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Psychological and economic considerations of rewards programs

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ABSTRACT

This study uses primary research and examples from the industry to demonstrate the application of human motivation and behavior theory in designing successful rewards programs. We identify the intrinsic and extrinsic motivators of human behavior that a firm needs to be aware of while designing a successful rewards program. Analysis of data collected from 228 respondents supports the hypotheses establishing the relationship between the antecedents, namely, Goal Proximity, Reward Valence, Perceived Effort, and Customer Reactance, and Consumer Intention to enroll in a reward program. We also find that Reward Valence has the strongest positive effect and Perceived Effort has the strongest negative effect on Consumer Intention. This study offers both prescriptive and descriptive insights. The results of this study further our understanding of the reasons of the success of various rewards programs. Also, the results of this study can aid managers in developing successful rewards programs by striving for effort-reward incongruity to overcome consumer reactance in joining rewards programs.

1. Introduction

> You get what you reward. Be clear about what you want to get and systematically reward it.—Bob Nelson

From sophisticated airline mileage and credit card programs to simple hardware store and coffee shop programs, consumer rewards programs have become an extremely popular facet of corporate marketing strategy over the last 25 years. According to the Nilson Report of 2003, only 35 million of 300 million active credit and debit card holders in the US participated in rewards programs during the previous year (Armstrong, 2003). According to Nielsen (2013)'s Global Survey, in 2013, almost 59% respondents stated that they had been offered loyalty programs at places where they shopped and almost 84% stated that they would choose a retailer that offered loyalty programs. Consumer rewards programs attempt to nurture consumer loyalty by influencing behavior. In practice, rewards programs compensate individuals with various types of remuneration for their purchasing behaviors. The program form, design, and implementation can be modified collectively or independently by the company to solicit the desired behavioral response.

This study set out to examine the psychological and economic considerations that marketers need to be aware of while designing successful rewards programs. The growing popularity of the consumer rewards program technique has prompted many companies to implement their own versions with varied results. This rapid expansion of rewards programs has led to varying degrees of success or failure based notably on the extent of research prior to development and implementation. Research indicates that properly constructed rewards programs can be a valuable asset leading to increased market penetration, higher revenues, and greater brand loyalty (Kivetz and Simonson, 2003; Kivetz et al., 2006; Mägi, 2003; Sharp and Sharp, 1997). Conversely, a haphazardly assembled rewards program can increase marketing costs without altering consumer behavior or producing the desired results.

Although there are limits to available research, the applicability of psychological behavior theory to understanding the economic success of a consumer rewards program invariably exists (Wirtz et al., 2007). An analysis of consumer loyalty programs (CLP), as they are often called, and of which rewards programs are a subset, is not complete without an examination of the psychological aspects that compel consumers to participate in such programs. Surprisingly, while there is ample research from the psychological discipline concerning rewards and motivation, relatively little research has been produced that determines the effects of rewards and rewards programs in the context of consumerism and consumption. In this study we examine the application of human motivation theory and behavior theory in designing successful rewards programs. We study the effect of Goal Proximity, Reward Valence, Perceived Effort, and Customer Reactance on a consumer's intention to enroll in a reward program (Fig. 1). To the best of our knowledge no study has examined the concomitant

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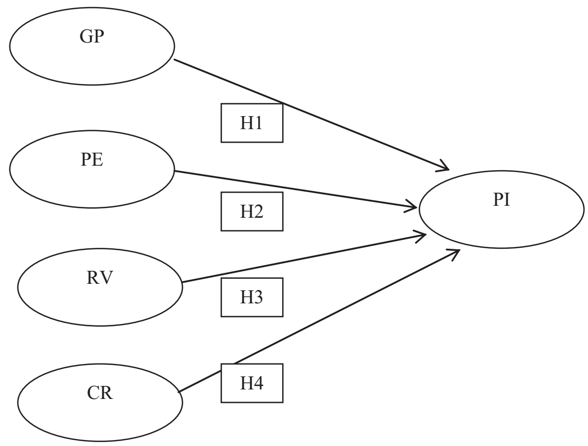

Fig. 1. Hypothesized model. GA: Goal Proximity; PE: Perceived Effort; RV: Reward Valence; CR: Customer Reactance, PI: Purchase Intentions.

influence of these four variables. Additionally, we rank the variables in the order of their influence and find that Reward Valence has the strongest positive effect and Perceived Effort has the strongest negative effect on Consumer Intention. Given tight budgetary constraints, ranking may help companies identify the more critical variables to focus on while designing successful rewards programs. The findings of the study are discussed using various examples from the industry. An understanding of the mechanism of rewards programs is necessary as poorly designed or implemented rewards programs can adversely affect firm performance. The authors also examine some common traps of rewards programs that marketers need to be aware of while designing such programs.

2. Theory

Previous studies investigate whether rewards programs are assets or liabilities, and what managers consequently do in order to revive them. These studies were created in order to determine whether: (1) Rewards programs create loyalty; (2) Rewards programs create spending habits that one may not have had previously; (3) Rewards programs are an asset to some companies; and (4) Rewards programs are a liability to other companies. Further, scholars have consolidated rewards programs and categorized them into four groups. These include: (1) members receive an additional discount at the time of purchase; (2) members receive an item for free when they purchase additional units; (3) members receive rebates or points based on cumulative purchases—popularly called consumer loyalty programs (CLP); and (4) members receive targeted coupons (Berman, 2006). Studies have indicated that among the different types of programs Customer Loyalty Programs remain as the most popular form of rewards programs and have potential to develop affective loyalty towards the retailer (García Gómez et al., 2012a, 2012b). Although there is some research that exists in the CLP domain (Table 1), what is there allows us to draw some interesting conclusions regarding the implementation and application of rewards programs. The focus of many studies is the timing or likelihood of adoption of loyalty program or the impact of the loyalty program. Key outcome variables investigated include intent to enroll, future purchase, and loyalty (attitudinal or behavioral). Loyalty programs have been shown to positively affect share of wallet (Mägi, 2003) and future purchases (Kivetz et al., 2006). Several studies indicate that loyalty programs, as the name suggests, have a significant positive direct effect on customer loyalty. Although the position taken by different researchers varies from very favorable (García Gómez et al., 2012a, 2012b), to moderate (Nunes and Drèze, 2004; Sharp and Sharp, 1997) to low (O'Brien and Jones, 1995), substantial support has been found for success of rewards programs in creating customer loyalty in the domain of grocery retail (García Gómez et al., 2012a, 2012b). Most popular types of reward offered in loyalty programs include tourism, utility goods, discount coupons, and experience/leisure. Although there is substantial research examining success of rewards programs in the context of grocery retail, there is fairly limited research examining rewards programs in the context of tourism services.

Intent to enroll into rewards programs is another area of research. Studies have examined the effect of nature of reward, individual characteristics and customer attitude on the customer's intent to enroll into the loyalty program (García Gómez et al., 2012a, 2012b; Leenheer et al., 2007). Researchers have examined effect of nature of rewards on the perceived value of (Yi and Jeon, 2003) and preference towards (Kivetz and Simonson, 2002) the loyalty programs. This stream of research indicates that the nature of reward offered can influence the outcomes of the loyalty program. In previous studies, rewards have been classified as tangible versus intangible, immediate versus deferred, direct versus indirect, efficient versus inefficient, monetary versus luxury, and utilitarian versus hedonistic to name a few. Although various classifications have been offered by different researchers, it has been noted that such classifications may be inadequate or specific to context of the study. Therefore a more comprehensive framework may be required under which one may be able to examine the effectiveness of different types of rewards programs.

In order to better understand the nature of rewards programs, a review of how rewards affect behavior and/or motivation is presented beginning with a discussion of the Law of Effect. The Law of Effect serves as the basic premise behind Reinforcement Theory, the predominant psychological mechanism behind rewards programs. The Law of Effect states that behavior that results in a pleasant outcome is likely to be repeated; behavior that results in an unpleasant outcome is not likely to be repeated (Thorndike, 1911). Skinner (1953) then popularized the concept of operant conditioning which is the process of applying the Law of Effect to control behavior by manipulating its consequences. Both positive and negative reinforcement can lead to future behavior. If the consequences of behavior are pleasant thereby making that behavior more likely to be repeated in the future, then this form of operant conditioning is called positive reinforcement. If the consequences of behavior are the removal of an unpleasant consequence thereby making the desired behavior more likely to be repeated, then the operant conditioning is referred to as negative reinforcement. Punishment and extinction are two other strategies of reinforcement. These two are not scrutinized in this study since their application to rewards programs seems unethical.

In its simplest form, a customer rewards program is designed to provide some benefit or equivalent substitution to the customer for executing some transaction (or number of transactions) with a particular firm. The idea is that the benefit, or reward, is of some value to the consumer, and because the reward is given in response to a certain behavior – in this case executing some transaction(s) – that behavior will be more likely to occur again in the future. This description of rewards programs certainly fits the classic definition of positive reinforcement. Similar to the myriad effects well-documented in reinforcement and motivational psychological literature, there seem to be analogies that exist within the consumerism/rewards context or are otherwise moderated by the consumer environment.

While examining the psychological aspects of rewards programs, the nature of the program is an important consideration as customers can respond in different ways to the different types of rewards programs. In order to develop the framework of our analysis, we