

Introduction:

This essay will present information relative to frequency loyalty programs in the hospitality industry. Included will be descriptions of the types of programs and identification of their key features. Also included will be discussion of new elements of the Starwood Preferred Guest Program and recommendations to the director of the HHonors Worldwide program on actions designed to answer Starwood's initiatives.

What is a frequency loyalty program?

A customer loyalty program is a scheme where customers are rewarded for repeat patronages (O'Malley, 1998). Johnson & Kurt (1998) stated a loyalty program as any marketing program is designed to increase the lifetime value of current customers through a long term interactive relationship. Accordingly, four areas are fundamentally important in defining the characteristics of a loyalty program, those being:

- Discount
- Internal rewards
- External partners
- Rewards and special treatments.

How do frequency loyalty programs work?

Hospitality loyalty programs tend to fall into two broad categories:

Points-based frequency programs where guests earn points based on spend or stays which can be exchanged for rooms or other benefits. Large, multiple segment operators with broad geographic distribution (such as Marriott,

Starwood, and Hilton) have implemented elaborate points-based programs, and such programs have numerous virtues:

- They are voluntary: the guest decides to join and decides to share their personal information.
- They are easy to understand: Guests stay, spend and get points, which can be redeemed for free stays.
- They are straightforward to administer, with the right investments in technology and business process integration.
- They support non-points-based awards also, such as special registration lines, or upgrades.
- They are effective: Market Metrix¹ reports that 34 percent of hotel guests say that a loyalty program was a key factor in hotel choice, from a sample dominated by points-based programs.

Recognition programs where guests' preferences are captured, retained and communicated throughout the brand and utilized to enhance future visits.

- The essence of a guest recognition-based program revolves around capturing guest preferences and making them available to enhance future stay experiences. Some of these programs call for enrollment and use of a member ID number. The Wyndham By Request program is one such example of this class of program.
- Others are based on staff observations, where line personnel are incented to record relevant guest behaviors, so that the request can be anticipated on the next visit.

Both varieties of programs have their place. Different organizations establish different programs according to their size, competitive posture and other attributes. These choices lead to other decisions about what technology to deploy and how to administer it.

Of course, the points-based programs support elements of guest recognition. Examples include flagging elite members as such to associates or populating reservations with key preferences such as nonsmoking or smoking. The difference is that in a points program, the points are the currency valued by the guest. In a recognition program, the experience becomes the currency and thus a tangible extension of the brand.

What are loyalty programs supposed to do and what are the major issues facing companies that offer such programs?

Hotel profitability is very sensitive to revenue. The purpose of the loyalty program is to reward loyal customers with preferential treatments and ensure their continual loyalty and long-term revenue. The ultimate goal is to make profits. If the program will not yield sufficient profits, it must be a failure.

Jones and O'Brien (1995) believed that there are five factors that will add value to a program from a customer's point of view:

- The cash value of redemption reward
- The range of choice of rewards
- The aspirational value of the rewards
- The subjective likelihood of achieving rewards
- The scheme's ease of use

Can these guest loyalty programs be measured and how do these programs affect the guest's decision process in selecting a hotel?

Customer loyalty is particularly important to the hotel industry, because most hotel-industry segments are mature and competition is strong. Reichheld and Sasser (1990) found that a 5-percent increase in customer retention resulted in a 25- to 125-percent increase in profits in nine service-industry groups they studied. Thus, the goal of relationship marketing is to build customers' loyalty based on factors other than pure economics or product attributes, and building a relationship with customers should be the strategic focus of loyalty programs.

Fornell (1992) stated that high customer satisfaction increases loyalty for current customers, reduces price elasticity, protects current customers from competitive efforts, lowers the cost of future transactions, reduces failure costs, reduces the need to attract new customers, and enhances the reputation of a firm. According to the research on the relationship between quality and customer satisfaction and economic benefits, conducted by Anderson, Fornell and Lehmann (1994), even though economic returns from improving customer satisfaction are not immediately realized, with a long run perspective, increasing customer satisfaction is extremely important because it affects future cash flows and market share increases.

According to Dr. Itamar Simonson, professor at Stanford's Graduate School of Business, "If consumers see an offer that seems to fit them better than other consumers, that fit completely colors their assessment of how attractive the

offer is. As a result, by creating what appears like personal fit, marketers can attract consumers to frequency programs and many other promotional offers."

Are loyalty programs successfully driving incremental revenue that is cost effective and profitable or is it now just part of the cost of doing business in this industry?

Although studies like those cited above demonstrate that loyalty programs would seem to be important to customers, what is not known is which program elements create satisfaction or repeat business, and therefore revenues. Indeed, the financial efficacy for hotels of loyalty programs is very unclear, since such programs are no guarantee of either customer loyalty or - more importantly - repeat business. Rather than "loyalty" programs, studies demonstrate that the most important factor in garnering repeat business is customer service.

From the study of relationships between customer satisfaction and loyalty, done by Jones & Sasser (1995), highly satisfied customers become highly loyal customers. Fornell, et al (1996) stated that customer satisfaction is generally seen as having a simple effect on loyalty. They found the link between satisfaction and loyalty in markets where customers have choices is a simple, linear relationship as satisfaction goes up so does loyalty. This finding can be applied to the hospitality industry given that customers have a number of choices. Therefore customer satisfaction is especially important in order to improve loyalty.

However, even “loyalty” is not synonymous with repeat business. A study published by Cornell University, for example, calls into question the widely held belief that loyalty means repeat business. The study, written by Cornell Hotel School Professor Judy Siguaw, was published in the August 2004 issue of the Cornell Hotel and Restaurant Administration Quarterly.

The theory that satisfied, “loyal” guests generate repeat business in the lodging industry was challenged by the results of a study of 364 guests at two similar big-city hotels. Analysis showed only a weak connection between satisfaction and loyalty, which is a precursor to repeat purchases. Examining such factors as purpose of travel and demographics, the study revealed another finding that may give hoteliers pause, especially considering the industry's huge expenditures on frequent-guest programs. The study found that business travelers were among the least loyal of the guests responding to this survey.

Other findings:

- Chief factors that built guest loyalty were hotel design and amenities.
- The foremost factor in the purchase decision was service.

“The implication is that hoteliers might consider redirecting some of their frequent-guest expenditures toward strengthening human resources and improving guest experience through design and amenities,” Siguaw observed.

Memo to Jeff Diskin:

In short, Mr Diskin, Hilton would make a mistake to involve itself in attempting to match each of the elements of its competitor's new campaign.

What are the different impacts these programs have on redemption across Hilton's offerings?

Hotel industry surveys indicate that the estimated market size for frequent guests program is worth \$11.1 billion and the average member belongs to 3.5 programs. Within that market, Hilton HHonors members spent about \$4.6 billion on accommodation per year, not all of which is with Hilton. The Hilton HHonors' members were a huge potential pool, from which Hilton should get more loyalty. From the historic operation status of Hilton HHonors, it had been successful. First, its revenues had been in the region of \$158 per night per guest, and occupancy had exceeded break-even. Second, it had established close relationships with franchisees. The franchisees identified with building long-term customer loyalty, understood the value of HHonors program, and were eager to become membership. Third, Hilton was the only hotel chain to offer Double Dipping. And Double Dipping brought win-win result for Hilton and its collaborating Airline partners. Hilton would get more customers' information or contact directly with the customers from airline frequent flyer programs.

How should Hilton respond to the 4 key features of Starwood's Plan?

- No Blackout Dates. Hilton should not attempt to duplicate this feature of Starwood's program. It has not been shown that opening additional dates improves either retention or repetition. On the other hand, doing so definitely does increase the program's cost, so there does not appear to be any benefit to this element. Predictive software programs can help determine the likelihood of vacancies, so that Gold members could be

- offered rooms during normal blackout periods, except during periods of extraordinary room demand.
- **No Capacity Controls.** As with blackout dates, there is no compelling evidence to suggest that the extraordinary costs of eliminating capacity controls would significantly improve repetition rates. Hilton accommodations should remain subject to capacity controls.
 - **Paperless Controls.** As mentioned previously, a loyalty program's ease of use and a customer's ability to conveniently redeem rewards are major factors in a program's success. Previously, there were convenience problems in Hilton's program, including Hilton's relatively limited network size and distribution. More than half of HHonors member stays went to competing chains annually; whereas, the software loyalty program of Starwood was much more user-friendly and simplified customers' ability to get rewards, thus improving their percentage of repeat visitations among program members. Hilton should abolish the paper-based certificates, relying instead on computerized redemption, thereby making the process easier for its HHonors members, and also reducing expenses by eliminating paper, handling and postage costs.
 - **Hotel Reimbursement.** Since blackout dates will not be lifted, it will be unnecessary for Hilton to increase its reimbursement rates to member properties.

Recommendations:

As was demonstrated in the 2004 Siguaw paper, Hilton would be more likely to improve its level of repeat guest visits by concentrating its time, efforts and money in areas of customer service and hotel amenities than in its HHonors program. Furthermore, the “double dipping” feature of the current HHonors program is a significant differentiator from any competing program, which already serves to satisfy some of the key elements that seem to make a loyalty program successful, including the redemption value, the range of choices, and the likelihood of achieving rewards, matters deemed important by Jones and O’Brien (1995). Hilton is already strong in each of the 4 areas suggested by the Jones & O’Brien paper:

- Discount – Monetary services that the program offers to all of their members.
- Internal Rewards – Rewards that the members can redeem to the hotels service/products.
- External Partners and Rewards – Partners and the rewards that the members can use/redeem.
- Special Treatments – Non-monetary services that the program offers to all of their Members

Other tactics that would enhance the HHonors program include service guarantees and robust complaint management programs.

Conclusion:

Hilton should not engage itself into the price war and advertising campaign of its competitor. Rather, Hilton should take a different position and hold on to its members and keep differentiating HHonors from Starwood and other competitors, using those factors of its current program that are already proven to be successful, such as room upgrades and airline miles, followed by free hotel stays, and other on-property benefits and services. Meanwhile, using the database of Hilton HHonors and cooperating airline partners would keep long-track record of customers' preferences as well as dislikes. That would successfully customize each guest's experience and offer the most efficient service for its guests. Consumer satisfaction and words of mouth would be a more effective and influential ads rather than huge-investment on advertising campaign.

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