
ADVANTAGES AND DISADVANTAGES OF DEPLOYING FREQUENT FLYER PROGRAMS AS IMPACT FACTORS AFFECTING AIRLINE CUSTOMER BEHAVIOR AND RETENTION

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Abstract

As findings for the Asian air travel market show, across all market segments frequent flyer programs can have a positive effect on airline loyalty (Chang & Hung, 2013, p. 29). At the same time, while these customer loyalty programs are in wide use in the airline industry, whether these programs can bestow durable competitive advantage remains debatable (Martín et al., 2011, p. 364). Similarly, studies on customer loyalty programs indicate that, despite their popularity, these programs do not have an unequivocal effect on customer behavior, which is likely to limit their effectiveness (Dorotic et al., 2012, p. 217). Therefore, the impact of frequent flyer programs on behavioral and affective customer loyalty, such as in the form of customer retention, and company performance demands further research, due to lacking scholarly consensus on either the positive or the negative influence of these programs on competitive advantage in the airline industry.

Key Words

Airline industry; frequent flyer programs; customer loyalty; customer retention; consumer behavior.

INTRODUCTION

While customer loyalty and airline choice have been amply researched, customer loyalty in the airline industry continues to be insufficiently understood. Whereas acceptable service standards are likely to represent minimum preconditions for airline loyalty, air flight price levels, in-flight services frequency and frequent flyer programs have been found to be the factors that have a significant impact on customer retention (Suzuki, 2007, p. 1). Despite the widely held theoretical assumption that customer loyalty programs significantly affect consumer behavior, the empirical evidence demonstrating the effectiveness of loyalty programs is relatively scarce, contradictory and inconsistent (Bolton et al., 2004, p. 271).

Despite the wide variety of loyalty programs and schemes, they can be generally defined as the programs that reward loyal customer behavior through continuously offered incentives that encourage repeat purchases. These loyalty programs can take the form of frequent flyer, frequent shopper or point card programs that foster attitudinal and behavioral loyalty, increase customer retention rates and augment the client income share that is spent on products and services (Stone et al., 2004, p. 305). Furthermore, given that, to join these loyalty programs, customers are required to provide detailed personal information, these programs provide opportunities for long-term, targeted marketing efforts that affect purchasing behavior through making discounts and benefits conditional on bonus point accumulation (Palmatier et al., 2009, p. 1).

In the airline industry, customer loyalty programs are deployed, primarily due to unequal profitability potential of different customer segments, high competition levels among airlines offering similar services, and the utilization of similar programs by competing carriers (Demoulin & Zidda, 2009, p. 391). The attractiveness of loyalty programs can be expected to be driven by utilitarian, hedonistic and symbolic benefits that they confer, such as economic savings, personalized treatment and social status (Meyer-Waarden, 2007, p. 223). The continued predominance of regular carriers in the consumer market indicates that low cost airlines likely face marketing, adoption and loyalty challenges related to the varied levels of consumer retention that these airlines achieve (Chang & Sun, 2012, p. 15).

Customer loyalty and frequency reward programs have long been recognized as important drivers of customer retention and purchase likelihood, due to their contribution to relationship marketing. Frequent flyer programs offer loyal customers tangible and intangible rewards, such as free flights, after they accumulate a sufficient number of service use points, such as travel miles (Meyer-Waarden, 2008, pp. 87-88). At the same time, in many cases loyalty programs can represent significant liabilities for companies offering related customer rewards, due to their management and benefit costs. It could be advisable to terminate ineffective customer loyalty programs, as some corporations have done to reduce their operations costs (Meyer-Waarden, 2007, p. 223).

Therefore, the influence of frequent flyer programs on customer retention in the airline industry demands a meta-analytical examination that this paper presents from a managerial point of view.

LITERATURE REVIEW

After being first introduced in the early 1980s frequent flyer programs have since been adopted by all major carriers in the airline industry, while enjoying over 90% membership rates among business travelers and with overall membership ranks upwards of 120 million around the world (Hanlon, 2007, p. 86). Within the framework of frequent flyer programs, their members accumulate bonus points related to distances they travel, fare prices they pay and the number of flight bookings they make (Gudmundsson et al., 2002, p. 409).

At the same time, within their frequent flyer programs airlines usually provide higher rewards to business-class customers per mileage traveled, so that business-class flight tickets are likely to earn significantly more bonus points than economy-class ones. Border-crossing alliances between airlines and online reservation systems make it increasingly possible to transfer award points between different frequent flyer programs and to take advantage within their framework of local retail, hotel accommodation and vehicle rental discounts (Gössling & Nilsson, 2010, p. 243).

The associated status points that are used for upgrading one's membership level can usually be earned through travel mileage on selected routes, such as intercontinental flights, and hotel stays at a restricted list of hospitality establishments. Since these customer status upgrades are more accessible to business-class, rather than economy-class, passengers, airline companies reward through these programs high-spending clients, while increasing the frequency of their air travel, especially given that in many cases status points have set expiration dates. This can prompt flight purchases primarily motivated by the consumer desire to maintain membership status or to take advantage of the conditional benefits it affords (Thurlow & Jaworski, 2006, p. 99).

In other words, frequent flyer programs are highly likely to have a significant effect on airline choice among business travelers, due to their mobility-stimulating influence on travel, consumption and route preferences. Thus, traditional airlines with highly developed networks of air travel hubs offering lounge services and connection flights can be expected to derive higher utility from frequent flyer programs, in terms of ticket booking volume and frequency, than low cost carriers that may not necessarily be able to offer comparable membership benefits, due to their limited-service business models. Additionally, the impact of customer loyalty programs is likely to be less pronounced among economy-class travelers, since this passenger group can be expected to either pay more attention to airfare prices or accord less importance to social status connotations than business travelers (Gössling & Nilsson, 2010, p. 250).

The importance of frequent flyer programs for the airline industry primarily derives from its unstable profitability, due to the cyclical nature of the demand for its products and services that can vary on a seasonal, weekly and daily basis. In the airline industry, numerous carriers make efforts to use frequent flyer programs for strengthening their market position. These frequent flyer programs are deployed not only due to their expected effect on customer choices, but also due to the opportunities they provide to retain particular customer groups, such as business class travelers (Taneja, 2003, p. 1).

On the one hand, targeted conditions on the use of frequent flyer benefits can be imposed, which can increase the economic benefit that airlines are likely to derive from loyalty programs, as many customers can be expected not to redeem their frequent flyer miles (Martín et al., 2011, p. 364). On the other hand, due to the association between frequent flyer programs and social status, the behavioral effect of higher customer loyalty levels they are aimed to have, as marketing programs, is likely to be restricted to business travelers, since they are less price-sensitive than other airline passenger groups and have relatively inelastic demand for airline services (Klophaus, 2005, p. 348).

THE ADVANTAGES OF FREQUENT FLYER PROGRAMS

Frequent flyer programs may be expected to affect airline choice, given that these programs enable airlines to establish long-term relations with their customers. In this respect frequent flyer programs are likely to be similar to customer loyalty programs in other market sectors that are deployed by companies as part of customer relations management strategies that are expected to lead to higher levels of brand loyalty, customer retention and purchase intentions (Bolton et al., 2004, p. 271). In other words, loyalty card programs are widely implemented by different company types as means for improving customer satisfaction, affecting consumer choice and developing customer relationships. As firms seek to have more enduring relationships with their clients, customer loyalty programs are, thus, perceived as an effective impact factors able not only to stimulate purchase intentions, but also to encourage repeated service usage or product buying behavior (Oliver, 2010, pp. 442-443).

Moreover, customer loyalty programs introduce economic and psychological switching costs that severing the relationship with the company will entail, since the aim of these programs is to encourage repeat purchase behavior via making customer rewards conditional on buying-related point accumulation. Since customer loyalty program points, such as frequent flyer miles, cannot be transferred to another company, these programs make switching to another service provider or product seller psychologically, economically and socially costly (Kivetz & Simonson, 2003, p. 454). Thus, these loyalty programs contribute to the creation of behavioral loyalty toward companies, since their customers relate loyalty program rewards and discounts to feelings of achievement, special customer status,

and identification with the organization. Therefore, loyalty programs are likely to be particularly beneficial for product or service providers, such as airlines, in competitive industries with interchangeable suppliers (Bhattacharya & Sen, 2003, p. 76).

Customers joining loyalty programs based on their initiative have been found to exhibit higher levels of purchase intentions, consumer expenditure and relationship duration (Datta et al., 2015, p. 217). Furthermore, empirical findings suggest that an automatic enrollment of customers into cost-free loyalty programs may contribute to higher levels of behavioral intentions, since program benefits can reinforce customer relationship with the company by providing relational, psychological rewards. In other words, reducing the threshold for loyalty program enrollment does not necessarily lead to lower effectiveness levels of customer loyalty programs (Dholakia, 2006, p. 109). Customer loyalty programs represent, therefore, marketing systems that companies deploy in an effort to increase their customers' behavioral loyalty by developing long-term, personalized, and customer-oriented relations with existing and prospective clients (Meyer-Waarden, 2007, p. 223).

At the same time, in many cases firms target these programs at customer groups that are most likely to respond to purchase incentives, engage in repeated consumption activities, and value individualized services or products (Meyer-Waarden, 2007, p. 224). In other words, customer loyalty programs serve as extensions of direct marketing and company-client communication, while making possible a differentiated treatment of particular customer groups on the basis of customer behavior information that is accumulated with the help of loyalty cards. However, this augmented ability to discriminate between customers and make individualized marketing offers is likely to depend for its effect on the extent to which companies can customize their products and services and provide premium services (Yi & Jeon, 2003, p. 229).

Furthermore, for frequent flyers the economic switching costs of loyalty programs are not likely to play a significant role, since their ticket purchase volumes allow them to meet reward criteria with relatively little effort. Likewise, for infrequent flyers customer loyalty programs can be expected to be relatively unimportant as factors influencing airline choice, since they rarely accumulate sufficient frequent flyer points to qualify for program rewards. This makes this customer group also insensitive to switching costs (Hartmann & Viard, 2008, p. 109). Thus, loyalty programs are most likely to be effective among moderate and light buyers of airline services both in the short and the long term, especially since frequent flyers tend to already reach their maximum purchasing capacity, which limits their ability to increase their usage levels of air travel services (Bolton et al., 2000, pp. 106-107). This consumer market segmentation has important implications for airline profitability, since frequent flyers with high loyalty levels are more likely not only to respond to ticket price promotions, but also to redeem their card membership rewards than other customer groups. By contrast, airline customers with light to moderate service purchase frequency are most likely to respond to loyalty program incentives with higher sales volumes.

However, these market segments are oftentimes underestimated as potential sources of company profitability (Cortiñas et al., 2008, pp. 52-53).

Given the desire of companies to maintain relationships with both price-conscious and price-insensitive customers, the relationship between frequent flyer programs and customer loyalty is not necessarily likely to be positive. This follows from the challenges that attend the efforts of companies to broaden their customer base without significantly lowering the prices of their goods and services. Emphasizing the psychological gratification value of the rewards that customer loyalty programs offer still demands minimizing the costs that the latter involve. This indicates that frequent flyer programs have both advantages and disadvantages (Meyer-Waarden, 2008, p. 89).

These findings indicate the importance that tailoring frequent flyer programs to different consumer market sector has for airline profitability, especially since in saturated markets the overall impact of loyalty programs on aggregate consumer behavior can be limited (Lacey, 2009, p. 392). In terms of empirical research, studies inquiring into the effectiveness of frequent flyer programs may need to control for the influence of the self-selection bias on consumer behavior by sampling both loyalty program members and customers that are not enrolled into airline card programs, in an effort to ascertain whether significant differences in purchase frequencies and volumes between various customer groups exist (Liu & Yang, 2009, p. 106).

Thus, across different airline customer groups, the positive effect of loyalty program membership can be expected to be relatively limited. However, since previous studies have used a wide range of consumer behavior indicators, such as retention rates, behavioral intentions and customer expenditures, there is a need for additional research into the effectiveness of loyalty programs in view of divergent empirical findings (Verhoef et al., 2007, p. 105). This is closely related to the opportunities for personalized marketing that loyalty programs offer, since their member profiles based on purchasing behavior enable a narrow targeting of promotional offers and communication strategies to specific customer groups. Furthermore, directing preferential customer treatment to particular market segments can increase the effectiveness of loyalty programs as long-term relationship building mechanisms that can be expected to reinforce behavioral loyalty (Melancon et al., 2011, pp. 341-342).

THE DISADVANTAGES OF FREQUENT FLYER PROGRAMS

Some studies have indicated that loyalty programs have no effect or a weak influence on customer behavior (Meyer-Waarden & Benavent, 2006, p. 61). Recent studies indicate that the benefits of loyalty programs lose their direct effect on customer behavior shortly after customer enrollment (Meyer-Waarden & Benavent, 2009, p. 345). The effectiveness of loyalty programs can also suffer from perceived costs they involve, such as the purchase frequency pressure they may introduce or access to personal data they

might require. Likewise, in some cases companies make loyalty program enrollment conditional upon meeting qualifying criteria that can incur additional, retroactive costs for customers, whereas in other cases loyalty programs are openly accessible, which can have a significant effect on their perceived costs (Demoulin & Zidda, 2009, p. 391). At the same time, personalized marketing strategies might entail economic costs if they become perceived as discriminatory or unduly favorable to particular customer groups, such as new program members. Therefore, loyalty program design may significantly affect both the attractiveness of these programs and their influence on customer behavior (McCall & Voorhees, 2010, p. 35).

It cannot, therefore, be ruled out that loyalty programs that demand from their customers a financial commitment in the form of enrollment fees or purchase volume can be unsuccessful in increasing customer retention (Datta et al., 2015, p. 217). Frequent flyer programs penalize their members if they fail to achieve certain travel frequency targets by making their benefits, such as faster check-ins, free tickets and discounted service upgrades, conditional on accumulating particular mileage or bonus point amounts above airline-defined threshold values. Therefore, these practices can also decrease the influence of customer loyalty programs on airline selection, especially if their award points can be used for other consumption choices, such as restaurant dining or daily shopping, and vice versa, and if customer benefits, such as discounts, for retail purchases done with program-associated companies exceed those for air travel reservations (Löfgren & Carlsson, 2004, pp. 1-2).

Prior studies have indicated that in general satisfaction and loyalty levels among airline customers are relatively low (Gilbert, & Wong, 2003, p. 519). Additionally, there is mixed empirical evidence that customer loyalty schemes have a significant impact on consumer behavior. This could be due to the difficulty of changing existing purchase behavior patterns with the help of loyalty program benefits, especially in competitive markets, such as the airline industry, due to a widespread imitation of successful loyalty programs that can increase marketing costs without producing a positive change in buying behavior (Meyer-Waarden & Benavent, 2006, p. 61).

While loyalty programs are theorized to act as behavioral reinforcement factors that reward company patronage, this effect can, however, be conditional on utility-cost calculations that are likely to be dissimilar for different customer groups, while limiting the positive effect of loyalty programs on customer retention rates (Kivetz et al., 2006, p. 39). Whereas holiday and business travelers have been found to be equally influenced in their airline choice by airfare prices and flight time, research findings indicate that for leisure travelers frequent flyer programs are significantly less important than for business travelers (Hess et al., 2007, p. 221). Moreover, new market entrants increasingly compete with traditional airlines in the business travel sector as well, such as on transatlantic flights between London and New York, by offering boutique travel services, such as upscale seating configurations and in-flight offerings (Seo et al., 2015, p. 126).

DISCUSSION

Given the growing presence of low cost carriers in the air flight market, airline customers may increasingly switch their loyalty to these carriers. Given the multiplicity of factors that affect airline customer choice, for both full-service carriers and traditional airlines the disadvantages of offering frequent flyer programs, such as their attendant costs, may not necessarily be offset by their putative advantages related to ensuring customer retention and increasing their purchase frequency and volume. This is corroborated by the mixed empirical evidence on the effectiveness of frequent flyer programs (Bolton et al., 2004, p. 271). For airlines, the primary value of frequent flyer programs appears to lie in the opportunity to provide personalized services based in customer preferences and characteristics the information about which is stored in membership profiles, while imposing psychological switching costs related to the perceived social status these programs provide and economic switching costs related to the foregone bonus points that customer accumulate (Palmatier et al., 2009).

While the air flight market is likely to be similar to other market sectors, where loyalty programs significantly decrease the likelihood that customer will switch between service providers (Meyer-Waarden, 2008, p. 87), the high and growing competition in the airline industry may limit the contribution of frequent flyer programs to company profitability. Nevertheless, frequent flyer programs can still be important in affecting the selection of airport and in-flight services, since point-related discounts can make particular choices, such as upgrading airplane seating type or using pre-departure lounges, more affordable than otherwise (Thurlow & Jaworski, 2006). As between-airline price competition grows, the psychological switching costs that frequent flyer introduce are likely to be their primary advantage, while their negative economic impact on airline revenues represents their disadvantage for airlines that may not necessarily be able to forgo these programs as potential instruments of customer retention (Meyer-Waarden, 2007; Taneja, 2003).

Frequent flyer programs can have influence not only on consumer choice between airlines, but also on the range of products and services that individual customers purchase. While the influence of loyalty programs on customer behavior can prove to be limited in its short- and long-term effectiveness among frequent service users, these programs can increase brand patronage levels, especially for low frequency service users (Liu, 2007, p. 19). In other words, despite the limited evidence on the behavioral effectiveness of loyalty programs in terms of customer retention in the airline industry, not offering these programs altogether can represent a disadvantage for airlines, due to the impact these programs have on long-term affective customer loyalty. Likewise, the utility of frequent flyer programs to airlines might be limited, since their lock-in effect on airline customer behavior across different customer groups may be relatively weak (McCaughey & Behrens, 2011, p. 1). Therefore, airlines can be advised to assess the advantages and disadvantages of frequent flyer programs

separately for different customer groups while flexibly adjusting their characteristics to customer profiles (Kivetz et al., 2006).

CONCLUSIONS

The interrelationship between the frequent flyer programs and their either positive or negative effect on customer loyalty and retention in different market segments only begins to receive research attention, especially in the framework of comparative studies that explore the interrelationship between these variables in relation to both traditional, full service airlines and low cost carriers. Therefore, whether strategically targeted frequent flyer programs can provide a significant competitive advantage to legacy carriers in their effort to maintain their market share remains uncertain, as the entry of low cost carriers into the airline industry may reduce the economic costs of switching between airlines that loyalty programs aim to increase (Seo et al., 2015).

Thus, the interrelationship between frequent flyer program membership and airline preference is likely to be insignificant. This may lead airlines to target these customer loyalty programs to market sectors that are most likely to generate revenues, such as medium-frequency flyers, that can compensate for the extra costs that premium services offered to frequent flyer program members involve (Martín et al., 2011, p. 367). However, legacy carriers that have traditionally been pursuing marked differentiation strategy emphasizing frequent flyer programs may need to be alerted both to their advantages and their disadvantages, since they have inflexible cost structures and can offer competitive airfare prices on particular routes only, such as short haul flights (Seo et al., 2015).

Therefore, future studies can be recommended to consider not only the expected benefits of frequent flyer programs, but also their increasingly unsustainable drawbacks, in light of empirical evidence. While this paper relies for its conclusions on secondary sources, its meta-analytical importance lies in the managerial implications that the examination of the state-of-the-art of scholarly literature leads to.

IMPLICATIONS

The managerial implications of this paper are that providing tiered frequent flyer programs that are targeted to different customer groups by offering service-related benefits rather than price discounts could be the most optimal business strategy to deploy by both traditional and low-cost airlines. If the empirical case for the effectiveness of frequent flyer programs cannot be made unequivocally (Bolton et al., 2004), the cost of program-related discounts may not be recouped through higher sales volumes that customer loyalty programs are expected to lead to.

Additionally, frequent flyer programs may be marginally important for both frequently flying high-spending individuals who are likely to accumulate

bonus point relatively fast and rare flyers that may base their decisions on route availability and cost considerations. Thus, frequent flyer programs may need to be primarily targeted at moderate-frequency flyers the airline choice of which may be swayed to a greater degree than that of other customer groups by a combination of social status connotations, point accumulation-related bonuses and service personalization. More prestigious membership ranks, such as gold or platinum frequent flyer cards, can also serve as targeted marketing channels for products and services that high-income individuals may be interested in obtaining (Gössling & Nilsson, 2010).

Furthermore, given the primarily psychological importance of frequent flyer programs for customers, in terms of their relationship with airlines, the economic value of the bonuses that these programs offer can be recommended to be reduced, in favor of providing more customized pre-departure and in-flight experience. As part of that, marginal discounts redeemable for bonus points can be offered, in order to expand per-customer purchase volume, rather than provide loyalty program-related airfare price discounts outright (Meyer-Waarden, 2007).

Thus, airline managers can be advised to increase and emphasize the symbolic value of frequent flyer programs by emphasizing the purchasing behavior of different customer groups, such as additional services for business-class travelers that loyalty programs can make more accessible. Additionally, cost-free membership programs can be expected to be associated with profitability-related advantages, since through these programs customer relationship can be developed with a wide range of customers ranging from infrequent, low-income customers to business-class frequent travelers. This could especially be the case for cost-conscious customers that airlines can be expected to retain to a higher degree if they reduce or eliminate the barriers for frequent flyer program enrollment (Datta et al., 2015; Dholakia, 2006).

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