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Customer loyalty: The new generation

Changes in consumer behavior due to the surge in digital mean companies need to revamp their loyalty programs. Here are the essentials for success.

Loyalty programs are a part of the ever-expanding movement to digital for consumers and businesses alike. McKinsey partner Jess Huang discusses the most important aspects and components of successful loyalty programs, from putting consumers first, to learning what companies want to gain from loyalty programs, to the data gathered from such programs. The following is an edited transcript of an extended video interview with Jess conducted by Thomas O'Toole, associate dean of executive education and clinical professor of marketing at the Kellogg School of Management, senior adviser to McKinsey, and the former CMO of United Airlines and president of its loyalty program, MileagePlus.

What is driving the new generation of loyalty programs

Thomas O'Toole: It's my pleasure to speak with Jess Huang, a partner at McKinsey & Company who coleads their loyalty work. Welcome Jess, and let me jump right in with the first question. Many companies have been introducing loyalty programs in the last few years, and a series of major companies are relaunching established programs. Why is this happening, and what's driving it?

Jess Huang: At the root of it is the fact that consumers are changing, and consumer trends are driving this. With the move to digital over the last ten years, consumers are spending more and more time on their phones and various digital channels. This makes it much easier to access the consumer, but there is also a lot more noise. Brands are trying to figure out the right way to break through that noise and develop a relationship with the consumer.

For example, you see new direct-to-consumer brands popping up all over the place. Because there's a very low barrier to establishing yourself as a brand, they're willing to spend on customer acquisition. So it's not that consumers are necessarily becoming less loyal, it's just so much easier to access them

and so much easier for them to try something new. So brands are really trying to figure out a way to develop and maintain that relationship with the consumer.

The second thing is that digital produces a ton of data, but how do you collect it and make sure you own it? How do you figure out what data is routed to a given consumer across a given channel? A lot of companies are realizing this, and if they can't figure it out, they're going to fall behind.

The relationship between loyalty and predictive analytics

Thomas O'Toole: How are companies using predictive analytics to improve the effectiveness of their loyalty programs, and how do you anticipate they'll do so going forward? More broadly, what is the relationship between loyalty programs and predictive analytics?

Jess Huang: This is a big, trending topic for companies. Predictive analytics can definitely help you refine and fine-tune the design of your loyalty program. It helps you better understand your different types of consumers, how much they're spending, and how valuable they are to you. So it allows you to start thinking about how to migrate them up in value and decide which ones you are willing to spend more on.

Predictive analytics also helps companies better understand what behaviors actually drive the high-value customers. For example, if you're a retailer that sells in multiple categories, you may realize that if you can get customers to buy X category, then they'll also shop three adjacent categories. If you know that, then you can design incentives into your loyalty program to drive that very specific behavior. More companies are trying to identify specific things that they want to do through their loyalty program by understanding the analytics, which is really important, so that they don't give too much away to the consumer.

Designing a loyalty strategy

Thomas O'Toole: What are the keys to a successful loyalty program?

Jess Huang: The first thing you need to do is define success, so you have objectives to measure your effectiveness. It cannot be as loosey-goosey as just wanting to drive loyalty with all consumers. You have to know which consumers you're targeting and what type of loyalty you're driving. What is it that you actually want them to do? Do you want them to spend on more profitable products or services? The next thing is to make sure that whatever you're trying to accomplish with the loyalty program is consistent with your overall company strategy and brand messaging.

You also want to design something that's flexible enough to remain viable as your company and strategy evolve. Finally, loyalty programs can get expensive very fast and don't always create value for companies. So you have to go in with eyes wide open and design a program that creates value for the consumer and for you. That often involves finding a way to leverage the gap between a consumer's perceived value of something and your cost to provide it.

Balancing the customer value proposition with business economics and value creation

Thomas O'Toole: When designing a loyalty program, how do you balance the customer value proposition with the business economics and value creation for the company?

Jess Huang: That's the holy grail of loyalty-program design and lies at the heart of every loyalty-program problem. It's tough, because you have to spend to offer something compelling that creates value for consumers. But if you spend too much on the business-economics side, you can quickly lose a ton of money. There are a couple things that can help you avoid this. The

first is making sure that your consumer value proposition strictly reinforces your objectives. Don't put in any additional value that you don't need to drive the specific objective.

Secondly, you want to identify features and benefits that consumers value but cost you very little. The last piece is having a good internal understanding of what value you're willing to give away and to whom. We tend to speak broadly about loyalty programs and value propositions, but you also need to think internally about how that value proposition differs for each type of consumer. You can do this explicitly by designing tiers in your program, or you can do it implicitly by how you design the broader program and how you think about what to offer each of those consumers. Having a clear internal understanding of what you're willing to give away to whom and making sure you're not giving away everything to everyone will help you balance that equation.

Typical business-objective and marketing considerations when relaunching a loyalty program

Thomas O'Toole: What business objectives, marketing aims, and concerns do you hear from clients who are considering relaunching an existing loyalty program?

Jess Huang: When companies think they need to relaunch a loyalty program, the biggest reason is usually that they're not seeing the performance they expected. The most common problem is a lack of engagement. Maybe a lot of customers are enrolled, but they're not actively engaging with a program or brand, and they're not buying much. So the companies ask, "How do we actually drive active users, drive their engagement, with the loyalty program?"

Another very common problem is a program that feels stale, doesn't feel innovative, or doesn't feel like you are offering anything

different from your competitors. So clients will ask, "What can we actually do to stand out and differentiate ourselves? How do I use the data to give me direction on how my loyalty program should be designed and look?" They also ask how to use their data to personalize communications with consumers outside of the loyalty program.

Identifying the most effective features and benefits when designing a loyalty program

Thomas O'Toole: How do you identify the specific features and benefits that will have the greatest impact when designing a loyalty program?

Jess Huang: When you're designing the program, it's all about the value proposition that you're offering to your customers. So you need to understand them first. What's their experience when they're interacting with your particular category or with you as a company? Do they have unmet needs? Would meeting them help develop a better relationship, make them spend more, or whatever it is that you're trying to drive with them? So you need a good understanding of the problem you can solve for your customers. Otherwise, you're just throwing stuff at them and hoping they spend more. You need to figure out what you can offer them and what it will cost you, which is the gap between the perceived value and the cost of offering it.

If there's something you can offer to meet those needs and solve those pain points, and it comes at very little marginal cost, you've hit the sweet spot.

Emerging loyalty-program areas

Thomas O'Toole: Travel, retail, and financial services have been at the forefront of loyalty

programs since their inception, but we now see them expanding into other categories, such as healthcare. Why is this happening, and what other categories do you see adopting loyalty programs?

Jess Huang: We're hearing more and more healthcare clients asking us about loyalty, as well as insurance clients. Some B2B clients are asking about it, too, which is a little bit unusual, because there are fewer programs to point to. I think this goes back to the trend of increasing access to the consumer and consumerization. So now everyone is thinking, "I'm expected to take advantage of all of these consumer touchpoints that I can access, but how should I be doing it?"

The bar for the customer experience and how you develop a relationship with the consumer has been raised by digital and other trends. So companies in industries that traditionally didn't build one-to-one relationships with the consumer now feel like they need to. Healthcare providers are thinking, "How do I actually continue to engage with my consumer in between visits and make sure that they come back to me?" That's something they're not used to wrestling with. It's the same with B2B companies. There's more consumerization in terms of access, so it's no longer just about the salesperson's relationship with the person on the other side. There's a lot more access and more ways to get in touch with them. So I think loyalty naturally pops up as a topic they start thinking about.

New loyalty-program considerations

Thomas O'Toole: You've worked on lots of major loyalty programs in a wide range of categories. For companies who are considering introducing a new loyalty program or relaunching an existing one, what guidance do you have for them?

Jess Huang: I think the number-one thing is to ask yourself is why you want to do this. If you cannot clearly articulate why you want to launch a loyalty program for a given customer or business objective, there's really no point, because you don't even know what you're designing. But if you have a clear idea of who you want to drive specific business objectives with, go and understand that customer. Don't just design a program you think you or your consumers would like. Look at your customers' transaction-and-engagement data and understand how they're interacting with you. Do the consumer research to learn what they want and what you can offer them before you even start thinking, "Well, I want my loyalty program to look like X."

Jess Huang is a partner in McKinsey's Silicon Valley office, and **Thomas O'Toole** is a senior adviser to McKinsey and associate dean of the Kellogg School of Management at Northwestern University.