

**MKTG 8604**

**New Frontiers in Retailing: Magic and Logic**

**The New Loyalty Paradigm and Next-Generation Loyalty Programs**

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## Executive Summary

A new loyalty paradigm is emerging with next-generation programs that are more effective at attracting, retaining, and engaging customers. Traditional loyalty programs are no longer sufficient to meet the evolving needs of brands and consumers.

To take these loyalty programs to the next generation, this paper we will explore three theses around what the new loyalty paradigm will be based on changing consumer trends and growing expectations:

**Thesis I: To win, brands must master hyper-personalization, which goes beyond traditional personalization techniques to create truly unique experiences for each customer.**

Hyper personalization is about leveraging data to create a different brand experience for an audience of one, while respecting individual data privacy preferences.

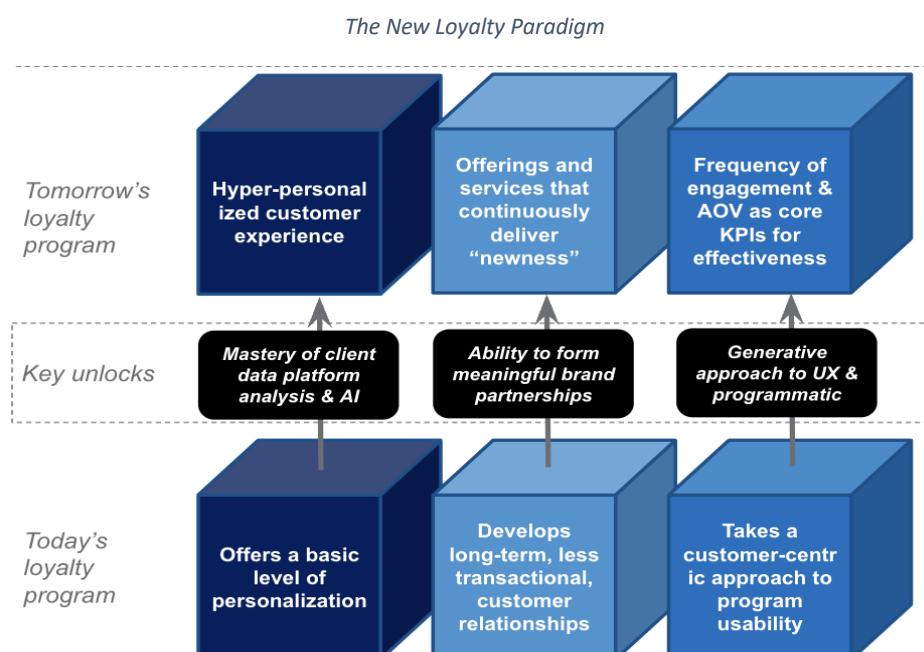
**Thesis II: Loyalty programs must move beyond transactional rewards and focus on creating constant newness and surprise to retain and entertain their customers.**

Brands should identify partnerships that can extend their brand value to the customer with new technologies, surprising brand collaborations, and relevant influencers.

**Thesis III: Brands must shift their focus from traditional loyalty metrics and design to optimize metrics that reflect customer engagement and lifetime value.**

Customer “stickiness” with the brand can be measured through new engagement metrics beyond transactional value such as time engaged and frequency of visiting.

Our analysis starts with the assumption that most brands today are already personalizing their loyalty programs, thinking of ways to be less transactional in their customer interactions, and taking a customer-centric approach to user experience and loyalty program interaction.



## Introduction and Problem Statement

In today's hypercompetitive market, traditional loyalty programs have become less effective in driving customer loyalty, with many customers feeling overwhelmed by a sea of similar programs and worried about where to spend their money amidst rising costs. Customers are now demanding more personalized, immersive, and memorable experiences from loyalty programs that go beyond transactional rewards.

Furthermore, data privacy concerns and increasing regulatory scrutiny are forcing companies to rethink their loyalty strategies, ensuring a balance of personalization and privacy. With the recent changes in Apple's data privacy rules and data privacy regulations such as GDPR, retailers are pushed to create first-party data to continue reaching their customers. Data provides insights for brands to better reach new customers and retain existing ones. Therefore, companies are exploring new loyalty paradigms and next-generation loyalty programs that offer more value to customers and build deeper, emotional connections.

Loyalty programs have evolved since the 18th century, with merchants using "loyalty currency" including copper coins, tokens, stamps, box-tops, and physical cards to reward customers for their purchases and encourage collection to redeem for rewards. With the rise of e-commerce and digital platforms, loyalty programs have evolved from physical tokens to digital systems that track actions across channels both in-store and online.

From a brand perspective, loyalty programs help to increase access to customer data, improve retention rates, encourage repeat purchases, and increase brand value. If done correctly, they are viewed by customers as delivering a positive and rewarding customer experience.

While many brands today understand these nuances and are taking steps to 1) offer a personalized rewards program, 2) create offerings and experiences that develop a longer-term, less transactional relationship with the customer, and 3) iterate on a customer-centric approach to user experience, the new loyalty paradigm takes it one step further. Hyper-personalizing content and offerings, driving newness, and elevating different KPIs to measure loyalty program effectiveness are the governing themes for the loyalty program of the future.

*Example of loyalty currency program from the 1960's*



## THESIS I: To win, brands must master hyper-personalization, which goes beyond traditional personalization techniques to create truly unique experiences for each customer.

There is a race amongst today's retailers to be as personal as possible when it comes to their customer relationships. The new loyalty is a relationship-based approach that builds emotional connections with customers in a hyper-personalized way. Hyper-personalization is about leveraging data to create a different brand experience for an audience of one, while respecting individual data privacy preferences. Providing personalized, engaging experiences that delight the customer will be key to the longevity of brands.

### Establishing an emotional connection between the brand and the customer



Figure 1 – Correlation Coefficients of Various Factors with Loyalty Across Different Sectors from Capgemini

Customer experience is critical to a company's retention with 89% of companies seeing customer experience as a key driver of loyalty and retention ([Huify](#)). CEO of Beyond Philosophy states “Many organizations do not consider an emotional attachment. The reason customers return is not just a rational perspective but an emotional perspective.” The correlation between emotions and loyalty is by far the highest, compared to rational and value ([Capgemini Report](#)). Moreover, *unique* customer experiences establish an even greater emotional connection between the brand and the customer. Notably, the retail sector has the highest correlation coefficient (0.74) among other sectors in the study (**Figure 1**). However, there is a disconnect - company executives think they understand customer emotions, but only 15% of consumers agree.

A brand establishes emotional connections by generating an authentic brand identity and providing customized experiences based on individual preferences, social responsibility, and customer engagement. A hyper-personalized experience is the biggest key to this. Beyond customer segmentation, hyper-personalization combines behavioral and real-time data to tailor products, services, and marketing content to each consumer.

Additionally, emotionally engaged consumers, both in-person and online, expect brands to know their individual preferences on a personal level (**Figure 2**). Personalization is table stakes and important to growing customer loyalty and retention over time.

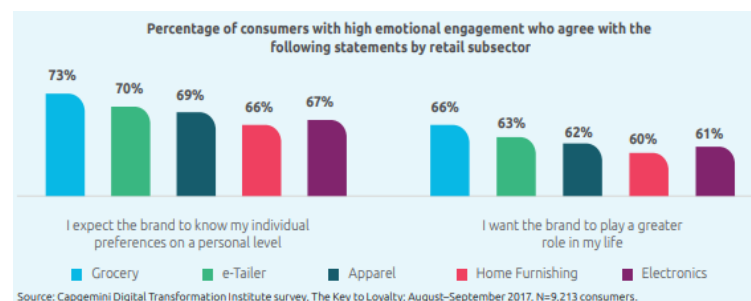


Figure 2 – Emotional Engagement Survey from Capgemini

### Leveraging data and AI to accelerate hyper-personalization

A mastery of client data platform analysis using AI/ML will allow retailers to offer the most personalized view of their brand to each customer, unlocking revenue growth. Customer data can be gathered via data platforms, loyalty programs, cookie tracking, and point-of-sale sites. AI can enable organizations to make sense of this data to make recommendations for customers and determine what actions to take. A traditional personalization experience might include advertising household goods a customer purchased a few months ago and suggesting they might need a restock. A hyper-personalized advertisement would include even more data about the purchase location and time, method of payment, and suggestions of complementary goods delivered on a preferred social media channel to be even more relevant to the customer.

According to [Instapage](#) (**Figure 3**), there is a personalization maturity curve, of which predictive personalization is at the highest end. **Starbucks** is an example of a company that has used AI and ML recommendation engines to deliver relevant, hyper-personalized experiences to their customers with great success. The coffee giant now counts some 30.4 million active members for the program in the US, meaning that ~12%, or nearly one in eight, American adults are loyal members of the club (**Figure 4**). They deliver over 400,000 variants of hyper-personalized food/beverage offers unique to a consumer's past order history and activity on the app, including location-based history. In fact, Deep Brew, Starbucks' artificial intelligence initiative, looks for tech-based solutions to optimize its business function and customer experience ([Starbucks](#)). By considering contextual data and customer preferences, Starbucks can increase the effectiveness of its marketing campaigns and boost revenue.

### Balancing hyper-personalization and customer privacy

As consumer concerns regarding how retailers and brands use data grow, companies must be conscious about how and when they use customer data. According to the [2022 Gartner Customer Service and Support Survey](#), 71% of B2C and 86% of B2B customers expect companies to be well-informed about their personal information during an interaction. Yet, high-profile data breaches and data ethics scandals have

Figure 3 – Personalization Maturity Curve from Instapage

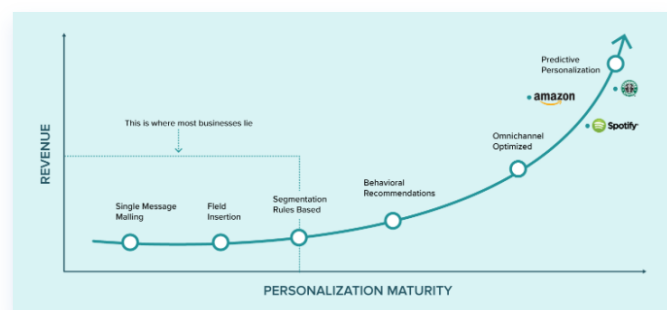
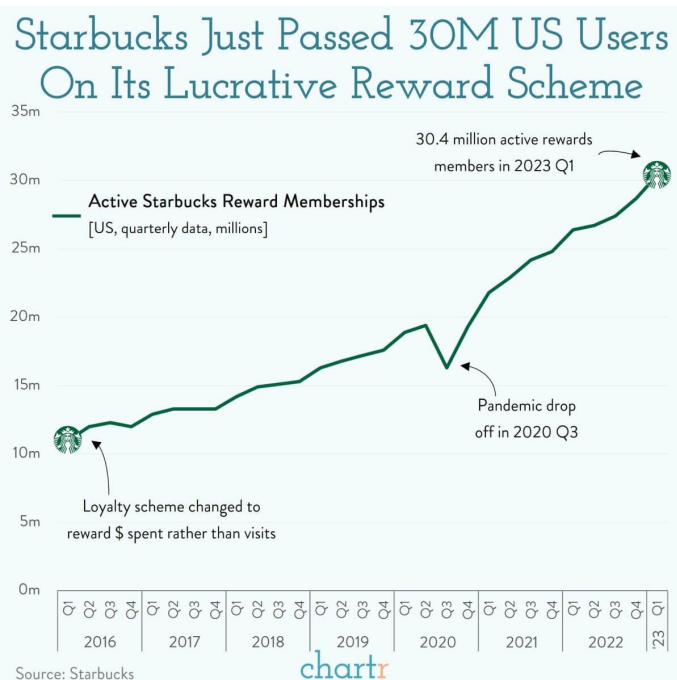


Figure 4 – From Chart, Starbucks' Reward Membership Volume



raised concerns over the use of data. As a result, iOS 14.5 required app users to opt-in to allow apps to track their behavior across other apps. To protect consumer data, brands must prioritize transparency and give customers control over how their data is used. By informing users on the intended usage of their data, they may be more likely to opt into tracking that enables hyper-personalization.

**Hyper-personalization can also drive brand advocacy through customer engagement and feedback**

Brand interactions are highly valued by emotionally engaged consumers. Valued customers who are asked to participate in product research, provide feedback, and be invited to brand events maintain a higher sense of belonging. The feeling of belonging creates a stronger connection to the brand. Those who advise on product development and engage in user testing are more likely to promote the brand and create a positive feedback loop because their personal feedback and suggestions have been heard. Consumers feel as though they are co-creators, contributing their opinions to strengthen a brand they love and becoming loyal advocates for the brand.

## **THESIS II: Loyalty programs must move beyond transactional rewards and focus on creating constant newness and entertainment to retain and attract customers.**

As loyalty programs continue to pop up seemingly everywhere, the traditional transactional approach to rewards is quickly becoming stale. To truly stand out amongst their peers, brands must focus on creating constant newness for their loyal members. This can be achieved through a variety of tactics, from offering exclusive access to new products or services to opening rewards offerings through partnerships with other brands. In this section, we will explore the importance of moving beyond transactional rewards in loyalty programs and how creating constant newness can help brands maintain a competitive edge.

### **The limitations of transactional rewards**

Transactional rewards, such as discounts or points for purchases, have long been the backbone of loyalty programs in the retail industry. However, as competition continues to increase and consumers become more sophisticated in their shopping habits, transactional rewards are no longer enough to attract and retain customers.

Firstly, transactional rewards create limited differentiation for brands. There are extremely low barriers to entry with this type of program because almost any competitor can easily replicate it. In a crowded market, customers may simply be swayed by the best deal or program offering the most points rather than true brand loyalty. Moreover, transactional rewards have diminishing returns. As customers accumulate points or discounts, the perceived value of each reward decreases over time. This can lead to a lack of engagement and a sense of boredom with the program. Finally, and most importantly, only rewarding customers for transactional behavior is missing out on a great opportunity to build a more meaningful, personal relationship.

To stand out and build long-term loyalty, brands must shift their mindsets from a purely transactional approach to a more experiential one, where customers feel valued and engaged beyond just the basic rewards. Luckily, brands are increasingly aware of this, and, according to a recent Deloitte study, over 54% of customer loyalty programs offer some form of non-transactional rewards ([Deloitte](#), 2021). But which non-transactional rewards are best? Well, that depends on your brand!

### **Designing for constant newness and surprise**

To overcome the limitations of transactional rewards, loyalty programs must focus on creating constant newness and surprise to retain and attract customers. We recommend brands begin by asking themselves a few strategic questions:

1. What unique experiences can we offer our customers that they can't get elsewhere?
2. How can we leverage data to personalize the experience for each customer?
3. What types of partnerships or collaborations can we pursue to add value to our program?
4. How can we incentivize customers to engage with our program beyond just the rewards?
5. How will we measure the success of our non-transactional loyalty program?

Ideally, this exercise will help brands align on their goals and unique competencies needed to create a truly differentiated experience for customers. Once complete, brands should consider the



plethora of tools and tactics available to help them achieve those goals. We have created some ideas in the infographic below:

*Figure 5 – Infographic Created by Us: 7 Tactics to Up Your Loyalty Game*

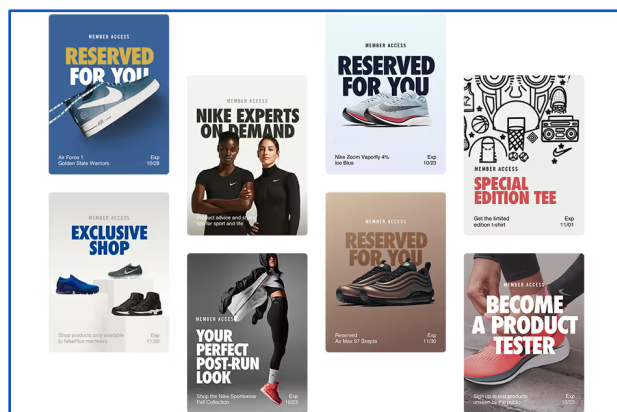


Regardless of the approach selected, an important final consideration for brands is if and how they want to tier their customers. For some brands, tiering customers can be a great incentive for them to spend more. However, other brands may benefit from experimenting with surprising and delighting customers across all levels of spend. This can help create more loyal customers who feel special and loyal to your brand regardless of their wallet size.

### Real examples with real results

We will now spotlight a couple of notable examples of brands that have successfully reinvented their approach to reward collection and redemption.

*Figure 6 – Examples of Customer Engagement Tactics in Nike's Apps*



**Nike** is a fantastic example of a few of the above-mentioned tactics. Customers become members by creating accounts through either the Nike app, Nike Run Club, Nike Training Club, or SNKRS. Once joined, members get access to member-only collections and get rewarded for their engagement with the Nike ecosystem of apps. Members have also had access to sporting events and early access to products ([eCommerce Fastlane](#), 2023). The results speak for themselves, now with over 160 million active members, the program drove 34% digital growth



on an annual basis, as of the end of 2022. Moreover, over 50% of brick-and-mortar, customers are members of the loyalty program ([The Current](#), 2022).

Figure 7 – Image of Target’s “store-in-a-store” with Ulta



Another example we were intrigued by is the partnership between **Target and Ulta**. With their store-in-store concept, customers can earn Ulta rewards when shopping at Target by linking their accounts ([Target](#), 2022). This is a great example of two brands with complementary product offerings working together to offer their customers new value, however, to take it a step further we see the future of loyalty programs offering customers the ability to cross-redeem rewards at either Target or Ulta. Like how credit card companies allow you to convert points to your favorite hotel loyalty program, thoughtful partnerships in other industries could yield similar benefits.

### **THESIS III: Brands must shift their focus from traditional loyalty metrics and design to optimize metrics that reflect customer engagement and lifetime value.**

Through the provision of hyper-personalized and uninterrupted novel offerings, loyalty programs implemented by brands can significantly enhance their value proposition to customers. This enhanced value manifests as a heightened level of customer engagement with the program, as well as an increase in the purchase of products and services. Therefore, the level of "stickiness" of a loyalty program is a crucial factor that contributes to the program's ability to generate sustained interest among customers. This stickiness translates to higher levels of customer frequency and average order value, serving as essential metrics for measuring the effectiveness of loyalty programs.

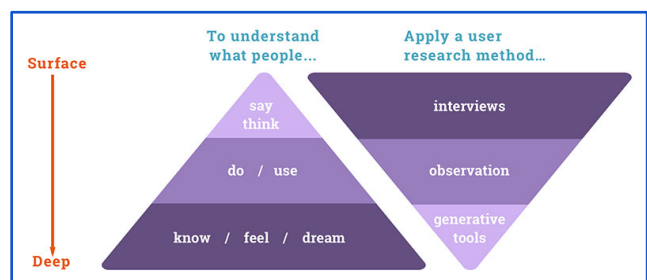
#### **The generative approach to user experience and programmatic content and advertising**

To build brand loyalty, retailers understand customer needs by analyzing customer data, personalizing products and marketing, and creating convenient methods to interact with customers. The next generation of loyalty programs needs to go beyond table stakes and focus on the generation of a unique user experience (UX) and access to its customers.

First, brands should take a generative approach to their user experience. This will not only enable retailers to develop a deep understanding of a brand's customers and find opportunities for unique solutions and product innovation but also dynamically improve customer experience with hyper-personalization. To meet the evolving demands of customers, brands should adopt a generative approach and continuously adapt their product offerings and communication strategies. For example, the online personal styling service **StitchFix** uses customer data and feedback to curate personalized clothing selections for each customer. Then, customers complete a style quiz and a stylist selects multiple clothing items each month for the customer. StitchFix customers can provide feedback on each item, which helps the stylist refine future selections. Each time a customer interacts with a brand, the customer should have the opportunity to provide detailed feedback, which the brand should collect and use to further generate loyalty and stickiness.

Additionally, retailers should use generative research to uncover customer behavior, needs, and motivations (**Figure 8**). The importance of generative research lies in its ability to distinguish retailers from their competitors, mitigate risks, facilitate the creation of user-centric designs and products, as well as provide time and cost savings ([Dovetail](#)). After generative research is conducted and the data is analyzed, brands will have a solid understanding of the best practices to employ to continually deliver meaningful products to customers.

*Figure 8 – Visual Explanation of Generative Research Method*

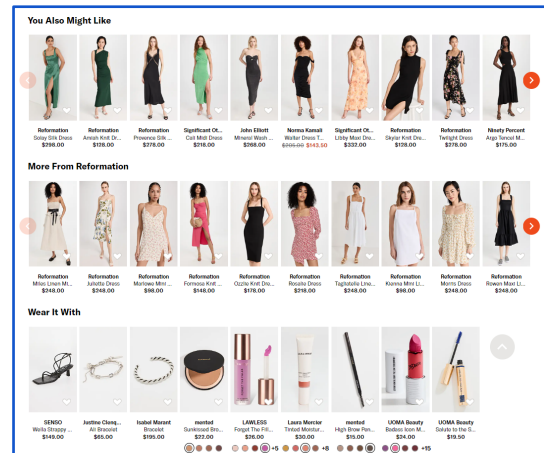


To enhance customer loyalty and increase retention rates, retailers should incorporate personalized and generative user experiences, as well as deploy targeted content and programmatic advertising strategies. For instance, **Shopbop**, an online fashion retailer, has implemented a sophisticated

product recommendation feature that presents customers with multiple relevant options, including items from the same designer and outfits that complement the viewed product (**Figure 9**). This approach has proven effective in maintaining customer engagement throughout the online shopping journey, while simultaneously providing fresh and contextually appropriate product suggestions with each interaction.

Additionally, programmatic advertising, or the use of automated technology for media buying, will be another key method for brands to utilize to grow their customer base and remain relevant to their consumers. Programmatic advertising uses data-driven decision-making to deliver targeted advertising messages to specific audiences, based on their interests, behaviors, and demographics. The programmatic approach allows advertisers to optimize their ad campaigns, reach their desired audience more efficiently, and improve their return on investment. Programmatic advertising and generative UX will strengthen the impact brands will cultivate with their customers, driving loyalty among their base.

*Figure 9 – Example of Generative UX and Personalized Content from Shopbop*



### Key performance indicators: Frequent brand engagement and average order value

The emergence of generative UX and programmatic advertising has the potential to revolutionize loyalty programs and enhance customer retention. Consequently, brands must focus on key performance indicators (KPIs) to effectively implement these approaches.

Loyalty programs should prioritize the *frequency of customer engagement* as a means to increase customer loyalty. Frequent brand engagement plays a vital role in attracting and retaining

customers by building emotional connections, enhancing brand familiarity, increasing brand awareness, and providing personalized experiences. Increasing and tracking the frequency of these interactions can enable brands to better understand customer expectations, curate brand experiences, and retain customers who may otherwise churn. In addition to tracking social media and advertising interactions, brands should develop a customer health score (**Figure 10**) to gain further customer insights and tailor future interactions. By prioritizing frequent, personalized interactions with customers, brands can cultivate a profitable relationship and increase customer retention over time. To achieve this, brands must monitor every

*Figure 10 – Components of a Customer Health Score according to Involve.Ai*



customer interaction in real time and use this data to gain a deeper understanding of their evolving customer behavior.

In addition to measuring engagement frequency, brands must also prioritize *average order value* as another important KPI. Average order value is vital to measure because it allows brands to measure the long-term value of individual customers, make informed marketing and pricing decisions, evaluate business strategies and performance, and ultimately earn more revenue from the same number of customers. As brands become more personalized to the customer, and offer that customer the things they want at the right time, it is likely that the customer will be willing to spend more per purchase.

### **Real examples with real results**

Again, **Nike** serves as an exemplary brand that has emphasized the importance of both frequency and average order value as key performance indicators. Specifically, in fiscal year 2022, Nike experienced a noteworthy 18% annual revenue growth in digital attributed to customer demand across its mobile apps. In Nike's quarterly earnings call President and CEO John Donahoe said, "Increased digital engagement is translating into more repeat buyers, a higher buying frequency, and increased average order value, ultimately driving higher lifetime value through membership. As retail consolidation continues and consumers converge around fewer digital platforms, a distinct Nike consumer experience is driving more direct connections, positioning us well for long-term growth" ([World Footwear](#)). By prioritizing these KPIs, Nike has successfully aimed to increase the frequency of customer interactions and enhance the average order value, ultimately contributing to its success.

In addition, **Sephora's** loyalty program encourages customers to spend more by providing exclusive perks and rewards, personalized recommendations, and limited-time offers. These offers are most seamlessly integrated into Sephora's app, which has played a significant role in the tracking of KPIs like engagement frequency and AOV. While exact statistics are not made publicly available, according to a report by [Criteo](#), a digital marketing technology company that provides personalized advertising solutions to brands and retailers, including Sephora, customers who use the Sephora app make purchases more often and have a higher order value compared to customers who only shop on the Sephora website. Sephora continues to improve its loyalty program through a combination of data analysis, customer feedback, and innovation, all factors that will continuously improve AOV and frequency of engagement.

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