customers delight. However, direct rewards and indirect rewards play the same role for those customers. Customers with high satisfaction for the airline service they use currently do not mind which type of reward they will receive, because they are satisfied enough for the service itself, but not for the FFPs they are enrolling. Hence, the type of reward for high satisfied customers is assumed not play an important role in the perceived value of FFPs (*H1a*).

*Yi and Jeon (2006)* claim brand loyalty and program loyalty as consequences of the value perception of the loyalty program. In this study, it is the FFPs loyalty showed in Figure 1. According to *Dowling and Uncles (1997)*, satisfaction is an essential variable which should be considered when discuss the effects of loyalty program, as the effects of loyalty programs are

<sup>1</sup> As this study focus on Frequent Flyer Programs (FFPs), timing of reward is ignored, because FFPs less to make immediate rewards to their customers. For this reason, this study only discuss the type of reward—direct and indirect rewards.

expected to be different in high satisfaction and low satisfaction. Customers with high satisfied are assumed do not take care of what they will receive from the FFPs. Based on the result of interview<sup>2</sup>, customers who use only one airline company claim that although they will be happy to get some rewards, they won't take what they will get from the airline service important, because they feel that they are one of the "family members" to the airline company. This is the feeling which is mentioned in *Oliver (1999)* as "Village". As customers who claimed that they are very satisfied with their airline companies do not take FFPs into a critical position, I propose that FFPs play a weak role under the high customer satisfaction (*H1b, c*).

However, perceived value of loyalty programs have positive effect on brand loyalty in the high involvement product or service which has been testified in *Yi and Jeon's (2006)* study. Although customers do not care which type rewards they will receive from the company, it does not mean that customers are not willing to accept those reward. Oppositely, high satisfactory customers take the perceived value of loyalty programs very critical. If they perceive value of loyalty programs are high, they will feel that they are "correctly treated" by the company, and then willing to continue the good relationship with companies. As highly satisfied customers have an affective to the airline service, it can expect the higher perceived value of FFPs, the higher loyalty will be formed to airline companies (*H1 d*). Hence,

➤ **Hypothesis 1: Under high customer satisfaction**

- a. Perceived value of FFPs is not different between direct rewards and indirect rewards
- b. Perceived value of FFPs has little effect on FFPs loyalty
- c. FFPs loyalty has little effect on airline loyalty
- d. Perceived value of FFPs has a positive effect on airline loyalty

#### **4-3 Frequent Flyer Programs when customers are low satisfied**

Considering from the literature of service recovery, the immediate rewards is sound than the delay rewards (*Smith et al., 1999; Maxham and Netemeyer, 2002*). However, in airline service, it is difficult to give an immediate reward to customers when something happened that makes customers are not satisfied. Then, it is silent on the type of compensation to provide dissatisfied customers (*Maxham and Netemeyer, 2002*). Invoking the mental-accounting argument, I posit that direct rewards should be more pronounced as a positive benefit in service experience mental account, and hence more effective in offsetting the negative experience. The customers who have low satisfaction about service or product

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<sup>2</sup> The interview had been practiced by the author from Aug.2008 to Oct.2010 in both Japan and China. 72 people (including 25 Japanese, 42 Chinese and 5 other countries' people) with use experience of airline accepted short interviews (5 minutes or less per people). Questions include that how much you are satisfied with the airline you currently use, how many FFPs you enroll currently, what rewards you prefer, whether you think the FFPs is effective and valuable, and how much you want to use the airline in the future. For Japanese and other countries' interviewees, the author made face-to-face interviews in airports and other places of Osaka and Kobe. For Chinese interviewees, the author request a friend who works as a manager in *elong.com*—one of biggest websites for booking airline tickets in China to make interviews.



will expect to get a reward which directly relates to the service or product they purchased (Keh, Lee, 2006). As direct rewards relate more closely to the value proposition of the service, they should be more representative of the mental consumption account involving the service experience (Heath and Soll, 1996). Purchasing the airline service can be seemed as a purchase behavior with high involvement because it has high switching cost including searching for alternatives, sunk cost and so on. As consumers are likely to pay more attention to the purchase of a product, direct rewards that are related to the value proposition of a product are likely to receive more attention than indirect rewards.

Compared to indirect rewards, direct rewards should be more easily and unambiguously integrated to form an evaluation of the mental account of the service (Ken and Lee, 2006). As the same as airline service, it can be assumed that customers with low satisfaction will feel higher the perceived value of FFPs if they receive direct rewards, because this makes them feel that they did not sacrifice so much as they get the reward directly related with the service they purchased (H<sub>2</sub> a).

Another interesting finding in the interview is that the customers who acknowledged that they are not enough satisfied with the airline companies they currently use, tend to enroll in several FFPs which is called as “polygamous loyalty” by Dowling and Uncles (1997). Then it can conclude that those customers do not loyalty to their airline companies, but loyalty to FFPs as they believed they can get enough benefit from it. Consequently, the important role of FFPs playing in low satisfaction is cleared. Therefore, I can propose that perceived value of FFPs has positive effect on both FFPs loyalty and airline company loyalty, moreover, FFPs will help airline companies to form loyalty to them (H<sub>2</sub> b,c,d). Hence,

➤ **Hypothesis 2: Under low customer satisfaction**

- a. Perceived value of FFPs is higher for direct rewards than for indirect rewards
- b. Perceived value of FFPs has a positive effect on FFPs
- c. FFPs have a positive effect on airline loyalty
- d. Perceived value of FFPs has a positive effect on airline loyalty

## 5. Future study

This present study is a research proposal which has not been testified by statistic analysis. Data collection will be practiced in Japan from Jan. to Mar. 2012 and the people who involve at least one Frequent Flyer Program will be selected as respondents. Customer loyalty---the “True Loyalty” to airline companies is the key dependent variable. Guided by prior studies, the author assesses “True Loyalty” through measuring repeat-purchase intention, self-stated retention, price insensitivity, commitment to vendor and the willingness to spread positive word-of-mouth. ANOVA will be employed as analysis instrument. The author expects the results can clarify how moderating effect of satisfaction works on customer loyalty to FFPs or airline companies, as well as how to identify the customers who have “True Loyalty” to airline companies.



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