An examination of restaurant loyalty programs: what kinds of rewards do customers prefer?

Dongsuk Jang

University of Nevada, Las Vegas, Nevada, USA, and

Anna S. Mattila

Pennsylvania State University, University Park, Pennsylvania, USA

Abstract

Purpose – This study aims to investigate customer preferences towards loyalty reward programs in the restaurant industry. Willingness to join such programs and expected benefits are also examined.

Design/methodology/approach – Focus group interviews followed by a survey methodology were used to test the research questions. The study sample included participants in a popular arts festival in Pennsylvania, USA and restaurant patrons in Las Vegas, USA.

Findings – A vast majority of study respondents favored immediate, necessary, and monetary gratification. These results were consistent across restaurant types (fast-food versus casual dining). Although savings was the most sought-after benefit, intangible benefits such as quality and convenience also received high ratings. Casual dining customers, in particular, seemed to be highly motivated by exploration and entertainment-type benefits.

Research limitations/implications – Future research should investigate the optimal level or combination of rewards. In addition, other types of restaurants (e.g. fine dining) might require different types of reward schemes.

Practical implications – The findings of this study suggest that restaurant operators in the casual dining and fast-food segments should consider employing immediate, necessary, and monetary rewards as opposed to points-system, luxury, and non-monetary rewards. In terms of motivation to join loyalty reward programs, the study results indicate that casual dining patrons are looking for exciting and entertaining rewards in addition to mere cost savings.

Originality/value – This paper helps restaurant managers to better understand customer preferences for loyalty reward programs and to realize the value of targeted rewards.

Keywords Loyalty schemes, Customer loyalty, Fast foods, United States of America

Paper type Research paper

Introduction

Customer loyalty is the name of the game in today’s highly competitive restaurant industry. It has been estimated that attracting a new customer is three to five times more costly than retaining an existing customer (Orr, 1995; Fierman, 1994; O’Brien and Jones, 1995). These cost advantages are generated by reduced service costs, increased spending (purchasing), lowered price sensitivity, and elevated word-of-mouth referrals (Reichheld and Sasser, 1990). To leverage customer retention, many restaurant companies have jumped on the frequency programs bandwagon. Some of these efforts have been highly successful. Subway’s Electronic Sub Club Card program, for instance, shows that the average reward member spends $7.85 per visit, almost 50 percent more per transaction compared to the average non-member, who spends $5.25 per visit (Frequency Marketing Inc., 2003).
Despite the popularity of loyalty reward programs in the restaurant industry, little is known about the attractiveness of the rewards offered. To that end, the purpose of this study is to explore restaurant customers’ reward preferences and their motivations for joining a loyalty reward program. More specifically, we examined several types of rewards, such as immediate versus accumulated (points system) rewards, necessary versus luxury rewards and monetary versus non-monetary rewards.

Background literature
The objectives of loyalty or frequency reward programs can be categorized into three basic groups. First, most of these programs are designed to protect the existing customer base and thereby maintain sales levels, margins, and profits. The second goal is to enhance the piece of the pie or the share of the stomach by increasing sales to existing customers. The third objective is to enhance cross-selling the company’s products and services (Dowling and Uncles, 1997). Rewarding customers for their loyalty is increasingly common in many segments of the travel industry, including airlines and hotels (Kim et al., 2004). As a result, customers are now able to pay for goods and services with new currencies such as frequent flier miles and Diner’s Club Rewards (Dreze and Nunes, 2004). Despite their rising popularity, both the academic literature and popular press cast some doubt over the effectiveness of these “frequent user” programs (Fournier et al., 1998; Dowling and Uncles, 1997). For example, a study of frequent gamblers showed that only about one third of the loyalty reward members were truly loyal to the company (Baloglu, 2002). Given these opposing views on loyalty programs, it is important to understand what kinds of rewards customers prefer when making dining decisions.

One of the elements that determine a program’s value from a customer’s perspective is the timing of the reward (Dowling and Uncles, 1997). Most frequent-dining programs offer financial rewards based on a points system to reward loyalty (Mattila, 2001). In other words, an accumulation of a certain number of points equals a reward. For example, one dollar spent is equal to one point and a total of 1,250 points is worth a free appetizer or a dessert at TGI Friday’s. Previous work, however, suggests that delayed redemption reduces the power of loyalty rewards (Bootzin et al., 1991). To alleviate this problem, many point-benefit programs regularly send their members a statement of accumulated points (Dowling and Uncles, 1997). Since people typically prefer immediate rewards to delayed gratification, we expect that most restaurant customers, if given a choice, prefer immediate rewards to point-system rewards even if accumulated rewards carry higher values.

Another factor driving customer preferences is the amount effort needed to reach the requirements of a particular reward. In general, the consumption of luxury items is hard for consumers to justify because such experiences tend to result in feelings of guilt (Berry, 1994; Prelec and Loewenstein, 1998; Kivetz and Simonson, 2002). Yet, Kivetz and Simonson (2002) found that when the reward requirement is high, customers seem to prefer luxury rewards (e.g. expensive wine) to necessary rewards (e.g. gas coupons). We thus predict that restaurant customers prefer necessary rewards over luxury items, but that increased effort leads to a higher preference for luxury rewards.

A third variable in the rewards game is the relative efficiency of monetary versus non-monetary rewards (Kivetz and Simonson, 2002). Some companies, such as
Discover Card, use cash as reward currency while others, such as American Express, stick to non-monetary rewards. As an example of monetary rewards in the restaurant industry, Rewards Network offers up to 20 percent saving in its affiliated restaurants around the country (Rewards Network Inc., 2004). Conversely, some restaurants reward loyalty with non-monetary items, such as Hardrock Cafe’s preferred seating for its All Access members. Since the results from our focus group interviews indicate that monetary rewards are more convenient to redeem and that they offer more flexibility, we expect that restaurant customers prefer monetary rewards to non-monetary rewards of the same value.

In addition to reward preferences, we examined consumer motivations for joining loyalty reward programs. Prior research in sales promotions has demonstrated that monetary rewards (savings) are not the only reason why consumers look for special deals (Chandon et al., 2000). Quality, convenience, value expression and hedonic benefits such as exploration and entertainment surfaced as additional motivators among shoppers. We expect that restaurant type might moderate customer motivations to join a loyalty reward program. In other words, hedonic or experiential benefits might be more relevant to casual dining restaurants while savings might be the driving force in the context of fast-foods.

Methods
To ensure that the concepts adapted from general marketing are applicable to the context of restaurant services, we conducted two, six-member, gender-specific focus group interviews with graduate students in hospitality management. The results from the transcribed tapes indicated that most participants preferred monetary and immediate rewards. Moreover, non-monetary benefits were also shown to be applicable to our context.

Questionnaire and sample
Based on an extensive literature review and the results of our focus group interviews, a survey questionnaire consisting of 19 items was developed. To test for context effects, two versions of the survey (A and B) were created. In the A survey, questions on pages 1 and 2 reflected a casual dining restaurant situation while pages 3 and 4 used fast foods as the context. The order of the context was reversed for the B survey. Burger King, Subway, McDonald’s and Wendy’s were used as examples of the fast food restaurants, while Outback Steak House and Red Lobster served as examples of casual dining restaurants. A 10 percent reward rate was assumed for both restaurant categories. At first glance this reward rate for fast food restaurants might seem unusual. However, a 10 percent reward rate is fairly common in the fast food industry. For example, Subway’s Electronic Sub Club gives the customer one point per dollar spent (plus double points for the first usage). Once the customer reaches a 50-point level, Subway offers a free six-inch sandwich. Since the price of a six-inch sandwich is about $4, this “freebie” is equivalent to a 10 percent reward.

Respondents were asked to state their preference for immediate rewards versus points-system rewards, necessary rewards versus luxury rewards, and monetary rewards versus non-monetary rewards. Following Kivetz and Simonson’s (2002) study, facial massage and wine were used as luxury rewards, while grocery and gas coupons served as examples of necessary rewards. To control for program requirements, the
required expenditures ranged from $200 to $500 and the number of visits from 40 to 100 for fast food restaurants and eight to 20 visits for fine dining restaurants. Relying on our focus group interviews and real-life examples, monetary discount/cash back were used for monetary rewards while preferred seating, flower delivery and luxury desserts exemplified non-monetary rewards. The final questionnaire was pre-tested with six randomly selected graduate students for comprehension and readability.

The sample population of this study was composed of participants in a popular arts festival in Pennsylvania and restaurant patrons in Las Vegas, USA. Having two geographically diverse samples enhances the generalizability of our results. The response rate was approximately 60 percent, thus resulting in a sample size of 145 respondents. Two responses were incomplete and they were eliminated.

**Results**

About 15 percent (11/71) of respondents in fast-food restaurants and 26 percent (18/70) of respondents in casual restaurants answered they would not join a 10 percent reward program. However, all reasons (concerns) expressed were regarding only the procedures, such as “expecting lots of promotion e-mails”, “difficulty in redeeming rewards”, and “don’t like to carry the reward card”, and not reasons such as “not interested in reward programs”. Thus, we included all those in our analysis.

In the fast-food context, 83 percent (60/72) of respondents preferred immediate rewards (immediate discount or cash back) to points-system rewards (after a customer’s bonus points reach a preset requirement, she/he can get somewhat higher quality rewards). Similar results were obtained for casual dining scenarios. Eighty-five percent (60/71) of the respondents preferred immediate rewards.

Ninety-three percent of the respondents (66/71) in the fast-food sample preferred monetary rewards (discounts or cash back) to non-monetary rewards (special services or products, such as preferred seating, flower service, or luxurious desserts) while the corresponding number was slightly lower in the casual dining sample (86 percent, 62/71). When we asked the participants who preferred monetary rewards over non-monetary rewards for their reasons, “more choices and flexibility” was the most salient reason (4.52 in fast-food restaurants and 4.60 in casual restaurant on five Likert scale anchored from 0 = strongly disagree, 3 = no opinion, 5 = strongly agree). The next closest choice was “convenient to redeem” (4.42 and 4.46, respectively).

The frequencies for necessary versus luxury rewards are shown in Table I. Although a vast majority of the respondents preferred necessary rewards ($20 worth of gas coupons or the same value grocery coupons) to luxury rewards ($20 coupons for wine or the same value facial massage), their preferences for luxury rewards increased

<table>
<thead>
<tr>
<th>Requirement</th>
<th>Fast food restaurant</th>
<th>Casual dining restaurant</th>
</tr>
</thead>
<tbody>
<tr>
<td>Preference (%)</td>
<td>n</td>
<td>Preference (%)</td>
</tr>
<tr>
<td>Requirement $200, reward $20</td>
<td>86.1</td>
<td>62/72</td>
</tr>
<tr>
<td>Requirement $500, reward $20</td>
<td>84.7</td>
<td>61/72</td>
</tr>
<tr>
<td>Requirement 40/8 visits, reward $20</td>
<td>91.7</td>
<td>66/72</td>
</tr>
<tr>
<td>Requirement 100/40 visits, reward $20</td>
<td>84.7</td>
<td>61/72</td>
</tr>
</tbody>
</table>

**Note:** Fast food restaurant conditions/casual restaurant conditions; 40 and 100 visits for fast food restaurants and eight and 40 visits for casual dining restaurants
slightly with higher effort requirements. Specifically, compared to its dollar amount counterpart, the frequency of patronage requirement resulted in a larger increase in people’s preferences, 8 percent and 7 percent increases for luxury rewards in the fast food and casual dining respectively.

Eighty-five percent of the respondents in the fast-food sample were willing to join a 10 percent loyalty program (i.e. for every $100 spent, there is a reward worth $10), while the corresponding number in the casual dining sample was slightly lower (74 percent). In terms of expected benefits from joining loyalty programs, savings was the most highly rated attribute in both samples. See Table II for the mean ratings. In addition, quality as a benefit received high ratings among the casual dining respondents (mean = 4.56). As expected, the means for value expression, exploration, and entertainment benefits were significantly higher for the casual dining sample than for the fast-food sample, ($t = -3.543, p = 0.001; t = -2.178, p = 0.031; t = -3.447, p = 0.001$, respectively).

**Implications**

Developing an effective loyalty reward program requires a thorough understanding of what kinds of rewards are perceived favorably by the firm’s customer base. The purpose of this research was to examine customer preferences for loyalty reward programs in the restaurant industry. Specifically, we examined customer preferences for immediate versus accumulated rewards (points-system rewards), necessary versus luxury rewards, and monetary versus non-monetary rewards.

The findings of this study indicate that both fast-food and casual dining customers seem to favor immediate, necessary, and monetary rewards over points-system, luxury, and non-monetary rewards. These results are largely consistent with previous research in various contexts (Berry, 1994; Dowling and Uncles, 1997; O’Brien and Jones, 1995; and Prelec and Lowenstein, 1998). The tendency to prefer immediate gratification, non-luxury rewards was consistent across demographic classification variables such as gender, age, income level, and employment status.

Consumer preference and management preference could be different. One of the reasons will be the cost. For example, management may want to offer a $10 dessert instead of giving $10 cash, because the actual net cost of the dessert will be lower than $10. So, how to coordinate both will be management’s task. Like this, offering a cash

<table>
<thead>
<tr>
<th>Table II. Expected benefits from joining a 10 percent restaurant loyalty reward program</th>
<th>Fast food restaurant</th>
<th>Casual dining restaurant</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Mean</td>
<td>SD</td>
</tr>
<tr>
<td>I feel that I am getting a good deal (saving)</td>
<td>4.56</td>
<td>0.60</td>
</tr>
<tr>
<td>I can have a higher-quality product at the same price (quality)</td>
<td>3.97</td>
<td>0.99</td>
</tr>
<tr>
<td>These programs make my life easier (convenience)</td>
<td>3.62</td>
<td>0.93</td>
</tr>
<tr>
<td>I can be proud of my purchase (value expression)</td>
<td>2.94</td>
<td>1.12</td>
</tr>
<tr>
<td>I feel like trying new brands (exploration)</td>
<td>3.25</td>
<td>1.19</td>
</tr>
<tr>
<td>These promotions are fun (entertainment)</td>
<td>2.99</td>
<td>1.25</td>
</tr>
</tbody>
</table>

**Note:** On a five-point Likert scale anchored from 0 = not at all, 3 = no opinion, 5 = strongly important
discount as an immediate reward is not always best. Our findings show that customers prefer immediate rewards, whereas management may want to conduct postponed rewards, which are more efficient to induce repeated patronage. Thus, how to coordinate both approaches into every different situation will be another management task.

Although the rate of preference increased slightly with higher reward requirements, the vast majority of our respondents preferred necessary or monetary rewards over more hedonic rewards such as a facial massage or a bottle of wine. This finding is somewhat inconsistent with Kivetz and Simonson’s (2002) study in which they reported that customers prefer luxury rewards when the effort required to reach a reward are high. They argued that increased effort tends to reduce feelings of guilt associated with the consumption of luxury items. In this study, increasing the requirements in terms of frequency had a stronger impact on shifting preferences for luxury rewards than manipulating effort via dollars spent. Consequently, restaurants might want to restrict the use of hedonic rewards to their most frequent customers. Given the high level of effort required to reach the “preferred customer” status, these consumers are less likely to feel guilty when offered luxury rewards such as an expensive bottle of wine.

Our study findings indicate that there is strong potential for developing loyalty reward programs in the restaurant industry. Less than 10 percent of the respondents currently carried a restaurant loyalty reward membership while nearly 80 percent showed interest in joining a 10 percent loyalty reward program (i.e. for every $100 spent, there is a reward worth of $10). By improving some procedures, such as no need to present the reward card, easier redeeming processes, and by clearly communicating the program benefits, restaurant operators could enlarge their membership bases.

In addition to monetary savings, customers are seeking quality, convenience, and entertainment benefits. These intangible benefits seem to be particularly salient in the casual dining context. Hence, casual dining operations might want to focus on advertising exciting and entertaining events as rewards as well as saving benefits when launching their loyalty reward programs.

This study forced customers to choose between several types loyalty rewards (i.e. monetary versus non-monetary, immediate versus points system and luxury versus necessary rewards). However, in real life, restaurant patrons might prefer flexible reward schemes that fit their individual needs. Future research with different methodology (e.g. conjoint analysis) is needed to shed light onto this issue. Moreover, investigating different types of restaurants, such as fine-dining or theme restaurants, would provide further insight into what truly drives customer preferences in the powerful loyalty reward game.

References


