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Pay-to-Play: The Dynamics of Paid Accumulating Rewards Programs

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Abstract

There is expansive research into customer loyalty programs (LPs) ranging from design factors to customer behavior as LP members, as LP adoption increases between customers and companies alike. However, while corporate players are experimenting with paid LPs, which often integrate accumulated rewards with a "membership fee" payment and premium service, there is a comparative lack of academic research on the subject. Moreover, there is a lack of consensus understanding on the drivers behind customer behavior in paid loyalty schemes, from conversion to engagement to retention, all of which differ from standard LPs due to the payment or fee required for the customer to invest in the relationship. This paper looks to better understand paid LPs through applying existing marketing, behavioral economics, and loyalty program research. Defining these paid LPs to require accumulated rewards (and thus excluding premium membership-style programs), it examines this new dimension of customer loyalty for both frequency and tier-based programs and provides insights on future ideas for paid LP research and corporate design.

Keywords

loyalty program, paid loyalty, frequency rewards, tier programs, loyalty program design, customer retention, accumulating rewards

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PAY-TO-PLAY: THE DYNAMICS OF PAID ACCUMULATING REWARDS PROGRAMS

By

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ABSTRACT

There is expansive research into customer loyalty programs (LPs) ranging from design factors to customer behavior as LP members, as LP adoption increases between customers and companies alike. However, while corporate players are experimenting with paid LPs, which often integrate accumulated rewards with a “membership fee” payment and premium service, there is a comparative lack of academic research on the subject. Moreover, there is a lack of consensus understanding on the drivers behind customer behavior in paid loyalty schemes, from conversion to engagement to retention, all of which differ from standard LPs due to the payment or fee required for the customer to invest in the relationship. This paper looks to better understand paid LPs through applying existing marketing, behavioral economics, and loyalty program research. Defining these paid LPs to require accumulated rewards (and thus excluding premium membership-style programs), it examines this new dimension of customer loyalty for both frequency and tier-based programs and provides insights on future ideas for paid LP research and corporate design.

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INTRODUCTION

Loyalty programs, their presence, and benefits

Customer loyalty programs, abbreviated here as LPs, are programs that are offered to customers to incentivize them through rewards, status, and/or experiences to make purchases with the company, promoting behavioral loyalty (Liu 2007). Although the primary source of revenue to the company is in the purchases from customers, companies often attach additional benefits like premium experiences to loyalty programs to increase their appeal to customers. After all, brand loyalty has been argued to be an integrated part of the psychological decision and commitment process for consumers, with repeat purchasing being the easily quantifiable, but far from only element of loyalty (Jacoby and Kyner 1973; Oliver 1999). On a corporate perspective, if an LP can generate a loyal base of customers, that means higher retention and a consistent floor for business, increasing the value and reducing risk of failure. Meanwhile, for customers, an LP serves as a psychological connection to the company for quality and satisfaction. Customers seek to avoid negative experiences and discount for risk and uncertainty (Kahneman and Tversky 1979), so the familiarity and rewards with a company are incentivizing to stay as a loyal customer. If executed correctly, a LP can be mutually beneficial towards the customer-company relationship.

Indeed, customer LP research indicates that loyalty programs can be empirically observed to have favorable outcomes for business. Empirical studies indicate that loyalty program participation has implications for higher customer retention, longer customer lifetimes, biased attitudes in favor of the company, psychological and monetary switching costs, habituation, and “excess loyalty” spending (Magatef and Tomalieh 2015; Liu 2007; Bijmolt, Dorotic and Verhoef 2010; Sharp and Sharp 1997). Loyalty program research is not limited to longer-term relationships, however, with programs that accumulate towards benefits all feasible to be classified as LPs. In fact, Kivetz, Urminsky and Zheng (2006) describe consumer behavior in loyalty rewards with the goal-gradient hypothesis, which argues that effort towards a goal increases with proximity, highlighting how the presence of rewards in loyalty program tiers or thresholds can observe customer purchase acceleration, echoed by Nunes and Drèze (2006). Across these studies, despite testing different loyalty schemes (in Magatef and Tomalieh (2015), numerous different program designs as well), a common theme is improved customer metrics, which Sharp and Sharp (1997) argue can contribute as much as 3 percent in market penetration and sales market shares for a company in the shorter-term, due to spurring customer behavior. Leenheer et al. (2007) similarly observe that LP membership has a slightly higher share-of-wallet usage with the firm, which is statistically significant, even if members are self-selecting.

There are relatively few academics that disagree with the benefit of loyalty programs, even though there is conflict over what loyalty programs are best used for. One criticism of the work praising loyalty programs argues that customer LPs are less suited for converting loyalty, than they might be for selection bias. After all, LP members show higher loyalty, but are typically comprised of customers who were spending at higher rates to begin with, which would make them see more value in the LP and be more likely to agree (Bijmolt, Dorotic and Verhoef 2010). Effectively, this argues them as a means to identify best customers, where the self-selecting process creates an implicit customer segmentation within the base, and concurs with Gomez, Arranz and Cillan (2006)'s perspective that LPs should be viewed as means to better retain the best customers, rather than focusing on transforming customers' loyalty as the primary goal. Meanwhile, Liu (2007) offers support for LPs by demonstrating a greater boost in purchase frequency and basket size for LP members who started off as lower-engagement customers, even though she stops short of disputing the selection-bias potential of loyalty program membership. As a whole, it is important to keep in mind that even if loyalty programs can be seen as selection-tools for best customers, that does not discount their value; even if they may not be as valuable in transforming new customers, they still provide the benefits and satisfaction to the company's existing customer base, boosting customer retention.

Loyalty program design

Despite the bulk of research into customer loyalty programs, and the numerous programs that exist today, there is less consensus on "ideal" design factors towards a standard LP. That is due to variance across different base structures, which can be classified into several different categories of LP design (Breugelmans et al. 2014; Magatef and Tomalieh 2015):

LP design factor	Description and impacts
Membership requirements	Either a threshold required to join the program, financial costs, or opportunity costs.
Program rewards structure	How customers can be rewarded through the LP. Many LPs can include VIP benefits such as early access to events, loyalty cards, and special privileges like discounts.
Accumulation and redemption	Rewards can be accumulated primarily via either frequency-based or tier-based programs. Redemption process impacts how customers benefit from rewards.
Communication	About the value of the program to customers before (for acquisition) and during membership (retention).

Figure 1: Overview of LP design factors

While research such as Magatef and Tomalieh (2015) and Kwiatek, Morgan and Baltezarevic (2018) explore different program structures, and in the latter compare relative importance, their work is done in an observational rather than prescriptive manner. After all, there is variety in the way companies incentivize their customers across industries, and even between competitors, using their LPs as a differentiation factors. For instance, even though most airline frequent-flyer programs involve earning points for travel at a high-level, their accumulation rates, VIP benefits and redemption structures differ, making each valuable in different ways to attract customers (CreditKarma 2019). Breugelmans et al. (2014) highlight this gap in research coverage as a general step for future direction, as better understanding of which structures to programs may be aligned well with certain industries or customer segments. Future research into this subfield, the inspiration for this paper, can improve customer outcomes.

Introduction to paid loyalty programs

Specifically, this paper looks to focus on the lack in research into financial membership requirements, or “paid LPs” hereinafter, which are payments from customer to company in order to be a member of that LP. The LP cost adds a cash outflow for customers, increasing the barrier to entry, even if it typically promises higher rewards than a free LP. The premium rewards thought concurs with work by Kahneman and Tversky (1979; 1991) and Anderson and Hair (1972) both suggests that the price factor may adjust customer perceptions and reference points, necessitating higher LP performance. Corporate experts such as Pearson (2019) argue that top customers will pay for best rewards and entitlements, especially as free LPs become ubiquitous and less individually special to customers. This concurs with Bijmolt, Dorotic and Verhoef (2010) who view LPs as a means of differentiating between initial customer loyalty due to the selection bias; creating a higher barrier to entry may eventually restrict loyalty membership to a company's best customers -- Gomez, Arranz and Cillan (2006) concur against using LPs for purely customer acquisition. Although Liu (2007)'s work suggests that these initially higher-loyalty customers see a reduced spike in favorable behavior after joining the LP, especially compared to lower-loyalty customers that join LPs, the premium status offered to these top customers may still be valuable, even if less directly quantifiable through spending alone. In fact, identifying, understanding, and building for the company's most valuable customers helps sustain long-term customer relationships and business success, in the customer-centricity worldview that Fader (2012) proposes.

This paper looks to help address that missing section of the academic literature through providing a review of the factors that could be impactful to these paid LPs. The lack of comprehensive research (outside of Ashley et al. 2015, which evaluates joining intentions) into paid-LP-specific contexts means that current work must be based on prior standard LP research, which often does not mention upfront fees as a factor. Moreover, the lack of research can lead to a "trial-and-error" method for developing paid LPs across industry, especially in a field that is relatively newer to existing loyalty experts. Drawing from loyalty program (program design, endowed progress, redemption patterns, rewards accumulation) and behavioral science (expectancy theory, value perceptions, sunk costs) research backgrounds primarily, I hope to analyze the factors that can be relevant to a customer paid LP system. Examining the membership acquisition, program rewards process, and communication (akin to the framework in Figure 1; Breugelmans et al. 2014) elements of a loyalty program, I hope to provide ideas that could be applied in developing these new paid, and often premium, customer experiences.

CLASSIFICATION

Defining paid LPs

Briefly, I must define what a "paid LP" is, since there is no real consensus in industry or academic context. For example, CVS CarePass provides direct pharmacist access and faster delivery (Pearson 2019), REI Co-op provides lifetime membership and classes (REI, n.d.), while GameStop PowerUp awards points and discounts on pre-owned games (GameStop, n.d.), yet all are considered to be "paid LPs" despite their very different rewards and structures. To define a paid LP, I can break the term into its two components simply. "Paid" indicates there should be a cost from the customer to the company as a fee for being part of the rewards program, a contrast to the majority of programs today. I do not distinguish between either one-time or recurrent payments in this definition, nor between costs paid at sign-up or afterwards -- there is not a wealth of literature to base that specificity off of, and while the distinctions are important in understanding customers, all can be reasonable approaches while still being a loyalty program.

Meanwhile, "loyalty program" leads to a reduction in breadth. Bijmolt, Dorotic and Verhoef (2010) and Breugelmans et al. (2014) both describe general approaches to defining the term loyalty program,[1] and while not creating a singular definition, mention that typical LP rewards usually involve some accumulation of currency based on behavior. Structure, duration, and communication are all relevant factors to LPs, but are typically common across paid memberships and paid LPs; however, accumulating rewards are not present in programs that focus more on premium service, such as the aforementioned CVS CarePass and REI Co-op. Although these are certainly loyalty efforts, I restrict the coverage of this paper to describing programs with accumulating rewards, since the dynamics behind non-accumulating rewards are

[1] The definition from Liu (2007) in the introduction is a very general view of LPs, soI specify further here.

different and less feasible to compare in tandem. Thus, I define "paid LP" is as follows:[2]

1. The program must be designed to incentivize behavioral/attitudinal loyalty in a customer relationship (Liu 2007; Bijmolt, Dorotic and Verhoef 2010; Leenheer et al. 2007);
2. It must include a personalized or superior experience for customers who are members;[3]
3. It must include some form of payment as the LP cost (Breugelmans et al. 2014);
4. It must accumulate rewards such as a specialized currency or cash rewards (Bijmolt, Dorotic and Verhoef 2010).

Admittedly, it is perhaps more accurate to specify these as "paid accumulating rewards" programs, since there are others who consider programs without an accumulating rewards or points (ex: standard discounts, free shipping) as LPs. However, definition #2 above creates this distinction here, since those programs likely are more different from rewards-accumulation programs than rewards-accumulation programs are between one another. For the sake of brevity, "paid LP" in this paper will refer to the definition proposed above.

Scope and examples

When I discuss paid LPs, there are dimensions within this general category, which have varied customer interactions and outcomes. With the actual fee itself, as has been mentioned, the fees can be either one-time or a subscription-based model, and when they are required to be paid also can vary. All of these still comprise paid loyalty programs, even though it is reasonable to understand that customers may view them differently. For example, customers have lesser

[2] However, others' definitions may vary; I previously considered REI as a paid LP earlier in this process.
[3] Len Llaguno (Founder and Managing Partner, KYROS Insights), in discussion with the author, May 2019.

certainty over the value their will receive if paying a fee at joining, rather than at the end of a year when they have experienced the benefits firsthand; they may be more hesitant to accept that uncertainty (Kahneman and Tversky 1991). I do not distinguish between these methods at present time but note that they are important to examine in the future, especially as research indicates that customer' likelihood to join an LP is influenced by cost (Ashley et al. 2015).

In terms of rewards structure, I will focus on the two program structures that Kopalle et al. (2012) highlight as methods of point accumulation: (1) frequency reward programs, where rewards are accumulated up to a certain level for redemption; and (2) tier-based qualification programs, where certain reward levels or services are acquired via certain point levels. Within frequency programs, some programs require thresholds to redeem rewards (Kivetz and Simonson 2002), while others, such as linear LPs, do not provide any benefit from stockpiling and enable redemption for rewards at will (Stourm, Bradlow and Fader 2015). Meanwhile, tiered programs include point or rewards accumulation, unlike paid memberships (ex: REI, CVS), but are distinctive for changes to the way customers are treated, such points or benefits at different tiers. An example is the Starbucks loyalty program, where customers earned stars for purchases, could move up across tiers such as "Green" and "Gold."[4]

Paid frequency programs can be seen much like standard ones, only with perhaps higher rewards and the presence of a fee. For tiered structures, where the payment comes into play can adjust how the tiered program works. For example, customers can pay to join distinct tiers of LP value (ex: Powerup; GameStop, n.d.), or customers can move up either through payment or spending with the company, such as with partnership LPs like the Hilton-American Express[5]

[4] Aimee Johnson (Chief Marketing Officer, Zillow; formerly Senior Vice President, Digital Customer Experiences, Starbucks), in discussion with the author, October 2018.
[5] Specifically, Hilton Honors program members can gain status through spending, but can be elevated faster if they are also Hilton-American Express loyalty cardholders.

(American Express, n.d.). Considering the categories proposed, I consider the following examples of paid programs as LPs, to provide clarity -- although the list is not exhaustive:

- Retail loyalty programs with subscription or one-time fees;
- Partnership credit cards with costs, which reward customers specific to one retailer or company. This includes frequent-flyer program cards;
- Paid credit cards designed to motivate customers to make them “first-in-wallet.”

In future research, greater distinction between types of loyalty programs and the companies whose LPs are examples of each would be valuable. For example, although the rewards-accumulating LPs discussed in this paper include both frequency and tiered LPs, premium memberships that still provide benefits -- just without economic accumulation of rewards -- are omitted intentionally to avoid confusion over the definition. Further dichotomization of this field would be valuable in setting up future research.

CUSTOMERS' INTENTIONS IN JOINING PAID LPs

Behavioral foundations of paid LP membership

To understand customers' intentions to join paid loyalty programs, a cost-benefit approach cited in both motivational science, behavioral economics and marketing literature can be applied. Expectancy-value theory argues peoples' choices and performance can be explained by beliefs of outcomes and their valuation of the situation (Wigfield and Eccles 2000). Specifically, in the subjective valuation of the task, the incentives, attainment value, utility, and cost are all factors in Wigfield and Eccless (2000)'s model, which is designed for task motivation but can be seen as a general idea for understanding the factors that customers may customer when determining if an LP is valuable. Marketing research findings concur in this sort of "cost-benefit analysis," where customers will want to join an LP if they feel that the benefits they can gain, namely rewards, exceed the opportunity and monetary costs of being a part of the LP (Leenheer et al. 2007; De Wulf et al. 2003; Ashley et al. 2011). Quantitatively, De Wulf et al. (2003) measure that around 70% of the decision to join lies on the cost and benefits, with a participation cost being the most negative utility factor, all else equal, in likelihood to join a LP. Therefore, failing to establish value of the loyalty program can lead to customers turned away by the presence, and quantity, of a membership cost, reducing customer adoption.

One important behavioral idea that applies to this customer decision is the construction of preferences, which means that different descriptions can elicit varying preferences from customers (Slovic 1995). Ajzen and Fishbein (2000) similarly show that "attitudes" (which they define as favorability "evaluations of an object, concept or behavior") are influenced by the accessible beliefs to a person. Even though a LP cost is less appealing to customers -- especially given the breadth of low-barrier, easy-sign-up free LPs available -- customers' perceptions of a loyalty program can be altered through the design and communication of the rewards, improving likelihoods of membership. This can be especially promising since customers with existing relationships with the company can demonstrate cue compatibility in favorable brand associations (Roehm, Pullins and Roehm 2002), and existing customers are likely the most appropriate targets for membership given the self-selecting nature of loyalty program customers (Bijmolt, Dorotic and Verhoef 2010; Gomez, Arranz and Cillan 2006). If a company already has influence and connection with these customers, it can be easier to manage perceptions and increasing value for these customers, adding mental incentives for them to overcome the negative influence of the program's cost.

Leveraging loyalty program structure to influence intentions

Bijmolt, Dorotic and Verhoef (2010) identify three different benefit categories of loyalty programs: utilitarian (or economic benefits; rewards, convenience, and gifts), hedonic (experiences), and symbolic (status and membership), which can be used to analyze how different loyalty program design factors are able to enhance customer perceptions.

In addition to communication, the way a company structures its program and corresponding rewards (utilitarian benefits) can have a moderating impact on customer perceptions and likelihood to become paying members. For example, companies can provide immediate rewards or "sign-on bonuses" to offset the costs of the program. De Wulf et al. (2003) finds that customers who are provided product and additional information do not see a meaningful benefit in utility, but the presence of immediate rewards mediates the relationship between communicated program benefits and utility. Kivetz, Urminsky and Zheng (2006), meanwhile, might classify these incentives as contributing to the goal-gradient effect, which would provide a twofold impact; in addition to the utility described above, the presence of having points accumulated towards rewards can accelerate purchase frequency as well. Furthermore, either having a higher "bonus" (or even a bonus at all) can increase premium status and perceptions for value for consumers (discussed in depth below; Leenheer et al. 2007). Looking ahead, further work could be valuable in understanding the tradeoffs between program cost, upfront rewards, and customer response, which could guide strategies for converting customers to paid LPs.

Loyalty program points are often used as a medium for customers' rewards when they spend money with a firm. The presence of a medium, however, can cause customers to focus on its benefits over the actual outcomes they can receive, as highlighted by Hsee et al. (2003), who find that customers tended to choose options that provided them with a higher rate of points, even if the actual outcome was not as proportionally valuable. Moreover, customers choose to have points that would convert into future money (at a discounted rate)[6] over ones that would ensure present capital, further supporting Hsee et al. (2003)'s hypotheses, an irrational response. Yet even though these points have no intrinsic value, research by Ashley et al. (2015) indicates that the mental taxation of considering these rewards is able to induce holistic analysis of a rewards program. Requiring customers to consider multiple factors, ranging from conversion of their utilitarian benefits to harder-to-quantify non-monetary value from the program, reduces their focus on the direct cost-benefit analysis. A holistic consideration of the value of the program, especially with more complex and numerous awards, as Ashley et al. (2015) describes, can increase membership joining rates even when the program is more expensive.

[6] Participants were given the option to select either a closer bank that gave 100 points that translated to $100 now, or a farther bank by one minute that gave 150 points for $150 in three years. The control removed the medium.

Allure of premium status and pain of privacy

Customers in LPs can receive monetary benefits through rewards, but the psycho-social benefits through experience and status are also important in their evaluation of an LP. While an ordinary free LP should, and often does, provide an enhanced experience compared to a standard customer experience, those in a higher-cost program begin with a higher reference point for its hedonic value to customers -- consistent with Zeithaml's (1988) research into price and signaling effects for perceived value.

Leenheer et al. (2007) argue that superior rewards and experiences, especially compared to non-loyalty program customers, creates a positive status feeling for customers, and enhances their loyalty, a symbolic value to the customer. Llaguno concurs, viewing the emotional responses through experience and status as key to modern loyalty programs, especially for longer-term sustainable customer loyalty[7], in concurrence with Roehm, Pullins and Roehm (2002). Knowing that people are reference-point dependent in their evaluations and perceptions (Kahneman and Tversky 1979), this is especially important when companies have both free and paid LP programs; the paid LP will be expected to have a higher quality of service, and must perform relative to that greater expectation and reference point in order to satisfy its members. Drèze and Nunes (2008) in their hierarchical-program research also find impacts of status, where adding subordinate tiers increases the perception of elite-ness in customers at higher tiers, particularly if tiers have status-exhibiting features such as priority queues in airlines that can boost emotional loyalty.[8] Customers who buy into paid LPs are aware of the higher status they may command as members, and while premium service is beneficial as Leenheer et al. (2007) demonstrates, it is important to supplement this with distinctions about status, which is socially

[7] Len Llaguno (Founder and Managing Partner, KYROS Insights), in discussion with the author, May 2019.
[8] David Andreadakis (Chief Strategy Officer, Kobie Marketing), in discussion with the author, October 2018.

constructed relative to others. This satisfies the top group of customers, while providing lower-tier customers the ability to observe value, which can influence their own consideration of paying for different rewards or enhancing their behavior with the company.

Another non-economic cost that can be a barrier to customers is the loss of privacy through joining a loyalty program (De Wulf et al. 2003; Leenhers et al. 2007; Ashley et al. 2011). Companies want to collect customer data to better understand their customer base, since successful customer analytics can indicate which customers to target for upgrades, which to prevent attrition from, and how to target new strong customers. However, some people may be less than favorable towards this. In fact, De Wulf et al. (2003) finds that asking for information reduces the utility appeal for customers to join, which parallels work by Ashley et al. (2011) that classifies information requests as a customer inconvenience. However, this inconvenience can be reduced through either complementary rewards like sign-on bonuses, or by reducing the perceptions of inconvenience. Companies can reframe these requests as "steps to improve the experience" instead of "requirements," for example, which enhance perceptions of value and improve utility at the sign-up process.

Future research opportunities

Stourm, Bradlow and Fader (2015) describe conversion rate stockpiling motivation in loyalty programs, where how much a point in an LP is worth influences the likelihood of a customer to spend it for rewards. However, with Ashley et al. (2015) and De Wulf et al. (2013), it would be interesting to further quantify customers' sign-up perceptions of fees and points. For example, for a given loyalty program fee, how does the conversion rate of points in a sign-on bonus influence customers' utility? It has already been explored that customers who value points less than cash will stockpile (Stourm, Bradlow and Fader 2015), but what conversion rates will trigger higher satisfaction to offset the impact of the cost? Such findings, similar to ones proposed by Breugelmans et al. (2014), would provide companies with a means to reduce the amount spent on sign-on incentives without compromising customer experience; companies could reinvest those savings.

In addition, how does customer churn happen in paid LP registration? I assume that customers signing up for the paid LP have already conducted their cost-benefit analysis and determined the LP provides surplus benefit to them. Yet, the research into free LPs shows that customers receive negative utility from requests for more information. Do paid customers react similarly, or is there an implicit understanding that a premium service will also request more data for the company? Are these customers merely dissatisfied with the process, or does it meaningfully impact their chances of becoming members even after the decision process? Making the actual registration and painless as painless as possible is likely to reduce churn, if any, and make customers more satisfied with the joining process -- perhaps mitigating the cost.

Discussion

We note that the strategies described encompass the customer decision process from initial perceptions and interest in the program to the actual registration process. These potential strategies are discussed in the marketing literature for general LPs, and in tandem can server well to improve customer perceptions of value. The integration of complex structures that bring multiple rewards and experiences -- across utilitarian, hedonic, and symbolic dimensions -- increase the propensity for customers to become paid LP members in two reasons. First, from the consumer perspective, the status elevation (Zeithaml 1988; Leenheer et al.), potential upfront incentives (De Wulf et al 2003; Kivetz, Urminsky and Zheng 2006), and general rewards structure of the programs brings multiple sources of value to customers. These accentuate the benefits of the loyalty program. Second, as Ashley et al. (2015) describes, increased rewards complexity also makes it more challenging to evaluate options purely holistically; non-monetary benefits may be considered more holistically in the cost-benefit analysis of deciding whether to join a paid LP. These two factors together increase customer perceptions and consideration ability in favor of the paid LPs, facilitating adoption.

At the same time, companies must be aware that this is through different design and communication factors that fundamentally elevate expectations of value from the loyalty program. These must be met in the actual customer experience. If not, customers looking back at the re-subscription process may have dampened perceptions of the program's value, especially with greater certainty of the benefits to them than they did at the initial joining. While in standard LPs, customers have far fewer costs, the actual fee that may be charged can outweigh the benefits experienced by the customers. Companies need to effectively manage these perceptions relative to the actual value of their programs, for paid LPs to be successful; customers must see the value in being a part of the premium program to not just join, but also stay and participate as LP members.

CUSTOMER BEHAVIOR IN PAID LPs

Overview

Customers who join a paid LP, for selection bias reasons, are likely to have a higher prior propensity to spend with the company (Bijmolt, Dorotic and Verhoe 2010; Pearson 2019). However, a paid loyalty program would be especially valuable if it can generate excess loyalty or spur more activity from the customers. While higher buyers typically do not experience as large of a bump due to a ceiling effect for purchase volume and frequency (Liu 2007), providing them with the LP experience can increase residual lifetime, or how long they are expected to remain a customer, increasing the individual lifetime value of customers.

In exploring the customer spending dynamics for paid LPs, I begin generally about paid LPs before distinguishing between frequency reward LPs (FRPs) and tier-based or hierarchical LPs, the two primary rewards structures highlighted in Kopalle et al. (2012). This is because much of the nudges that can be examined to understand how people may behave in paid LPs can be applied to both. For example, goal-gradient research (Kivetz, Urminsky and Zheng 2006) for incentives can be either used in the context of reaching different tiers in tiered programs, or approaching rewards thresholds and value in frequency programs. While the structure of the specific program influences what can be applied to each (ex: a tiered program that requires upfront cost to move across tiers does not benefit from the goal-gradient's value in switching tiers), I omit the nuance of specific programs as has been addressed prior. I note that this review is not meant to provide a directly prescriptive solution for loyalty programs. Rather, the general goal is to understand how different marketing ideas can be used to advance paid LP development and research. Specific applications should depend on the industry and company.

Behavioral responses to LP cost

Several behavioral science factors, in addition to the rewards in loyalty programs themselves, suggest that paid LP programs are likely to see improvements in customer behavior, from a firm perspective. McCall and Voorhees (2010) view the payment as an initial effort and investment towards the loyalty program. Thaler (1980) describes how customers fail to ignore sunk costs and pre-commitment, where customers have already spent the money and committed to being part of the LP, subsequently spending money to justify that decision, fundamentally concurring but from a different customer perspective. Jang, Mattila and Bai (2006) illustrate how customers have regret after paying for a membership when they observe a superior service or lower membership fee elsewhere but were reluctant to attribute when their membership fees paid were lower. By considering their initial payment instead of just marginal costs and benefits when making a given purchase decision, customers are acting irrationally and have their preferences influenced -- in this case, to remain "loyal" to the LP provider (Jang, Mattila and Bai 2006). This "membership-fee effect" sees customers attempt to take advantage of benefits more post-payment (such as season tickets for plays) as well, contrary to economic theory (Dick and Lord 1998). Furthermore, post-decision dissonance research supports these theories, as customers who have already spent (or are committed to spending) for the program have a desire to, at least subconsciously, extract value from the LP in order to justify the value of the purchase -- this can increase behavioral loyalty as well even for already-frequent customers.[9] This is independent of considering the LP design itself, which can spur customer activity as well.

Moreover, the nature of the premium program may incentivize customers to spend more. Specifically, customers can receive the status benefits when they interact with a particular store,

[9] Dr. Marissa Sharif (Assistant Professor of Marketing, Wharton School), in discussion with the author, May 2019.

providing a psychological motivation to select a particular company to do business with. For example, a customer looking to book a flight, assuming comparable prices, I would expect to select the carrier where they have a paid program with over one that they do not, due to highly visible preferential treatment to enhance the experience.[10] In fact, Ashley et al. (2015) demonstrate that customers who pay a fee for a program have more favorable attitudes, leading to behavioral loyalty. The counterargument here is that customers likely have a stronger emotional or behavioral connection with the company they join a paid LP with are already predisposed to select its service. However, the paid LP complements this by adding status and premium experience, increasing the likelihood of customers foregoing alternative options. On a longer-term perspective, this combination of benefits may be more valuable for companies. Dholakia (2006) in Bijmolt, Dorotic and Verhoef (2010) among others argues that purely economic value can distract customers to focus on the rewards only instead of their intrinsic attitudes and motivation towards the company.

Purchase acceleration and artificial loyalty creation

There is well-documented research regarding the goal-gradient effect and endowed process effect in loyalty programs. Customers who are provided with additional progress towards the rewards goal, even when they have not earned it, demonstrate accelerating purchase frequency and volume (Kivetz, Urminsky and Zheng 2006; Nunes and Drèze 2006). Within paid loyalty programs, the idea of artificial loyalty creation through additional rewards plays well into the rewards accumulation, customer value, and premium status perspectives, and could be leveraged in paid LPs effectively. First, De Wulf et al (2003) describes how immediate rewards

[10] David Andreadakis (Chief Strategy Officer, Kobie Marketing), in discussion with the author, October 2018

can be used to offset the negative utility received from the cost of a LP. Companies, particularly in the credit industry, may offer starting rewards to incentivize customers to begin spending immediately with them after becoming LP members (American Express, n.d.; Kivetz, Urminsky and Zheng 2006). However, if this takes place in the form of accumulated LP points, customers may see it illusionary process and trigger this effect. This is irrespective of how many total points are needed since participants are more sensitive to the proportion of completion; indeed, Kivetz, Urminsky and Zheng (2006) found stronger performance from customers displayed this acceleration more when given 2/12 purchase credits than just purchasing 10 from scratch, a finding also observed in Nunes and Drèze (2006). In tiered LPs that enable customers to move across tiers by spending, this research has the greatest direct impact; customers are likely to reach the next tier faster, improving member engagement in the LP. Other tiered and frequency reward LP customers can be expected to behave similarly; in fact, this research was conducted on a frequency LP simulation. Even with linear programs, which do not have a set redemption target, and there exists heterogeneity in redemption behavior, customers have various point balances at which they view redeeming as more advantageous than stockpiling (Stourm, Bradlow and Fader 2015), so this effect can also spur behavioral loyalty.

One novel extension that could be applicable to paid LPs, specifically frequency programs, exists in using this knowledge to provide intermittent rewards for customers, whether in additional points or experiences. For example, companies can choose to provide rewards boosts either to further reward strong customers or re-engage dormant ones.[11] Customers who receive these benefits can be spurred to further spending through the goal-gradient, improving their engagement. Moreover, they may view these additional rewards as indicators of their

[11] Len Llaguno (Founder and Managing Partner, KYROS Insights), in discussion with the author, May 2019.

preferred status at the company (Leenheer et al. 2007; Kivetz and Simonson 2002), playing to customers' egos and psychological validation and enhancing their beliefs and attitudes about the company and LP. At least in the short-term, frequency of customer behavior would increase. For companies, it is important to avoid creating consumer perceptions of "deserved" rewards since customers already believe that greater loyalty should merit more benefits, and the expectation may not be bet in future periods (Reczek, Haws and Summers 2014). Conversely, though, awareness about these additional rewards can have rippling effects through a LP customer base, since customers may feel that engaging more with the LP increases chances of their benefits -- and subsequently do so (Reczek, Haws and Summers 2014). This is even without knowledge of how the underlying rewards decisions are made, unlike standard rewards where customers have awareness of the accumulation and redemption targets.

A second extension applying to tiered programs only comes through Eggert, Garnefeld and Steinhoff (2014), who explore the impacts on elevating customers to the higher tier before they have fully earned it, hoping that the higher status and rewards motivate customers to spend more. Unlike providing points that help customers achieve rewards, the idea of "endowed status" is that customers elevated will have both an utilitarian (better rewards) and symbolic (ability to demonstrate newfound status) motivation to spend. Receiving the superiority of the more elite level (Drèze and Nunes 2008) as a free "reward" for their behavior (Kivetz and Simonson 2002) also can provide customers with a greater perception of the LP's benefits. However, since customers can sometimes be wary or feel undeserving of free upgrades (Eggert, Garnefeld and Steinhoff 2014; Reczek, Haws and Summers 2014), an opt-in system can ensure that customers are not being dissatisfied by the process. Plus, customers who decline still receive the offer, constructing slightly more positive beliefs about the LP to them. While these concepts could be applied to standard LPs as well, their integration with a sense of superior treatment aligns them well with customer expectations -- and satisfaction -- in enhancing paid LPs.

Future research opportunities

There is interesting opportunity in the role of paid LPs' premium status on customer spending. For example, what is customers' tradeoff between premium status and money? Namely, are customers willing to spend more for a company they have a paid LP with? If so, paid LPs would be seen as selection signals of attitudinal loyalty, indicating that beliefs and memories constructed about a particular company/service (Ajzen and Fishbein 2000) are more valuable than customers' own price elasticity of demand. In addition to concurring with existing LP researchers on relationship-building value of LPs (Gomez, Arranz and Cillan 2006; Bijmolt, Dorotic and Verhoef 2010; Leenheer et al. 2007), this would provide companies security from their best competitors, where another firm's product would have to exceed both economic *and* psychological value perceptions to be competitive.

Additionally, does a "fleeting" perspective of initial incentives impact customers' engagement after redemption later on? Kivetz, Urminsky and Zheng (2006) found that strongly accelerated behavior on an initial frequency program card could lead to shorter re-engagement times, but does this generalize, especially when paid LPs may have much larger endowed benefits to help offset their costs? Would a re-subscription bonus enhance customers' future engagement with the paid LP, or would a lower program fee overall be more effective in improving customer satisfaction? Given that there are several different ways to frame and quantify the bonuses and costs, even ones that may balance out in value, understanding the interplay between them can lead to more optimal approaches to stimulating activity.

Finally, as inspired through talks with Len Llaguno,[12] how can businesses determine strategies to provide these goal-gradient-esque rewards? For example, operating in a predictable manner (such as providing rewards to people who accumulate above or below a certain threshold) could reduce the feeling of special treatment to customers, and may be better communicated as just another benefit in the program. A predictive model for customer dormancy or hyper-activity could be created through quantitative stochastic models, such as probability models proposed for retention and customer value by Fader and Hardie (2006) or Romero, van der Lans and Wierenga (2013), among others. This model would be able to target customers with rewards at scale, improving the overall commitment of the customer base through this goal-gradient effect.

[12] Len Llaguno (Founder and Managing Partner, KYROS Insights), in discussion with the author, May 2019.

CUSTOMER REDEMPTION AND RENEWAL PROCESS IN PAID LPs

Customer renewal decision process

When customers initially join a paid LP, they conduct a cost-benefit analysis where the decision is made to join of benefits exceed costs (Leenheer et al. 2007; De Wulf et al. 2003; Ashley et al. 2011). Especially as paid LPs can be more complex with rewards structures and offerings, some of this analysis can become holistic in nature (Ashley et al. 2015), increasing likelihood to join these programs despite the cost of doing so. If this was a onetime cost, it would not be rational for customers to drop out of the program, since they would not receive benefits unless they re-paid. Instead, they are more likely to simply become dormant customers. However, many paid LPs involve repeated payment, often in a subscription format, to continue using the benefits of the program. Cognitive dissonance means customers may interact with the program to validate their decision-making or get more value out of the payment, but the often year-long timeframes between renewal means customers have the opportunity to establish their patterns of use, reducing the uncertainty in value that they have to accept at sign-up.[13]

Therefore, customers have to feel they got enough value out of the program to continue their LP members. With LPs in general, but especially paid/premium ones, potentially selecting a company's strongest customers (Bijmolt, Dorotic and Verhoef 2010; Gomez, Arranz and Cillan 2006), it is critical for companies to retain these customers, or risk their customer core weakening. In fact, value perception was directly linked to brand loyalty in high-involvement LPs (which would include longer-term programs like paid LPs), in addition to being indirectly linked to brand loyalty through the mediating effect of LP-specific loyalty (Yi and Jeon 2003; Omar et al. 2010). In fact, this indirect impact through utilitarian (and also hedonic) value is

[13] David Andreadakis (Chief Strategy Officer, Kobie Marketing), in discussion with the author, October 2018.

similarly observed by Tang, Zhang, and Cheng (2012), who show that the actual benefits of the customer relationship mediate the impacts of LP value and effectiveness to longer-term customer loyalty. Customers need to recognize the value that the LP provides to them in order to accept the renew process; otherwise, it is difficult for a company to persuade individuals to renew a costly paid program, and retention is far more important here than it would be for a free LP.

Redemption for customers and company

Reward redemptions are one of the key methods in which customers receive utilitarian benefits, and also a key opportunity for nudging customer behavior. As Ashley et al. (2015) and Stourm, Bradlow and Fader (2015) both note, rewards points and other pseudo-currencies have no intrinsic value on their own, even if they are convertible to cash and products. Research indicates that customers often accumulate their points for loyalty programs, such as for larger purchases, self-gifting on occasion, and perceived impacts on their behavior and relationship with the company (Smith and Sparks 2009). Although companies have a financial liability for these reward redemptions, from a marketing perspective it is beneficial towards maintaining the customer relationship for customers to redeem these points. In fact, particularly for contractual relationships such as a subscription-based paid LP, monetary rewards such as through redemption provide higher utility to customers than they do in non-contractual settings (Furinto, Pawitra and Balqiah 2009), supporting this belief. Subsequently, companies may find value in placing triggers to enhance ease of redemption (Stourm, Bradlow and Fader 2015), prompting customers to redeem their rewards periodically and experience the benefits of the LP. Potential narratives could be based on customer motivations for redeeming, such as “Treat yourself, it’s Friday/a holiday/your birthday,” which can be identified through focus-group methodologies conducted in Smith and Sparks (2009). Conversely, companies can create their LPs with different point values, since altering the "worth" of points can prime customers to redeem for monetary value instead of "less valuable" points (Stourm, Bradlow and Fader 2015).

In fact, easier computations are indicated by Kwong, Soman and Ho (2011) to improve the likelihood that customers understand benefits and redeem points, either for direct cash value or for estimating savings. Companies can facilitate this process by directly offering comparisons for the consumers, such as "you can receive 25% off your purchase/$600 back on rewards today" for instance, removing the computational complexity and allowing customers to quickly estimate that value. While this may seem contradictory to Ashley et al. (2015) which says that increased complexity benefits paid LP membership propensity, it is important to make the distinction between the stage in the LP lifecycle. At inception, customers have no grounding of value, and are effectively estimating the cost-benefit analysis; on the other hand, at renewal, customers are already aware of a rough perception of their value received -- and these efforts will boost the availability of that information to customers.

Loyalty program points can be seen as a switching cost that customers do not want to forego if they do not resubscribe. However, switching costs do not generate intrinsic loyalty to the company. Yet, if customers are able to actually experience the rewards and see the benefits, they become positive assets towards the development of attitudes and future behavior with the firm. Although redemption of rewards and taking advantage of general membership benefits are not the only way to communicate value about the program, they are one of the most salient, and successfully doing so has positive ramifications for paid LP customer retention.

An integrated model of loyalty program value

Unfortunately, not everyone will see paid LP management through this customer-centric (Fader 2012) marketing perspective that argues for customer value and relationships. Stourm, Bradlow and Fader (2015) model how customers stockpile their rewards points, while Kwong, Soman and Ho (2011) mention the trillions of LP miles alone, that are not redeemed and sit, unexpired, as corporate liabilities. Financial disclosures do not mandate customer relationship data, and financial offices within companies may see attrition as an opportunity to reduce liability, especially when a single company could be responsible for billions of dollars.[14] From this lens, it does not make sense to incentivize customers to redeem rewards, even if it helps retain customers.

Fortunately, there may be an intersection that meets these desires in tandem.[15] Customer lifetime value provides provides a way to determine customer value over the entire interactions between an individual and a, firm through a combination model of factors including retention, revenue flows, and acquisition costs (Dwyer 1997). In fact, as indicated by Kumar, Venkatesan, and Reinartz (2008) through field experiments, switching to a customer-focused strategy can improve financial returns while reducing investments, and maintaining beneficial customer relations. Customer retention drives repeat transactions, and is a primary component of extending a firm's future lifetime value -- which has expanded research into understanding the customer journey process such as Lemon and Verhoef (2016). When considering the redemption and renewal process of paid LP customers within a customer journey, there becomes an opportunity to quantify the benefit of redemptions, and focus on a stronger paid LP strategy.

[14] Len Llaguno (Founder and Managing Partner, KYROS Insights), in discussion with the author, May 2019.
[15] A special thank you to Len Llaguno (Ibid) here -- for the inspiration to integrate these fields would provide a practical and invaluable resource for marketers to leverage in paid LP settings, where redemption is more important.

A firm's value can be expressed as the sum of the individual lifetime values of all its customers. For each customer, their future expected lifetime is projectable in their spend recency, frequency and amount, where both residual lifetimes and expected future purchase volume are able to be calculated, taking customer heterogeneity into account (Fader and Hardie 2010). However, models such as those by Stourm, Bradlow and Fader (2015) could be extended to value not just individual propensities to redeem, but how different levels of redemption likelihood will lead to various outcomes for a company (such as the amount paid in rewards).[16] If a company is attempting to incentivize a customer to extend their paid LP membership, then it only makes sense if the firm can generate higher residual lifetime value for the company. Adapting the standard CLV understandings, this can be viewed as an acquisition CLV model -- only with the lifetime value representing residual lifetime value, and the acquisition cost being the liability that the company has to distribute to the customers.

$$Value = E[RLV] - E[Redemptions] \times P(Redemption) - E[Cost\ of\ incentives]$$

Figure 2: High-level model proposition[17]

This would provide a model that companies can use to if seeking retention is profitable and valuable for their LPs. In fact, the nature of Fader and Hardie (2010)'s work means that such projections can be done on a customer level. This concurs with existing LP research and would serve to isolate the best customers, over time. It is only fitting that, just as the customer wants individual treatment for investing in a paid LP relationship, the company eventually decides if it wants to reinvest in them through a similar individual manner.

[16] Len Llaguno (Founder and Managing Partner, KYROS Insights), in discussion with the author, May 2019.
[17] RLV: Residual lifetime value; Cost of incentives is the cost for campaigns to boost likelihood of redemption.

CONCLUSION

Paid customer loyalty programs are emerging in the modern business world, but as of date there is limited paid-LP-specific research (primarily Ashley et al. 2015; related work in Jang, Mattila and Bai 2007; online articles from business professionals). Especially as these programs become more prominent, it is important to understand how they fundamentally operate, in order to create more optimal programs for company and customer alike. In this review, I classify paid LPs to include only those with accumulating rewards, outline factors that influence value perceptions at membership sign-up such as tier structure and reward complexity, propose explanations and opportunities through behavioral economics and the goal-gradient theory as to program engagement and spend, and examine the customer renewal process with room to consider the value of redemptions further from a corporate perspective.

While I propose several future research directions including point values, goal-gradient boosting models, and initial sign-up bonuses, there is plenty more to be done within this field. Further work into understanding empirical customer tendencies as paid LP members and renewals will be critical to developing the understanding of how these programs work, for example. In fact, one of the biggest limitations of this paper was the lack of empirical evidence, restricting it to interpretation in the context of behavioral economics and existing LP literature. Given that loyalty program data is hard to acquire, especially data with sufficient length and volume (many of these programs are very new), it is understandable why there may not have been as much empirical research yet conducted. Moreover, if existing LP work can be applied, at least generally, to paid LPs, many scholars may not view these new adaptions of loyalty programs as sufficiently novel of a business idea to research separately.

Yet, the potential for these paid programs is immense. Research ranging from expectancy-value theory to consumer status perceptions, loyalty program behavior, and customer lifetime value suggest that having an elite "paid" program could allow companies to best-fit their most valuable customers. Paid LPs can be status symbols that incentivize customers to enhance their interactions with a firm, leading to development of greater customer loyalty -- which is less observed in existing research that often only can examine one program (due to availability) per setting. Plus, the knowledge available in quantitative marketing has the potential to model these programs. Complex lifetime value calculations are used in increasingly many companies today, while advanced econometric and machine-learning models can capture nuances in customer behavior, meaning that the only things in the way of a model like the one I propose to understand LP renewal with are (1) data access and (2) someone to conduct the research.

This review is far from a complete understanding of paid loyalty programs, simply because there is so much nuance to the different varieties and complexities that can be present. But that is what makes this entire loyalty program field interesting -- the companies implementing these programs are always trying new rewards and structures to appeal to customers, each of which can be examined through a marketing and economics lens. The interaction of the factors can create highly profitable settings for businesses, but moreover provide great customer experience and status towards those who the business values most. Being able to create a model to value how customers behave in a paid LP, such as considering lifetime value and redemption cost, was the original goal of this paper -- and still remains an aspiration for future work on my personal behalf. Just as an effective paid loyalty program can spark a customer to buy in and love the experience, the incredible multifaceted dynamics of this newer marketing subfield similarly has captured my personal loyalty.

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