Spending or Stockpiling:
Loyalty Program Design and Consumer Decisions to Redeem Points

In many loyalty programs, customers earn points for their purchases and then they can exchange their accumulated points for additional products and services. For example, United Airlines awards members of its MileagePlus rewards program five points (miles) for each dollar spent, and a member might choose to redeem 25,000 points for a flight ticket that costs $250. In a sense, these loyalty program points function as a currency that consumers can spend on products and services instead of spending money. However, we argue that there are important differences in the way consumers think about loyalty points compared to money, and more generally, other currencies.

In this research, we study consumers’ choices between redeeming loyalty points or spending money. Specifically, we investigate how different design characteristics of a loyalty program influence consumers’ choices to redeem loyalty program points or spend money for a specific purchase. We further examine whether the effects are specific to redemption of loyalty points or more general to spending in an unfamiliar currency.

To this end, we first propose a model of the consumer’s choice to redeem points or use money for a purchase, and then we conduct a series of studies to investigate how the design characteristics of a loyalty program influence consumers’ choices. Two key factors captured in our model are the perceived value of a loyalty point relative to money (e.g., in the U.S., the perceived value of a point relative to a dollar) and the consumer’s psychological preference
(bias) for spending points vs. money on a given purchase. We argue that loyalty program design characteristics may affect consumers’ redemption behavior by influencing either the perceived value of a point or consumers’ preferences for redeeming points relative to spending money.

In a series of studies, we investigate how the design characteristics of a loyalty program, such as the numerosity of the exchange rate between loyalty points and money, whether the exchange rate is variable or fixed, the evaluability of the point value, and the price level of the items being redeemed, influence consumers’ choices to redeem loyalty program points or spend money for a specific purchase. In practice, many loyalty programs use a high numerosity exchange rate, such that the number of points required for a reward redemption considerably exceeds the number of dollars required for a cash purchase (e.g., 25,000 points may be required for a reward that costs $250), rather than a low numerosity exchange rate (e.g., 250 points are required for a reward, which costs $250). Loyalty programs can also choose whether to use a fixed exchange rate (e.g., 1 point is always worth $1) or dynamically vary the exchange rate (e.g., 25,000 points can be redeemed for a round-trip flight from New York to San Francisco; if monetary prices for this flight vary between $300 and $500 while the point requirement is fixed, the exchange rate varies between .012 points per dollar and .02 points per dollar).

We first show that when deciding whether to spend loyalty points vs. cash, consumers treat points as a valued resource and try to maximize the value of points redeemed. However, we find that consumers’ willingness to spend loyalty program points instead of stockpiling them for a purchase are systematically shaped by the design characteristics of the loyalty program. We also show that some of these loyalty program design characteristics influence consumers’ redemption behavior mostly by influencing the perceived value of a point (exchange rate), while others will influence redemption behavior mostly by influencing the consumer’s preference
(psychological bias) for redeeming points relative to spending money. Thus, our results further suggest that loyalty program managers can influence both the perceived value of points and redemption rates by manipulating loyalty program characteristics. To increase the perceived value of points, managers should use high numerosity exchange rates ($1 = 100 points). On the other hand, to increase willingness to redeem points, managers should offer high price level reward options, fix the exchange rate between points and money, and use low numerosity exchange rates ($1 = 1 point).

Notably, we show that these characteristics have a stronger effect on loyalty program point redemption than on more general spending of foreign currencies. That is, stability of the exchange rate, numerosity, and price level influenced redemption rates for points, but not for foreign currency. Thus, these effects cannot be explained by lower familiarity with points than money, and we cannot apply previous research on spending foreign currencies to inform loyalty program design. Clearly, loyalty program design characteristics are critical to consider when thinking about how to engage members as they stockpile and redeem their points, and we propose an initial framework for studying their effects.