

Making brand loyalty programmes succeed



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Abstract

After interviewing 37 packaged goods managers, a consumer study is conducted to determine what types of brand loyalty programmes work best for what types of consumers. In general, loyalty programmes are found to be most appropriate for products and services that have high margins, are heavily invested in over a consumer's lifetime, and are difficult to differentiate. The best programmes offer relevant benefits to the consumer, avoid self-serving behaviour, and offer rewards that directly support the proposition of the brand. Interestingly, programmes offering benefits of only moderate value are shown to have the most cost-effective impact on increasing purchases. These findings lead us to believe that most generous loyalty programmes may provide unnecessarily costly benefit packages. For many programmes, less may be more.

Loyalty programmes seemed to be the marketing fad of the 1980s. What began with American Airlines' AAdvantage programme in 1981 (and really, with trading stamps well before that), quickly grew to include almost every major airline in the country. Complementary services such as hotels and rental car agencies soon followed, with Holiday Inn and Marriott debuting Priority Club and Honored Guest, respectively, in 1983. By the end of the decade, though, some companies were beginning to question the effectiveness and necessity of their own programmes. In 1990, for example, both Radisson and Omni Hotels retreated from the loyalty programme arena in order to concentrate more on service.¹

Today, however, loyalty programmes are still used by many companies and are being established by many more.

They can now be found across a spectrum of industries, from credit cards issuers to long-distance carriers to restaurants and grocery stores. Recently, consumer packaged goods companies have begun to embrace the concept of these programmes. PepsiCo, for example, has established loyalty programmes for both its Pepsi Cola and Frito Lay products. Frito Lay's Planet Lunch programme, the biggest promotional programme in the snack-maker's history, follows a similar formula to Pepsi's Pepsi Stuff. By collecting and redeeming points on Frito Lay packages, participants can earn various awards. The most valuable prize, a camera, can be earned by sending in 375 points.²

For some companies, the decision to establish a loyalty programme was made according to the principle that it is more expensive to obtain a new

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Table 1 The best practices of loyalty programmes

Ideal products and services	Loyalty programmes work best for products and services that have high margins and are difficult to differentiate. They are also appropriate for products and services that a customer will invest heavily in over a long period of time.
Amount of customer information	The best programmes collect a wealth of customer information. This information, usually obtained by matching enrolment data and purchase behaviour, is used to tailor products and services to the specific needs of consumers.
Relevance to the consumer	Companies with the best programmes continually refine the benefits of their programmes to make them relevant to the consumer. The benefits must be real, not self-serving to the sponsoring company.
Rewards	Rewards should directly build loyalty in the consumer by supporting the proposition of the brand.
Customer Retention	The best programmes go beyond retaining their programme members as customers. Loyalty programmes should also increase the amount a customer spends with the organisation.

customer than it is to keep a current one. Using a loyalty programme to retain customers, however, doesn't come without a price. 'Customer loyalty isn't cheap ... the Sheraton frequent traveler program costs \$30m to \$50m annually. But the lack of loyalty is even more expensive.'³ If a company can increase customer retention by 2 per cent, costs can decrease by as much as 10 per cent.⁴

Yet not all loyalty programmes experience long-term success. In some cases, companies regretfully rush into a loyalty programme because the competition established one of its own. In other cases, after a programme has been established, its intended purpose sometimes becomes clouded or forgotten over time. Instead of being an effective marketing tool for an organisation, the programme becomes an expensive administrative task. The purpose of this research is to discuss best practices of loyalty programmes and answer the following key questions in order to improve their effectiveness:

- What products and services are best suited for loyalty programmes?
- What consumer information should be collected?
- How can the cost effectiveness of a loyalty programme be calculated?
- What benefit levels are most appropriate for what consumer segments?
- What product categories respond best to loyalty programmes?

THE BEST PRACTICES OF LOYALTY PROGRAMMES

To gain a better understanding of the best practices of loyalty programmes, telephone interviews were carried out with 37 marketers responsible for loyalty programmes from service companies, consumer packaged goods companies and direct marketing agencies. The directed interviews focused on their successes, their regrets and their advice about the successful elements of loyalty programmes. This information was then analysed and compared with an 84-manager mail

survey that we conducted in parallel. The best practices summarised in Table 1 are a result of this comparison.

WHAT PRODUCTS AND SERVICES ARE BEST SUITED FOR LOYALTY PROGRAMMES?

Loyalty programmes work best for products and services with high margins and for products and services that a customer will invest heavily in over a long period of time. They also work best for products and services that are not unique.⁵ Airlines and hotels, therefore, are ideal for these programmes, since their services are difficult to differentiate and are more expensive in comparison with other purchases. In addition, consumers will spend a great deal for these products over their lifetimes if they frequently travel for pleasure or business. Loyalty programmes, therefore, serve to capture a majority of these lifetime purchases. In other words, these programmes attempt to maximise the lifetime value of a customer to a firm.

From a different angle, according to Dowling and Uncles,⁶ consumer loyalty programmes work better for high-involvement products than for low-involvement products. Their assertion is consistent with the high margin theory since high-involvement products tend to be more expensive and have higher margins. Consider, however, that a major premium ice cream manufacturer currently operates a successful loyalty programme for its line of ice cream. This product line is suitable for a consumer loyalty programme since it is not unique, has high margins, and has the ability to be purchased many times over a customer's lifetime. Though ice cream is

not a high-involvement product, the ice cream manufacturer has been able to create and increase consumer involvement by periodically mailing full-colour brochures full of dessert recipes and new product information to its programme members. The exclusivity of belonging to such a programme and benefit of being the first to receive information about new products and services can make the consumer feel special and closer to the organisation. Leveraging this emotional connection is a key element of success in promotions and with loyalty programmes for hedonic products and services.⁷

In fact, since the incentives used in a consumer packaged goods programme are not as valuable as for an airline or hotel (coupons versus free trips or upgrades), Bissel⁸ argues the only way consumer packaged goods loyalty programmes can be effective is to build customer involvement. That involvement can be created by communicating to consumers in a way that 'appreciates the consumer's personal needs and lifestyle'. While the miles or points awarded by airlines and by hotel programmes establish an exit barrier for a consumer, the emotional link developed with the product by a consumer packaged goods company is its programme's exit barrier. Consumers that are not willing to put forth the effort to begin a relationship with a new brand, therefore, will remain with the existing brand.

WHAT CONSUMER INFORMATION SHOULD BE COLLECTED?

The best loyalty programmes are able to obtain a wealth of customer information on product usage, purchasing habits, feelings, attitudes, personality

and demographics. This information is then used to tailor products and services to the specific needs of consumers. Primarily, information is obtained through an initial enrolment process and subsequent recording of purchases. Airlines, hotels and car rental agencies have an advantage in information collection, since customers must identify themselves at the time of purchase. This customer information can then be easily linked with previously established enrolment data to establish focused marketing efforts to unique segments of purchasers. The best companies also respect their customer's wishes to keep information obtained in the relationship confidential.

The best consumer packaged goods loyalty programmes require an enrolment form that obtains background information from the customer. A programme that simply requires a name, address and proofs of purchase from consumers redeeming awards is not building a long-term, knowledgeable relationship with the customer. An enrolment form is a means of self-selection. Consumers willing to take the time to complete an enrolment form for a programme are usually more interested in the product than a casual purchaser. Some programmes even require a sufficient number of proofs of purchase to be included with an enrolment form to ensure only the most interested and frequent consumers are joining the programme. The result is a database of consumers most likely to want a long-term relationship with the company.

Consumer packaged goods companies, however, are at a disadvantage, since a customer's purchases cannot be easily linked with established cus-

tomers information. Though some have partnered with retailers to obtain this information, consumer packaged goods manufacturers currently do not have the capability to obtain data for every customer purchase. Consumer packaged goods companies that supplement customer communications with coupons to induce purchase can use redemption rates as a way to measure effectiveness. However, these data can be less than accurate if a company's best customers avoid the use of coupons. For now, the best that consumer packaged goods companies can do is rely on panel data to evaluate the effectiveness of their programmes.

THE 'THREE Rs' OF LOYALTY PROGRAMMES

(1) Relevance to the consumer

Companies with the best programmes continue to refine the benefits of their programmes to make them relevant to the consumer. A manufacturer of low-fat, frozen foods for health conscious consumers publishes a quarterly magazine that includes recipes and articles about exercise and nutrition. This manufacturer feels the success of its programme comes from a well-defined focused effort to provide information that its customers want. A beverage producer feels the success of its programme can be attributed to rewards (sports gear with the beverage's logo) that were of interest to its target market of teens and young adults.

These companies conduct extensive research to determine what its members desire from belonging to the loyalty programme. One major hotel chain, for example, uses periodic focus groups to determine whether any

changes need to be made to its frequent guest programme. Another hotel chain uses surveys to stay a step ahead of its competitors' loyalty programmes. As part of its loyalty programme, the ice cream manufacturer was periodically mailing a full-colour brochure with dessert and non-dessert related recipes. After consumer research concluded consumers were not interested in non-dessert recipes, however, the manufacturer switched to an all-dessert recipe format.

No matter how relevant, however, a programme cannot appear to be too self-serving. A company that continually heaps promotions for its products or services onto its customers will undermine any attempt of establishing a sincere relationship. Members must be provided with real benefits that make them feel valued, not targeted.

(2) Rewards to the consumer

According to Dowling and Uncles,⁶ rewards used in a loyalty programme should directly support the 'value proposition and position of the product'. A gasoline retailer that uses free airline travel as a reward is indirectly motivating loyalty in its customers. When the award programme disappears, the prime reason for purchasing the product also disappears. An airline, however, is directly supporting the value proposition of its own product by offering free flights and first class upgrades as rewards.

At first glance, it appears incongruent for a beverage company to reward consumers with sports gear. In actuality, the programme was a long-term brand-building effort rather than

a temporary sales promotion. The prizes, combined with television and radio advertising and point of purchase materials, connected with the consumers' perceptions of the brand's personality.⁹

(3) Retention of the consumer

The companies with the best loyalty programmes go beyond merely retaining their programme members as customers. Using detailed information about background and purchase behaviour for more focused targeting, companies with effective programmes are able to generate incremental business from their members and maximise their share of a customer's purchases. The major hotel chain mentioned previously uses retention rates as one of the measures of success for its programme. It also examines, however, whether or not rewards are simply subsidising business that would have occurred regardless of the programme. Herein lies one of the biggest hidden costs of loyalty programmes.

If members expire from the programme, they should still be treated as current members.¹⁰ A major airline, for example, sends a special offer to members that have not flown for several months after expiring from the programme. While keeping non-members permanently in the database is not recommended owing to cost considerations, such initial treatment demonstrates the company is concerned for its customers even when their purchases stop. Membership expiration is also an opportunity to communicate with the customer and discover whether leaving the programme resulted from a change in

lifestyle or past dissatisfaction with the product. If the reason is dissatisfaction, this communication effort is an opportunity to resolve the problem and potentially win back a customer. If dissatisfaction was not the reason for expiration, communicating with the customer is an opportunity to show appreciation for past purchases. Since former members have the ability to influence new and existing customers, a positive last impression of the company is important.

DETERMINING THE COST EFFECTIVENESS OF A LOYALTY PROGRAMME

The cost effectiveness of a programme cannot be determined by simply subtracting its administrative costs from gross profit. Such an equation does not account for profit cannibalised by rewards (free products, coupons, etc.) given to or redeemed by consumers whose purchases remain unchanged from pre-programme levels. These consumers could be true loyalists who would have purchased a product or service without the motivation of a loyalty programme. Yet, they could also be consumers who refrained from switching to a competitor because of this loyalty programme.

Loyalty programmes must increase purchases beyond the cost of what would be cannibalised from existing sales. A major cereal manufacturer, for example, scrapped a test loyalty programme, though it helped increase sales in the targeted segment by 7.1 per cent. At the same time, the redemption rate of coupons (given as rewards to the targeted segment) increased from 5 per cent to 22 per cent. Coupons were cannibalising too much of exist-

ing sales, making the programme ineffective.

In the simplest form, the cost effectiveness of a programme can be determined by the following equation:

$$\text{Gain/loss} = (U_a P) - D - (U_w P) - A$$

where U_a is unit sales after programme implementation, P is price per unit, D is dollar amount of coupons or other incentives used, U_w is unit sales before programme, and A is the administrative cost of the programme.

This equation can then be used to determine the cost effectiveness of programmes for different levels of users. Since administrative costs are fixed, they are removed from consideration when comparing various programmes across different user groups, such as heavy users versus light users.

WHAT LOYALTY PROGRAMMES ARE MOST COST EFFECTIVE?

To determine how a certain type of programme influences a particular level of user, three separate questionnaires were administered to over 153 members of the Brand Revitalisation Consumer Panel.¹¹⁻¹³ Each consumer was asked about their purchase intentions toward one of three different loyalty programmes and for three different product lines. Three levels of loyalty programmes were developed: a high-reward programme with valuable benefits, a moderate programme with average benefits, and a low-reward programme with minimal benefits. Each respondent received the same level of loyalty programme for all three product lines. Respondents were only aware of the level of loyalty programme that had been randomly as-

Table 2 Examples of three loyalty programme levels

High-reward programme	Moderate-reward programme	Low-reward programme
A monthly full-colour booklet with recipes, games and puzzles, and information concerning new and existing products in the product line	A quarterly full-colour booklet with recipes and information concerning new and existing products in the product line	A quarterly one-page newsletter with information concerning new and existing products in the product line
Coupons included in the booklet for a \$1.00 discount off any product in the product line	Coupons included in the booklet for a \$0.50 discount off any product in the product line	Coupons included in the newsletter for a \$0.25 discount off any product in the product line
Free product line merchandise with 10 proofs of purchase. (For example, receive a free coffee mug with the product line's logo by sending in 10 proofs of purchase.)	Free product line merchandise with 20 proofs of purchase. (For example, receive a free coffee mug with the product line's logo by sending in 20 proofs of purchase.)	Product line merchandise with 20 proofs of purchase and a \$5.00 postage and handling fee (For example, receive a coffee mug with the product line's logo by sending in 20 proofs of purchase from any product in the product line and \$5.00 for postage and handling.)

signed to them. The different levels offered to the other participants were not discussed.

The three product lines involved in the study were Kellogg's cereals (Special K, Frosted Flakes, Rice Krispies), Betty Crocker meal and side preparation products (Hamburger Helper, Suddenly Salad, Bisquick), and Land O' Lakes dairy products (Land O' Lakes Butter, Land O' Lakes Dairy Case Cheese, Land O' Lakes Sour Cream). The three levels of loyalty programmes are noted in Table 2.

Consumers on the panel were asked to estimate their purchases in the next 12 months for a particular level of programme. Past purchase behaviour was also recorded to determine the consumers' level of current product line use (non-user, light user and heavy user) and to judge the growth or decrease in sales for a particular level of programme. While there were originally concerns with having con-


sumers estimate and project their usage for 12 months,¹⁴ pre-studies showed that this was the most sensitive measure to use in this regard. Having people make these projections was effective in capturing the purchase intentions of stockpile-prone, multiple-unit purchases that do not always occur on a weekly or monthly basis.¹⁵

Changes in intended purchases were used to evaluate the effectiveness of these programmes. Actual total purchases from the entire last 12-month period were used to establish the level of product use (non-user, light-user and heavy-user). Light users and heavy users of a particular product line were estimated using average purchases per year. In general, light users were coded as people who purchased 12 or fewer times in the past year, and heavy users purchased the target product in excess of 12 times in the past year. Sixty-eight per cent of the user base were coded as light users.

Table 3 Change in purchases across all products and all users

High-reward programme	Moderate-reward programme	Low-reward programme
+1.4 97%	+1.2 80%	+0.7 60%

Table 4 Change in units purchased across user segments

Programme level	Non-user	Light user	Heavy user
High	+0.1 	+1.2	+2.4
Moderate	+1.2	+0.8	+2.0
Low	0.0	+0.8	+1.1

RESULTS

Across all products and all types of users, the high-reward programme generated a 1.4-unit increase in estimated purchases for the next month, while the moderate-reward programme generated a 1.2-unit increase in purchase intentions, and the low-reward programme generated a 0.07-unit increase (see Table 3). Across user segments, the high-reward programme generated the most increase in units purchased for both the light- and heavy-user segments (see Table 4). As the programmes became less attractive, sales increases for heavy users decreased from 2.4 to 1.1 units. The moderate and low programmes had the same impact on the light user, increasing sales only 0.8 units for the next month. It is interesting that the moderate-reward programme stimulated the most purchase increase among non-users, while the high and low programmes had little or no effect on this user segment. Subsequent interviews indicated that the overly high levels of high-reward programmes intimidated non-users. To these people, high-

reward programmes implied too much involvement and commitment.

Perhaps the most important decision for a manager to make is which loyalty programme will be most cost effective to implement. In this study, the most cost-effective programme for non-users and heavy users offered only moderate levels of benefits. As shown in Table 5, this moderate benefit programme captured an average monthly incremental gain of \$2.95 from the non-user and \$3.10 from the heavy user. For light users, the most cost-effective programme was the one that offered the lowest benefit package. This programme level captured an average monthly incremental gain of \$2.00 from the light user.

These results demonstrate the importance of choosing an appropriate programme level. A marketer targeting a specific segment could actually spend less on a programme and gain more in return. In this study, for example, using a high-reward programme to target a heavy user would be the least cost effective. A company would gain only an additional \$0.50 per customer

Table 5 Estimating the cost effectiveness of brand loyalty programmes

Programme level	Average monthly purchases before/after programme start (in units)	Change in purchases (in units)	Average monthly revenue after programme start (\$) ^a	Dollar amount of coupons used (\$) ^b	Average monthly revenue before start (\$) ^c	Gain/loss (\$) ^d
Non-user						
High	0.0/0.1	+0.1	0.30	0.10	0.00	+0.20
Moderate	0.1/1.3	+0.2	3.90	0.65	0.30	+2.95
Low	0.0/0.1	0.0	0.00	0.00	0.00	+0.00
Light-user						
High	1.3/2.5	+1.2	7.50	2.50	2.50	+1.10
Moderate	1.7/2.5	+0.8	7.50	1.25	1.25	+1.15
Low	0.8/1.6	+0.8	4.80	0.40	0.40	+2.00
Heavy-user						
High	4.3/6.7	+2.4	20.10	6.70	12.90	+0.50
Moderate	3.8/5.8	+2.0	17.40	2.90	11.40	+3.10
Low	4.1/5.2	+1.1	15.60	1.30	12.30	+2.00

^a (Monthly purchases before programme + change in purchases) * 3.00/unit. \$3.00 per unit was arbitrarily chosen for this discussion

^b Assumes all purchases were made with coupons of either \$1.00 (High Reward Programme), \$0.50 (Moderate Reward Programme), or \$0.25 (Low Reward Programme). Dollar amount of coupons used = Face value of coupon * Average monthly purchases after programme start

^c Average monthly purchases before programme * \$3.00/unit

^d Gain/Loss = Average monthly revenue after programme — Dollar amount of coupons used — Average monthly revenue before programme start

by implementing this level of programme to target the heavy user, but could obtain \$2.60 more per customer by implementing the moderate programme instead. Even the low-reward programme would provide a more cost-effective advantage compared with the high-reward programme. By identifying and targeting different user segments simultaneously, a company could tailor its rewards and leverage the cost effectiveness of its loyalty programme.

When reviewing these findings, it must be kept in mind that this study measured changes in the purchase likelihood of consumers, not their actual purchases. The actual purchase behaviour of these consumers would change when uncontrollable variables

(such as competitive actions) are added to their environment.

DISCUSSION AND MANAGERIAL IMPLICATIONS

Marketers need to understand that for a loyalty programme to be successful, it must offer obvious benefits to the consumer (see Table 6). In this study, the high- and moderate-reward programmes offered obvious benefits to the consumer in the form of informational product newsletters, valuable coupons and free merchandise. These results indicate that marketers can motivate non-user and heavy-user segments to increase purchases with programmes offering only a moderate level of benefits — light users need

Table 6 Loyalty implications for marketing managers

	Targeting non-users	Targeting light users	Targeting heavy users
Type of programme: In general, the more obvious the benefits, the more effective the programme.	A programme with average benefits is the most effective in stimulating initial trial.	A programme with below average benefits can generate a similar increase in purchases as a programme with comparatively better benefits.	A programme with average benefits can generate a similar increase in purchases as a programme with comparatively better benefits.
Type of product Convenience foods: A programme with attractive benefits is the most effective in increasing planned purchases.	A programme with average benefits is the most effective in stimulating initial trial.	A programme with very attractive benefits is the most effective in increasing planned purchases.	A programme with very attractive benefits is the most effective in increasing planned purchases.
Meal preparation items: A programme with average benefits can increase purchases significantly higher than programmes with better benefits.	A programme with average benefits is the most effective in stimulating initial trial.	A programme with average benefits can generate a greater increase in purchases than a programme with comparatively better benefits.	A programme with average benefits can generate a greater increase in purchases than a programme with comparatively better benefits.
Perishable foods: A programme with average benefits can generate a similar increase in purchases as a programme with comparatively better benefits.	A programme with average benefits is the most effective in stimulating initial trial.	A programme with average benefits can generate a greater increase in purchases than a programme with comparatively better benefits.	A programme with very attractive benefits is the most effective in increasing planned purchases.

even less. Since light users are already interested in the product, only a marginal push is necessary to change behaviour. To a company, a programme offering more valuable incentives to their customers would not be worth the cost.

Across all products, the moderate-reward programme was the only programme that motivated non-users to purchase. Perhaps, the high-reward programme required too much involvement on the part of the non-user and the low-reward programme did not offer enough benefit to induce

trial. The moderate-reward programme might have struck the right balance. As non-users become more familiar with the product, however, a programme with more benefits might be required to sustain interest.

The products used in the study, Kellogg's, Betty Crocker and Land O' Lakes, could be generalised into three categories: convenience foods, meal preparation items and perishable foods. Kellogg's cereals, for example, are an alternative to the traditional hot breakfast. The Betty Crocker products are not meals in themselves, but aid in the

preparation of main meal items and sides. The Land O' Lakes products fit into a category of perishable foods, since they have a limited shelf life and must be refrigerated.

Table 6 outlines the best reward programmes for three broad categories of products. For convenience foods, a programme with very attractive benefits (like the high-reward programme in the survey) is the most effective in increasing planned purchases. Specifically, light and heavy users of this category respond best to this level of loyalty programme. Since these products tend to have higher margins, the coupons in the survey's programme might be inducing additional purchases from consumers wanting more value.

For meal preparation items, a programme with average benefits can increase purchases significantly more than programmes with better benefits. Users of these products might already be content with the value they receive and are not attracted by the coupons. The quarterly newsletter, for example, might be of interest to those wanting new recipes for the products they are currently using. This interest could serve to increase involvement with the brand and positively affect planned purchases.

For perishable foods, a programme with average benefits can generate a similar increase in purchases as a programme with comparatively better benefits. Heavy users, however, should be targeted with an attractive programme. Since perishable items are difficult to stockpile without a good reason for use, perhaps heavy users are enticed with coupons that reduce the risk of purchasing items that might expire before consumption.

SUMMARY

Many different elements must be considered in establishing a profitable loyalty programme. Once established, however, these elements cannot be ignored if the programme is to continue retaining and increasing the value of your customers. Changes in customer needs or use, reactions from competitors or shifts in product or service costs can negatively affect loyalty programmes.

A loyalty programme is a long-term proposition, not a short-term promotion. Management has to be committed to a programme that will last for years, not months. Such commitment will help develop and maintain a strong lifetime relationship with customers. The result of such a close connection will bring many rewards to both sides.

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