

## **Customers: The New Competitive Asset** **By Retail Forward, Inc.**

Throughout the history of retailing, growth has resulted largely from physical expansion—new store openings and new product introductions—as well as ever-lower costs. Tangible assets—property, plant, equipment and inventory—were the chief source of value creation. In today’s saturated and mature retail environment, new locations are less productive and new products are less successful—often they merely divide the same amount of business among a larger number of stores or SKUs. Retailers and suppliers are finding it more and more difficult to grow the business the old-fashioned way.

Customers and customer relationships are the new assets. They are not on the balance sheet, but they are the lifeblood of retailing, driving cash flow and enduring value. With fewer opportunities to build new stores, retailers now must focus on how to get more from existing stores and existing customers. This will require a greater focus on optimization of the demand chain—customer-facing activities, marketing effectiveness and proactive management of *customer assets*, not just inventory.

The key to future prosperity is fairly simple—listen to the voice of the customer.

It starts when retailers move from a focus on efficiency to a focus on intelligence—using technology to manage larger and more complex businesses and using information to optimize supply chain—but perhaps more importantly, demand chain—activities. The retailer’s goal is to do more with the products, stores and customers it already has.

Retailers can derive a lesson from Six Sigma by focusing on those moments of truth where things break down and defects occur (e.g., long lines, inability to find products, out-of-stocks). They must be riveted on what the customer is trying to accomplish and work to eliminate the defects in the shopping process by meeting customers’ qualifiers or basic requirements, performing well on their satisfiers or attributes that determine store choice, and innovating the breakthroughs that become customer delighters. Customer intimacy—where every touch point becomes a moment of truth in the business—is what this is all about.

The ability to get intimate will require that retailers understand what creates value for each individual consumer for each shopping occasion and then execute an appropriate strategy at every point of contact. For the most part, retailers haven’t made much progress moving to intelligence from efficiency, and fewer still are working on the transition from intelligence to intimacy.

With very few exceptions, retailers talk a strong “customer intimacy” game: They acknowledge the need to use a panoply of tools—from POS analysis to loyalty programs—to know more about customers. However, finding examples of retailers that are able to manage customer equity in a way that makes a material impact on the business is trickier. Very few have actually developed relationships that really resonate with customers and/or the customer analytics capability that allows them to create value for each individual consumer for each shopping occasion and to execute an appropriate strategy at every point of contact.

## Today's Customer Data-Driven Retailer

Despite obstacles, the movement to gain competitive advantage by leveraging shopper data from loyalty programs and other sources is gaining new steam. It is being fanned by a new push by retailers to launch frequent shopper programs and new consumer-facing technologies. The movement is showing progress with growing evidence that retailers are successfully leveraging customer data in various ways to drive traffic and sales.

### *New Converts to Loyalty Programs*

The technology and operational infrastructure is being put into place to collect customer information at all the points of contact. Because a key to achieving customer intimacy is to track each customer with the same degree of precision and interest that retailers currently apply to individual SKUs, a growing number—and a growing diversity—of retailers are launching or upgrading frequent shopper and other loyalty programs.

Retailers as diverse as U.K. supermarket retailer Morrisons; Gome, China's largest home appliance retailer; U.S. apparel specialists American Eagle and bebe; quick-serve restaurant chain Pizza Hut and online retailers Red Envelope and WineWeb.com are among those joining retailers with long-established loyalty programs by launching their own programs.

- Morrisons' decision to investigate a loyalty scheme represents a turnaround of its long-held stance that it would not introduce a loyalty program. Reportedly, the retailer is considering a loyalty program not only because of the added value it can provide customers but also because of the valuable data that can be gathered.
- bebe's clubbebe uses incentives (e.g., a \$10 reward for every \$250 in purchases) instead of discounts to reward members. The program is designed to allow the company to consolidate and track customers' spending across stores and channels. A prerequisite for joining the program is a valid e-mail address, which augments bebe's e-mail marketing databases.
- Drawing on its reputation as a premier source for gifts, Red Envelope is positioning the reward certificates its frequent shopper members get as perfect for gift giving.

Retailers with long-standing loyalty programs are augmenting and expanding member benefits to enhance appeal.

- Supermarket retailers Kroger, Giant Eagle and Coles Myer (Australia) are adding fuel discounts as a benefit to give members better value from their everyday shopping.
- Drug store retailer Duane Reade revamped its Dollar Rewards program (originally launched in 1999) in early 2005. Members now earn points for every dollar spent, which gives shoppers more incentive to use the card on every visit versus earlier iterations of the program that gave members promotional savings. Members get a \$5 reward for every 100 rewards points accumulated. The rewards can be used as cash on the next visit. Sales using the card are now more than 40% of sales, up from 25%.

## *New Customer-Facing Technologies*

Loyalty programs are not the only way to gather customer data and connect with consumers. New and emerging customer-facing technologies yield new shopper insights and offer retailers new ways to communicate with customers. Among the technologies generating the most buzz are radio frequency identification (RFID) and mobile phone applications.

Though most current RFID applications and tests involve tracking products, applications that track customers or customer behavior are emerging. Some of the initial applications revolve around improving customer service.

- A quick-serve restaurant operator is using RFID technology to improve service for its most frequent customers. Cusi customers can wave their card in the vicinity of a myCusi kiosk at the restaurant. The kiosk recognizes the customer by name, calls up previous orders and asks if she wants to order “the usual” or offers alternatives. The system debits the account on file so no cash is exchanged and there is no receipt to sign. The order goes to the kitchen electronically. Customers who order using the myCusi kiosk typically receive their food within four minutes, compared with an average wait time of 12 to 14 minutes for regular counter service.

Beyond the customer service applications, RFID-enabled devices or cards used by shoppers in a retail store environment could help retailers learn how long shoppers stay in specific departments or look at specific displays and how often they shop without making a purchase. This knowledge, combined with purchase data, would create a more robust understanding of a retailer’s customer base.

- Tesco has reportedly equipped shopping carts in its Korean hypermarkets, Tesco HomePlus, with RFID tags to monitor shopping patterns in an effort to more efficiently manage the store layout and product location.

Mobile marketing is being touted as the perfect solution to the problem of a fragmented media market. While mobile target marketing may be considered invasive and undesirable by older consumers, younger consumers are likely to be more receptive to this type of contact—especially if compelling content, incentives, entertainment and/or interaction are offered.

- In May 2004, French Connection, the global fashion brand, in conjunction with Enpocket, a leading mobile marketing solutions provider, rolled out a mobile marketing and CRM program in the United States and the United Kingdom. The campaign combined a multi-channel call-to-action with a text-and-win model. Announcements over FCUK FM—which broadcasts in all 1,500+ FCUK stores, on digital radio and on the Web—as well as outdoor, print, online and in-store ads encouraged mobile users to text in a common short code to participate in a music trivia game and qualify for prizes. As a result of the campaign, FCUK has built a database of mobile users and can profile customers and target individuals with specialized mobile content.

- Sainsbury's Jacksons convenience store chain has been testing a mobile message loyalty scheme. The 11,000 members in the Shop Scan Save program at 35 stores received a barcode that identifies them as a member and can be read by the chain's POS systems. The members are sent text messages with product discounts they are eligible for. When the barcode is scanned on the members' next shopping trip, the discounts for all applicable products in their cart are deducted from the total. Additionally, members can send a text message to Jacksons to request offers for products—e.g., wine or chocolate—or brands they are interested in buying and receive back any existing offers on these or related items.

### *The Progress Leveraging Shopper Data*

As with all other optimization analytical tools, the data mining capabilities required to successfully use customer information—to transform customer information into customer knowledge—as well as the cultural, process and organizational changes required to execute these strategies successfully do not yet exist in many organizations. However, progress is being made. Now, as retailers look to the future, it appears that retailers are looking to make direct, valuable links between customer data and key operational metrics and data analysis:

- *Market Basket Analysis*: Identify products that are frequently purchased together to facilitate impulse buying and improve customer satisfaction by making the shopping experience more convenient.
- *Shopping Mode Analysis*: Understand why consumers shop your stores to become the destination of choice.
- *Customer Lifetime Value Analysis*: Utilize loyalty card date to identify and initiate customer loyalty to increase wallet share.
- *Promotion Effectiveness Analysis*: Identify the source of uplifts and drive better returns on promotional spending.
- *Store and Customer-Focused Metrics*: Identify opportunities for store development, acquisitions and product range expansions.

### *Market Basket Analysis*

Data generated from frequent shopper or customer loyalty programs is ideally suited for market basket analysis because retailers can analyze correlations between items bought on the same trip as well as between items bought on separate trips. Retailers can also consider purchase decisions within the context of the shopper's profile. However, market basket analysis typically requires significant processing power. Grocer Ahold USA upgraded its data warehouse platform earlier this year to allow it to analyze greater volumes of data—and do so faster than before. Ahold's goals for its market basket analysis are to increase sales and reduce costs.

Stop & Shop, one of Ahold's chains, is testing a cart-mounted interactive tablet—the Shopping Buddy—to assist shoppers with navigation, price inquiries and self-checkout—all reactive uses of the technology. But the Shopping Buddy technology is also reactive. It can make real-time product suggestions based on shopper's previous purchases—an example of how market basket analysis can be used to get more sales from existing customers.

The mining of market basket data also can provide insight into multiple customer-facing activities including: the development and introduction of new products (including the development and expansion of private brands), assortment rationalization (including SKU deletions), and store layout and adjacency planning.

### *Shopping Mode Analysis*

Shoppers choose where to shop based on a number of variables—e.g., the product and services assortment, the store environment, pricing and promotions—among other things. The way shoppers evaluate the appropriateness of a store vis-à-vis these variables often depends of the “mission” or goals of any given shopping trip. Understanding shoppers' missions—and designing stores appropriately—can help retailers identify, attract and retain the most profitable customer segments.

For the past couple of years, Best Buy has been undergoing a transformation. At the heart of the transformation is a commitment to “customer centricity”—a strategic initiative designed to tailor each store's assortment to the types of customers that actually shop there. The company is focusing on five customer types that contribute the most to its financial health: young entertainment enthusiasts, affluent professional males, families who are practical technology adopters, upscale suburban moms and small businesses.

Looking at the business from the customer's point of view, rather than from a product category perspective, provides opportunities for Best Buy to increase its market share with both existing and new customers. By viewing the business as a portfolio of customers, the retailer hopes to “deliver superior customer experiences and earn commensurately higher financial returns—a mutually exclusive value exchange.”

As of December 2005, 284 of the company's stores had been converted to customer-centricity “segmented” stores. The performance of these stores has led the chain with the earliest converted stores generating the highest results.

### *Customer Lifetime Value Analysis*

As retailers focus increasingly on the demand chain, they must recognize that not all customers are created equal in terms of their profit potential or lifetime value. The ability to identify the customers with whom the retailer wants to become intimate in order to allocate resources productively will be a critical measure of success.

Retailers that have invested in loyalty card programs are in search of a more advanced solution to realize the value from their investment. By analyzing the customer lifecycle through loyalty card data, retailers can better understand the dynamics of their customers' purchasing behavior and identify real opportunities to increase share of wallet and build loyalty.

This analysis measures the lifetime/horizon value of distinct customers and of the customer-base as a whole and identifies key gaps, opportunities and challenges—assisting in the identification of the best options for increasing value and minimizing losses; customers to defend and reviewing the quality of new customers.

#### *Promotion Effectiveness Analysis*

The ability to more accurately forecast the results of promotions will result in a higher ROI on those promotions for retailers as well as allow retailers to better negotiate with suppliers for trade promotion dollars.

With its improved Dollar Rewards card program (discussed earlier), Duane Reade has the information it needs to do multi-zone marketing and merchandising to meet the needs of both convenience-driven urban shoppers and price-driven suburban shoppers. It also can test, and perhaps more importantly, measure the effectiveness of reward programs for specific groups of customers—e.g., baby products purchasers, seasonal products purchasers. The measurability of the program was instrumental in getting manufacturers to team up with Duane Reade to target specific shoppers.

Members of Modell's Sporting Goods' MVP program earn a \$20 reward for every 400 points earned—one of the most generous rewards programs in the sporting goods industry. The rich program attracts a large share of Modell's shoppers which in turn gives the retailer a rich customer database from which to do targeted direct mail campaigns mailings. Because of its large and detailed customer database, Modell's has achieved mailing response rates of 10% to 20%, which has attracted greater vendor co-op support.

#### *Store and Customer-Focused Metrics*

One size rarely fits all in today's world, and it certainly won't in the future. It will be increasingly difficult to go to market with a single, monolithic store model. An increasingly complex and diverse consumer market will result in greater market segmentation. To meet the differing needs of customers at specific times or in specific locations and maximize the market opportunity, individual retailers will increasingly turn to micro-merchandising and micro-merchandising. This will require being able to assess specific store's performance—as well as understand the drivers of that performance and the characteristics that make or break the performance of stores or product categories.

As part of its strategy to get closer to the customer, U.S. regional grocer Bi-LO is stepping up its micro-marketing efforts. With upgraded space and floor planning capabilities, the chain has the ability to deliver a precisely tailored product assortment to each store. The goal is to increase customer satisfaction because the store appeals to customer demographics in each location.

Similarly, the Auchon-owned supermarket chain Atac (France) is adapting the product mix in each store to reflect its location and its shopper base.

## Closing the Gap between Customer Behavior and Operational Activity: The Coming Era of the Customer

Greater customer intimacy and knowledge—i.e., a true understanding of who every shopper is—will be valued by the customer when it is effectively translated by the retailer into a superior shopping experience based on the identification and interpretation of individual interests, needs and wants.

As retailing enters the era of the customer, the consumer value proposition will be focused on the customer experience. It will be about connecting with customers on a visceral level. Value will be delivered by strong retail brands that stand for something important to the customer. Retailers that are able to couple the brand experience with flawless delivery of desired benefits will create a customer experience that will win business in the years ahead.

It used to be the rule was build it and they will come—create a point of presence. Now the battle is on the frontline of every contact marketers have with the customer.

— *Retail Forward, Inc.*  
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### About Retail Forward, Inc.

Retail Forward, Inc. is a management consulting, market research and executive development firm specializing in retail intelligence and strategies.

Recognized as an authority on retailing, Retail Forward offers a variety of research and consulting services for retailers, consumer products companies and other organizations with an interest in these industries.

Retail Forward's consulting and research capabilities include corporate strategic planning, market positioning strategy, new concept development, customer analytics, consumer research, economic forecasting and competitive analysis.

More than 250 leading retail and consumer products companies belong to the company's syndicated research and executive development program, the Retail Forward Intelligence System™ (RFIS). RFIS monitors, assesses and forecasts trends in retailing and related consumer behavior, and distributes value-added news, analysis and perspective in the form of newsletters, in-depth reports, and conferences.

For more information on Retail Forward, Inc., visit the company's Web site at [www.retailforward.com](http://www.retailforward.com).