Arvato Systems Whitepaper

How to Adapt Your Loyalty Program to New Customer Requirements

THE EVOLUTION FROM TRANSACTION-BASED CUSTOMER ENGAGEMENT TO EMOTIONAL EXPERIENCE

ARVATO SYSTEMS

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Executive Summary

Bonus programs are important instruments for retailers to increase customer loyalty. Programs such as the „DeutschlandCard", the „Payback card", Lufthansa's „Miles & More" or Deutsche Bahn's „BahnBonus" have been well established for many years. Thanks to their attractiveness for customers, these customer loyalty programs are still working very well today. However, it is foreseeable that transaction-based offers may no longer appeal to all customer groups in the long term.

Gen Z and Gen Alpha in particular have different expectations of a customer loyalty program. Here, „Loyalty 3.0" offers a new dimension of customer loyalty programs as a solution scenario. The term describes an approach to building and maintaining customer relationships that is still unfamiliar to many companies. It's about understanding people's desires for reward, status, performance, competition and interaction and meeting those needs. Big data, artificial intelligence, gamification and social media often play a supporting role in this. Innovative technologies such as blockchain and non fungible tokens (NFT) can also be used.

In our whitepaper, we present innovative strategies that foster an emotional connection to the brand and enable sustainable engagement across all relevant channels - online and offline. You'll gain valuable insights on how to develop new types of customer loyalty programs, discover inspiring real-world examples, and take a look at the future of customer loyalty programs in Web 3.0.

At a Glance: The Terms Loyalty and Customer Loyalty Program

In this whitepaper, you will see the terms „loyalty" and „loyalty program" used interchangeably. The differences between these terms are explained below:

„Loyalty" encompasses not only customer loyalty, but also emotional connection to a company. This emotional connection can be based on positive experiences, values, or shared goals.

„Customer loyalty programs" are marketing strategies that aim to promote and strengthen customer loyalty. They incentivize repeat business through discount cards, loyalty points, or VIP memberships. These initiatives are designed to strengthen the existing bond between customers and a company.

1. Loyalty Programs over the Course of Time

In sales and marketing, it is common knowledge that acquiring new customers is far more expensive than retaining existing ones. To ensure customer loyalty, companies have developed solutions early on to encourage long-term commitment to their brand.

The oldest known form of customer loyalty programs are the **STAMP CARDS,** still in use today, which originated in the 18th century. A stamp is given to customers upon every purchase they make. When the card is full, it can be redeemed for merchandise or discounts.

The next development stage involved programs where customers receive **POINTS** for every purchase. These points can be redeemed for rewards such as discounts, free items, and services.

TIERED PROGRAMS offer incentives to customers based on their engagement and loyalty. Customers can progress up the tiered structure by making additional purchases or participating in more activities. The higher they advance, the greater the rewards and benefits they can receive.

Cross-company customer loyalty programs reward customers for their purchases across multiple participating companies with attractive incentives, typically in the form of **REWARDS**. Programs such as the well-known DeutschlandCard and Payback have proven to be highly successful.

2. Loyalty Programs In the Light of New Customer Expectations

Looking at the young, digital generations, companies should consider evolving their customer loyalty programs. The reason for this recommendation lies in the changing expectations of customers - especially the youngest generations, „Gen Z“ and „Gen Alpha“.

Generation Z includes individuals born between 1994 and 2010. This makes Gen Z the first generation to grow up entirely in the digital age. These customers use digital technologies, social media and messengers extensively and naturally, and they expect the same from their favorite brands.

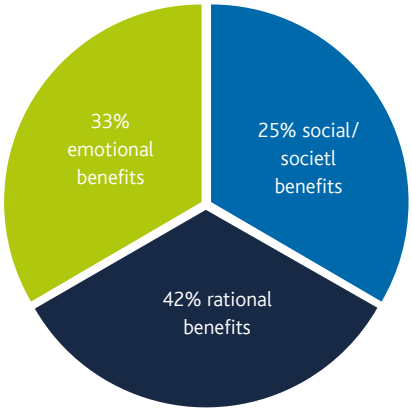
In addition, GenZ values sustainability, honesty and transparency, individuality and personal expression. Transaction-based loyalty programs may appear overly consumer-driven, manipulative, superficial, and generic.

Generation Alpha represents the next generation. Beginning in 2010 and lasting until about 2025, it includes the children of Millennial parents, born between 1980 and 2000. Gen Alpha is considered the first generation born entirely in the digital age.

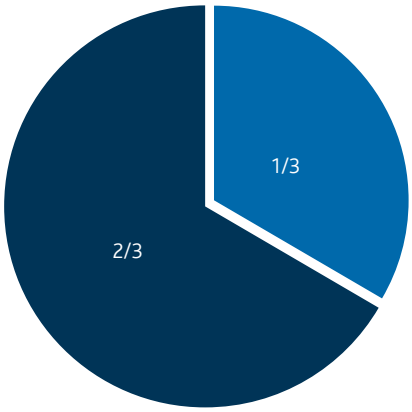
From birth, they grow up in a world dominated by smartphones, tablets and social media. They will embrace new technologies such as artificial intelligence, augmented reality, and the metaverse as a matter of course.

There are no reliable studies on Generation Alpha yet. However, members of this generation are expected to be creative and innovative. They see technology as a means to create and explore new possibilities. Their values are driven by global awareness and a critical view of the world due to the pandemic and climate change.

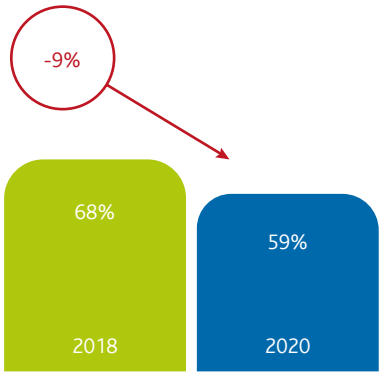
Web2 loyalty programs do not provide the values that customers are looking for



Benefits consumers expect from loyalty programs (McKinsey, 2020)



Two-thirds of established customer loyalty programs do not add value, many even reduce value (McKinsey, 2020)



Proportion of GenZ consumers active in at least one membership rewards program (Forbes, 2022)

3. Trend Topic Loyalty 3.0 - What Does It Mean?

The Web is in a constant state of evolution. Web 2.0 did not focus on technical improvements to the internet, but rather on a new approach to using the internet. The emphasis was on user interaction, exemplified by social media platforms.

In terms of the increasing demands on loyalty programs, Web 2.0 will no longer be able to meet the needs of Generation Z customers. The chart shows the results of recent studies that confirm this fact. According to Forbes (2022), the number of Gen Z consumers in a loyalty program will decline by nine percent. This is because two-thirds of customer loyalty programs do not deliver the benefits customers want (McKinsey, 2021). Consumers are looking for emotional and social benefits from loyalty programs (McKinsey, 2020). Rational benefits like discount codes are out.

Web 3.0 is all about making the Web smarter, more connected, and more personalized. The guiding principle of Web 3.0 is community. A range of technologies such as blockchain, NFTs (non-fungible tokens) and peer-to-peer are being used to achieve this. In addition, data analytics and artificial intelligence are being applied.

So how can companies harness the potential of Web 3.0 community building for their brand and product experiences, and to engage and inspire current and future generations of customers?

Loyalty 3.0 - The Customer Loyalty of the Future?

Loyalty 3.0, the new dimension of customer loyalty, reflects the central motif of Web 3.0 - the community is the focus. Fans of a brand are networked and communicate with each other and the brand. They build an intense connection with the brand by helping to shape offerings and participating in emotional experiences. These experiences motivate customers to return to the brand again and again.

Offers are based on individual customer preferences and behaviors. They take place on a variety of channels - on the website, on social media platforms and, in the future, in the metaverse - as well as offline in retail stores or at events. Loyalty 3.0 offers a modern approach to loyalty that adapts to changing customer behavior and enables companies to build deeper and more meaningful relationships with their customers. Features of a Loyalty 3.0 program include:

- **Personalization:** Loyalty 3.0 programs use data analytics and artificial intelligence to personalize customer offers and experiences. By better understanding customer preferences and behaviors, companies can offer rewards and benefits that are relevant and valuable to individual customers. One feature of the underlying Web 3.0 concept is that users can link their wallet to the accounts of their Loyalty 3.0 programs.

- **Engagement across all channels:** Loyalty 3.0 programs use various channels such as social media, mobile apps, newsletters, and retail experiences to engage customers. In this context, the metaverse is becoming increasingly important. These cross-channel activities are essential to delivering a seamless customer experience that matches customer preferences.

- **Longer dwell time at real and virtual experience points:** A key goal of loyalty programs is to increase the amount of time customers spend with the brand at real or virtual experience points. A great example is in-store retail, where customers are rewarded with engaging experiences that make their time in-store more enjoyable. For example, points can be awarded when customers use a selfie station, sign up for a newsletter, or participate in a consultation. These points can then be redeemed for attractive goodies. This can be done online by posting brand-related content on Instagram or participating in a social media campaign

- **Emotional engagement and customer loyalty:** The new generation of customer loyalty programs aims to build and maintain an emotional bond with customers. One way to do this is through gamification, which integrates playful elements into the commerce context. These incentives encourage customers to repeatedly interact with the brand, fostering greater loyalty and promoting brand advocacy.

- **Meaningful customer data:** The analysis of customer behavior via cookies remains controversial. Many customers now reject them. In addition, Google will probably no longer support third-party cookies from around the middle of next year. Loyalty 3.0 programs can collect more comprehensive and detailed customer data than cookies. Offers such as surveys, polls, or quizzes motivate customers to voluntarily share their data. Such GDPR-compliant „zero-party data" can include information about preferences, interests, and contact information. Zero-party data is more valuable than cookies because it is more accurate, specific, and reliable. It gives companies a more comprehensive view of their customers' behaviors and preferences. This data can be used to improve the overall customer experience and to develop marketing and product development strategies.

- **Higher Customer Lifetime Value (CLV):** Loyalty 3.0 programs significantly increase customer lifetime value. Long-term, loyal customers who have developed a strong emotional attachment to a brand will continue to choose that brand's products. In this context, the price plays a less decisive role than it does for buyers who only buy a product on an occasional or one-time basis.

- **Improved brand image:** Loyalty 3.0 programs can help improve a brand's image by creating a positive and memorable customer experience. Customers interact with the brand much more intensely. This, in turn, can lead to stronger customer loyalty as well as positive communication about the brand, for example on social media channels.

- **Differentiation from the competition:** Thanks to an attractive Loyalty 3.0 program with a unique customer experience, companies have a good chance of sustainably positioning themselves in their markets. By introducing such a program early, they can clearly differentiate themselves from the competition.

4. Examples of Programs With Loyalty 3.0 Elements

A number of well-known companies have already developed and successfully implemented Loyalty 3.0 programs. Here are some inspiring examples:

- **ADIDAS:** Adidas' points-based benefits program, „adiClub", offers members exclusive products, access to events and trips, premium memberships to the running and training apps, and more. Members are motivated to participate in various promotions. For example, they can vote on T-shirt designs or contribute to the „Run for the Oceans Project" with every mile. These projects enhance the image and emotionalization of the brand and, thus, the members' loyalty.

- **NIKE**: With its .SWOOSH platform, Nike has unveiled the „Web 3.0-based home" for its digital „creations," which is currently in „closed beta". Users can buy, collect and share their favorite virtual shoes, jerseys and accessories within the community. They can also curate collections created by Nike-athletes, celebrities and selected users. These digital assets can be worn in video games, for example. In early June 2023, Nike announced a partnership with EA Sports Experiences. This will allow users to express their style in games. The .SWOOSH platform is a perfect example of community engagement in the new Web 3.0 world.

PORSCHE: During last year's Art Basel in Miami, Porsche unveiled the first collection of the brand's NFTs as part of its Web 3.0 strategy. The 3D-artist Patrick Vogel develops digital artworks based on a white Porsche 911 image. Buyers can influence the design of their individual NFT (co-creation). The result is a personal work of art that Porsche describes as „rare, iconic and timeless". The purchase of NFTs is limited to three motifs per person. Buyers can access their NFTs through various crypto wallets.

STARBUCKS: Starbucks is offering „Starbucks Odyssey", a Loyalty 3.0 program based on Web 3.0 technology and NFTs, to its rewards members, whom it aims to surprise and delight. The experience allows members to participate in a series of fun activities called „Journeys." Upon completing a Journey, members receive collectible „Journey Tokens" (NFTs) and „Odyssey Points". These give them physical and digital access to new benefits and immersive coffee experiences they cannot get anywhere else.

BANG & OLUFSEN: With its Loyalty 3.0 project under the motto „see yourself in sound", the well-known manufacturer of high-quality consumer electronics offers another example of what emotional customer loyalty can look like today. Based on the customer's own musical taste - with optional access to the Spotify account - an AI generates individual avatars. These can be customized and dance across the screen to the selected music. They can be shared as a link or downloaded as a video. Registration gives participants access to personalized content, exclusive events and special offers.

5. How to Define Your Loyalty 3.0 Strategy

Get a comprehensive overview of the key strategic approaches for developing and implementing a Loyalty 3.0-based customer loyalty program.

- **Understand the needs and preferences of the target group:** Like Web 3.0, Loyalty 3.0 should focus on the community. Conducting customer surveys and analyzing customer data can provide insights into the most effective rewards, experiences, and engagement strategies.

- **Focus on personalization:** Personalization is a key element of Loyalty 3.0. Customers are looking for experiences and rewards tailored to their individual preferences and behaviors. Data analytics, AI, NFTs and other technologies can help create personalized experiences.

- **Consideration of all touchpoints**: Online and offline are merging more and more. Therefore all channels should be treated equally and connected - the stores, the e-commerce platform, social media, and, in the future, the metaverse.

- **Incorporate gamification:** Incorporating playful elements makes the customer experience more entertaining and emotionally engaging. This leads to a stronger connection and identification of customers with the brand. Integrating challenges, medals, and rankings can increase active participation and further drive customer loyalty. Gamification features include different levels of membership and leaderboards that encourage playful competition with friends as part of a loyalty program. Partici-

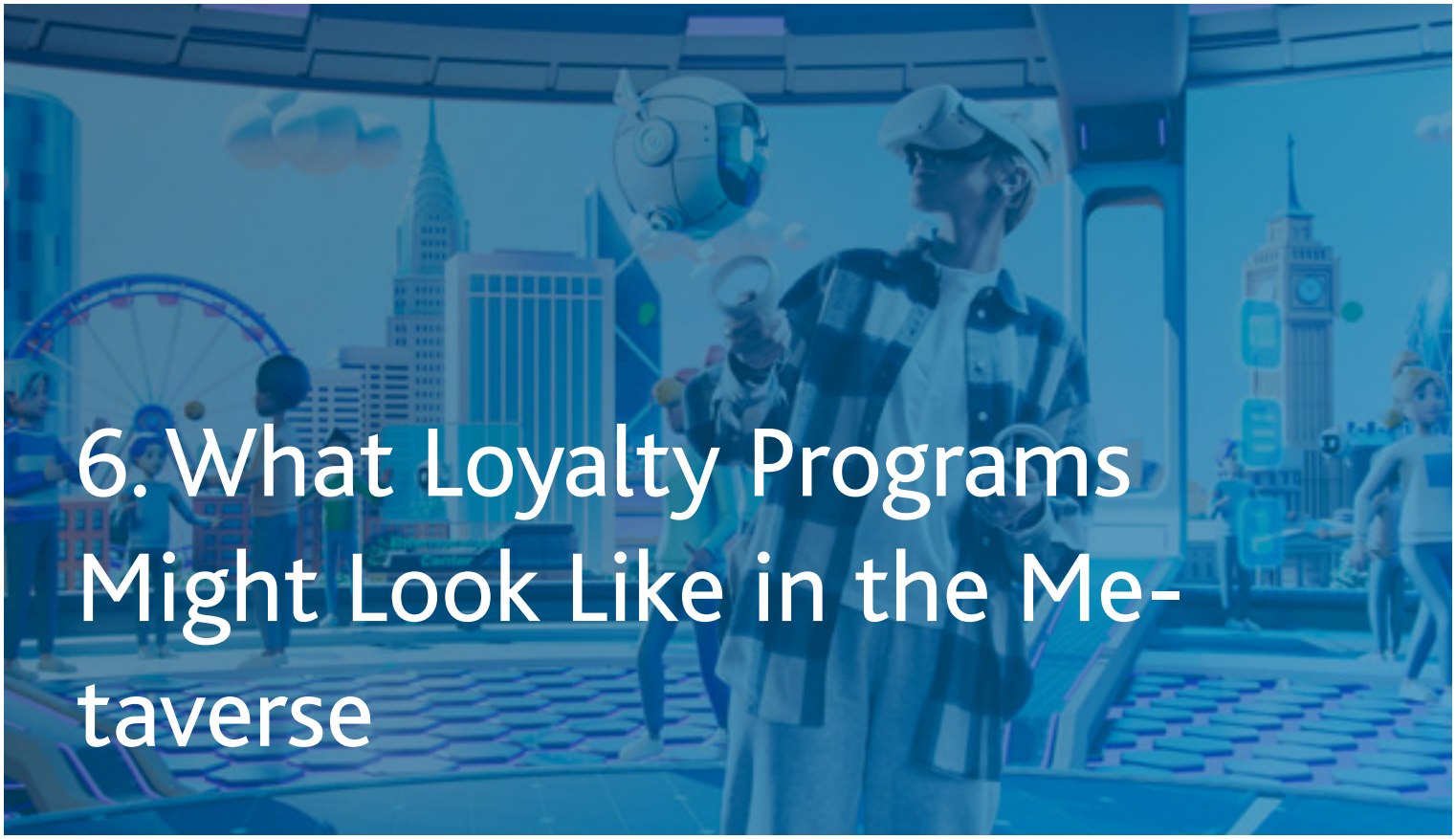
pants are also rewarded for specific actions. These „micro-rewards“ can include points for recommending the brand to friends, giving away discount codes, attending an event, or visiting a store. Sharing game wins on social media can also be rewarded with units.

- **Create emotional connections:** Building emotional connections with customers through personalized experiences, social engagement, and other strategies helps increase customer loyalty and brand advocacy. Evaluating customer responses and conducting targeted surveys can help determine which actions are appropriate.

- **Evolve existing loyalty programs:** A Loyalty 3.0 program does not have to be developed from scratch. Existing loyalty programs can be enhanced. Analyzing them with a Loyalty 3.0 mindset often reveals several common threads. A good example is the addition of gamification elements (see above). Also, many community development options can often be integrated with manageable effort. Examples are votings, polls or (design) contests.

- **New technologies:** It is essential to understand which technologies are relevant to the target group and how they can create the most attractive and engaging customer experience possible. Consider technologies such as NFTs, virtual reality, augmented reality, and, in the medium term, the metaverse.

- **Measure and optimize:** To ensure the success of your Loyalty 3.0 program, it is essential to continuously measure its effectiveness and optimize it based on customer feedback and data analysis. Metrics such as Net Promotor Score (NPS) and Customer Lifetime Value (CLV) can be used to analyze the impact of the program and identify areas for improvement.



6. What Loyalty Programs Might Look Like in the Metaverse

The metaverse offers unprecedented opportunities to create extraordinary customer experiences and a whole new digital experience. Companies can build virtual presences on metaverse platforms such as Roblox, Fortnite, Decentraland, and others. Users move through these worlds as avatars. These can be customized with skins - virtual clothing and accessories. It is also possible to collect virtual objects such as furniture and decorations. In this way, users can connect with their favorite brands in a virtual space.

This opens up new possibilities for Loyalty 3.0. For example, a personalized virtual goodie can be created based on previously collected points. For example, if a customer has bought lipsticks in five different colors from a cosmetics brand, the customer will receive an AI-generated virtual dress in those colors. This dress is a skin that can be added to an avatar on metaverse platforms.

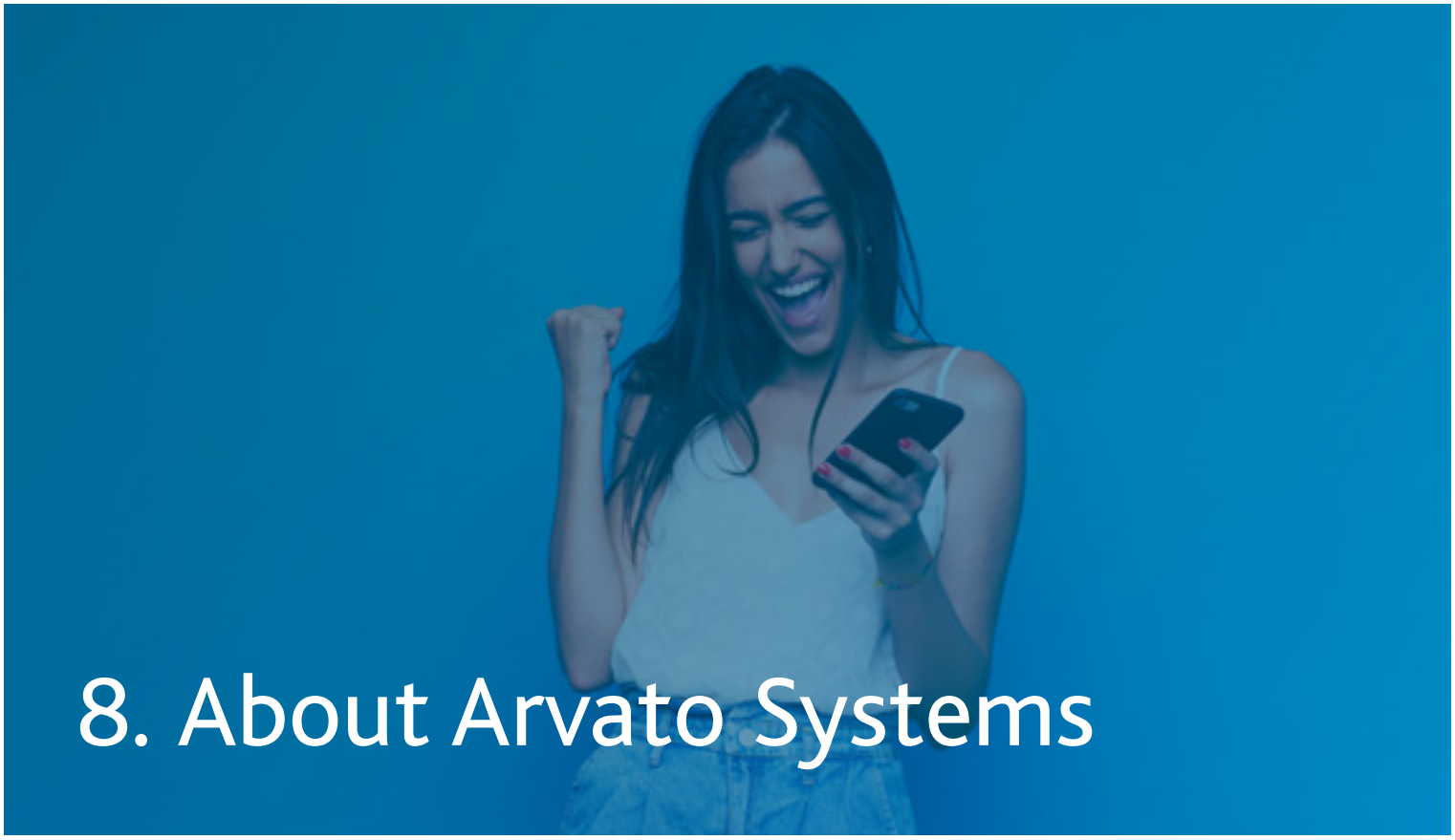
At the same time, digital assets like NFTs make it possible to target communities of brands with the same values. For example, if consumers have loyalty NFTs from a cosmetics brand that promotes self-love and climate protection, they can also be targeted by a fashion brand with the same values. In this way, rich cross-brand experiences can be created in the metaverse.

7. Conclusion

Established customer loyalty programs continue to work well. However, they may face declining acceptance in the future, as Gen Z and Gen Alpha members want loyalty programs that match their strong affinity for digital technologies. They also have high expectations for emotionality and individuality. In addition, a purely bonus-based approach to increasing loyalty will not resonate with their values.

The future of customer loyalty is based on Loyalty 3.0. A Loyalty 3.0 program is therefore an indispensable element in the development of future-proof customer loyalty strategies. With those programs, companies can address these customer groups in a targeted manner and retain them for the long term.

However, companies should be quick to address the opportunities and challenges of this new approach to customer loyalty. The pioneering phase is over, but early adopters still have a clear advantage over their competitors.



8. About Arvato Systems

Global IT specialist Arvato Systems supports major companies in Digital Transformation. About 3,300 staff in over 25 locations stand for in-depth technology expertise, industry knowledge, and focus on customer requirements. Working as a team, we develop innovative IT solutions, transition our clients into the Cloud, integrate digital processes, and take on IT systems operation and support. As a part of the Bertelsmann-owned Arvato Group network, we have the unique capability to work across the entire value chain. Through our strong strategic partner network with global top players such as AWS, Google, Microsoft, and SAP, we continuously strengthen our know-how and leverage the most advanced technology.

We Empower Digital Leaders.
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Our Loyalty 3.0 Glossary

Definitions and in-depth insights into Web 3.0 and the metaverse - get explanations of key terms like NFTs, blockchain, and more. Dive in and expand your knowledge:

Augmented Loyalty

The term describes a new paradigm that combines traditional loyalty programs with modern technologies to provide customers with a highly personalized and seamless loyalty experience.

Blockchain

Blockchain technology enables the tamper-proof transmission of information. It allows digital transactions to be reliably documented in a way that is understandable to all users. It creates the trust and transparency necessary to interact in the metaverse.

Co-Creation

This means involving customers in the development of products or services. Loyalty 3.0 programs can use incentives to motivate customers to participate. In this way, companies not only create a highly personalized customer experience, but also learn a great deal about their customers‘ wants and needs.

Customer Advocacy

Loyalty 3.0 programs can motivate customers to become brand advocates by sharing their positive experiences through engaging experiences and rewards.

Metaverse

The Metaverse is a virtual space in which people move around as avatars and companies can present themselves as 3D presences. Users can interact with each other and with businesses, and purchase virtual products. This opens up new ways of marketing, sales, and customer service for retailers and manufacturers.

Micro Rewards

Small rewards include customers' points for specific actions, such as leaving a review or sharing a post on social media.

Net Promotor Score (NPS)

The Net Promoter Score (NPS) is a key metric that measures the extent to which consumers would recommend a product or service to others. It is determined from customer surveys based on the ratio of advocates to detractors of the brand.

NFT

The abbreviation „non-fungible token" describes the digital proof of ownership of intangible goods. NFTs have become well known through the hype surrounding digital artwork, for example, and are also commonly used in computer games to acquire items. These tokens can be used to prove ownership.

Peer-to-Peer

In peer-to-peer networks, communication does not take place via servers, but between individual computers - an aspect of decentralization. Participants are directly connected to each other and have the same rights.

Web3

The terms Web3 and Metaverse often need to be corrected. The term Web3 describes a set of technologies that support decentralized Web application development. The Web3 is a technological foundation for the metaverse, not „the metaverse" itself. In addition, some metaverse applications use Web3 technologies only partially or not at all.

Web 3.0

The terms Web3 and Web 3.0 could be more precise. While Web3 describes the technological foundation of the metaverse, Web 3.0, often referred to as the „Semantic Web," represents an evolution of the World Wide Web. It is based on standards defined by the World Wide Web Consortium (W3C). The goal is to enable the internet to process information more intelligently. To this end, websites are to be linked to each other and be able to interact.