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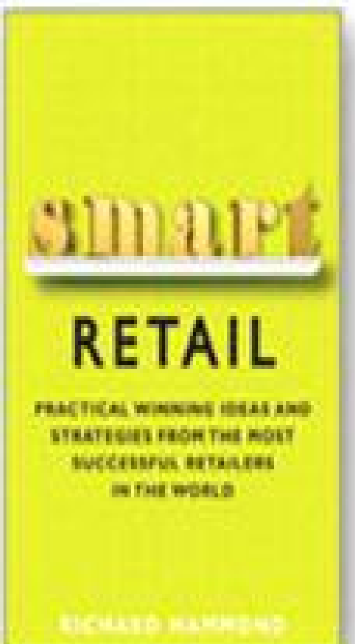
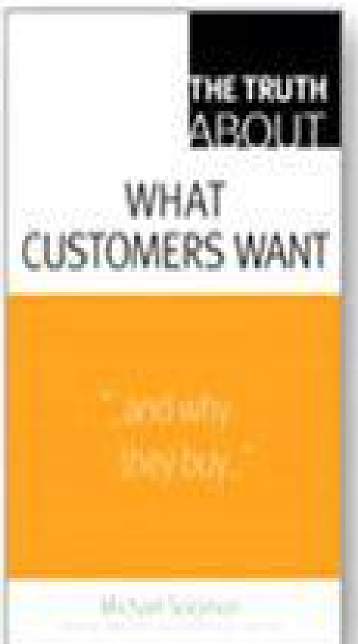
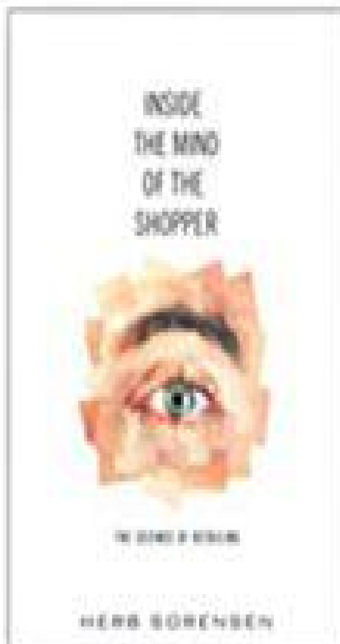
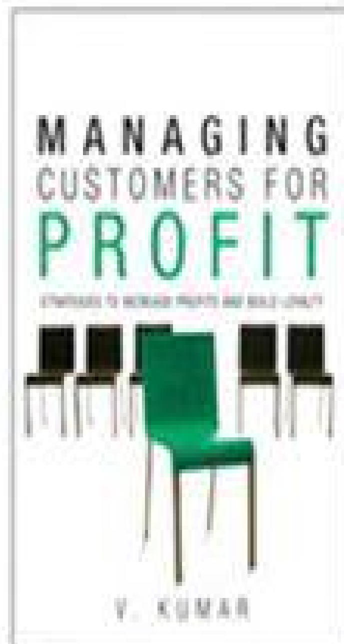
THE DEFINITIVE GUIDE TO CUSTOMER RELATIONSHIP MANAGEMENT









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The Definitive Guide to Customer Relationship Management (Collection)

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Managing Customers for Profit

Strategies to Increase Profits and Build Loyalty

V. Kumar

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Dedicated, with love, to Anita & Rohan, and Prita.

Praise for *Managing Customers for Profit*

"Dr. V. Kumar is one of the world's leading experts in customer relationship management (CRM). In this book, he offers practical guidance to managers on how to implement CRM strategies in their own firms. It is a *must have* book for anyone interested in developing profitable and stronger relationships with their customers."

—***Russ Winer*, Executive Director Marketing Science Institute and William Joyce Professor of Marketing Stern School of Business, New York University**

"Not only have I had the opportunity to participate in one of Dr. Kumar's presentations on *Managing Customers for Profit*, but we also followed through with him in bringing the know-how to our company. We definitely see tremendous value in his concepts and strategies described in this book as evidenced by successes seen in other companies. Currently, we are implementing the framework prescribed in his book in India."

—***Maninder Singh Juneja*, Senior General Manager, Head–Retail Channel Liabilities Group, ICICI Bank Limited, India**

"This book is the antidote that marketers have needed to satisfy the pressing demand for accountability. The concepts and metrics are grounded in the realities of customer behavior, while speaking the language of senior management."

—***George S. Day*, Geoffrey T. Boisi Professor; Professor of Marketing, Co-Director, Mack Center for Technological Innovation, Director, Emerging Technologies Management Research Program**

"Marketing leaders face many pressing challenges and opportunities in a rapidly changing global business environment and, as a result, are always on the lookout for fresh insight, new learning, and real-world experiences that they can leverage. Dr. Kumar's new book is a *must read* for marketing managers in B2C- as well as B2B-focused businesses who are looking for a strategic approach to maximizing customer profitability. Kumar's book provides a different and proven model. Marketers should have to read it."

—***Dennis Dunlap*, CEO, American Marketing Association**

"Customer management has become a key business function as organizations seek to complement an understanding of what they do with their brands with a deep knowledge of those they serve: customers. Dr. Kumar's book is an essential resource for those who wish to optimize their customer investments. Strategically, it ties customer-facing activities to the firm's objectives. Operationally, it has an insightful analysis of the activities that will lead to the achievement of those objectives. And in terms of accountability, it has the marketing metrics to calibrate success in execution, including diagnostic information for learning organizations. Dr. Kumar's pre-eminent academic credentials combined with his extensive industry practice are married to make this book of immense value to both academics and practitioners."

—***John Roberts*, Scientia Professor, Faculty of Business, University of New South Wales, Sydney, Australia and Professor of Marketing, London Business School**

"Firms that view their customer base as a portfolio and manage that portfolio most effectively will continue to outperform those that do not...In this important and comprehensive look at how to manage customers for profit, V. Kumar lays out the issues, dispels the myths, and provides templates for success. I recommend you read this book before your competitors beat you to it."

—***Gary L. Lilien*, Distinguished Research Professor of Management Science and Co-founder and Research Director, Institute for the Study of Business Markets (ISBM), Penn State**

"One of the best books in marketing that analyzes and demonstrates how to *simultaneously* manage both customer loyalty and company profitability by targeting and reallocating the four Ps of Marketing."

—***Jagdish N. Sheth*, Charles H. Kellstadt Professor of Marketing, Goizueta Business School, Emory University**

“Today’s hyper-competitive financial services marketplace makes it more important than ever to manage our business to maximize the lifetime value of our customer relationships. V. Kumar has been a leading practitioner as well as a pioneer in extending the state of the art in this area. Now with the publication of this book, he has put together a compelling overview of the fundamental theory and key tools required to optimally manage customer relationships.”

—***Jim Pedrick*****, Senior Vice President of Strategic Marketing, ING Financial Services**

Foreword

Whilst corporations continue to strive to improve customer loyalty and customer profitability, the conventional customer profitability model offers a great opportunity for enhancement. Based on my experience over the last two decades across three different industries, quite often, the link between customer satisfaction, customer loyalty and customer profitability is tenuous. Secondly, since customer satisfaction and loyalty are measured across the customer base, corrective actions are designed uniformly for all customers. However, neither the customers nor the customer behavior is uniform!

With organizational resources being scarce and improvement of marketing return on investment (ROI) being a key challenge for business managers, it is imperative to have a fresh perspective to customer relationship management (CRM) with customer profitability and the notion that different customers should be managed and satisfied differently as its focus. This profit-based strategy draws upon robust CRM research that lays emphasis on future customer value. The future value of customer profitability can be measured through the customer lifetime value (CLV) metric. Dr. Kumar has developed innovative quantitative approaches to calculate CLV, which can be leveraged for CRM decisions relating to customer acquisition, retention and attrition.

CLV is a powerful tool that could potentially be the source of competitive advantage for organizations and provide the armory to win in the marketplace. This book is recommended for business managers interested in nurturing long-lasting relationships with customers to drive profitable growth.

—***Sangeeta Pendurkar***
Chief Marketing Officer, HSBC Bank Middle East Limited

Preface

This book is aimed at top/mid-level management of small, medium, and large business-to-business (B2B) and business-to-consumer (B2C) enterprises that have the power and resources to change customer management strategies in their organization. This book also serves as a guide for executives-on-the-rise to understand the importance of customer-oriented strategies.

What constitutes an effective customer management strategy? Is it enhancing customer loyalty, widening the customer base, or maximizing customer profitability? Although conventional wisdom suggests that enhancing customer loyalty and widening the customer base are effective strategies, this book focuses on the profitability angle and establishes that managing customers based on their profitability is the most effective approach to customer management.

This book identifies three paths to profitability a firm can undertake: operational excellence, brand equity, and relationship marketing. If relationship marketing is selected as a path to profitability, managing customer loyalty becomes crucial. While managing loyalty programs, companies have traditionally placed undue emphasis on maximizing customer loyalty. This book adopts a fundamentally different approach toward customer management and demonstrates that stable healthy growth of a company is built on the profitability of customers, not just on their numbers or loyalty. This book also shows that loyal customers are not always profitable, and not all profitable customers are loyal. Therefore, when firms are developing a customer management strategy, they must adopt an approach that closely links loyalty with profitability.

To effectively manage loyalty programs, firms use several customer selection metrics, such as Recency-Frequency-Monetary value (RFM), Past Customer Value (PCV), Share of Wallet (SOW), and Customer Lifetime Value (CLV). This book concludes that CLV outscores other metrics when it comes to profitable customer management. CLV outscores the other metrics in this regard because it is a forward-looking metric and because it factors future customer behavior into current marketing initiatives. Empowered with CLV, firms can reevaluate and overhaul their existing customer management strategies. This book offers nine strategies to manage customers profitably. These strategies aim to select the right customers, manage them profitably, and retain them through optimal allocation of resources. Furthermore, these strategies demonstrate the benefit of pitching the right products to the right customers at the right time, holding on to profitable customers, encouraging multichannel shopping, increasing brand value for customers, acquiring potentially profitable customers, and identifying customers who provide value through referrals. The knowledge obtained through implementing these strategies can then be leveraged to acquire prospective customers with a higher profit potential.

Although CLV can be an effective tool to measure and manage direct (transactional) contributions made by customers, it overlooks the indirect (referral, word-of-mouth) contributions toward firm profitability. To maximize profit, the crucial contribution made by customer referral behavior has to be carefully monitored and managed. This book introduces Customer Referral Value (CRV) as a metric that firms can use to maximize the indirect contributions made by customers. CLV, used in conjunction with CRV, will enable marketers to implement strategically designed marketing initiatives to profitably manage customer loyalty.

This book identifies organizational and implementation challenges that firms might encounter when adopting a CLV-based approach and suggests appropriate guidelines to overcome such challenges. Firms need to adopt an "interaction-orientation" approach when dealing with customers. By establishing a strong firm-customer relationship, and by treating customers as a resource, managers can effectively implement the CLV-based strategies. Because CLV is a dynamic approach, marketing strategies have to be constantly updated for sustained profitability. This book recommends a balanced approach, keeping in mind the ethical issues involved in collecting and managing customer-level information. This book also outlines issues that firms might potentially face when implementing a CLV-based approach and suggests the necessary strategies to stay ahead of the competition.

Organization of the Book

This book adopts a strategic approach toward profitable customer management and illustrates the strategies needed to manage customers efficiently. It presents techniques to aid in customer-oriented marketing initiatives using the concept of Customer Lifetime Value. The book consists of 15 chapters.

Chapter 1 introduces key concepts of customer management. It describes the different paths to profitability and identifies relationship marketing as the one that leads to profitable customer management. It also discusses the role of loyalty programs in bringing firms and customers closer to each other. Chapter 2 links loyalty with profitability and discusses the drivers of profitable customer loyalty. After establishing the need for managing customers for profit, Chapter 3 reviews the popular metrics used to measure customer loyalty. The concept of Customer Lifetime Value is discussed, as is how to measure CLV. Chapter 4 describes how to build and sustain profitable customer loyalty and calls for a fundamental outlook change to manage customer loyalty. Chapter 5 outlines nine strategies available to managers to maximize CLV. These strategies will help firms decide how to select the best customers (Chapter 5), make loyal customers profitable (Chapter 6), optimally allocate resources (Chapter 7), pitch the right products to the right customers at the right time (Chapter 8), prevent customer attrition (Chapter 9), encourage multichannel shopping behavior (Chapter 10), maximize brand value (Chapter 11), and link acquisition and retention to profitability (Chapter 12). Chapter 13 introduces the concept of Customer Referral Value (CRV), which firms can use to measure the indirect impact (referrals, word-of-mouth) made by customers toward the firm's profit. Chapter 14 discusses potential organizational and implementation challenges when adopting a CLV-based approach, and Chapter 15 covers potential issues that need to be addressed to sustain profitable customer management.

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About the Author

Dr. V. Kumar (VK) is the inaugural holder of the Richard and Susan Lenny Distinguished Chair Professor in Marketing, and the Executive Director of the Center for Excellence in Brand and Customer Management, in J. Mack Robinson College of Business at Georgia State University. Previously, Dr. Kumar was the ING chair professor of marketing and the executive director of the ING Center for Financial Services in the School of Business at the University of Connecticut. He was recently ranked among the top five marketing scholars worldwide based on his research productivity. Dr. Kumar has been recognized with many teaching and research excellence awards and has published numerous articles in premier journals of marketing, such as the *Harvard Business Review*, *Journal of Marketing*, *Journal of Marketing Research*, *Marketing Science, and Operations Research*. He has won several awards for his research publications in scholarly journals, including the Don Lehmann Award twice for the best paper published in the *Journal of Marketing/Journal of Marketing Research* in a two-year period and the MSI/Paul H. Root Award twice for two different *Journal of Marketing* articles contributing to the best practice of marketing. He has coauthored more than 100 articles, book chapters, and textbooks, such as *Marketing Research, International Marketing Research*, and *Customer Relationship Management: A Databased Approach*. He is currently on the editorial review board of several scholarly journals and has lectured on marketing-related topics in various universities and organizations in the United States, Europe, Australia, and Asia. His current research focuses on international diffusion models, customer relationship management, customer lifetime value analysis, sales and market-share forecasting, international marketing research and strategy, marketing resource allocation, sales promotion, and interaction orientation.

Dr. Kumar is also a consultant to many Fortune 500 firms, for whom he has helped design suitable marketing strategies to identify the most profitable customers. His work with IBM and P&G has been recognized by INFORMS as award-winning entries in the 2006 and 2007 Practice Prize Competition, respectively. Recently, Dr. Kumar was conferred with *two Lifetime Achievement Awards* from the American Marketing Association Special Interest Groups for his contributions to the fields of marketing strategy and interorganizational marketing. He received his Ph.D. from the University of Texas at Austin.

Dr. Kumar can be reached by email at (dr_vk@hotmail.com).

1. Introduction

"Customer is king" is a centuries-old corporate saying. Not much has changed in the current century other than the fact that your company's customer can also be the *most sought after*. Because of advances in technology and globalization, you never know in what form competition will emerge to attract your customers. For example, the incumbent books-retailer leader Barnes & Noble was overshadowed by a then-innocuous Internet-based company, Amazon; IBM was challenged by the new entrant Dell; and American car companies are currently running huge losses at the expense of Japanese and Korean car manufacturers.

A common factor governing the success or failure of any firm is almost always the ability of the firm to service its customers better or offer superior value propositions. So, what's new? It is common wisdom that customer relationship initiatives are *expected* to deliver superior financial performance. However, *reality* often belies *expectation.*

Consider Continental Airlines, for example.[1] In late 1994, Continental had lost an average $960 million per year for the previous four years. Customers were annoyed by the way the airline was being operated—unreliable, dirty, and frequently losing passenger baggage. The Department of Transportation ranked Continental last on the list based on its on-time airline rankings. By March 1995, Continental had moved from last to first in the on-time rankings. In 2000, Continental Airlines was ranked number one in customer satisfaction by J. D. Power and Associates. An unprecedented recovery! The biggest underlying success factor was Continental's ability to win back customer satisfaction. There was no doubt that Continental had a winning customer management formula. But, was the formula profitable? What about the cost of satisfying the customers? Between 2001 and 2005, Continental Airlines reported an average net loss of about $200 million per year.

In the mid 1990s, Dell Corporation introduced a novel e-commerce business model.[2] The company's strategy of selling directly over the Internet with no intermediaries (such as retail outlets) was the most talked about success story of the early twenty-first century. Dell's revenues and earnings grew by more than 30% year after year, and the company reported a return on invested capital of 243% for 2000. *Fortune* magazine listed Dell as America's third-most admired company. Television audiences in the United States were treated to an extensive advertising campaign by Dell that showed Dell employees putting in long hours in their customer contact centers to service customers. Was Dell's success profitable in the long run? Dell's stock has tumbled more than 40% over the past two years on decreased sales and slimmer profit margins. In March 2007, Dell reported a 33% drop in fourth-quarter profits and warned that growth and profit margins will remain "under pressure" for the next few quarters.

A common underlying theme of these two examples is the importance of sustaining successful customer management initiatives in the long run. In other words, although it might be possible to keep customers happy and loyal in the short run, the greater challenge often lies in achieving that objective with both *growth* and *profits* in the long run.

It may be argued that operational efficiencies are also important. We don't deny that fact. However, operational efficiency cannot hold precedence over customer focus. Consider the case of First USA & Capital One, for example.[3] Both companies are prominent players in the credit card industry. However, what sets them apart is their customer management approach. First USA is "laser focused on operating efficiency and to pass those savings on to customers," according to former Chairman Richard Vague. In contrast, Capital One's primary goal is to "deliver the right product, at the right price, to the right customer, at the right time." This is an interesting paradox between two players of the same industry selling exactly the same product.

First USA transacted its business with little differentiation across its customers. This approach was consistent with its corporate structure, which was organized around products or functions. The company's customer acquisition strategy was based on luring customers from other credit card companies and using affinity partners. The company did not make an investment in archiving customer data. Therefore, it lacked the ability to compute individual customer profitability. Employees were mandated to try to retain all customers irrespective of whether they appeared as good or bad prospects in the long run. In 1999, the bank discontinued the policy of allowing a grace period for late payments and raised late-fee penalties. This policy was applied uniformly across the board, across all customers. Not surprisingly, a mass exodus of customers (both profitable and unprofitable) resulted. The company was later forced to revoke its policy. However, the damage was done.

In contrast, Capital One's primary focus is customers. The company conducts business by microsegmenting its customer base so that each customer can be individually serviced in consonance with the customer's value potential. Furthermore, Capital One set up a customer data warehouse that has an unmatched ability to mine any customer's information in a matter of seconds. For instance, when a customer calls, computers instantly access the full history of the customer and cross-reference it with millions of other customers. If a valuable customer calls to cancel a credit card, the call-routing system automatically rattles out three attractive counteroffers that the customer service representative can use to negotiate. In a nutshell, each customer is treated differently. Capital One's deep commitment to knowing its customer is evident from the fact that in 2000, Capital One ran 45,000 tests on product variants, procedural changes, and customer interactions.

So, what was the financial consequence of these two approaches? As the credit environment worsened, First USA's customer attrition rate grew by 50%, contributing to a 23% decline in revenue in 2000, and the company's first ever loss. On the other hand, Capital One earned 40% more interest income from each customer as compared to First USA, with double the profit margin, despite being half the size.

The bottom line is that the bottom line matters. To manage and sustain profitability, we need to come up with the right marketing strategies, backed by the right marketing metrics. Although there are 50+ important metrics that every executive should know,[4] this book focuses on one particular metric: the *Customer Lifetime Value* (CLV) metric. This book takes an in-depth look at how marketing strategies based on this powerful metric can help manage customer relationship and profitability simultaneously.

Customer Lifetime Value

Customer Lifetime Value refers to the net present value of future profit from a customer. The beauty of the metric lies in the fact that it is *forward*-looking, unlike traditional measures based on past contributions to profit. Hence, it enables marketers to adopt the right marketing activities *today* to increase *future* profitability. Moreover, CLV is the only metric that incorporates all the elements that drive profitability: revenue, expense, and customer behavior. Thus, the metric keeps the focus on the customer (rather than the product) as the driver of profitability. In fact, in recent times, the importance of CLV has evolved from merely being an important metric to a way of thinking and of doing business.

Figure 1.1 shows a typical life cycle curve of a customer. If a manager at time (t) were to make a managerial decision regarding this customer, would it make sense to decide based on the customer's past customer value, or would it make sense to decide based on the customer's future value. If the customer's future revenue is expected to drop as compared to past revenue (as seen in Figure 1.1), it may make sense moving forward to reduce the marketing expenditure for this customer.

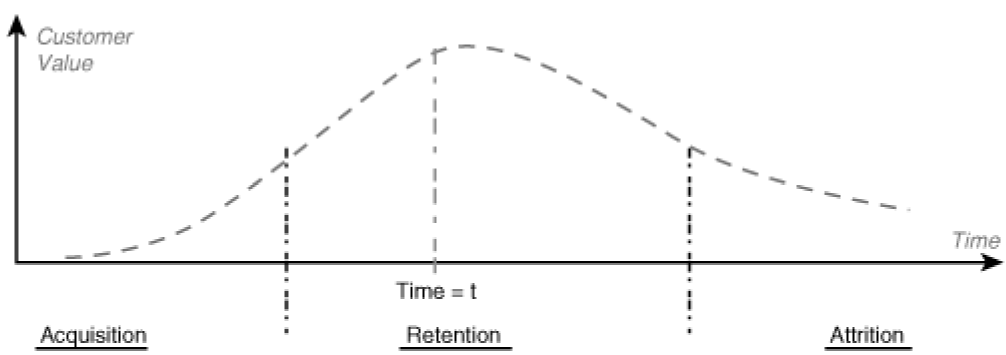


Figure 1.1. Typical life cycle of a customer

Because the metric is forward-looking, the value associated with the CLV is an estimate or a prediction. Therefore, it is imperative that proper methods be employed to measure CLV.

CLV can be measured in two fundamental ways: top down and bottom up.

Top-Down Approach

As shown in Figure 1.2, the top-down approach involves estimating the average customer equity (or lifetime value) of the customer. This can be accomplished by identifying and measuring the drivers of customer equity at the firm or customer segment level. For example, Lemon, Rust & Zeithaml define the drivers of customer equity as comprising the value equity, brand equity, and relationship equity.[5] These drivers are measured based on the customer's objective and subjective assessments of these three drivers of customer equity. The drivers are typically measured using a survey-based methodology because the drivers include subjective assessments of the customer that are not directly observed (such as the customer's attitude toward the firm's brand and the customer's brand awareness). It is practically infeasible to measure these drivers from each customer through a questionnaire. This is particularly true for large firms having millions of geographically dispersed customers. Hence, the drivers are typically measured on a small sample of customers and then extrapolated across the population to arrive at the customer equity at the firm level or the customer segment level.

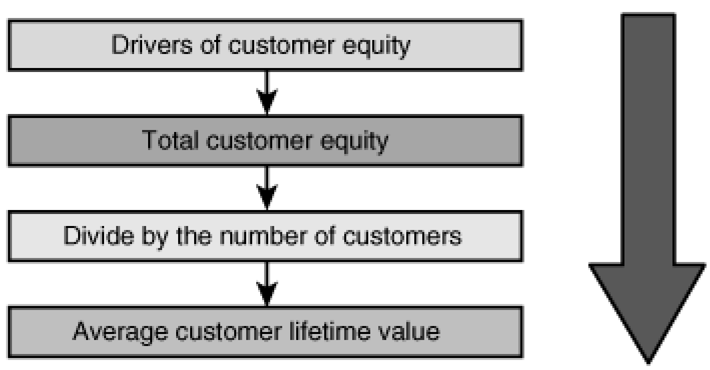


Figure 1.2. Top-down approach to measuring CLV

The customer equity at the firm or the customer segment level can then be divided by the total number of customers of the firm/segment to arrive at the average lifetime value of a customer.

Another way to compute customer equity using the top-down approach is by applying observed aggregate measures pertaining to customers at the firm level. These measures include the total number of customers of the firm, their growth, the average margin per customer, the average customer retention rate, the average customer acquisition cost, and the discount rate for the firm.[6] Using these measures, firms can easily calculate customer equity at the firm level.

The main benefit of top-down approaches is the ability to measure customer equity without the need for customer-level information for *all* customers of the firm. Such an approach offers a simple way to compute the overall customer equity of a firm. However, a potential drawback is that all customers of the firm (or customer segment level) have the same CLV. Therefore, they are all treated as equal. In reality, customer values can differ significantly within the customer base (or segment). In fact, most firms swear by the Pareto principle (the 80/20 rule). That is, 20% of customers usually provide 80% of the total value to the firm. In such a scenario, it is advisable to adopt a computation method that recognizes the individual-level differences in customer value.

Bottom-Up Approach

As shown in Figure 1.3, the bottom-up approach involves first estimating the lifetime value of each customer of the firm. Thereafter, the individual CLV measures are summed up across the customer base/segments to arrive at the total customer equity at the firm/customer segment level.

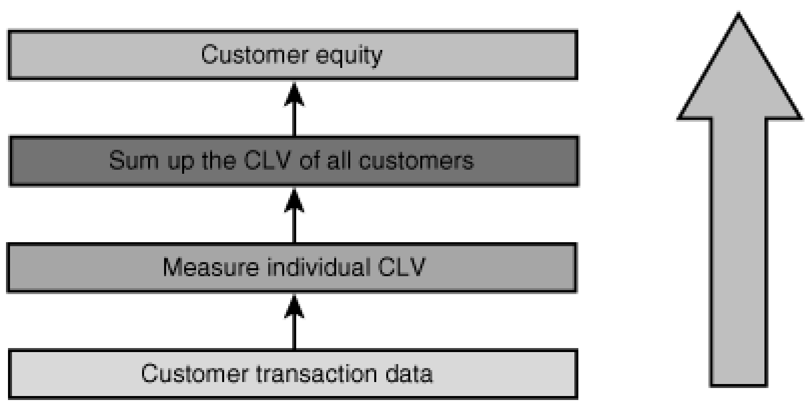


Figure 1.3. Bottom-up approach to measuring CLV

A key requirement of this approach is that it needs data at the customer level. Not all firms may meet this criterion. Further, estimation of CLV for each customer could be time-consuming, especially for large firms with millions of customers. However, the bottom-up approach offers rich customer-level insights (such as individual customer behavior, response to promotion, and individual customer value) that might have otherwise been lost due to aggregation under the top-down approach. Our contention is reinforced by new challenges infused by the changing business landscape of the twenty-first century, as shown in Figure 1.4.

Table 1.4. Changing business landscape of the twenty-first century

	Traditional Business	Twenty-First Century Business
Philosophy	Sell products	Serve customers
Orientation	Market orientation	Interaction orientation
Management Criteria	Portfolio of products	Portfolio of customers
Strategy Motivation	Increase customer satisfaction	Increase customer profitability
Selling Approach	How many customers can we sell this product to?	How many products can we sell to this customer?
Strategy Outcome	Sales maximization	Customer Lifetime Value maximization

The shift in focus from products to customers has been a significant development of the twenty-first century. State-of-the-art marketing is now concerned with servicing each customer differently. These developments have been accelerated by technological advances. Increase in computation power and reduction in data-storage costs have prompted several companies to set up huge IT infrastructures to archive customer-level data. The proof lies in the ubiquity of grocery cards, retailer credit cards, and point-based loyalty schemes (such as airline frequent-flyer programs). All these measures are a means to a common end: collection of customer-level data in an effort to know the customer better. So, if you don't know your customers, your competition will! Further proof comes from companies that have succeeded in knowing and managing their customers at the individual level. Such organizations have been richly rewarded because of an improvement in both cost and profit efficiencies. For example, Harrah's Entertainment, a prominent casino and gaming resort chain, has consistently outplayed its competition and recorded impressive financial performance despite a weak economy. The critical success factor: superior ability to cater to its customers based on a forward-looking metric.

The concepts covered in this book apply to disparate relationships, regardless of whether the customer is contractual or noncontractual, whether the firm sells a product or a service, or whether transactions with specific customers occur repeatedly or are just one-off (and perhaps with follow-up services). CLV can be measured across all these situations, but how it is measured will vary. Chapter 3, "Customer Selection Metrics," covers CLV measurement issues across various scenarios.

Therefore, the adoption of the CLV metric seems to be not only sufficient but a necessary condition of business in the twenty-first century. Given the increasing focus on customers, this book strongly advocates the bottom-up approach to CLV estimation. The bottom-up approach enforces customer-centricity within an organization, as you will discover in the subsequent chapters of this book. The full potential of the CLV metric is realized when all customer-level marketing strategies of the firm are aligned and integrated with the CLV metric.

Aligning Customer Management Strategies with the CLV Metric

Figure 1.5 illustrates a typical customer life cycle scenario. Based on the location of the customer on the life cycle plot, the firm can extend acquisition, retention, or customer win-back strategies in an effort to speed acquisition, increase revenue during retention, and delay attrition. The net result is a lift in customer value. This is denoted as strategic impact in Figure 1.5.

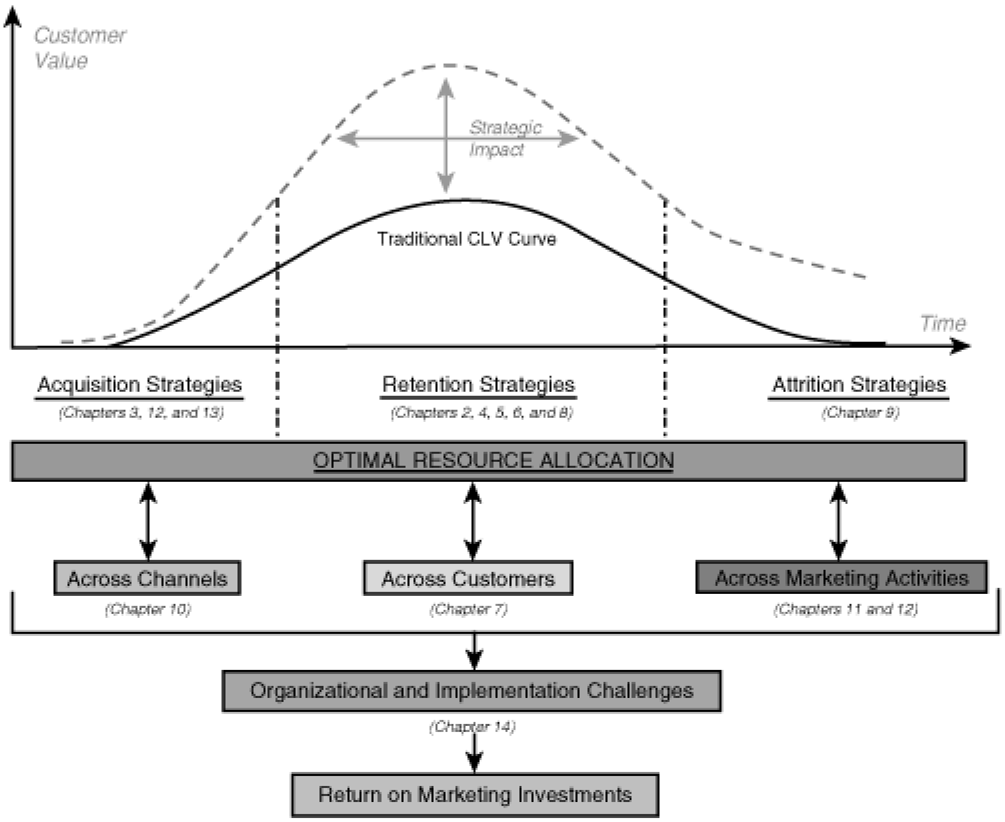


Figure 1.5. Typical customer life cycle scenario

The rest of this book takes an in-depth look at powerful customer-level strategies relevant to virtually any business in the business-to-consumer (B2C) or business-to-business (B2B) domain. With regard to the customer acquisition stage, this book covers how firms can go about acquiring profitable customers, the best metric to use while acquiring customers, and how to use customer referral as a strategic tool to acquire new customers. With regard to the retention stage, this book examines how firms can manage customer value, loyalty, and profitability simultaneously; that is, how can they pitch the right product to the right customer at the right time. With regard to the customer attrition stage, this book discusses dynamic proactive strategies to prevent losing customers. Deployment of these customer-level strategies has resource allocation consequences that lead to greater cost and profit efficiencies. This book talks about reallocation of resources *across different channels* to increase the level of interaction and hence spending per customer. Resource allocation *across customers* helps in the prudent reallocation of limited marketing budgets from low-profit customers to customers who are expected to provide higher profits in the future. Resource allocation *across marketing activities* seeks to balance marketing budgets across acquisition and retention strategies. The net result of all customer-level initiatives is a higher return on marketing activities. However, this is often an impediment in the wake of strategy-implementation challenges at the organizational level. These challenges have been addressed in a separate chapter of the book. The book chapters relevant to each strategy/topic are indicated in parentheses in Figure 1.5. All strategies are state-of-the-art, with a proven track record of unprecedented success when implemented at select Fortune 500 corporations.

2. Maximizing Profitability

Relevant Issues

- Are loyal customers profitable customers?
- What is the link between loyalty and profitability?

Firms, across various industries, have used loyalty programs as a primary tool to build and maintain long-term relationships with their customers. For more than 20 years, the airline industry has been administering loyalty programs. Customers are typically awarded one point for every mile traveled, which they can later redeem for free trips and other offers. The hotel industry is another example of an industry that uses loyalty programs. In this case, customers are rewarded according to the number of days/nights or the number of stays. Over the past ten years, the retail industry has also offered loyalty programs, with customers rewarded for every dollar spent.

Firms tend to cite profitability as the justification for such loyalty programs; they believe that over time, long-term customers tend to spend more, cost less to serve per period, have greater propensity to generate word-of-mouth, and pay a premium when compared to short-term customers. For these reasons, they think loyal customers are more profitable than nonloyal customers, and that by cultivating loyalty alone, a company can increase its overall profitability.[1]

However, a recent marketing study has shown empirical evidence that not all loyal customers are profitable, and not all profitable customers are loyal.[2] The relationship between loyalty and profitability is much weaker, and more nuanced, than proponents of loyalty programs claim.

This finding shows the need for a more accurate measurement of customer behavior and loyalty and its effect on the firm’s profitability. So, the question is, are loyal customers profitable? Before we answer this question, the traditional view of loyalty is examined. The following section briefly reviews the evolution of loyalty programs over the years and customer buying behavior.

Loyalty Programs

Traditionally, firms have vied for loyal customers in the belief that they are the most profitable ones. These firms have primarily used loyalty programs as the tool to establish and maintain a strong relationship with customers. Loyalty programs are marketing processes that reward customers based on their repeat purchases. After customers enroll in loyalty programs, they tend to purchase more from the focal company, thereby increasing their own store-switching costs and making them more likely to purchase from the focal firm. In return for their loyalty to the firm, customers are rewarded through various means. In some cases, they accumulate "points" that they can later redeem for products or services, mostly from the focal firm. In other instances, they are given, based on their level of loyalty, special promotions and offers not given to others.[3] For example, Dorothy Lane Market, a small grocery retail chain in the United States, custom targets its coupons and promotions by directly mailing them to its profitable customers instead of offering coupons and promotions through newspapers, which reach all the customers. In addition, the firm offers greater discounts and better promotions to customers who have been more loyal and profitable to the firm (as compared to relatively new customers). This has enabled the firm to successfully reduce its customer churn rate.[4]

Even though loyalty programs are most well known in the business-to-consumer (B2C) setting, loyalty programs do exist in the business-to-business (B2B) setting, but they are usually called something different. For example, the loyalty program administered by a corporate service provider is called a tier of *relationship benefits*. In this type of program, client firms are categorized based on their level of loyalty and the revenue they bring in, and are rewarded accordingly. For example, loyal clients are offered personalized websites to service them; thus, when the client accesses the service provider's website, he is directly led to a specialized website that deals with the specific needs and services of that client.

The use of loyalty programs as an instrument to build customer relationships has been around since the early twentieth century. Sainsbury

(UK grocery chain) archives from the 1930s reveal how managers wrote to customers who had not made their usual shopping trip, in an effort to maintain patronage. Later, the store used Green Stamps, which customers enthusiastically supported, despite the need to paste them into books.[5]

Loyalty programs are necessary because consumers have varying degrees of loyalty associated to brands, stores, and companies.[6] A loyalty program provides marketers an opportunity to retain customers with the focal firm by offering a mutually beneficial relationship between the customer and store; the store receives the repeat patronage, and the customer receives some incentives for becoming "behaviorally" loyal. Despite its early presence in marketing, most of the advancements in loyalty programs have occurred in the past 25 years. These advancements include the introduction of frequency reward programs, the promotion of customer clubs, and purchase-based incentives, among others. Figure 2.1 presents a timeline of loyalty programs.

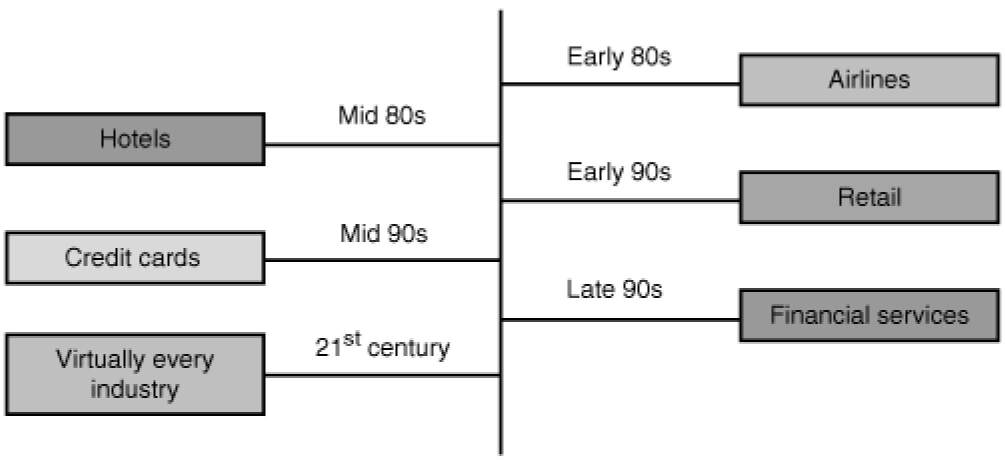


Figure 2.1. Evolution of loyalty programs

Loyalty programs were first in force in the airline industry during the early 1980s. American Airlines introduced its frequent-flyer program, AAdvantage, in 1981. Consumers could earn free flights for every *x* number of trips they made with American Airlines. This program came into effect to counter the decrease in margin resulting from competition. Soon, United launched a similar program that considered the length of the trip to reward customers. With other players following suit, award programs started to steamroll. By 2002, there were more than 120 million airline frequent-flyer members worldwide, with most residing in the

United States (74 million), Europe (24 million), and Asia (21 million).[7] American's AAdvantage is now the largest frequent-flyer program in the world. As of November 2003, it had grown to a membership of more than 45 million.[8]

The hotel industry followed the model established by the airline industry. Marriott was the first hotel chain to launch loyalty programs, in 1983, with its Honored Guest Awards, based on the total number of days/nights per year and the duration of the stay. This sparked a series of loyalty programs from other hotel chains, such as Starwood with its Starwood Preferred Guests Program, Hilton with its Hilton HHonor, and Hyatt with Hyatt Gold Passport. By October 2003, Marriott Rewards had grown to 19 million members and more than 2,700 participating hotels worldwide.[9]

In the early 1990s, grocery stores started implementing loyalty card programs for their customers. These programs were aimed at building customer loyalty by

- Encouraging customers to visit the store more often, and
- Increasing the Share of Wallet (SOW) by encouraging customers to spend more.

In 1995, Tesco launched its Clubcard loyalty card in the United Kingdom.[10] Other popular loyalty cards include the Boots Advantage card, introduced in 1997; the Somerfield Saver card, introduced in 2002; and the Marks & Spencer's &more card, introduced in 2003. In the United States, some of the popular cards include the Albertsons Preferred Savings Card and the CVS/Pharmacy ExtraCare card.

Loyalty programs then reached the casino industry in the late 1990s, with Harrah's launching its Total Rewards program. Since the inception of its rewards program in the late 1990s, Harrah's has increased its share of customers' gaming budgets from 36% to 50%.[11] Casino loyalty programs typically provide a membership card (swipe card) that records all customer transactions (casino games, restaurants, stores, hotel stays). This behavior-tracking technology gives casinos an insight into customer behavior, and in turn helps in designing effective customer relationship strategies.[12] The effect of implementing these loyalty programs on the overall performance of Harrah's is illustrated in Figure 2.2. As you can see, the total revenue has been steadily increasing, and the overall profit also exhibits an upward trend. Other popular loyalty programs in casinos include those of Grand Casinos and the Tropicana.

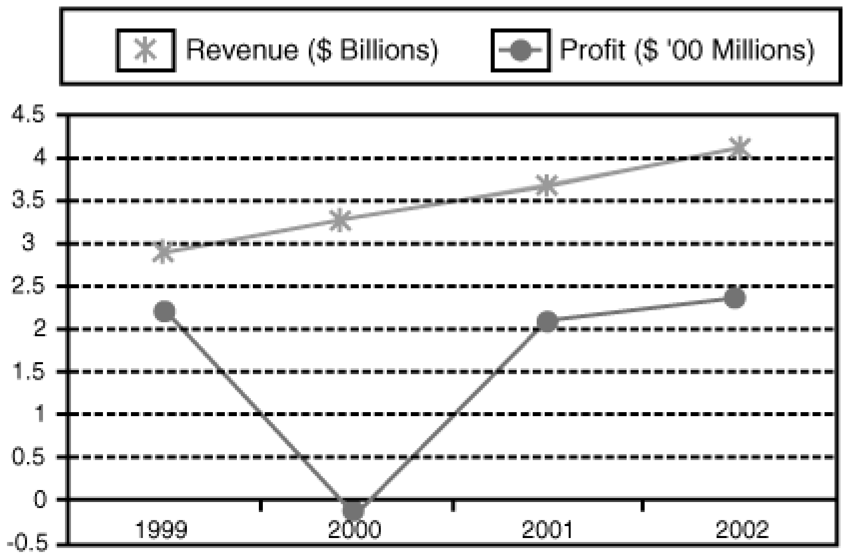


Figure 2.2. Effect of loyalty measures on the performance of Harrah's Entertainment

Recently, cruise lines have joined the loyalty bandwagon. Cruise lines have started rewarding their customers based on the number of days at sea. Customers are rewarded with discounts for selected trips, upgrades when available, advance notice of special promotions, special invitations to captain receptions, and so on, based on their level of loyalty.[13] Customers of Silversea Cruises are rewarded with a free week's cruise if they have sailed for 250 days with the firm. Seaborn offers its customers complementary trips, up to 2 weeks free, if they have sailed for 140 days. Some firms also provide special services to their loyal customers, offering them free laundry service, Internet access, and priority embarkation. Regent Cruise Line offers its highest loyalty customers free pickup from and return to their home/airport. Disney Cruise Line offers its loyal customers advance booking privileges to excursions, specialty restaurants, and so forth. Disney's loyal customers also receive a custom-designed pin set of Mickey and Minnie, a mesh beach bag, and other goodies as rewards for their loyalty.

Companies constantly update their loyalty programs to suit customer needs. According to Gartner Analyst Adam Sarner, U.S. companies spent more than $1.2 billion on customer loyalty programs in 2003.[14] Loyalty programs have become an important relationship-marketing tool used by marketers to identify, award, and retain profitable customers. Therefore, a clear understanding of the goals of a loyalty program is necessary to design and implement effective marketing strategies. In addition, when designing the benefits and incentives of the loyalty program, companies should always consider the profitability of the loyalty program with regard to each customer.

How Do Loyal Customers Really Perform?

In spite of all the time and resources spent on loyalty programs, a question remains: How do loyal customers really perform? The loyalty program of a large U.S. high-tech company was studied to answer this question.[15] This firm had instituted a cost scheme to analyze the effect of its recently initiated loyalty program. This scheme was executed for the next five years, and the company was able to determine the profitability of all its customers in the loyalty program over this period. This scheme, apart from measuring the direct product costs for every customer, also measured the associated costs such as advertising, service, sales force, and other organizational expenses. The loyalty program cost the firm $2 million annually, and the cost-tracking scheme allowed the firm to calculate the overall profitability of its customers. The results were rather surprising. Nearly half of the “behaviorally” loyal customers (customers who regularly made purchases for a minimum of two years) studied barely generated a profit. On the other hand, nearly half of the highly profitable customers were short-term customers, customers who bought a large number of high-margin products in a short time before they stopped buying from the firm.

Are Loyal Customers Profitable?

To address this issue, the relationship between how long customers stay with a firm and the firm’s profitability was studied for four different companies: a high-tech corporate service provider, a U.S. mail-order company, a French grocery retailer, and a German direct brokerage firm.[16] Table 2.1 shows the results. If a strong relationship exists between loyalty and profitability, one would expect a strong positive correlation. A perfect correlation between these two factors (indicated by $r = 1$) would mean that managers could make predictions with certainty about a customer's level of profitability based on the loyalty of each customer. The weaker the correlation between the two factors (that is, the closer the r value is to 0), the weaker the relationship between customer loyalty and customer profitability.

Table 2.1. Correlation between Loyalty and Profitability

Companies Studied	Correlation between Loyalty and Profitability (r)
Corporate service provider	0.30
Grocery retailer	0.45
Mail-order company	0.20
Direct brokerage firm	0.29

From the results shown in Table 2.1, you can see that the association between loyalty and profitability is moderate at best and weak at worst. The correlation coefficients were found to be 0.45 for the grocery retailer, 0.30 for the high-tech corporate service provider, 0.29 for the direct brokerage firm, and 0.20 for the mail-order company.

This study provides an overall glimpse of the relationship between the duration of a customer's tenure with the firm and the firm's profitability. But, several myths pertain to loyal customers, especially the three main myths widely held by proponents of customer loyalty:

- Loyal customers cost less to serve.
- Loyal customers are willing to pay more for products.
- Loyal customers serve effectively in marketing the company's products.

Each myth was tested by looking at data from the four companies mentioned previously. Customers from each company who had started to do business at the same time were selected, and their purchase behavior was tracked over a period of four years.[17] This study also included how these companies approached these customers over time and what level of service was given to them. The following sections discuss the detailed results of this study.

Myth 1: Loyal Customers Cost Less to Serve

One of the widely held beliefs is that loyal customers, even though they can be expensive to acquire, turn out to be profitable in the long run because the acquisition cost is spread out over a large number of future transactions. This belief is based on the assumption that these customers will be profitable in their future transactions. Another more reasonable argument linking loyalty to reduced cost is that as the customers become acclimated to the company's products and transaction process, they will need less attention, and hence will consume fewer operational resources (in turn making them more profitable). For example, a loyal customer who buys software products from a specific firm will need less customer support; perhaps the customer will have access to the online store and other less-expensive resources to solve his problems without needing the intervention of a customer support technician.

Based on studying the four companies, no evidence supported these arguments. The cost of maintaining a relationship with a customer (which includes, apart from the transaction costs, the cost of marketing communications through email, direct mail, telephone, and so on) varies widely within a given company. In some cases, this cost varied by a factor of 100 or more. But, none of the loyal customers in all four companies studied were found to be consistently cheaper to manage when compared to short-term customers. Actually, evidence to the contrary was found in the case of the high-tech service provider, where the loyal customers were found to be more expensive to manage. This finding is not very surprising. It is widely known that in the B2B setting, long-term customers tend to be less profitable because long-term or experienced customers generally tend to purchase in high volumes and demand deeper volume discounts and more personalized service. In fact, the high-tech corporate service provider, to win over its top 250 clients, had developed a customized website for each client to receive personalized service from special sales and service teams. Maintaining the website and the special teams cost the firm $10 million annually.

This trend is also reflected in the other industries studied. In the case of the mail-order catalog firm, it took about the same amount of marketing spending to generate a comparable level of sales for long-term customers as it did for short-term customers. (It took about 6 cents of marketing spending to generate $1 in sales.) The reason for this was when a long-term customer migrates to a less-expensive channel (for example, ordering products using the company's website rather than through a brick-and-mortar store), that customer expects lower prices, and this offsets the cost savings realized by making the customer use a cheaper communication channel. A similar trend was observed in the case of the grocery retailer and brokerage firm. This study showed that loyal customers expect something in return for their loyalty, and in turn, this behavior might make their relationship with the firm less profitable than expected over the long term.

Myth 2: Loyal Customers Are Willing to Pay Higher Prices for the Same Products

Another widely held belief is that loyal customers are so used to purchasing from the focal firm or brand that they are willing to pay a premium to get the same product than a less-loyal customer. It is argued that customers stay long enough with a firm because of the high cost associated with switching to a different supplier. Therefore, they are willing to pay a higher price (up to a reasonable level) to avoid switching.

This belief might be relevant to a certain extent in the B2C setting, where customers who are more familiar with the transaction process of a particular firm might be willing to pay more in a given transaction for the same products they could get elsewhere at a cheaper price. For example, customers who are used to ordering from a particular catalog might be averse to switching and might pay a little more to buy a given set of products from this catalog retailer rather than another retailer who discounts the products. However, this trend is very unlikely in the corporate setting, where clients might bargain for lower prices in return for greater purchase frequency.

The evidence from the high-tech service provider proves that loyal customers are not always willing to pay higher prices. The long-term customers of this firm paid somewhere between 5% and 7% less, based on the product category, than the relatively new customers. In addition, contrary to expectation, the same trend was replicated in the B2C setting. The customers in a B2C setting also expect to get something in return for their loyalty. For example, in the case of the mail-order firm, in a particular product category long-term customers paid as much as 9% less when compared to newer customers.

This shows that loyal customers are far more price sensitive when compared to newer customers, both in the B2B and B2C settings. This could be because loyal customers are a lot more familiar with the various product offerings and can therefore better assess the quality and value of the products. Also, they are more aware of the reference prices, causing them to react more cautiously when compared to relatively new customers when the price seems high. This behavior was evident in the mail-order company, where loyal customers will mostly opt for a cheaper product alternative when compared to more recently acquired customers, who have a much lower familiarity with the firm. Overall, customers tend to be more sensitive to any form of price differentiation, and it is very difficult for firms to implement such strategies for any duration. Recent surveys report that customers expect lower prices in return for their loyalty to the firm. U.S. telecom firms are one example where firms offer special discounts in the beginning and raise prices at a later stage, only to experience low rates of customer retention.

Myth 3: Loyal Customers Effectively Market the Company

Managers have a high expectation that loyal customers act as effective marketers of the company and its products. Many managers argue that by investing in loyalty programs, they could benefit from the new customers that the loyal ones bring to the firm. To test this belief, a series of surveys were administered to the customers of a French grocery retailer to measure the extent of their passive and active word-of-mouth marketing. Passive word-of-mouth marketers named the focal firm when asked to recommend a grocery retailer, and active marketers spontaneously shared information with family or friends about the positive experience with the company. The customers' actual loyalty to the firm was measured by analyzing their previous purchase behavior, such as the products purchased, the frequency of purchase, and the product categories they purchased from. Apart from this, the "attitudinal loyalty" of customers was also measured by querying the customers on how loyal they feel toward the firm, how satisfied they are with the firm, and whether they are considering switching to a different firm.

This study showed that the link between the loyalty of customers and their propensity to act as word-of-mouth marketers for the firm was not strong. But, some interesting results were revealed when customers' behavior loyalty and attitudinal loyalty were considered separately. It was found out that customers who scored high on both behavioral loyalty and attitudinal loyalty were 54% more likely to be active word-of-mouth marketers and 33% more likely to be passive word-of-mouth marketers when compared to customers who scored high based only on behavioral loyalty only. Similar studies of customers from the high-tech service provider also reflected this trend. Customers who scored high on both attitudinal and behavioral loyalty were 44% more likely to be active word-of-mouth marketers, and 26% were more likely to be passive word-of-mouth marketers. This study holds important lessons for managers. To identify effective word-of-mouth marketers, they need to look at both the attitudinal and behavioral loyalty of their customers, instead of focusing only on their purchasing behavior. You can find a more detailed discussion about attitudinal and behavioral loyalty in Chapter 6, "Managing Loyalty and Profitability Simultaneously." Apart from the myths discussed here, various other myths about loyalty and the benefits of customer loyalty[18] misguide managers when making and executing their marketing decisions. Firms should approach these loyalty myths with caution and avoid all the pitfalls inherent in them when implementing strategic decisions.

Debunking the Myths

To clearly understand the relationship between loyalty and profitability, customers from four firms (as discussed previously, a high-tech service provider, a grocery retailer, a mail-order catalog firm, and a direct brokerage house) were segmented based on the longevity of their relationship with the firm and their level of profitability. As shown in Figure 2.3, the customers from all these firms were segmented into four groups based on their loyalty and profitability, and their contributions to overall profit were determined. The results show an interesting scenario. As you can see, a sizable number of long-term customers (Segment 4) from all four firms yield only marginal profit, whereas a large number of the short-term customers (Segment 1) are highly profitable. Customers in Segment 1 are the main cause for driving down the correlation between loyalty and profitability. Because this trend is observed in all four industries, it is clearly demonstrated that the belief "all loyal customers are profitable" is just a myth.

	Segment 1	Percentage of Customers	Segment 2	Percentage of Customers
High Profitability	High-tech service provider	20%	High-tech service provider	30%
	Grocery retail	15%	Grocery retail	36%
	Mail-order	19%	Mail-order	31%
	Direct brokerage	18%	Direct brokerage	32%
	Segment 3	**Percentage of Customers**	**Segment 4**	**Percentage of Customers**
Low Profitability	High-tech service provider	29%	High-tech service provider	21%
	Grocery retail	34%	Grocery retail	15%
	Mail-order	29%	Mail-order	21%
	Direct brokerage	33%	Direct brokerage	17%
	Short-Term Customers		Long-Term Customers	

Source: W. Reinartz and V. Kumar, "The Mismanagement of Customer Loyalty," *Harvard Business Review* 80(7), 2002: 86. Printed with permission from the Harvard Business School Publishing.

Figure 2.3. Association of profitability and loyalty of customers

To test the belief that "loyal customers are willing to pay more for the same product," we studied customer spending behavior in a European grocery retailer. The customers were segmented into four quartiles based on how long they had shopped with the retailer, and the average price paid by each quartile across various product categories was determined. As you can see from Figure 2.4, very little difference exists between the average price paid by customers in the top and the bottom loyalty quartile. This clearly debunks the myth that "loyal customers are willing to pay more for the same products."

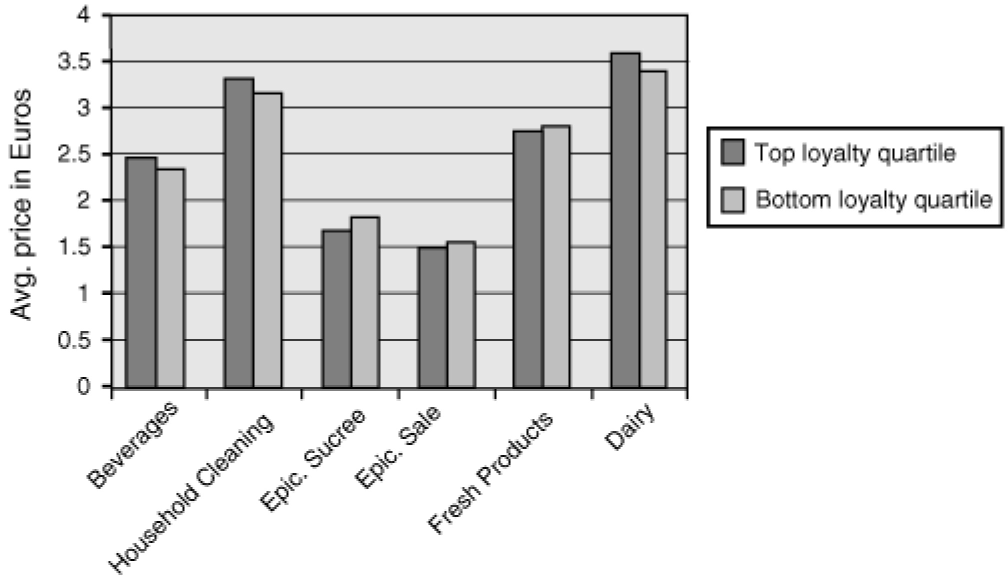


Figure 2.4. How much more are loyal customers willing to pay?

Where Do Firms Go Wrong?

In spite of the overwhelming presence of loyalty programs in virtually every industry, firms implementing them have tended to overlook certain important limitations, often to the detriment of company profitability. Instead of building long-term profitable customer relationships, these programs have become a major drain on the marketing resources of firms, resulting in an overall reduction in profitability. One major limitation that has often been ignored is the cost of implementing loyalty programs. These programs were implemented across all customers, irrespective of whether they were profitable. One standout example of firms following such a strategy is the early loyalty programs introduced in the airline industry. Earlier, customers were rewarded based on the miles they traveled with a given airline, regardless of the price they paid. This resulted in the economy-class traveler and the first-class traveler being awarded the same number of points. Such a strategy often resulted in the airline spending more on the economy-class customer than what that customer brought in as profit from the sale of the ticket. Only recently has this trend in airline loyalty programs been corrected. Now, airline customers are rewarded based on what they spend, using a fare tier-class structure rather than just the number of miles traveled.

An example of a failed loyalty program in the airline industry is the loyalty program launched by Latin Pass. Latin Pass, a frequent-flyer consortium of ten Latin American airlines, ran a promotion in 2000 awarding one million miles to customers who visited ten Latin American countries and utilized hotel and rental car partners within a certain timeframe. Latin Pass had to terminate the promotion earlier than planned when 50 people qualified for rewards in three months and generated costs of up to $10,000 per qualified customer. This demonstrates the pitfalls in executing loyalty programs without considering the cost involved in implementing them.

Another example of a failed loyalty program is the one introduced by Safeway. Safeway, a U.K.-based grocery retail chain, introduced its ABC (Added Bonus Card) loyalty program in 1995. Safeway abandoned the program in 2000, claiming that it was unable to use the information generated by the program to generate enough incremental sales to justify the program's high cost. Instead, Safeway is focusing on weekly promotions and improved customer service.

The Problem with Measuring Loyalty

One of the main problems in implementing loyalty programs is using outdated metrics to measure a customer's value. Loyalty metrics are used by firms to rank order their customers based on their loyalty to the firm and their past purchasing behavior. Some of the traditionally used metrics are Recency-Frequency-Monetary value (RFM), Share of Wallet (SOW), and Past Customer Value (PCV). (An elaborate discussion of various loyalty metrics is presented in Chapter 3, "Customer Selection Metrics.") Firms use this rank ordering of customers to direct appropriate marketing strategies to them. The problem arises when they choose the wrong customers based on these faulty metrics. Traditional metrics assume that past customer behavior will be replicated in the future. In reality, this is not the case, particularly in a noncontractual setting. The traditional metrics do not give any recommendation as to what specific marketing strategies need to be taken to maintain a customer's relationship. To overcome these drawbacks, we use the forward-looking Customer Lifetime Value (CLV) metric to measure and manage customer loyalty. CLV accurately predicts customer's future behavior based on his/her past purchasing behavior and gives a CLV score for every customer. Managers can design detailed marketing strategies based on the CLV scores of the customers. (Chapter 3 contains a full discussion of the various ways to calculate the CLV of customers.)

When to Stop Investing in a Customer

Making objective marketing decisions becomes difficult if firms cannot accurately predict what the customer's future spending behavior is going to be. This problem becomes particularly relevant when firms use traditional metrics such as RFM, SOW, and PCV (Past Customer Value) to measure a customer's value. Because these metrics assume that the customer is going to continue his/her purchasing behavior in the future, they misjudge the customer's worth and purchase lifetime with the firm. This presents a skewed picture to the managers, causing them to implement suboptimal marketing campaigns. The managers continue to invest in a large number of customers who have ceased to purchase from the firm and have no intention of returning to the firm. This drains the firm's limited marketing resources and ignores the opportunity to invest in more profitable customers. (In the case of the high-tech service provider, about 40% of its customers were not worth chasing because they were unlikely to make a purchase in the future. In spite of this, the firm continued to invest in them.)

To study the effect of retaining unprofitable customers on a firm, the customers of a general merchandise catalog retailer were segmented into four groups based on their level of loyalty and profitability[19]. As you can clearly see in Figure 2.5, both segments of customers start out to be profitable, and they generate comparable profits until month 20. After that, customer 1 maintains his/her current profitability level, whereas customer 2 becomes less and less profitable. At this point (month 20), the firm can greatly benefit from using a forward-looking metric to assess its customers. If the firm assumes that customers are going to continue their past purchasing behavior into the future, the managers will keep allocating an equal amount of resources to both customer 1 and 2. Clearly, customer 2 is not worth pursuing.

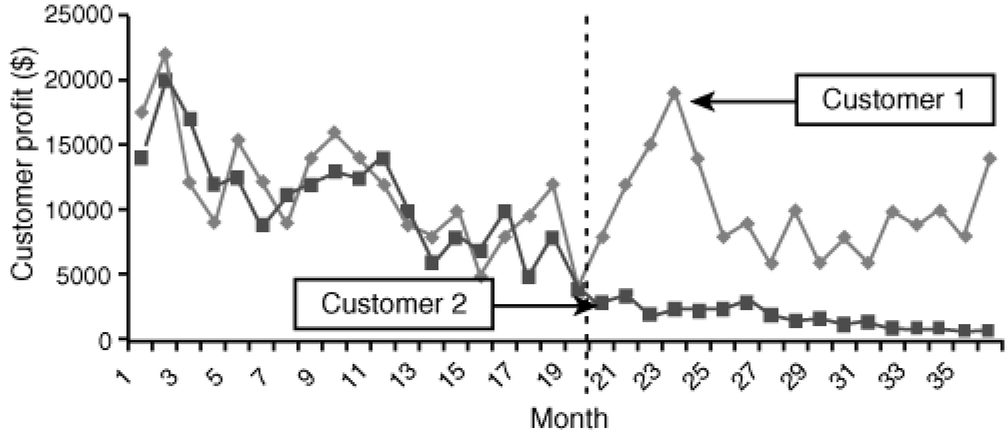


Figure 2.5. When to lose a customer: a case study

If the firm can accurately predict the purchasing behavior of its customers, it can custom target its profitable customers with promotions and messages. The use of a forward-looking metric such as CLV will save the firms from incurring such losses, helping managers invest their marketing resources more wisely and ensuring a larger return on investment (ROI) for each marketing campaign.

Conclusion

Firms are often mistaken when they believe that loyal customers are profitable. These firms are just as wrong when they believe that by creating loyalty programs they can make their customers more "behaviorally" loyal, with higher profit to follow. The reality shown in the examples in this chapter proves otherwise. Loyalty does not automatically ensure profitability, and the relationship between loyalty and profitability is more complex than is often perceived. In addition, firms regularly use outdated loyalty metrics to measure the value of their customers, and these lead managers to implement flawed marketing strategies that drain the firm's resources. By accurately predicting the value and relationship duration of a customer via a forward-looking metric such as CLV, firms can generate profit by targeting customers who are actually going to add to the firm's profit in the future (regardless of whether these customers are behaviorally loyal or just short-term customers who buy a lot now and switch to another firm later). This chapter does *not* conclude that loyalty programs are a waste. Instead, to be more effective, loyalty programs must be tailored with a metric that measures the future profitability of customers. To do this, managers need a metric such as CLV to tie in with their loyalty programs, to understand the incentives necessary to entice all their customers to make future purchases.

3. Customer Selection Metrics

Relevant Issues

- How can we measure a customer's worth?
- How do we incorporate future purchase behavior in calculating a customer's worth?

Various customer selection metrics are available for measuring and managing loyalty. These metrics help companies to measure the value of customers and prioritize them based on their contribution to overall profits. This enables the firms to allocate a higher proportion of resources to the customers who are expected to generate greater profit. Several metrics are currently available. Practitioners in the mail-order industry predominantly use the Recency-Frequency-Monetary value (RFM) metric, whereas high-tech firms tend to use Share of Wallet (SOW) to implement their marketing strategies. Past Customer Value (PCV), used in the financial services industry, is another metric. Customer Lifetime Value (CLV) is an advanced metric that is widely gaining popularity across all sectors and industries. The forward-looking CLV metric, used to predict customers' future behavior, is applied when designing and implementing marketing strategies for the present, with the goal of maximizing profitability.

This chapter describes how various metrics, including the CLV, are computed for noncontractual but repeated transactions scenarios (the most common relationship in the market). This chapter also discusses other scenarios, such as contractual transactions and one-time purchases with add-on services.

Traditional Metrics

Traditionally, the metrics used for resource allocation were RFM, SOW, and PCV. These methods are backward-looking and do not consider if a customer is going to be active in the future. These methods only consider the observed purchase behavior and assume that the future will be the same as the past for each customer. A detailed description of these metrics is provided in the following section.

RFM (Recency-Frequency-Monetary Value)

RFM is a widely used customer selection metric that stands for **R**ecency-**F**requency-**M**onetary value. It is mainly used in the mailorder and catalog industries, where predicting the future purchase behavior of customers is crucial, and it has been estimated that 71% of the firms use RFM in their direct marketing efforts.[1] This technique uses past customer information to evaluate and predict customer behavior and customer value, as follows:

- Recency is a measure for the time elapsed since a customer last placed an order with the company.
- Frequency is a measure of how often a customer orders from the company in a certain time period.
- Monetary value is a measure of the amount that a customer spends on an average transaction.

To compute the RFM score, it is necessary to first determine values for each of the different variables for each customer and then add them together based on the relative weights of the metrics. These relative weights can be determined directly by managers or by using simple regression techniques. To understand how businesses compute an RFM score and use it strategically in marketing campaigns, consider the following example.

ABC Sportswear, a catalog seller of sportswear, has the budget to contact one of its two customers. The company has the purchase behavior data for each of these two customers over a period of five months (January through May). Both the frequency and the dollar value of the transactions are shown in Tables 3.1 and 3.2, respectively. At the beginning of June, ABC Sportswear wants to select the best customer on whom it can invest its limited marketing budget.

Table 3.1. Dollar Amount Spent by Each Customer

Customer	January	February	March	April	May
1	200	50	80	100	200
2	300	200	0	25	45

Table 3.2. Purchase Frequency of the Customers of ABC Sportswear

Customer	January	February	March	April	May
1	3	1	2	1	1
2	2	1	0	1	2

To figure out which customer to market to, ABC Sportswear computes the RFM score of each customer; the customer with the higher RFM score will be selected for its marketing campaign. To compute the RFM score, ABC Sportswear determines the relative weights of the three variables Recency, Frequency, and Monetary value to be 50%, 20%, and 30%, respectively (see Table 3.3).

Table 3.3. Table for Calculating the RFM Scores

Recency =	20 Points If Purchased within the Past Month
	10 points if purchased 2 months ago
	3 points if purchased 3 or 4 months ago (count only once)
	That is, if the customer has purchased both 3 and 4 months ago (February and March), the Recency point is 3 (not 6).
	2 points if purchased 5 or more months ago
Relative weight	50%
Frequency =	3 Points for Each Purchase within the Past Six Months
Relative weight	20%
Monetary Value =	10% of $ Volume of Purchase within the Past Six Months
Relative weight	30%

The RFM scores of the two customers are calculated using the data from Table 3.3 and are presented in Table 3.4.

Table 3.4. Customers Rank Ordered Based on Their RFM Scores

	RFM Scores
Customer 1	41.2 (Rank 1)
Customer 2	38.2 (Rank 2)

Based on these scores, Customer 1 has a higher (41.2) RFM score than Customer 2 (38.2). Because RFM is a relational measure, a higher ranking means that you are a better customer. So, ABC Sportswear decides that

Customer 1 will likely be a better target for its marketing resources than Customer 2.

Share of Wallet

Share of Wallet (SOW) indicates the degree to which a customer meets his or her needs in the category with a focal brand or firm.[2] SOW is used widely in retail businesses such as supermarkets and in financial companies mainly to identify whether consumers are loyal to a specific store or whether they shop around at different stores. For example, one consumer might shop 100% of the time at the same grocery store, whereas another consumer might choose to shop equally across four different stores, giving each store a 25% SOW. This metric provides business-to-business (B2B) companies with an idea of what portion of the marketing budget is being spent with that firm. For example, a technology firm knows that if a business customer is spending 100% of its IT budget with them that the business customer is behaviorally loyal and relies specifically on that firm for all its IT needs.

SOW can be estimated either at the individual level or at the aggregate level. With respect to a customer scoring metric, it is almost exclusively measured at the individual level because measures at the aggregate level do not give managers enough information about individual customers to make actionable strategies. At an individual customer level, SOW indicates the degree to which a customer meets his or her needs in a specific category with a focal brand or firm. The individual SOW is computed by dividing the value of sales (*S*) of the focal firm (*j*) to a buyer in a category by the SOW (the total amount spent by the customer in that category across all the firms) of the same customer in a time period. SOW is measured in percentages.

Equation 3.1.

$$\text{Individual SOW} = S_j / \sum_{j=1}^{J} S_j$$

where,

S = sales to the focal customer

j= firm

Equation 3.2.

$$\sum_{j=1}^{J} = \text{sum of the value of sales made by all firms that sell products to a certain buyer}$$

For instance, consider the two customers from ABC Sportswear used in the RFM example in the previous section (purchase data in Table 3.1). The total dollar amount spent by these two customers in the five-month period (January through May), and the overall amount they spent on sportswear (total spending at ABC Sportswear and their competitors), is shown in Table 3.5. The calculated SOW for each customer is also shown.

Table 3.5. SOW Data on Two Customers of ABC Sportswear

	Amount Spent in ABC Sportswear from Jan–May ($)	Total Amount Spent on Sportswear in the Same Period ($)	SOW
Customer 1	630	2,000	31.5%
Customer 2	570	1,000	57%

By simply dividing the amount spent at ABC Sportswear by the total amount spent on sportswear during that time period, ABC Sportswear can figure out each customer's SOW. You can see that Customer 1 has a lower SOW than Customer 2. Here, ABC has to choose a customer with a higher SOW because customers who spend a higher percent of their wallet with a firm are more likely to continue to stay loyal to that firm (that is, be repeat purchasers). Even though a customer with a low SOW might show great potential for future growth, that customer spends most of his or her budget elsewhere. Such a customer is more likely to be a brand-switcher (nonloyal), making it difficult to guarantee a repeat purchase. Therefore, ABC Sportswear chooses Customer 2 as the better customer to target using its limited marketing budget.

Past Customer Value

The Past Customer Value (PCV) model is built on the assumption that the past profitability of the customer indicates the level of future profitability. This model extrapolates the results of past transactions into the future, to obtain a measure of the customer's future value. The value of a customer is determined based on the total contribution (toward profit) made by the customer in the past. Because the various products and services are bought at different points in time by the customer, the contributions from past transactions should be adjusted for the time value of money. The cumulative contribution until the present period represents the PCV of a customer. PCV can be computed using the following formula:

Equation 3.3.

$$\text{PCV of a customer} = \sum_{t=1}^{T} GC_{it} * (1+r)^{t}$$

where,

i = number representing the customer

r = applicable discount rate (for example, 15% per annum or 1.25% per month)

T = number of time periods prior to the current period when the purchase was made

GC_{it} = gross contribution of transaction of the i^{th} customer in time period t

The gross contribution made by each customer is given in Table 3.6. The PCV score for the two customers (from the original ABC Sportswear example) is calculated based on the formula given in equation 2 (assuming the discount rate as 1.25% per month). Table 3.7 shows the results of these calculations.

Table 3.6. Total Dollar Amounts Spent and the Gross Contribution Made by the Customers (Assuming Gross Contribution = 30% * Purchase Amount)

	Jan	Feb	March	April	May
Customer 1					
Total Spent ($)	200	50	80	100	200
GC ($)	60	15	24	30	60
Customer 2					
Total Spent ($)	300	200	0	25	45
GC ($)	90	60	0	7.5	13.5

Table 3.7. PCV of the Customers

(For computational details, please refer to www.drvkumar.com/mcp)

	Past Customer Value (PCV), as of June
Customer 1	$196
Customer 2	$180

Based on the PCV scores, ABC Sportswear decides that Customer 1 has the greater potential for profitability because the PCV score for Customer 1 ($196) is higher than for Customer 2 ($180). Therefore, in this case, ABC Sportswear chooses Customer 1 as the ideal customer for its current marketing campaign.

The Need for a Forward-Looking Metric

Based on the three commonly used scoring metrics (RFM, SOW, and PCV), ABC Sportswear has conflicting decisions. If ABC were to use RFM or PCV, it would select Customer 1 as the optimal customer for an upcoming marketing campaign. However, if ABC were to use SOW, it would select Customer 2 as the optimal customer for an upcoming marketing campaign. So, which, if any, is the best metric?

When managing customer loyalty to achieve maximum profitability, it is not sufficient to just track customer data and transactions. It is imperative to predict future customer behavior and accommodate this prediction when designing marketing strategies. Metrics such as RFM, PCV, and SOW score customers based on their past purchasing behavior and create an index as to which customers are most desirable, making the key assumption that past buying is symmetrical to future buying. In addition, each of the metrics makes other key assumptions that do not reflect marketplace reality.

The RFM metric is based on rank ordering existing customers based on their purchasing history. Although it does uncover some aspects of customer buying behavior (RFM) that do have an impact on future buying behavior, the actual score does not reveal any key information to marketers, such as whether a customer is loyal, when a customer is likely to buy next, or how much profit a customer is likely to give.

The SOW metric has its significant shortcomings, too. Although it does uncover the level of loyalty a customer has with the firm, which the RFM score does not, it suffers from the lack of ability to explain when a customer is likely to buy next and how profitable a customer will be in the future. In addition, if SOW is the only metric used for marketing resource allocation, it tells nothing about the SOW. Because of this, a small firm ($100,000 in spending) with a 90% SOW would be considered a better prospect for marketing resources than a large firm ($1 million in spending) with a 50% SOW.

The PCV metric was used to try to answer the question of how much a customer provides in profit. However, in calculating the future value of the customer, it makes the assumption that the past spending behavior of the customer is going to continue in the future, and the past pattern is a good predictor of future behavior. In the rapidly changing market scenario, this could prove to be a costly error. Based on this metric, the firm would be in no position to accommodate for market shifts, changes in product offerings, and so forth. Also, although it does look at profitability directly, unlike RFM and SOW, it does not give the marketer any information about when to market in the future.

This leads us to the quest for a forward-looking metric that overcomes these drawbacks posed by the traditional metrics, to help firms to accurately measure customer behavior and manage customers profitably. We have found a solution to this problem in the Customer Lifetime Value (CLV) metric. Unlike other traditional measures that include only past contributions to profit, the merit of CLV rests on the fact that it is a forward-looking metric. CLV assists marketers to adopt appropriate marketing activities today, to increase future profitability. In addition, the computation can be used to include prospects, not just current customers (as used by the RFM, SOW, and PCV metrics). Further, CLV is the only metric that incorporates into one all the elements of revenue, expense, and customer behavior that drive profitability. This metric also manages to score over other metrics by adopting a customer-centric approach, rather than a product-centric one, as the driver of profitability. The following section explains the concept of CLV and discusses how CLV can be measured.

Introducing Customer Lifetime Value (CLV)

Traditionally, it was assumed that loyal customers are always desirable because they are more profitable for the firm. Although this might be true in a contractual setting, where there is no repeat cost to entice customers into buying, the case of a noncontractual setting presents a different picture.

In a noncontractual setting, it might be difficult to ascertain the duration for which the customer has been associated with a firm. In the absence of a contract that guarantees future revenue generation, it is difficult to predict for how long the customer is going to stay with the firm. In such a scenario, predicting the lifetime duration of a customer by observing buying patterns and other explanatory factors assumes importance. Further, the poor correlation between loyalty and profitability as exhibited by the traditional metrics creates the need for firms to use a customer value metric such as the CLV to ensure that valuable (as opposed to simply loyal) customers will be profitable customers. CLV considers the total financial contribution—revenues minus costs—of a customer over his or her entire lifetime with the company and therefore reflects the future profitability of the customer. So, CLV can be defined as follows:

> The sum of cumulated cash flows—discounted using the weighted average cost of capital (WACC)—of a customer over his or her entire lifetime with the company

Calculating the CLV can be the basis for formulating and implementing customer-specific strategies for maximizing customers' lifetime profits and increasing their lifetime duration. In other words, CLV helps the firm to treat each customer differently based on his or her contribution, instead of treating all the customers in a similar fashion. Calculating CLV helps the firm to know how much it can invest to retain the customer so as to achieve positive return on investment. A firm has limited resources and ideally wants to invest in those customers who bring maximum return to the firm. This is possible only by knowing the cumulated cash flow of a customer over his or her entire lifetime with the company, or the lifetime value of the customers. After the firm has calculated the CLV of its customers, it can optimally allocate its limited resources to achieve maximum return. The CLV framework is also the basis for purchase-sequence analysis and customer-specific communication strategies. CLV can be considered as the metric that guides the allocation of resources for ongoing marketing activities in a firm adopting a customer-centric approach.

Although a “true” CLV implies the measuring of a customer’s value over his or her lifetime, we compute the CLV of a customer over a three-year time period for most applications. Of course, you might now wonder why three years. First, no one truly knows how long a customer is going to live. Second, given that future cash flows are discounted heavily, the contribution beyond three years might be quite small. Third, the predictive accuracy of the models we use can also decline over longer forecasting times. Fourth, a major purpose of computing CLV is for resource allocation; resources have to be allocated today based on the customer’s value in the near future. The exceptions to this three-year measurement period are for the auto industry (we suggest 20 years for the future time horizon, to include at least 3 purchases) and the insurance industry (we suggest 7 to 10 years, so that the firm can recover the acquisition costs, which can take up to 7 years).

The calculation of CLV for all customers helps firms to rank order customers based on their contribution to the firm’s profit. This helps firms develop and implement customer-specific strategies that can maximize customer lifetime profits and lifetime duration. Figure 3.1 illustrates the approach for measuring CLV.

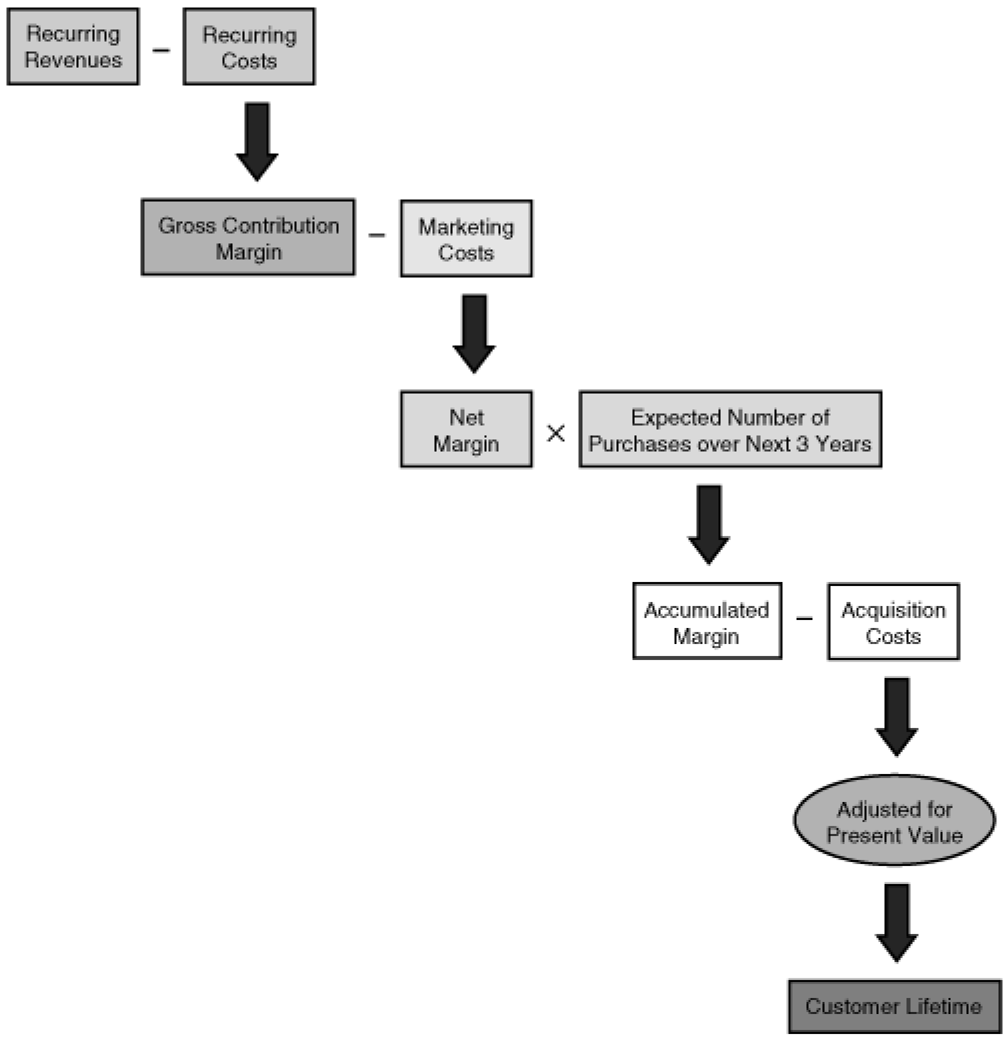


Figure 3.1. CLV measurement approach

Given the limited resources, it is natural that firms invest only in those customers who provide the maximum return. In this regard, calculating CLV helps the firm to know how much it can invest in retaining the customer in order to achieve positive return on investment. This is possible only by knowing the cumulated cash flow of a customer over his or her entire lifetime with the company or the lifetime value of the customers. Based on the calculation of CLV, firms can optimally allocate their limited resources to achieve maximum return by developing and implementing appropriate strategies. The CLV is thus considered as a metric that guides the allocation of resources for marketing activities in a firm by adopting a customer-centric approach.

Specifically, CLV assists firms to decide the following:[3]

- Which customers should be provided with preferential and sometimes personal treatment
- Which customers to interact with through inexpensive channels such as the Internet or the touch-tone phone
- The timing of contacting the customer with an offer
- Which prospect will make a better customer in the future, and is therefore worthwhile to acquire now, and which customer to let go of
- What kind of sales and service resources to allocate
- On monitoring customer activity, to readjust the form and intensity of their marketing initiatives

CLV Measures

It has been established that whereas traditional metrics do not take into account the probability of being active in the future and the costs, the CLV approach incorporates both these aspects in the calculation. If a manager wants to evaluate marketing resource allocation plans that are targeted at improving the long-term value of customers, appropriate control measures have to be put in place. This means that looking at profit on a per-transaction basis does not suffice. Managers want to have an idea about how the value of a client has evolved over time. The general term that has been used to describe the long-term economic value of a customer is *lifetime value.* In very simple terms, CLV is a multi-period evaluation of a customer's value to the firm. It assists managers in allocating resources optimally and developing customer-level marketing strategies. The lifetime value of a customer can be calculated either at an aggregate level or at an individual level.

Aggregate Approach

According to this approach, the average lifetime value of a customer is derived from the lifetime value of a cohort or segment or even the firm. Three approaches are available to compute the average CLV.

In the first approach, the sum of lifetime values of all the customers is calculated. The value referred to as the customer equity (CE) of a firm is calculated as follows:

Equation 3.4.

$$CE = \sum_{i=1}^{N} \sum_{t=1}^{T} CM_{it} \left(\frac{1}{1+d} \right)^{t}$$

where,

CE = customer equity of the customer base in $ (sum of individual lifetime values)

CM = average contribution margin in time period t (after taking into account marketing costs)

d = discount rate

i = customer index

t = time period

N = number of customers for which the CE is being estimated

T = number of time periods for which the CE is being estimated

Now, from where do we get this information? The contribution margin (CM) and the duration (T) are derived either from managerial judgment or come from actual purchase data. The discount rate (d) is a function of the cost of capital of the firm and can be obtained from the financial accounting function. The average CLV could then be calculated by dividing CE by the number of customers.

In the second approach, the average CLV of a customer is calculated from the lifetime value of a cohort or customer segment.[4] The average CLV of a customer in the first cohort, or Cohort 1, can then be expressed as follows:

Equation 3.5.

$$Average\ CLV = \sum_{t=1}^{T} \left[\frac{(GC - M)}{(1+d)^{t}} r^{t} \right] - A$$

where,

r = rate of retention

d = discount rate or the cost of capital for the firm

t = time period

T = number of time periods considered for estimating CE

GC = average gross contribution

M = marketing cost per customer

A = average acquisition cost per customer

Case Study

The purchase behavior of a cohort of 100 customers in a financial services firm, NSE Inc., was observed over a period of 3 months starting January 2005. The average gross contribution from this group of customers in the next month (April 2005) is projected to be $500. The marketing cost and acquisition cost per customer is $45 and $60, respectively. The discount rate is 15% per year, or 1.25% per month. The retention rate for this cohort is 0.75. Assuming that the discount rate, retention rate, and gross contribution are constant over time, the average CLV of a customer belonging to this cohort over the next three time periods is determined as follows:

Equation 3.6.

$$CLV = \frac{455}{(1.0125)^1} * (0.75)^1 + \frac{455}{(1.0125)^2} * (0.75)^2 + \frac{455}{(1.0125)^3} * (0.75)^3 - 60 = \$712$$

This approach considers only the average gross contribution (GC), the average acquisition cost per customer (A), and marketing cost (M) per customer for calculating the CLV. Although the retention rate (r) is the average retention rate for the cohort and is taken to be constant over a period, the case in reality may suggest otherwise. This is so because customers may choose to discontinue the relationship with the firm at different points in time, and hence the retention probabilities would vary across customers. Therefore, the retention probabilities will have to be factored in while calculating CE. Recently, the assumption of using a constant retention rate has been relaxed.[5]

In the third approach, the CE of the firm is first calculated as the sum of return on acquisition, return on retention, and return on add-on selling.[6] Following this, average CLV can then be calculated by dividing CE by the number of customers.

One of the important applications of computing average CLV is to evaluate competitor firms.[7] In the absence of competitors' customer-level data, firms can deduce information from published financial reports about approximate gross contribution margin, marketing, and advertising spending by competing firms to arrive at reasonable estimates of average CLV for competitors. Such an exercise would help the firm to know the profitability of the competitors' customers. The average CLV approach can also be used to evaluate the market value of the firm. It has been demonstrated that for high-growth companies, aggregate CLV of a firm or CE may be used as a surrogate measure of a firm's market value.[8]

However, average CLV has limited use as a metric for allocation of resources across customers. This is because the average CLV metric does not capture customer-level variations in CLV, which is the basis for developing customer-specific strategies. Also, calculating the aggregate CLV does not allow corrective measures to be implemented at the segment level or the individual customer level. Therefore, it is necessary to calculate the CLV of individual customers to design individual-level strategies.

Individual-Level Approach

As mentioned previously, CLV, at an individual level, is calculated as the sum of cumulated cash flows—discounted using the WACC—of a customer over his or her entire lifetime with the company. It is a function of the predicted contribution margin, the propensity for a customer to continue in the relationship, and the marketing resources allocated to the customer. In its general form, CLV can be expressed as follows:

Equation 3.7.

$$CLV_i = \sum_{t=1}^{T} \frac{(\text{Future contribution margin}_{it} - \text{Future cost}_{it})}{(1+d)^t}$$

where,

i = customer index

t = time index

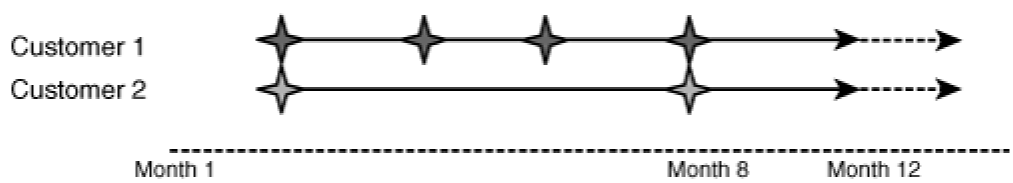
T = number of time periods considered for estimating CLV

d = discount rate

The calculation of CLV includes determining the future contribution margin and future costs, both of which are adjusted for the time value of money. The calculation of contribution margin and future costs are given in the following section. The components required to calculate CLV are discussed next.

P (Active)

To calculate the future contribution from a customer in a noncontractual setting, firms should know the probability of the customer being active with the firm at future time periods. In such circumstances, *P* (Active) is used. It refers to the probability that the customer continues to be active in a subsequent time period. Calculation of this probability at an individual level is essential for CLV calculation at an individual level. This is because each customer is likely to have different purchase patterns and inactive periods. Figure 3.2 illustrates this point.



Source: V. Kumar, G. Ramani, and T. Bohling, "Customer Lifetime Value Approaches and Best Practice Applications," *Journal of Interactive Marketing*, 18(3) 2004: 60–72

Figure 3.2. Variation in inter-purchase time

Given the customer's past purchasing behavior, one can predict the probability of individual customers being active in subsequent time periods using a simple formula.

Equation 3.8.

$$P\ (\text{Active}) = (T/N)^n$$

where,

n = number of purchases in the observation period

T = time period of the most recent purchase

N = current time period for which P (Active) needs to be determined

In Figure 3.2, the “stars” indicate purchases made by a customer. Therefore, for Customers 1 and 2, the *P* (Active) for month 12 is as follows:

P (Active) for Customer 1 in month 12 = $(8/12)^4$ = 0.197, where $n = 4$

P (Active) for Customer 2 in Month 12 = $(8/12)^2$ = 0.444, where $n = 2$

In the preceding example, it is interesting to note that a customer who has bought four times in the first eight months and has not bought in the past four months has a lower probability of buying in the twelfth month, when compared to a customer who has bought only twice in the same period of eight months. This is because it can be seen that Customer 1 has been making one purchase every two months and has failed to maintain his purchase frequency by not making a purchase in the tenth and the twelfth month. Whereas, even though Customer 2 has made fewer purchases overall, Customer 2 makes a purchase every six months and hasn’t missed any purchase occasions. This indicates that Customer 2 is more likely to be active in the future, and hence he is assigned a greater *P* (Active) value.

A few limitations apply to the use of this approach to calculate P (Active). First, this model is applicable only to those situations in which a customer has a fixed SOW in a given time period. Therefore, the more the customer buys early on, the less is available for future time periods. Also, the model penalizes higher frequencies of buying because any fraction raised to a higher power (which is the frequency of buying) results in a lower probability. These limitations can be relaxed if the focus is on modeling the expected inter-purchase time (explained later in this book).

Average Monthly Gross Contribution

Firms ascertain the average gross contribution margin (AMGC) by deducting the average cost of goods sold from the average monthly revenue from a customer. This is calculated based on the customer’s past purchases. This is obtained for all customers (i) and for the time period (t) for which the lifetime value is being estimated. To arrive at the present value of the future contribution, the AMGC of the customers is adjusted with a discount rate (d), for the number of time periods (n).

Net Present Value (NPV)

The net present value (NPV) of the expected gross contribution (EGC) can be calculated by taking the product of the *P* (Active) of customers at period n and the discount-adjusted AMGC for all customers (i), and adding this quantity over all future time periods (T). This is calculated as follows:[9]

Equation 3.9.

$$\text{NPV of } EGC_{it} = \sum_{t=1}^{T} P(Active)_{it} \times \frac{AMGC_{it}}{(1+d)t}$$

where,

$AMGC_{it}$ = average gross contribution margin in period t based on all prior purchases

i = customer index

t = period for which NPV is being estimated

T = number of periods beyond t

d = discount rate

$P\ (Active)_{it}$ = probability that customer i is active in period t

The following case study demonstrates the calculation of the NPV at the individual customer level.

Case Study

Consider the spending pattern of the two customers of ABC Sportswear from the previous sections. Refer to Table 3.6 for the spending patterns of the two customers over a five-month period (January through May). The AMGC of Customer 1 is calculated as follows:

Equation 3.10.

$$AMGC_1 = \frac{(200+50+80+100+200)}{5} = 126$$

Table 3.8 shows the AMGCs of Customer 1 and Customer 2.

Table 3.8. AMGC of the Customers

	AMGC
Customer 1	$126
Customer 2	$114

The probability of the customer being active, *P*(Active), is calculated for the following three months (June, July, and August) using the formula given in Equation 3.8, and the values are shown in Table 3.9.

Table 3.9. Probability [P (Active)] of the Customers Being Active in Future Time Periods

	June	July	August
Customer 1	0.40	0.19	0.10
Customer 2	0.48	0.26	0.15

The NPV of EGC for June, July, and August for Customer 1 can be calculated as follows, based on the data available in Tables 3.8 and 3.9. Assume the discount rate is 15% per year, or 1.25% per month.

Equation 3.11.

$$NPV of\ EGC_1 = 0.40^* \frac{126}{(1.0125)^1} + 0.19^* \frac{126}{(1.0125)^2} + 0.10^* \frac{126}{(1.0125)^3} = \$85$$

Table 3.10 shows the NPVs of Customers 1 and 2.

Table 3.10. NPV of EGC of the Customers

	NPV of the EGC
Customer 1	$85
Customer 2	$99

Calculating CLV

To calculate the lifetime value of a customer, the acquisition (*A*) and the marketing costs (*M*) incurred at future time periods have to be deducted from the NPV of EGC of a customer. The marketing costs at future time periods should be discounted with the appropriate discount rate (*d*) to arrive at the present value of these costs. The discounted marketing costs

(M) and the acquisition cost (A) are then subtracted from the NPV of EGC to arrive at the CLV of a customer. If the marketing costs are accounted at the beginning of a given time period and the gross contribution at the end of a time period, we can express CLV as follows:

Equation 3.12.

$$\text{CLV of customer } i = \sum_{t=1}^{t} P(Active)_{it} \times \frac{AMGC_{it}}{(1+d)^t} - \sum_{t=1}^{T} M_{it} \times \left(\frac{1}{1+d}\right)^{t} - A_i$$

where,

$AMGC_{it}$ = average gross contribution margin in period t based on all prior purchases

i = customer index

t = period for which NPV is being estimated

T = future time period

d = discount rate

$P(\text{Active})_{in}$ = probability that customer i is active in period n

M = marketing costs of the firm

A = acquisition costs of the firm

Components of CLV

The components of the cost and future contribution margin that determine the calculation of CLV are as follows:

- **Marketing cost (*M*).** Marketing cost refers to the costs of programs that service customer accounts, increase the value of existing relationships such as loyalty or frequent-flyer programs, and attempt to “win back” lost customers. In general, it includes development and retention costs. A major component of these costs is the cost of marketing through various channels of communication such as direct mail, email, and face-to-face interactions. The calculation of marketing costs becomes straightforward when firms decide the channel of contact, the number of contacts, and the cost involved in contacting each customer. Such an exercise would help firms in developing customer-specific communication strategies.

- **Discount rate (*d*).** Because the value of money is not constant across time, and because money received today is more valuable than money received in future time periods, the gross contribution and marketing costs have to be discounted, to arrive at the present value of money. This is done by dividing the cash flow in time period t by $(1 + d)^t$ where d is the discount rate. The discount rate (d) depends on the general rate of interest and is normally proportional to that of a Treasury bill or the interest that banks pay on savings accounts. It can also vary across firms depending on the cost of capital to the firm.
- **Time period (*t*).** The number of future time periods (t) refers to the natural "lifetime" of the customers. The word *lifetime* possesses different connotations when considering one-time purchases (such as a house) and regular purchases (such as groceries). Another important aspect is the estimation of duration while making marketing decisions. For most businesses, it is reasonable to expect that customers will return for a number of years (t); however, there are no strict guidelines to decide the value of t. For instance, a direct-marketer of general merchandise may consider a four-year time span as the maximum; in other cases, only two years might be considered as the maximum while developing marketing decisions. After all, beyond a certain time period, any calculation and prediction may become difficult because of the presence of uncontrollable factors such as customer attrition (customers switching to a different firm or product) and new competitors, among others.

Advanced Model for Measuring CLV

When a firm is using *P* (Active), managers must address certain concerns. For example, under *P* (Active), it is assumed that a customer will not come back to the firm after choosing to discontinue that relationship. With such customers referred to as "lost for good," this approach systematically underestimates CLV.[10] This could be overcome by using the "always-a-share" approach, which takes into account the possibility of a customer returning to the firm after a temporary dormancy in a relationship.[11] By incorporating such an approach while predicting the frequency of a customer's purchases, managers would have a better view of future customer activity.

A more advanced model for calculating CLV models the inter-purchase time (quantified by *frequency)* rather than *P* (Active). The inter-purchase time is modeled by fitting a distribution over the past inter-purchase behavior of the customer and by determining the expectation value of this distribution. Using *frequency* rather than *P* (Active) accounts for customers who are dormant for a particular period of time (as frequently for purchases such as automobiles or computers) and who then come back to the firm. This provides a more realistic and robust prediction of customer purchasing behavior. This advanced model involves predicting three parameters that can be plugged into calculating CLV:

- Future customer activity (*frequency*)
- Future marketing costs (*MC*)
- Gross contribution margin from each customer (*GC*)

The method used here for predicting the future customer activity is to predict the frequency of a customer's purchases given past purchases. This model is based on the assumption that customers are most likely to reduce their frequency of purchase or exhibit a period of long dormancy before terminating a relationship. This assumption is based on the reasoning that a decline in the frequency of purchase is either due to splitting of loyalty between companies or due to the customer ceasing to buy a particular product because of falling demand or outdated products. In this framework, CLV is measured by predicting the purchase pattern (frequency of purchases) over a reasonable period. This time period (customer lifetime) varies from industry to industry. (Typically, for example, automakers can expect customers to make a purchase every five to seven years, whereas computer manufacturers can expect customers to make a purchase every one or two years.) It is prudent to predict the purchasing pattern of customers over a fixed time period instead of in perpetuity because

- Uncertainty explodes for longer time periods. Over longer time periods, customers' needs change, their position in the family cycle changes, they might switch jobs, and therefore they may have different requirements.
- Product offerings are changing due to technological advancements and based on customer needs.

- CLV predictions need to be updated based on a rolling-time horizon to accommodate changes in other environmental factors.

Based on the predictions of contribution margin, purchase frequency, and variable marketing costs, the CLV function can be calculated. In one of the studies, the drivers of the purchase-frequency model (*frequency*) for the customers of a B2B firm were as follows:[12]

- Number of product purchase upgrades
- Cross-buying behavior of customers (across product categories)
- Ratio of number of customer-initiated contacts to total contacts (customer initiated and supplier initiated)
- Product return behavior
- Frequency of web-based contacts
- Frequency of customer contacts (in-person, direct mail, and telephone) by the firm
- Average time between two customer contacts

Similarly, the drivers of the gross contribution margin (*GC*) model can be listed as follows:

- Customer's contribution margin from the previous year
- Total number of customer contacts across all channels
- Total quantity purchased across all product categories

Two methods can be used to forecast the future marketing cost ($MC_{i,l,m}$):

- The first method assumes that the past cost will continue in the future, if there is not much change in marketing costs at the customer level over the years.
- The second method considers the future marketing cost as a function of current purchase activity and current marketing cost.

Based on the input derived from these models, the lifetime value of a customer can be calculated as follows:

Equation 3.13.

$$CLV_{it} = \underbrace{\sum_{t=1}^{T_i} \frac{GC_{i,t}}{(1+r)^{t/frequency_i}}}_{\text{PV of Gross Contribution}} - \underbrace{\sum_{l=1}^{n} \frac{\sum_m MC_{i,m,l}}{(1+r)^l}}_{\text{PV of Marketing Cost}}$$

where,

CLV = Customer Lifetime Value

$GC_{i,t}$ = gross contribution from customer (i) in purchase occasion (t)

$MC_{i,l,m}$ = marketing cost for customer (i) in communication channel (m) in time period (l)

where,

$MC_{i,l,m} = c_{i,m,l}$ (unit marketing cost) * $x_{i,m,l}$ (number of contacts)

$frequency_i = 12/expint_i$ (where, $expint_i$ = expected inter-purchase time for customer [i])

r = discount rate for money

n = number of years to forecast

T_i = number of purchases made by distributor (i), until the end of the planning period

The measurement of CLV for each customer enables managers to optimally allocate resources so that CLV can be maximized. Therefore, the model considers purchase frequency and the gross contribution margin of customers as a function of marketing resource variables. Based on the customer responsiveness to marketing actions (provided by the purchase-frequency and the gross contribution margin models), resource allocation strategies that can maximize CLV are developed.

In the preceding model, $x_{i,m,l}$ gives the number of customer contacts made in a particular channel during a given time period. This includes in-person contacts initiated by the sales team and direct-mail and telephone contacts. The marketing cost incurred in such contacts is given by $c_{i,m,l}$. The frequency factor ($frequency_i$) helps in forecasting the purchase frequency in the following years. The term $GC_{i,t}$ predicts the gross contribution margin made by a customer in each future purchase occasion. Similarly, future marketing cost ($MC_{i,l,m}$) is also generated for each customer. Although this CLV model is a significant advancement beyond earlier customer value models, continuous effort is being made to improve the CLV measurement model. For example, there are two issues related to calculating CLV that are relevant and need to be addressed: endogeneity and heterogeneity. If you fail to account for these statistical issues, the actual measurement of CLV might be biased.

Endogeneity is a statistical issue in the CLV model that relates directly to causation. This CLV model predicts the three parameters (frequency, MC, and GC) independently, meaning that it does not take into account whether it is current MC that leads to future GC or whether it is potentially current GC that leads to future MC. This issue has a relatively straightforward solution and requires only that all three parameters be simultaneously obtained.[13]

Heterogeneity is a statistical issue in the CLV model that relates directly to customer profiles. If we assume that different customers respond differently to marketing messages, it is therefore not ideal to have the same weights on all coefficients in the GC model relating to marketing communications. The solution to this problem is also fairly straightforward. If you allow regression weights to be different for each customer, you will get more accurate results for each customer.[14]

The CLV model will continue to improve, especially because of increasingly available customer data and the competitive market. However, having a reliable model, such as the one described earlier, as a basis for measuring CLV is the key to establishing optimal marketing strategies (detailed in the following chapters). When you understand how to implement this model, you can then determine how best to measure CLV for different firms. The following case study provides a numeric demonstration of calculating CLV for a B2B firm, based on the inputs from these models.

Case Study

The calculation of CLV for customer (i) is explained based on the data collected from a B2B firm. The unit cost ($c_{i,m,l}$) for different channel contacts such as telesales and a salesperson are $30 and $600, respectively. The number of such contacts ($x_{i,m,l}$) through different channels is shown in Table 3.11. The predicted frequency and predicted gross contribution margin from a customer in each purchase occasion in the next two years are also given in Table 3.11.

Table 3.11. Predicted Gross Margin over Time

Time Period	June 2004	September 2004	June 2005	December 2005
Predicted gross contribution margin ($)	20,000	22,000	31,000	23,800

Time period (l) = 2 years

Frequency of purchase = 2 purchases per year

Unit cost of telesales = $30

Number of predicted contacts through telesales = 25 in year 1 and 20 in year 2

Unit cost of salesperson = $600

Number of predicted sales contacts by salesperson = 10 in year 1 and 15 in year 2

Discount rate (r) = 15%

The CLV score can be calculated for this data as follows:

Equation 3.14.

$$CLV_i = \left.\frac{20000}{(1.15)^{0.5}} + \frac{22000}{(1.15)^{0.75}} + \frac{31000}{(1.15)^{1.5}} + \frac{23800}{(1.15)^{2}}\right\} \text{PV of Gross Contribution}$$

$$\left.-\{(\frac{600*10}{1.15}) + (\frac{600*15}{(1.15)^2}) + (\frac{30*25}{1.15}) + (\frac{30*20}{(1.15)^2})\}\right\}$$

$$= \$68{,}465$$

As you can see from the CLV calculations, the lifetime value of a customer depends to a great extent on whether the customer is going to be active in future time periods. This is especially important in a noncontractual setting because the customer has the freedom to leave the relationship at any time.

In a contractual relationship, you must estimate two sources of revenue/contribution margin: the regular monthly contribution from the customer for the relevant time period, and the additional contribution from the add-on services/products that the customer is predicted to buy in the relevant period. The information about which products/services may be added can come from the use of choice and purchase timing models described in Chapter 8, “Pitching the Right Product to the Right Customer at the Right Time.” The CLV model can be revised as follows:

Equation 3.15.

$$CLV_i = \sum_{t=1}^{T} \frac{BaseCM}{(1+r)^t} + \sum_{t=1}^{T} \frac{\hat{p}(Buy_{it}=1)^*\hat{C}M_{it}}{(1+r)^t} - \frac{\hat{M}C_{it}}{(1+r)^t}$$

where,

CLV_i

= lifetime value for customer *i*

$\hat{p}(Buy_{it})$

= predicted probability that customer *i* will purchase in time period *t*

$\hat{C}M_{it}$

= predicted contribution margin provided by customer *i* in time period *t*

$\hat{M}C_{it}$

= predicted marketing costs directed toward customer *i* in time period *t*

t

= index for time periods; quarters in this case

T

= marks the end of the calibration or observation time frame

r

= monthly discount factor; 0.0375 in this case (15% annual rate)

Base CM

= predicted base monthly contribution margin

Similarly, if it is a one-time transaction but with the opportunity for add-on products/services, the information for which products/services are likely to be added can come from the choice/timing model described in Chapter 8. As for the prediction of the one-shot purchase of a significant item, you can use a logistic regression model (described in Chapter 9, “Preventing Attrition of Customers”) or the choice model (described in Chapter 8), combined with a regression-type model for predicting the quantity of that purchase. Finally, you can use the models suggested for any service-oriented businesses.

After the CLV has been computed, firms must look ahead to maximize it, to reap the full benefits of the metric. The following chapters discuss the various strategies firms can use to maximize CLV.

Conclusion

Some of the most popular metrics currently in use, such as the RFM, SOW, and PCV, are inherently backward-looking. In other words, they do not account for future customer behavior that is critical for making customer management decisions. The CLV metric illustrated throughout this chapter overcomes this fundamental drawback. Furthermore, the CLV metric is the only metric that incorporates all the elements that drive profitability: revenue, expense, and customer behavior. This enables managers to efficiently measure and manage customer value.

4. Managing Customer Profitability

Relevant Issues

- How do we build and sustain profitable customer loyalty?
- What are the drivers of profitable customer loyalty, and how do they help in managing customers?

To implement effective marketing initiatives, firms should have a good understanding of how their actions affect their relationship with the customer and how they affect profit. Customers have different preferences and different goals with the company. Some are long-term customers, and some transact only in the short term. Some are more profitable to the company than others. Their frequency of transaction with the company varies widely. Some buy only through certain channels (such as catalogs), and some customers are comfortable buying through multiple channels. Some customers buy all their products from a specific category with the company, and some come to the company for specific needs. How can the company measure and understand how its individual marketing actions are affecting the purchasing behavior of such a diverse group of customers?

The answer to that question lies in using profitable customer loyalty (also known as CLV, Customer Lifetime Value) as the primary tool to design and implement marketing initiatives. As described in the preceding chapter, firms can classify and manage customers based on their CLV. Because CLV captures their past behavior, their projected future behavior, and the marketing costs incurred to maintain them, CLV can serve as an important guide in deciding whom to follow and how to approach the customers. It can also guide managers in understanding how their actions influence customer behavior, and in analyzing the effectiveness of their marketing initiatives. For example, if a firm changes its mailing strategy and follows a more selective approach, it can monitor how this particular action affects the CLV of its customers. The change in CLV can give a direct measure of the strategy's effectiveness, and it can guide firms to make a final decision regarding continuing, abandoning, or modifying this strategy.

The guiding rule in making these strategic decisions is simple: Do the actions taken by the company maximize CLV? If yes, continue with the strategy; if no, abandon or modify the current methods.

After you decide to utilize the CLV, the next step is to clearly understand the factors that drive a profitable relationship with the customer and how they affect the CLV. Understanding this relationship will benefit the company in two ways:

- It gives a better understanding of the structure of a profitable customer relationship.
- It helps managers take proactive measures to maximize a customer's lifetime value.

Typical CLV Drivers

CLV drivers are the main factors that affect the lifetime value of a customer. These drivers determine the nature of the relationship between the firm and the customer, and they help estimate the level of profitability and the CLV of each customer. The drivers of CLV can be broadly classified into the following categories:

- **Exchange characteristics.** The exchange characteristics broadly include all the variables that affect and influence the customer-firm relationship, such as the customer spending level, cross-buying behavior, purchase frequency, product returns, marketing contacts made by the firm, and loyalty instruments.
- **Customer characteristics.** Demographic variables, such as location of the customer, age, income levels, and so forth, constitute customer heterogeneity. Classifying customers based on their demographic and psychographic indicators can help firms segment customers and effectively manage the customer-firm relationship.
- **Product characteristics.** This consists of the type of products offered, the timing since product acquisition, and the typical lifetime associated with the product.
- **Firm's marketing actions.** This constitutes the number of marketing messages, offers, promotions, individual visits by salespersons and so

on, and the frequency and timing of these contacts.

A Specific B2B Case Study

The exchange characteristics are predominantly the same for the majority of the cases in the B2B and the B2C setting. (The drivers that reflect the customer characteristics could vary in these circumstances.) A typical list of CLV drivers used in a B2B setting follows here and is also illustrated in Figure 4.1. Other CLV drivers will have to be considered in other contexts.

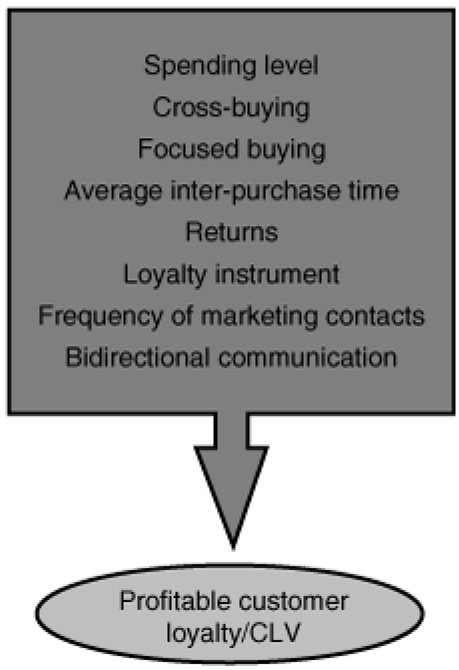


Figure 4.1. Typical CLV drivers

- **Spending level.** This conveys the average monthly spending level in a given period of time. This factor has a positive effect on the customer's lifetime value; that is, the greater the spending level of a customer, the greater his/her CLV. When we understand whether this affects the CLV, the next question is this: How much influence does this have on a customer's CLV? A recent study showed that when the average monthly spending level increased by just $10, the likelihood of termination of the relationship went down by 33%, on average.[1] This is not surprising, because if the customer spends a large share of his/her wallet on the company, it is more unlikely that the customer will switch to a different firm.

- **Cross-buying.** This refers to the degree to which customers buy products from a large number of available products or categories offered by the firm. For example, in the case of a department store, one customer might just buy casual wear and shoes; whereas another customer might buy formal wear, accessories, shoes, casual wear, and children's clothing. The latter customer demonstrates a greater scope of interaction with the firm. The greater the cross-buying behavior, the greater the CLV is for the customer on average. This is because when the customer engages with the firm across various departments, it demonstrates the level of comfort the customer has with the firm's offerings and indicates a strong customer-firm relationship. And, these customers are less likely to terminate their relationship with the firm. For every additional department the customer purchases from, the risk of losing the customer is reduced by about 66%.
- **Focused buying.** This represents the level of purchase made by a customer within a single category. The more heavily a customer purchases from within a single category/department, the lower the customer's lifetime value. This is consistent with the cross-buying effect noted previously; that is, the more spread out the customer's buying pattern across different categories, the greater the CLV and the lower the risk of losing the customer. For example, a customer may buy a particular product (shoes, for example) on a regular basis from a retailer, and it could be reasoned that there is nothing wrong with a customer being comfortable with buying a single product repeatedly throughout the customer's lifetime. But, because there is only a limited interaction with the firm, there is a greater risk of the customer losing interest in the product, leading to the termination of the relationship, and hence a lower CLV.
- **Average inter-purchase time.** This refers to the average number of days between two purchases. This factor has an inverted U-shaped relationship with the customer's lifetime value; that is, the CLV tends to be smaller when the inter-purchase time is either too long or too short. Customers with an intermediate inter-purchase time have the greatest CLV. This might sound counterintuitive, because one might expect customers who make the most frequent purchases to be the most profitable. But, in reality, sustaining this high purchase

frequency over a long period of time is not possible given the finite resources, particularly in the general merchandise category. Therefore, such customers end up terminating their relationship with the firm more often than not. For example, a customer may buy shoes and clothes from a retailer. It is unlikely that the customer who makes several purchases within a very short period of time will continue to do so over extended periods. Such items are purchased in a continuous, regularly spaced cycle. This customer might be stocking up on the merchandise that should last for a long time and is unlikely to come back to the firm. There is a lower limit for the average purchase time, too. Customers who don't make a purchase over long periods of time are more likely to have switched to a competitor or stopped using the product altogether, and hence have a low CLV.

- **Returns.** This refers to the number of products the customer returns between two purchase periods. This has an inverted U-shaped relationship with the CLV. Too few or too many returns indicate that the customer is a low-CLV customer. An intermediate number of returns indicates a healthy relationship with the firm. This might sound counterintuitive. But returns provide firms with an opportunity to interact with the customers and satisfy their needs. Also, higher returns indicate that customers are comfortable using the venues open to them and find it an efficient way of transacting with the firm. If the firm has a no-hassle return policy, more customers will be motivated to get more involved with the firm. This opportunity could be turned into a positive reinforcement by making this a positive experience for the customer. Also, because the degree of returns depends on the degree of spending, it could mean that the customer is spending more with the firm. But, too many returns can be harmful to the firm and indicate that the return opportunities have not been exploited properly.
- **Loyalty instrument.** It indicates the status of the customer with the firm. Does the customer own a loyalty card; and if so, at what level (in the B2C setting)? Is the customer a premium service member, based on the revenue contribution made by the customer in the previous years (in the B2B setting)? Customers typically use the loyalty instrument to receive discounts and accumulate points to be redeemed for a special gift at a later date. Issuing of a loyalty card or usage of any other loyalty instruments has a positive impact on the profitability

of the customer. By acknowledging that the customer is valuable to the firm, the firm reduces the propensity of the customer to quit the relationship and increases the possibility that the customer will return to the firm to fulfill other needs.

- **Frequency of marketing contacts.** This refers to the number of times a customer is contacted through the various communication channels (telephone, direct mail, direct contact by sales personnel, and so on) between two observed purchases. This factor has an inverted U-shaped effect on the CLV. Too few or too many marketing contacts are not helpful. Marketing efforts are very effective in preventing customers from terminating their relationship and in reminding them about the firm and offering promotions to make them come back to the firm. Therefore, making too few marketing contacts is detrimental to the firm's relationship with the customer. Also, marketing contacts can be very effective in targeting selective product promotions to the customers. Sometimes, however, marketers overdo this, and thus cause a deterioration or termination of the relationship. Overcontacting customers can lead to the customers completely ignoring future promotions and offers and terminating the relationship. Therefore, firms should optimize their marketing initiatives and maximize CLV.
- **Bi-directional communication.** This refers to the ratio of the number of customer-initiated contacts to the total number of customer contacts made (both customer and firm initiated) between two purchases. Bidirectional communication strengthens the customer-firm relationship, indicating customer involvement and increasing the interdependence between firms and customers. This is particularly so in the case of a B2B setting, where customers can initiate contacts with the suppliers to fulfill their training requirements or to get an appraisal about a new product and so on. The greater the bidirectional communication, the greater the profitability.

As stated in Chapter 1, "Introduction," several pathways can lead to an increase in customer equity. A top-down approach would be implemented with the aim of increasing customer equity by using drivers such as *brand equity, value equity,* and *relationship equity.* By maximizing these drivers, the firm can maximize customer equity. Another way to approach this issue, as recommended in this chapter, is to adopt a bottom-up approach, where the various CLV drivers (discussed previously) can be used to increase the lifetime value of customers and thus maximize customer equity. The CLV drivers discussed here are closely linked to the drivers of customer equity such as *brand, value,* and *relationship equity.* For example, a customer's past spending level relates to the *brand equity* driver. The past purchasing activity relates to the *value equity* of the firm, and the cross-buying behavior relates both to the *value* and *relationship equity.* Firms can adopt either approach based on their standing and level of customer-level data and so forth. If a firm doesn't have extensive data about its customers and their purchasing behavior, adopting a top-down approach through maximizing customer equity through *brand, value,* and *relationship equity* is ideal. Whereas, when the firm has customer-level data available, it can adopt the bottom-up approach and maximize CLV through the CLV drivers.

A B2C Case Study in the Retailing Industry

To study the significance of various drivers and to quantify their effect on CLV in a B2C setting, a study was carried out involving a major retailer that sold apparel, shoes, and accessories for both men and women.[2] A large sample of more than 300,000 customers was taken from the firm's customer database for this study, and their individual CLV scores were calculated (based on the techniques outlined in Chapter 3, "Customer Selection Metrics"). As expected, a wide distribution of CLV scores was obtained from these customers.

Traditionally, the retailer used several measures to identify customer loyalty, such as the regularity of purchase, the frequency, and the tenure of the customer with the firm. The regularity of purchase is a measure of how often the customer buys from the firm. Frequency refers to the inter-purchase time, and tenure refers to the total duration during which the customer has transacted with the firm. A correlation study was done to test the effect of these measures of loyalty on the observed future profitability of the customers. Table 4.1 reports the results. Intuitively, one would expect loyal customers to be profitable, and would therefore expect a strong positive correlation between loyalty and profitability. As you can see from the table, the correlation is very weak between the regularity and frequency of purchase and the future profitability of the customer. Also, it is clear that firms cannot rely on traditional loyalty metrics such as RFM (Recency-Frequency-Monetary value method, described in Chapter 3) to manage their customers because only a weak correlation exists between the RFM scores of the customer and the future profitability. If the firms use the traditional metrics, they might end up investing marketing resources in and cultivating relationships with the wrong customers. Firms should adopt a forward-looking metric such as the CLV to identify profitable loyal customers and invest their resources toward such customers.

Table 4.1. Does Loyalty Drive Profitability? Correlation between Profitability and Different Measures of Loyalty

	Regularity	Frequency	RFM	Tenure
CLV	r = –0.09	r = 0.17	r = 0.19	r = 0.44

Next, the customers were segmented into ten deciles based on their CLV scores, with the customers in the top two deciles constituting high-CLV customers, the customers in segments three through five constituting medium-CLV customers, and the customers in the bottom five deciles constituting the low-CLV customers. Figure 4.2 shows the segmentation of customers based on their CLV score. This study brought to the fore several interesting insights about customer profitability. It was observed from this study that the top 20% of customers accounted for 95% of profit, and the retailer was actually losing money with 30% of customers. This is because, as you can see in Figure 4.2, several customers in low-CLV segments have negative CLV scores.

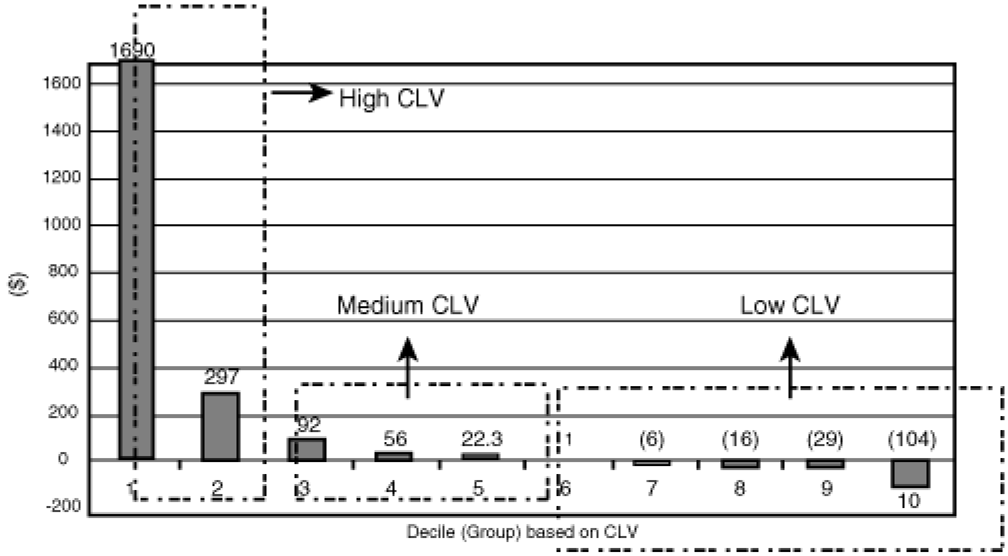


Figure 4.2. Customer segmentation based on their CLV scores

Based on this customer segmentation, a customer profile analysis was done for the low- and high-CLV customers, and some interesting group-level differences were observed. Table 4.2 gives the typical profiles of a high- and low-CLV customer for this specific retailer. This analysis showed that the most profitable customers were professionally employed and married women in the 30 to 49 age group. They had children and a high household income. High-CLV customers typically were members of the store's loyalty program, lived closer to the store, and shopped through multiple channels. In contrast, the typical low-CLV customer was a low-income, unmarried male customer in the 24 to 44 age group, primarily a single-channel shopper, lived farther away from the store, and did not own a home. Doing such profile analyses can help firms put a face on the CLV score of a customer and help them to effectively manage their customers.

Table 4.2. Profile Analyses of High- and Low-CLV Customers: A Retailing Case Study

Typical High-CLV Customer	Typical Low-CLV Customer
Gender: Female	Gender: Male
Age: 35–54 years	Age: 25–34 years
Marital status: Married	Marital status: Single
Presence of children	No children present
Estimated household income: $125,000+	Estimated household income: < $50,000
Stays closer to retailer	Stays farther away from retailer
Loyalty card member	Not necessarily a loyalty card member
Mail-order shopper	Single-channel shopper
Shops frequently in upscale stores	

Based on this study, customers were segmented based on their CLV scores (high and low CLV) and their profit potential. Several segment-specific marketing strategies were recommended to the firm. Table 4.2 shows the customer segmentation and Figure 4.3 shows the marketing strategies adopted. As shown in this figure, minimal spending should be allotted to the customers with low CLV scores and low profit potential. In the case of customers with high CLV scores and low profit potential, the current level of spending should be maintained.

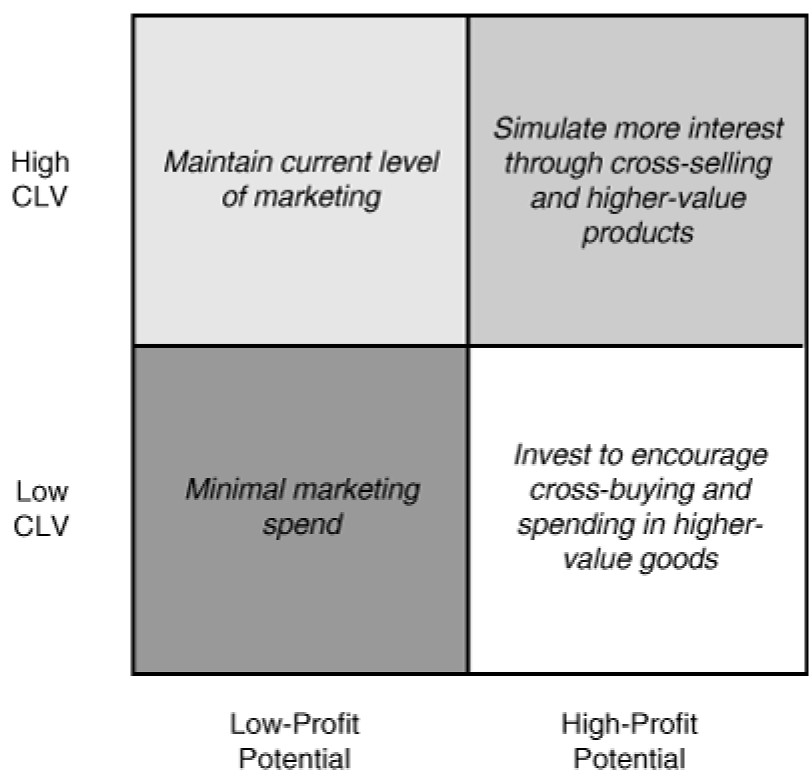


Figure 4.3. Marketing actions taken by the firm based on the CLV score

In the case of low-CLV, high-potential customers, they should be encouraged to cross-buy from different product categories and higher-valued products. In the case of customers with high-CLV and high-profit potential, firms should take measures to simulate interest among customers by cross-selling across different product categories and promoting higher-value purchases (see Figure 4.3).

The next step of this study included finding the effectiveness of the various drivers of CLV and their impact on maximizing the CLV score of a customer. For this part of the study, only the high-CLV customers were considered. Figure 4.4 shows the results of this study. The results show the increase in the CLV of a customer given a 15% increase in any of the categories of the drivers. The retailer could use the information from these results to implement appropriate marketing programs. For example, if a firm knows that increasing the number of categories a customer purchases from (cross-buying) by 15% generates a 20% increase in the CLV score for that customer, given all else being equal, a firm can try to induce cross-buying behavior by offering specific promotions for customers to buy across different product categories.

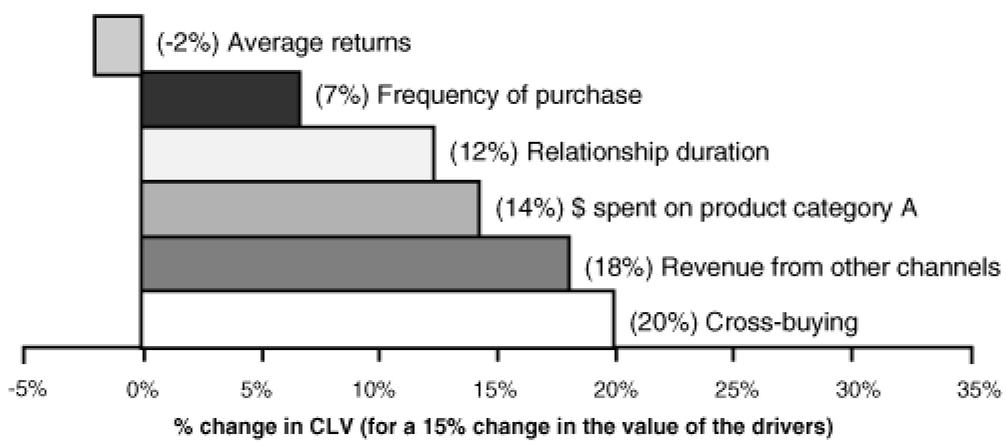


Figure 4.4. Interpreting the impact of the drivers of CLV: a retailing case study

Source: Adapted from V. Kumar, D. Shah, R. Venkatesan. "Managing retailer profitability—one customer at a time!" *Journal of Retailing*, 82(4) 2006: 277–294. Copyright New York University.

The key drivers of the CLV are (1) Cross-buying, (2) Multichannel shopping, (3) Selling a specific product, (4) Relationship duration, (5) Frequency of purchase, and (6) Average number of returns. The relative impact of each of these drivers of CLV is described in detail:

- **Impact of cross-buying.** As shown in Figure 4.4, if the cross-buying behavior of high-CLV customers is increased by 15%, their CLV goes up by 20%. This shows that if the customer purchases from more product categories from the retailer, the future profitability of the customer increases. This underlines the importance for firms to build strong relationships with customers both in terms of the value of purchases and the number of product categories purchased from.
- **Impact of multichannel shopping.** If customer spending through other channels (such as web and catalog) is increased by 15%, the CLV score for the customers goes up by 18%. These results show that regular store customers who also buy through alternative channels have a greater lifetime value for the firm. Multichannel shopping gains particular significance with the growth of the Internet and firms increasingly offering products through their websites. Apart from providing added convenience to shoppers, multiple channels also serve to increase revenue and decrease cost for firms by moving customers to low-cost channels and offering a wide range of products that could not be offered in brick-and-mortar stores.
- **Impact of selling a specific product.** A 15% increase in the spending on product category A increased the CLV of the customers by 14%. This CLV driver could serve as a tool for firms to simultaneously manage product profiles and customers. If a retailer wants to know how introducing a new product or changing an existing product profile will affect customer value, the firm can use this method to analyze the situation. In this case, there seems to be a causal relationship between purchasing of product A and the high CLV of the customer.
- **Impact of relationship duration.** As shown in Figure 4.4, if the customer's relationship duration is increased by 15%, the CLV score goes up by 12%. This shows that it is important for retailers to retain their high-value (CLV) customers. But, firms should not attempt to retain all customers. As pointed out previously in this book, not all loyal customers are profitable. Therefore, firms should adopt

strategies to retain profitable customers and build loyalty and profitability at the same time. (Chapter 6, “Managing Loyalty and Profitability Simultaneously,” discusses this strategy in more depth.)

- **Impact of frequency of purchase.** If the customer’s purchase frequency is increased by 15%, the CLV score of the customers goes up by 7%. This result highlights the fact that even though purchase frequency is an important driver of CLV, it has the least positive effect on the CLV score as compared to the other drivers.
- **Impact of average number of returns.** With a 15% increase in the average number of returns made by customers, their CLV score goes down by 2%. However, the relationship between product returns and CLV is more complex than what is suggested by this result. In limited numbers, product returns could indicate a healthy relationship with the customer, because it shows that the customer is willing to communicate with the firm and connect with its channels. However, too many product returns could be damaging to the firm, because it shows that the episodes of product return have not been exploited properly to build a relationship with the customer.

As shown in Table 4.3, 15 stores of the retailer were rank ordered based on the sum of the lifetime value of the customers and their past revenue. As shown in the table, the rank order of the stores based on their lifetime value differs significantly from the rank order based on past revenue. A similar discrepancy was observed when the past and future revenues of the customers were compared. This clearly shows that firms cannot rely on past store performance. Instead, they have to rely on their customer portfolio and its future value. As pointed out earlier, on average around 30% of customers have a negative lifetime value. Stores need to exercise greater caution as to whether they are acquiring and retaining the right customers. The manager can look up the CLV score of a customer to decide on the level of spending on that customer and still remain profitable. For example, the manager should not spend more than $92 per customer (on average) in Decile (Group) 3 (refer back to Figure 4.2) to ensure a profitable lifetime duration with the customer. In acquiring new customers, managers can refer to the profile of a typical high-CLV customer and look for new customers with similar profiles and prioritize resources on these customers. This approach can be used to evaluate relatively new customers, to make marketing decisions about existing customers, and to allocate marketing resources across various customers.

Table 4.3. Measuring Store Profitability

Store	Store Revenue ($)	Revenue Rank	Expected Store Profitability Based on CLV	Profitability Rank
1	20,196,138	1	3,304,942	4
2	11,870,392	2	1,731,856	9
3	9,761,732	3	–4,471,439	14
4	8,705,402	4	7,635,066	1
5	6,487,945	5	2,579,805	7
6	6,314,190	6	–5,816,329	15
7	5,085,694	7	4,660,984	2
8	4,510,125	8	2,759,272	6
9	4,357,225	9	2,526,916	8
10	4,311,662	10	3,577,310	3
11	4,189,061	11	185,066	12
12	3,880,850	12	1,031,893	11
13	3,856,373	13	1,117,543	10
14	3,777,840	14	3,053,192	5
15	3,757,544	15	–348,419	13

This case study helps identify various CLV drivers, such as cross-buying, product returns, multichannel shopping, and so on. Other firms can customize these drivers and add new ones according to their business context, and then test them as to how they affect the lifetime value of customers. This gives firms an invaluable tool on which to base their day-to-day marketing decisions, and it increases the potential for implementing the firm's decision through manipulation of the drivers. The results obtained from this case study have several strategic implications, as follows:

- The performance of store managers can be evaluated based on CLV scores of the store.
- Store-based decisions can be made to maximize CLV:
- Stores should target the type of customers each store should have to maximize CLV.

- Stores should tailor strategies to address a specific set of customers based on their CLV scores.

Conclusion

At any given moment, firms need to make several marketing and strategic decisions regarding their customers and products. The CLV framework provides firms with an effective and centralized method to consistently make the right decisions. As recommended in this chapter, firms should always aim to maximize their CLV, and all decisions should be based on this criterion. And by understanding the drivers of CLV that define the customer-firm relationship, and by taking appropriate measures to maximize the CLV using these drivers, firms can ensure profit maximization and success in the future.

5. Maximizing Customer Profitability

Relevant Issues

- Why do we need a Customer Lifetime Value (CLV)-based approach to manage customer profitability?
- What are the strategies that can be used to maximize CLV?

The previous chapters described the concept and measurement of CLV and how various factors affect the lifetime value of a customer. The next step is to use strategies based on CLV to maximize customer profitability. This chapter identifies several strategies that can be used to maximize customer profitability.

The Wheel of Fortune

A full understanding of each customer's lifetime value will enable a firm to maximize its own value by maximizing the number, scope, and duration of such value-creating customer relationships. In this chapter, we discuss a set of strategies that can be used by firms to maximize their CLVs. These strategies can be broadly classified into "across-customer" strategies and "within-customer" strategies. By using CLV as a cornerstone to design and implement these strategies, firms can ensure profit maximization.

Across-customer strategies include

- Efficient customer selection by targeting customers with high profit potential
- Managing existing sets of customers and rewarding them based on their profit potential
- Investing in high-profit customers to prevent attrition and ensure future profitability

Within-customer strategies aim at maximizing profits by either increasing revenue or reducing cost or by doing both. The within-customer strategies include multichannel shopping (revenue maximization), optimal allocation of resources (cost reduction), and managing the purchase sequence of the customers (revenue maximization and cost reduction). Maximizing the brand value is another key within-customer strategy.

Figure 5.1 lists these cutting-edge marketing strategies that can be used in maximizing CLV. I call it the Wheel of Fortune. Implementing these strategies is a cyclical process. The knowledge acquired in implementing these strategies should be used as the basis for deciding which customer to pursue in the future and how to select the most profitable set of customers.

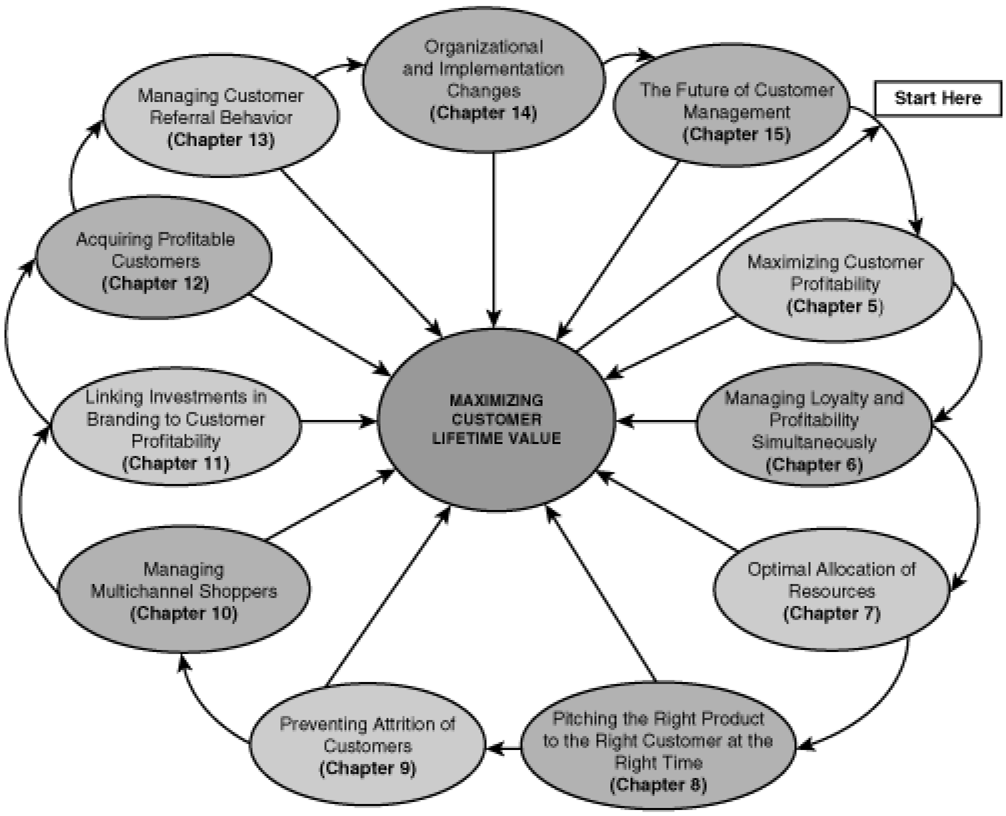


Figure 5.1. The Wheel of Fortune: Strategies Used for Maximizing CLV

As illustrated in Figure 5.1, the CLV maximization cycle starts with selecting the right customers based on future profitability. The strategies that follow this aim at efficient management and retention of customers. The next step is to manage loyalty and profitability of these customers simultaneously. The return on investment (ROI) from the limited marketing resources can be maximized by optimally allocating resources to profitable customers and contacting them through the most effective communication channels at the most appropriate time with the right message.

The next strategy involves pitching the right product to the right customer at the right time. This can be achieved by predicting the purchase sequence of the customers and adapting the marketing initiatives accordingly. Also, preventing the attrition of customers is an important step in retaining the most profitable customers. This could be achieved by obtaining a good understanding of the spending patterns and intervening at the right time to prevent the customer from terminating the relationship with the firm. With the coexistence of online stores, catalog-based businesses, and physical store locations, managing customers in the multiple channels is an important strategy. By encouraging customers to buy from multiple channels and by encouraging them to use the lower-cost channels to make their transactions, firms can maximize profit.

The next strategy is the one used by firms to link a customer's brand value to the customer's profitability. By following this strategy, firms can identify areas for improving brand value and optimally allocate resources to improve the brand value and improve customer profitability.

The last strategy links the acquisition and retention of customers to profitability. By targeting the right customers and retaining customers with high profit potential, firms can ensure future profitability. The experience (or information) obtained by implementing these strategies is taken into account while making future decisions about customer selection and other strategies, thus ensuring a dynamic process that can be exploited to maximize profit. A brief introduction to all these strategies follows.

Customer Selection[1]

The first step in implementing a successful marketing strategy is to select the right customers. Customer selection is a crucial step for several reasons. First, the marketing budget of a firm is limited, and managers have to make choices as to where and on whom they should spend the limited resources available to them. Second, not all customers are equally profitable. As shall be established in future chapters, an overwhelming share of profit is generated by a small percentage of customers. This necessitates targeting those customers with high profitability, and this is the basis of the customer selection strategy.

Traditionally, firms rank order customers based on their profits and prioritize their resources based on this ranking. As described previously, several customer selection metrics have been used by companies for this purpose, such as RFM (Recency-Frequency Monetary value), SOW (Share of Wallet), PCV (Past Customer Value), and CLV (Customer Lifetime Value). As shown in the previous chapters, of these metrics, the forward-looking CLV metric is the most successful in predicting future customer profits.

The performance of the traditional metrics versus the CLV metric in customer selection has been compared numerous times, with CLV always offering higher levels of profitability. For example, in a recent study, customers from a large high-tech services company were rank ordered from best to worst according to each metric. The total revenue, costs, and profits from the top 15% of the customers were compared. The total observation period of the study was 72 months (6 years). The customers were rank ordered according to each metric based on the data obtained from the first 54-month period. The total revenue and the profit generated by the top 15% of customers under each metric were observed over the next 18 months. Table 5.1 shows the results from this study.

Table 5.1. Comparison of Metrics for Customer Selection

Using the First 54 Months of Data to Predict the Next 18 Months of Purchase Behavior (for the Top 15% of the Customers)

	CLV	RFM	PCV
Average revenue	30,427	21,201	21,929
Gross value	9,184	6,360	6,579
Variable costs	107	100	95
Net value	9,077	6,260	6,484

It is clear from Table 5.1 that the net value generated by the customers who were selected based on the CLV score is about 45% greater than that generated through customers selected through other traditional metrics. This shows that using CLV to select customers is far more effective than using the traditional metrics. These findings provide substantial support for the usefulness of CLV as a metric for customer scoring and customer selection.

Managing Loyalty and Profitability Simultaneously[2]

Often, managers fall into the trap of believing that loyalty is the true measure of customer profitability. As explained in the previous chapters, the link between loyalty and profitability is a lot more complex and subtle. By directing all their marketing resources to achieve and maintain loyalty, managers are not only pursuing the wrong customers, but also ignoring customers with high-profit potential. This strategy clarifies the relationship between loyalty and profitability and provides managers with the required framework to manage loyalty and profitability at the same time. In implementing this strategy, the difference between behavioral and attitudinal loyalty is highlighted. Behavioral loyalty refers to the loyalty of customers as reflected through their immediate purchase behavior. Attitudinal loyalty refers to the higher-order, long-term relationship of the customer with the firm. Traditionally, firms relied solely on behavioral loyalty as a measure of a customer's loyalty. But, as explained later in this book, this gives a skewed and often unreliable measure. This strategy explains how "true" loyalty could be measured and what role behavioral loyalty and attitudinal loyalty play in attaining profitability.

The first step in implementing this strategy is to segment customers based on their loyalty and profitability to the firm. Several measures of loyalty and profitability can be used for this purpose. Customers are segmented into cells based on their loyalty and profitability levels, and different strategies are directed toward each set of customers to maximize their loyalty and profitability.

After the customers have been segmented, the next step is to build a loyalty program that aims at maximizing the overall profitability of the firm. This strategy presents a framework that can be used to build such a loyalty program. The framework suggests several steps that can be used to build and sustain profitable customer loyalty.

All customers are not equally profitable. Always remember this when putting a loyalty program in place. A firm's loyalty program should be able to reward customers depending on their level of profitability. For loyalty programs, a two-tiered approach is recommended. The tier 1 rewards are aimed at all customers based on their current and past purchase behavior. This tier 1 reward is a simple, explicit way of rewarding customers and attracting new customers. Tier 2 rewards are aimed at influencing the future purchase behavior of customers. Tier 2 rewards are more selective and reward customers to influence their behavioral and attitudinal loyalty.

Implementing this strategy will enable firms to build and sustain profitable customer loyalty. This chapter provides a comprehensive framework to approach this problem and suggests several steps that can be used to build a more robust and profitable loyalty program.

Optimal Allocation of Resources[3]

Firms are often constrained by limited marketing resources. This poses a challenge because these resources cannot be allocated to all their customers. Ideally, firms should be investing only in customers who are profitable. However, many companies continue to spend resources on a large number of unprofitable customers. They either invest in customers who are easy to acquire but are not necessarily profitable or try to increase the retention rate of all their customers, thereby wasting limited resources. One reason for this is that these firms have not identified who their most profitable customers are and how resources should be spent on them to maximize profitability.

This strategy makes detailed recommendations about optimal allocation of resources to individual customers. The first step is to identify the most profitable customers and the customers who are most responsive to marketing efforts. The second step is to figure out the right mix of different channel contacts for each customer. This depends on how responsive each customer is to these channels of communication (email, direct mail, telephone, direct visit by a salesperson) and how cost-effective these channels are.

The next step in implementing this strategy is to decide how frequently the customer should be contacted and what the inter-contact time should be. Also, the various factors that affect customer behavior—such as upgrading (to a higher product category) and cross-selling (in a different category) and so on—need to be analyzed. Therefore, by carefully monitoring the purchase frequency of customers, the inter-purchase time, and the contribution toward profit, managers can determine the frequency of marketing initiatives to maximize CLV.

This strategy suggests that it is unwise to inundate all customers with marketing initiatives. It has been shown that such an approach only alienates customers and makes them less responsive to such efforts. A more measured approach is recommended, where each customer's responsiveness to each channel of communication is considered and a carefully designed strategy is implemented to allocate the limited marketing resources.

Pitching the Right Product to the Right Customer at the Right Time[4]

Companies are constantly trying to predict customer buying behavior. In such an exercise, the most common method used by companies involves two steps:

1. Estimating the probability that a customer will choose to purchase a particular product
2. Estimating the probability that a customer will make a purchase at a particular time

Most firms stop at the first step, which limits their ability to accurately predict the timing of purchases. However, even those companies that follow the process may not be successful. In a multiproduct firm, it is not easy to predict what product a particular customer is going to buy next. But, from the firm's point of view, this is a very valuable piece of information because the firm can then decide the message and timing of the customized communication strategy. An ideal contact strategy is one that allows the firm to deliver a sales message relevant to the product likely to be purchased in the near future by a customer. This could be achieved by accurately predicting the purchase sequence.

Understanding the purchase sequence calls for analyzing past customer purchases and estimating the likelihood of future purchases to design optimal contact strategies. Some questions that need to be answered are as follows:

- In which product category is the customer likely to make a purchase?
- At what intervals and during which time period will the customer make a purchase?
- How much is the customer likely to spend? (In other words, how profitable is the customer likely to be?)

This strategy describes a model that helps to analyze and answer the preceding questions and predicts the purchase sequence of each customer. After these questions have been answered, the next step is to design an optimal allocation strategy aimed at efficiently contacting customers to induce them to make the next purchase. When tested in a business-to-business (B2B) setting, 85% of the customers predicted by this model to make a purchase actually went on to do so. In comparison, only 55% of the customers predicted by the traditional model actually made a purchase. When this strategy was implemented in the B2B setting, an increase in ROI of 160% was observed. Therefore, this strategy suggests that efficient management of the purchase sequence not only increases revenue by accurately predicting and preempting a customer purchase, but also minimizes cost by reducing the frequency of customer contacts.

Preventing Customer Attrition

An efficient customer retention strategy that leads to profit maximization requires holding on to those customers with high profit potential. Scientific models, such as the dynamic churn models, are used to predict which customer is likely to leave the company and suggest proactive actions for companies. These models empower managers to execute timely, customer-specific marketing interventions that result in an increase in ROI.

When implementing a customer retention strategy, managers face questions such as when to intervene, how to intervene, and through which channel to intervene. While developing a framework, it should be remembered that each customer may have potential for some level of future profit. When designing an intervention strategy, the first step is to study the customer's quitting tendencies. After we identify the potential value through the computation of CLV, we can then create a value proposition at the time of intervention that would not exceed the CLV. This way, the retained customers are still expected to be profitable in the future.

After deciding on the need to intervene and identifying the customers to be intervened with, firms must identify when to intervene. To prevent customer attrition, a proactive intervention strategy is necessary to address those customers who show a strong need for intervention. The dynamic churn model, when implemented with an Internet service provider (ISP) firm, saved more than 30% of the customers who were showing signs of leaving the firm. This savings resulted in an incremental ROI of about 10, based on the saving of customers and retaining them for at least one more year. This strategy of intervening with customers who exhibit potential to churn can result in higher profits for firms.

Managing Multichannel Shoppers[5]

Due to the arrival of complex distribution systems for various industries and sectors, and the growth of web-based sales, firms are spreading themselves across various channels to appeal to diverse customer segments. For example, customers purchase in some retail stores such as Macy's and JCPenney through brick-and-mortar stores, through the Internet, or through mail-order catalogs. Each of these channels services a different set of customers and provides varying levels of service. This leads to reduction in service cost, resulting in an increase in profitability.

The study referred to in this section demonstrated that in a B2B setting, multichannel shoppers are more profitable than single-channel shoppers. Specifically, multichannel shoppers differ from single-channel shoppers by providing higher revenue and having a deeper relationship, a higher SOW, and a higher likelihood of being active. By implementing this strategy in the B2B firm, it was found that customers who shopped through all three channels generated three times the revenue when compared to single-channel shoppers. Also, the likelihood of staying active for those who shop through three channels was about four times more when compared to single-channel shoppers. Multichannel shoppers initiate more contacts with the firm, have longer tenure, purchase more frequently, and are more receptive to contacts through multiple communication channels. Further, the study showed that there exists a nonlinear relationship between returns and multichannel shopping, and that there is a positive enticement toward multichannel shopping when customers are contacted through various communication channels.

Understanding customer behavior in each channel can help managers to migrate low-value customers to low-cost channels and thus reduce cost. For example, if a customer who predominantly buys by ordering from the catalog over the telephone can be migrated to buying from the firm's website, the cost of servicing the customer could be significantly reduced. This strategy identifies the drivers of multichannel shopping and how it influences channel adoption. Further, a conceptual framework that identifies the customer-level characteristics and supplier factors that may influence purchase behavior across multiple channels is provided.

These results show that by effectively managing the purchase pattern of customers across various channels, firms stand to gain from the cost reduction and customer retention. This strategy illustrates how firms can harvest these benefits by managing multichannel shopping.

Linking Investments in Branding to Customer Profitability[6]

A typical dilemma faced by any corporate board is whether to invest in building brands or to invest in building the customer base. Which of these routes will ensure maximum profitability? The answer is probably to invest in both. Also, it would be difficult to estimate how investing in brand building contributes toward attaining higher profitability. A key way to address these issues is to establish a link between brand value and CLV to manage individual customer brand value. This results in maximizing the CLV. This strategy explores the link between Individual Brand Value (IBV) and CLV, and it offers insights about bridging the gap between IBV and CLV.

Brand equity and customer equity have traditionally been viewed as two separate marketing assets. However, building a brand through traditional approaches does not necessarily achieve growth in the CLV. Measurements on components of an individual's brand value are suggested so that a firm can identify how its customers value the brand. This framework enables a firm to optimize a customer's lifetime value, thereby allowing simultaneous growth in brand equity and customer equity. Based on these results, the firm can redesign its communication strategies to cater to the needs of such customers. In one of the implementations, after the brand value was linked to CLV, the scores of the components of the brand value were improved to yield a higher CLV.

Acquiring Profitable Customers[7]

The strategies listed previously are aimed at selecting the right customers, managing them profitably, and retaining them through the optimal allocation of resources. The knowledge acquired in implementing these strategies could be used to acquire prospective customers with high profit potential. This approach to link acquisition and retention of customers to firm profitability is a key contribution of the CLV-based approach.

While making direct marketing investment decisions, many marketers still overemphasize short-term cost over long-term gain, leading to companies pursuing customers who are cheap to acquire and cheap to retain without essentially being profitable. Conventionally, most companies use customer acquisition and retention rates to measure their marketing performance. This approach could diminish returns to the firms because they might be spending more on acquiring and retaining a customer than on what the customer brings in as revenue. Further, different groups of customers require different levels of acquisition/retention spending to maintain their relationship.

The CLV approach recommended in this book suggests optimizing the acquisition/retention costs and directly links such efforts to overall profitability. This strategy helps firms to decide which customers are worth chasing and which dormant customers should be pursued to come back to the firm. Firms should use customer profiles to identify the customers who are most likely to be profitable. This can be achieved by identifying customers with similar characteristics as existing high-CLV customers and by adopting an appropriate marketing strategy. After the customer behavior of a catalog retailer was observed, customers were segmented based on their cost of acquisition and cost of retention. It was found that the largest segment (32%) was made up of customers who were easy to acquire and retain. But they accounted for only 20% of the total profit. On the other hand, 40% of the total profit came from the smallest group of customers (15%), who were expensive to acquire but cheap to retain. Therefore, linking acquisition and retention to profitability helps the firm to target and retain profitable prospects and customers. This demonstrates the importance of the efficient allocation of the marketing budget across acquisition and retention initiatives to maximize profitability.

Viral Marketing Strategies[8]

Although the CLV metric has been shown to outperform all other behavioral metrics such as RFM or SOW, it does have one main limitation as a complete measure of a customer's value. Even though all customer relationship management (CRM) programs collect data on transactions and demographics, they fail to measure data on customer attitudes. And, even if they do collect data on customer attitudes, such as in the form of surveys, these attitude measurements are often left out of the estimation of CLV.

It is clear that not only can customers contribute to the firm through their own transactions (direct profit), but they also have an impact on the transactions of other customers through word-of-mouth and referrals (indirect profit), and both can increase the value of that customer to a firm. A recent study showed that less behaviorally loyal customers tend to have a stronger impact on referring new customers when compared to more behaviorally loyal customers. It was also shown that the referral process is not only able to bring in customers without excessive marketing expense, it is also able to bring in customers who are not likely to join through traditional advertising and promotions by the company. While designing a marketing strategy to target our highest-value customers, we need to consider the actual value that each customer can bring to the table in terms of both direct and indirect profit.

There are two approaches for maximizing customer profitability: maximizing CLV and managing customer referral behavior. The concept of Customer Referral Value (CRV), which is defined as the value of the referral behavior of a specific customer, is introduced in implementing this strategy. This metric enables managers to measure and manage customer referral behavior. This dictates that customers be valued based on their indirect impact on the firm's profits, through savings in acquisition costs and the addition of new customers by way of customer referral.

Implementation/Interaction Orientation[9]

When implementing these strategies, firms need to fundamentally reorient their marketing approach. Traditionally, firms had a “product-centric” approach, and managers were focused on making and selling superior products. In this process, the entire focus remained on the products. For firms to maintain future profitability, a “customer-centric” approach becomes imperative. In this approach, the timely interaction between the customers and the firm, and effective management of this interaction, is recognized as a major source of competitive advantage. We define this interaction between the firm and the customer, which helps in developing organizational resources for successful customer management strategies, as interaction orientation.

In the interaction-oriented approach, marketing activities are conducted with the customer. The customer is viewed both as a source of business and as a resource for the firm. The power of customer-to-customer linkages is recognized and nurtured as a customer empowerment component.

The various components of the interaction-oriented approach are as follows:

- Customer capacity is the belief that the individual customer is the unit of every marketing action or reaction.
- Interaction response capacity is the degree to which a firm can provide successive products or services based on the previous feedback by a specific customer and all other customers.
- Customer empowerment is the extent to which customers connect with the firm and other customers, collaborating and sharing information, praise, and criticism about the firm’s products and services.
- Customer value management is the extent to which a firm is able to quantify and calculate the individual customer value and reallocate its resources to higher-value customers based on this evaluation.

By adopting these measures, firms can customize their products and services by better understanding the needs of their customers. This leads to increased customer satisfaction, generates positive word-of-mouth, and leads to acquiring and retaining profitable customers.

The Future of Customer Management

Traditionally, the focus of implementing customer management (CM) strategies was to reduce cost and to an extent make customer management more efficient. But firms have started to realize that CM strategies can not only help retain loyal customers, but can also help businesses grow their revenue and profit.

Firms should realize that CM is not an end in itself, but a means to an end. Firms should employ "customer-centric" strategies to reap the full benefits of CM strategies.[10] By doing so, firms will be able to successfully implement CM strategies in lucrative business scenarios, set reasonable expectations for returns, and evaluate and understand new business opportunities that will arise.

When implementing an interactive marketing approach, firms need to assess individual customers, including their needs, wants, and ways and means of communication. They must also assess lifetime value and profitability. This assessment will involve establishing a department that identifies the necessary components and interfaces for delivery of products/services to the customer. The department also appoints monitors and measures the impact on any change in the firm's consumer base.

In the future, a firm that can accurately assess customer feedback and market trends through an interactive marketing approach will be able to respond to market changes and customer needs within a day (or perhaps even the instant a customer walks in). Such a response requires that the right systems be in place to effectively control and capture all relevant customer data. If the right information system is in place, the data can be processed in real time, and relevant information for the ideal marketing strategy can be provided instantly. Therein lies the future of customer management: You have a marketing plan for each and every customer—to make these customers even more profitable as soon as the purchasing information is updated.

The Power of CLV and the Wheel of Fortune

The strategies listed in this chapter are an integral part of a comprehensive customer management approach recommended in this book. Even though these strategies can yield great results when implemented separately, they work best when implemented as a whole. The knowledge acquired from implementing each strategy can be used to improve on other strategies, and this information can be collectively used to refine future marketing initiatives. All these strategies are powered by CLV and derive the benefit of using a forward-looking metric to evaluate a customer's worth to the firm. Because the CLV takes into account the customer's past and future purchasing behavior, it gives an accurate picture of a customer's worth to the firm and thus enables managers to design and modify their marketing strategies accordingly. Each of the strategies mentioned in this chapter is discussed in detail in the following chapters.

Conclusion

While CLV has proven to be a superior metric, the challenge is maximizing it. As demonstrated in this chapter, there are nine strategies that could effectively manage customers profitably. These strategies aim to select the right customers for future targeting, identify and segment customers with the highest potential for profits in the future, optimally allocate marketing resources to customers across channels to maximize CLV, pitch the right product to the right customer at the right time, prevent attrition of high value customers, identify and target the customers for multichannel shopping, allocate the right amount of marketing resources to build a profitable branding strategy, identify the optimal marketing resources to acquire and retain profitable customers, and identify customers who provide value through customer referrals. Managers may implement these strategies to maximize the firm profits.

6. Managing Loyalty and Profitability Simultaneously

Relevant Issues

- Should we build customer loyalty?
- How do we choose the right customers?
- How do we avoid choosing the wrong customers?
- How do we manage profitable customer loyalty?

As discussed in the previous chapters, selecting customers purely based on their loyalty is not a prudent approach. To administer efficient reward programs, it is necessary to distinguish between the behavioral and attitudinal loyalty of customers and to alter existing programs to improve each measure. Also, segmenting customers based on their profitability and adopting segment-specific strategies are essential. This results in the efficient allocation of resources (and thus leads to an increase in profitability). This chapter provides a framework that allows firms to classify and manage customers based on their profitability and longevity.

Behavioral and Attitudinal Loyalty

Conventionally, customer loyalty has been defined as a behavioral measure (that is, the loyalty of a customer as obtained from his purchasing behavior). A majority of the existing loyalty programs reward customers based on their behavioral loyalty: The more you spend, the greater the reward. As discussed in the previous chapters, customers should be rewarded based on their profitability, not just on their behavioral loyalty alone. Even if you incorporate this aspect of customer profitability into your loyalty programs, it is still incomplete because the current loyalty programs are not forward-looking; that is, customers are rewarded based on their current and historical purchasing behavior, and the programs do not consider the future profit potential of the customers. That brings up the first question answered in this chapter: Is it possible to design a loyalty program that can reward customers "today" based on their "future" profitability?

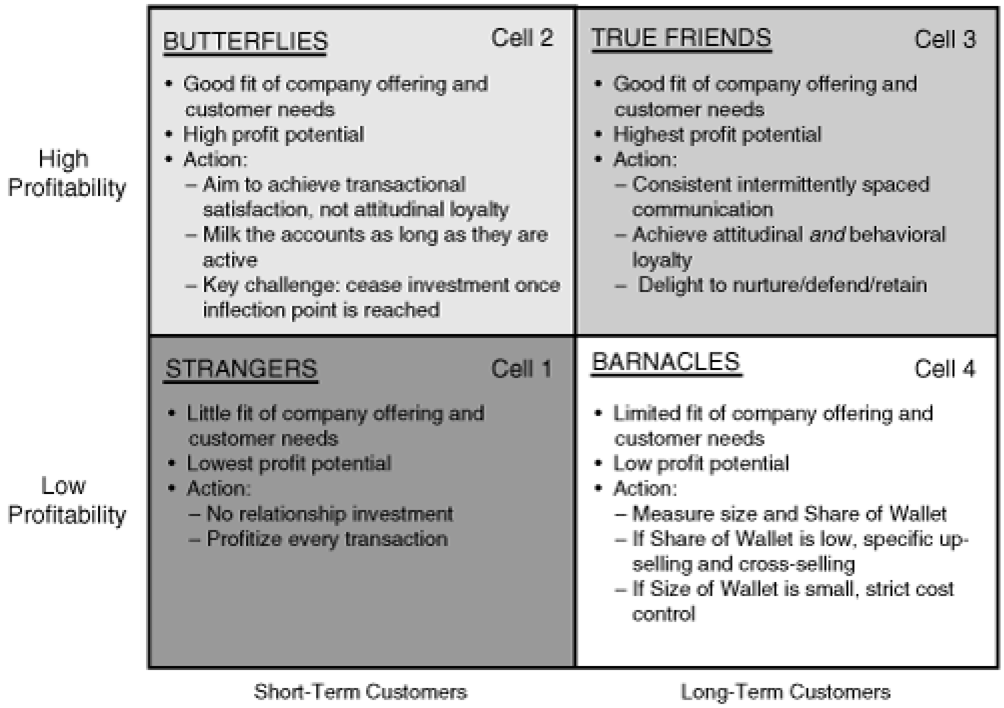
To answer that question, we first have to understand the deeper question: What is "true" loyalty? *Truly loyal customers* have been defined as customers "who feel so strongly that you (the company) can best meet their relevant needs that your (the company's) competition is virtually excluded from the consideration set; these customers buy almost exclusively from you (the company)."[1] This observation implies that to build and sustain "true" customer loyalty, it is necessary to include the attitudinal behavior of customers that drives customer behavior.

What is attitudinal loyalty? *Attitudinal loyalty* indicates a higher-order and long-term commitment of a customer toward the firm. This commitment cannot be inferred from just observing the purchasing behavior of customers.[2] In addition, customers who exhibit attitudinal loyalty have a greater propensity to display certain behaviors, such as having a greater likelihood of future purchase or being more likely to recommend the focal firm to their friends and acquaintances.[3] These customers could provide unprecedented customer growth to the company through word-of-mouth publicity or referral behavior. A loyalty program that doesn't factor in both the attitudinal and the behavioral aspect doesn't maximize the potential for profitability, because it is clear that

- Behavioral loyalty by itself cannot be a measure of true loyalty.
- Behavioral loyalty can be an unreliable predictor of customer profitability.[4]

Customer Segmentation

The first step in this process is to segment customers based on their loyalty and profitability diversity. Several measures can be used for this purpose. Figure 6.1 illustrates one such measure; customers are segmented into four groups based on their expected future profitability and on the prediction as to how long they are expected to stay with the firm (duration). After they have been segmented into one of the four cells, a different loyalty strategy is then applied to each cell. Just from this segmentation alone, it is clear that the relationship between loyalty and profitability is more complex than previously believed.[5] Some customers are very loyal but not profitable at all (Cell 4); others are short-term customers and highly profitable (Cell 2). Therefore, because the customers in each cell differ significantly in their behavioral motivations, a different loyalty approach is taken toward each segment of customers to maximize their profitability.



Source: W. J. Reinartz and V. Kumar, "The Mismanagement of Customer Loyalty," *Harvard Business Review* 80(7) 2002: 86. Printed with permission from the Harvard Business School Publishing. Source: V. Kumar and D. Shah, "Building and Sustaining Profitable Customer Loyalty for the 21st Century," *Journal of Retailing*, 80(4) 2004: 326. Copyright New York University.

Figure 6.1. Managing loyalty and profitability simultaneously

- **Cell 1: strangers (low-profitability and short-term customers).** The set of customers who are not loyal to the firm and bring in little or no profit are called strangers. These customers have very little fit between the company's offerings and their own needs; therefore, they have very little profit potential. They have to be identified very early on, and any investment toward building a relationship with them should be avoided. Profit should be made from every transaction with these customers because it is likely that the current transaction with these customers could be their last.

- **Cell 2: butterflies (high-profitability and short-term customers).** These profitable, but transient customers can be very profitable, but often do not exhibit traditional behavioral loyalty. Butterflies are very prevalent in many industries. These customers tend to buy a lot in a short time period and then move on to new firms after making those transactions. These customers avoid building a long-term relationship with any single firm. For example, many direct-brokerage firms call such customers “movers” (those who spend large amounts and trade often but switch to a different firm when they find a better deal).

One mistake often repeated when managing these customers is to continue to invest in them even after they stop purchasing from the focal firm. Such efforts to retain butterflies are mostly futile. In a study conducted in various industries, it was observed that attempts to convert butterflies into loyal customers rarely succeeded, and the conversion rate was less than 10% in each industry. So, firms should stop treating butterflies as potential “true believers” and instead adopt a more prudent approach: Enjoy their profits while they last and stop investing in them at the right moment when they switch. This usually involves adopting a short-term, hard-sell strategy through intensive promotions and mailing campaigns that involve promotions for products in other categories (cross-selling). Note that even though this is a good approach toward butterflies, it might irritate loyal customers. The corporate service provider studied uses this strategy with very good effect.[6] The firm telephones those customers it has identified as butterflies four or five times shortly after their most recent purchase, and depending on the product category, contacts them with just one direct mailing 6 to 12 months later. If these communications yield no result, the firm completely stops communicating with these customers.

- **Cell 3: true friends (high-profitability and long-term customers).** Customers who are both loyal and profitable are called true friends. These customers buy steadily and regularly (not too intensively) over time. True friends are generally satisfied with existing arrangements with the firm, as reflected in their loyalty and profitability. They are usually comfortable engaging with the firm’s processes. For example, for the mail-order company in that study, it was found that customers had a tendency to return goods at a high rate, indicating that they had a high level of comfort engaging in both buying and returning products. Care should be taken in building relationships with these true friends, because these customers have the highest potential to bring long-term profitability. However, this does not necessarily mean inundating these customers with marketing communications and promotions. In the case of the mail-order catalog firm in that study, it was observed that intensifying the contact level by increasing the mailings and so on was more likely to have a negative impact on the loyal and profitable customers than to increase sales. When flooded with excess mailings, customers tend to ignore all of them, throwing out everything without even looking at the mailings. However, when sent the right number of promotions, they are more likely to look at the material and respond to it.

Firms should find new ways to cultivate and reward loyalty of true friends, which will in turn maximize their profitability and convert them into true believers. In the case of the grocery chain in that study, several measures were taken to reward customers based on their loyalty, and the results were reflected in increased sales and attitudinal loyalty. It was observed that customers who scored high on both attitudinal and behavioral measures of loyalty were 120% more profitable when compared to customers who just exhibited behavioral loyalty. This pattern is not only relevant in the business-to-consumer (B2C) setting, but also holds good in the business-to-business (B2B) setting. In the case of the corporate service provider, it was observed that the customers who exhibited both attitudinal and behavioral loyalty were 50% more profitable when compared to customers who just demonstrated loyalty through behavior alone.

Firms can take a range of measures to reward the loyalty of their customers, and more important, make them feel rewarded for loyalty. The grocery chain lets loyal customers participate in optional emailings of special promotions. Also, it allows these loyal customers special access to many of its company-sponsored events and seasonal promotions.

- **Cell 4: barnacles (low-profitability and long-term customers).** These customers, if managed unwisely, could prove to be a severe drain on company resources. The size and volume of the transactions made by these customers are too low to justify the cost incurred in marketing and maintaining their accounts. They are comparable to the barnacles attached to the hull of a ship; they only create additional drag. If managed in the right manner, they could become profitable in the future.

The primary step in designing a strategy for these customers is to evaluate the size and share of their wallet. If the problem is the small *size* of their wallet, these customers are not valuable enough to continue pursuing. If the problem is identified as small *Share* of Wallet, these customers have the potential to spend more, and they should be pursued and induced to purchase more. This task of tracking the spending pattern of customers to evaluate their value is made much simpler by the advancements in computer and database technology. The French grocery chain in this study was able to track the purchases of individual customers and obtain impressively reliable estimates about their share and Size of Wallet in specific product categories. Based on this information, the company can easily classify the potentially profitable customers and offer them specific promotions to induce them to buy more from the company (in both the previously purchased product categories and unrelated product categories).

A Framework for Building and Sustaining Loyalty

To take action and build an effective loyalty program, it is first necessary to learn how to segment your customers, as discussed in the preceding section. Then, after this segmentation has been completed, you must build a loyalty program with an overall objective of achieving maximum profitability. This section discusses a framework that firms can use to build and sustain customer loyalty (see Figure 6.2). To implement the framework, three fundamental objectives must be fulfilled:

1. Build and enhance behavioral loyalty.
2. Cultivate attitudinal loyalty.
3. Link loyalty to profitability.

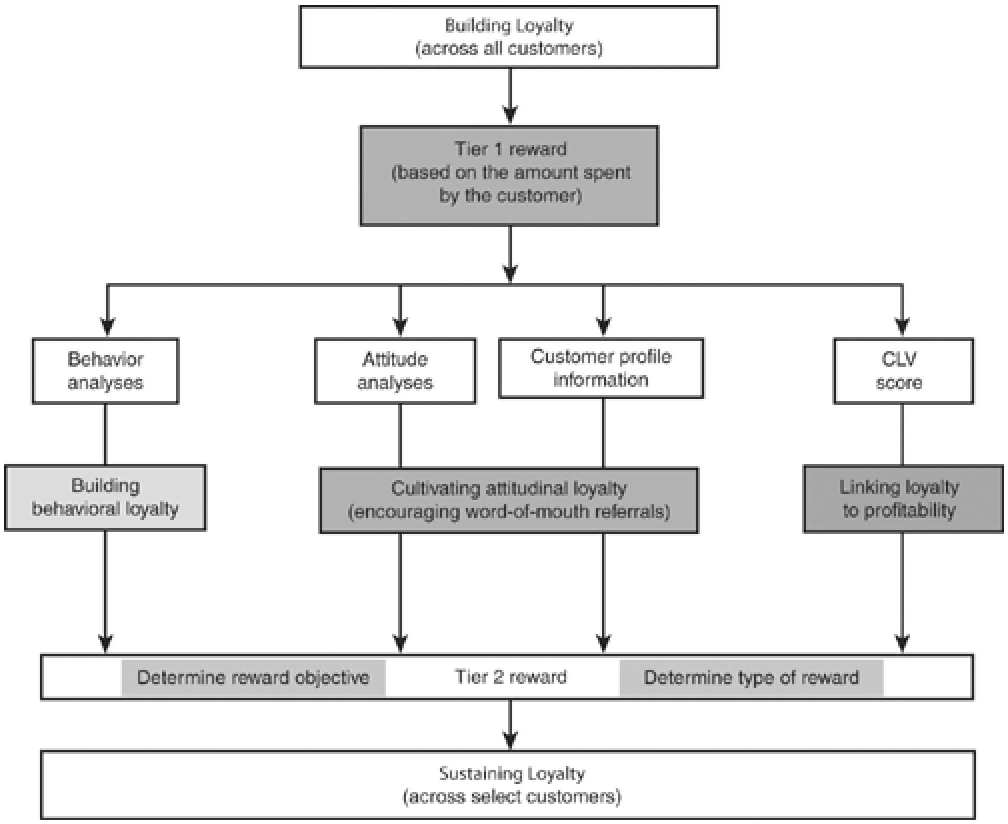


Figure 6.2. Framework for building and sustaining profitable customer loyalty

These fundamental objectives can be used to represent a tiered reward system. In the following sections, these objectives are explained in detail, and several operational guidelines are given for implementing a profit-oriented, tiered reward system.

Building and Enhancing Behavioral Loyalty

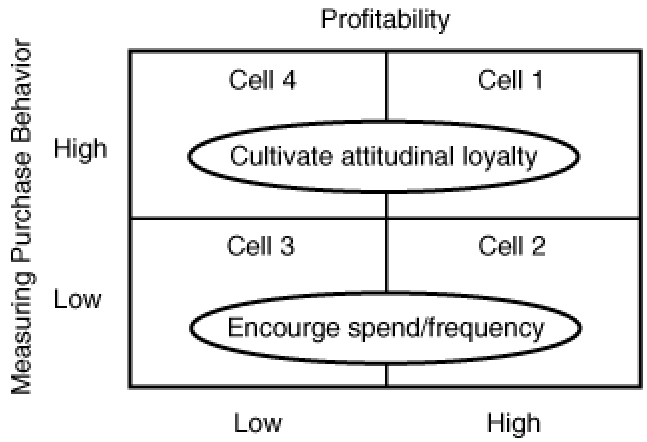
As discussed in the earlier sections of this chapter, to achieve true loyalty of the customers, it is necessary to enhance both their behavioral and attitudinal loyalty. Customer loyalty of any form is meaningful to the firm only when it is reflected in the purchasing behavior. Enhanced purchasing behavior leads to an increase in the direct and tangible returns to the firm, as compared to attitudinal behavior, which may be expressed in terms of long-term commitment and trust, but need not translate into actual purchase behavior. So, pure attitudinal loyalty of customers, without being linked to behavioral loyalty, may only provide limited returns to the firm.

Therefore, it is crucial for the firm to build behavioral loyalty before cultivating attitudinal loyalty.

Most loyalty programs implemented by firms today are aimed at rewarding the behavioral loyalty of the customers, and most of the loyalty programs are represented at the aggregate level of customer behavior.

As illustrated in the previous chapters, rewarding customers based on just their aggregate purchase behavior is skewed and misses several key points. For example, in a traditional loyalty program, two customers who spend $100 in a department store get the same reward irrespective of how their spending pattern is distributed across high-profit and low-margin products, or how they buy from different product categories. Even if one of them buys predominantly low-margin products or sale items, this customer gets rewarded based only on his/her overall spending. To design an effective loyalty program, both the purchase behavior and the profitability aspect of the customers have to be investigated. The following questions must be asked to design a loyalty program: Did the customer buy all the products from a single category/department, or did he/she buy from different departments and product categories? The answer to this question gives insight about the customer's future purchasing behavior. Does the customer frequently buy low-margin or high-margin products? Does the customer predominantly buy sale items or full-price items or both? The answers to these two questions help firms understand how profitable the customer is likely to be in the future.

It is clear that even customers spending the same amount in revenue can have very different future profitability and purchase behavior. Hence, customers should be segmented based on these two dimensions: profitability and purchasing behavior. Figure 6.3 shows how the customers can be segmented on these dimensions.



Source: V. Kumar and Denish Shah (2004), "Building and Sustaining Profitable Customer Loyalty for the 21st Century," *Journal of Retailing* 80(4) 2004: 317–330. Copyright New York University.

Figure 6.3. Purchase behavior analyses

When segmenting customers based on their purchasing behavior, remember that this measure varies across industries and product categories. For example, a multiproduct firm such as a financial services firm will be concerned about the degree of cross-buying across various product categories, whereas a single-product, single-price vendor such as Amtrak will be more concerned about the frequency of buying and will use that as a measure of purchasing behavior. Irrespective of the measure of purchasing behavior used, it is crucial to compare, contrast, and analyze the purchasing behavior against the profitability of the customer. Such analyses would result in a framework that could be used to make informed marketing decisions and interventions. This framework can be used to recognize a very strong purchasing behavior, as represented in Cell 1, or to initiate corrective actions to increase the purchasing behavior of customers in Cell 2 (such as sending promotions to encourage cross-buying, or increasing the profitability of customers in Cell 4). Cell 3 represents either new customers or customers with low revenue potential. The new customers could be induced to spend more with the firm by being offered upfront incentives; these customers should be monitored before investing further in them. Customers with low revenue potential should be managed through low-cost marketing channels, such as email promotions, web-based customer service, and so on.

Cultivating Attitudinal Loyalty

The importance of attitudinal loyalty was discussed in the previous sections, and concerns about the attitudinal loyalty of customers should play an integral part when designing a loyalty program. Firms should be able to understand the customer's attitude toward the firm and should be able to measure customer attitudes in a meaningful way. Aspects about customer attitudes can be measured by conducting surveys at the customer level. Other measures, such as customer feedback and focus groups, can also be used. Managers should consider the fact that information from surveys reflects one particular set of customers in the given timeframe. Hence, surveys conducted at various timeframes across various customer segments can be used to compile a comprehensive picture of customer attitudes.

Attitudinal loyalty has to be "cultivated," and this should involve going above and beyond the standard marketing interventions generally used by firms. Attitudinal loyalty may often result in a long and fruitful relationship between the firm and the customer. Just as firms use behavioral loyalty to ensure profitability, attitudinal loyalty can be used to build an invisible exit barrier for their customers. This is particularly significant in noncontractual settings, where switching costs are low.[7] To design an effective approach to cultivate attitudinal loyalty, firms need to know their customers well (and beyond just the information present in the customer's purchasing history). Detailed customer profile information that contains data about customer heterogeneity and other demographic information should be used to predict the future profitability of a customer.

Linking Loyalty to Profitability

Any marketing initiative should be aimed at maximizing the profitability of the firm. This also holds true for loyalty programs. Customer loyalty programs that have been implemented without an eye on the profitability aspect have led to disastrous results. One example is the ABC Card program introduced in 1995 by the UK-based grocery chain Safeway. This program was implemented without being linked to profitability, and this resulted in the operation and communication costs outweighing the benefits from the program. This led to the program being scrapped in 2000.[8]

One effective way to establish the link between loyalty and profitability while designing these loyalty programs is to use the CLV metric. As described in the previous chapters, CLV is a forward-looking metric that predicts the future profitability of the customer based on the current available data. By using CLV, firms can identify the customers who are most valuable and spend the limited marketing resources on them. Also, by understanding which customers are least profitable in the long run, firms can limit the marketing intervention in these cases. Further, strategies and the effective use of CLV are discussed in detail in the following chapters. In the following sections, strategies are proposed that can be used to define the customer loyalty framework.

Operationalizing the Framework

A two-tier rewards strategy is proposed to effectively operationalize the framework. The two tiers are classified based on the desired results and the level of differentiation. Challenges involved in implementing this strategy include the following:

- The ability to discriminate customers based on their purchasing behavior, attitude, profile, and profitability potential, without alienating the customers
- The ability to build and sustain loyalty without sacrificing customer profitability

The detailed exploration of the two-tier strategy follows:

Tier 1 Rewards

Tier 1 rewards are aimed at achieving the following strategic objectives:

- **A baseline rewards approach.** Reward all customers based on their current and past purchasing behavior irrespective of their attitude or their purchasing pattern. Implementing such a simple, explicit, and fair baseline reward system ensures that all customers are aware of the rewards program. This also ensures that new customers with no previous transaction history with the firm are aware of the rewards program and receive Tier 1 rewards.

- **Collecting customer transaction data.** Tier 1 programs also serve as a way to collect transaction data about the customers. Most loyalty programs use loyalty cards with magnetic strips to record transaction data, and the customers are generally rewarded for using these cards by discount offers and so on. The presence of a Tier 1 rewards program also offers customers the incentive to record their transactions during every purchasing occasion, the data from which can be used to accurately analyze and understand the purchasing behavior.
- **Ensuring scalability of the loyalty programs.** The reward programs should be scalable and attempt to reward customers in proportion to their spending. In other words, the more the customer spends with the firm, the more reward he/she gets.

Based on these objectives, you can see that Tier 1 represents a standard, unidimensional rewards strategy, where customers get instant gratification, because they are rewarded based on their total spending. Tier 1 programs should be administered at the aggregate level to build loyalty across all customers, as shown in Figure 6.2. The terms of earning and redeeming the rewards/points would be the same for all customers and should be clearly stated in the policy documents. Because of this, Tier 1 programs are easy to duplicate by the competition. And, note that the majority of the loyalty programs offered today fall under this category; they mostly reward behavioral loyalty of the customers at the aggregate level.

Tier 2 Rewards

Unlike Tier 1 programs, Tier 2 rewards are forward-looking. They seek to influence the customer attitude and behavior in the future based on the past performance of the customer. Tier 2 rewards are more selective and reward specific customers to cultivate their behavioral loyalty and enhance behavioral and attitudinal loyalty. In Tier 2 programs, firms can decide the following:

- Who should be rewarded?
- What type of reward should be given?
- How much should the reward be worth?

All customers are eligible for Tier 1 rewards, but this pool of customers are further probed on four critical parameters—behavioral analyses, attitudinal analyses, customer profile information, and CLV score—to decide who should receive Tier 2 rewards. The specific objective to be fulfilled by the Tier 2 reward is dictated by the outcomes of the behavioral and the attitudinal analyses. For example, if Luke is a customer who has performed well in the attitudinal analyses and the profitability aspect but is lacking in the purchasing behavior dimension such as cross-buy, the main aim of the Tier 2 rewards would be to encourage Luke to cross-buy among product categories. Also, high-profit customers are rewarded bonus points based on their level of profitability. When instituting Tier 2 rewards, a customer's cumulative status should also be considered. For example, if a customer has a history of profitable purchasing behavior with the firm and returns to the firm after a dormant period, the customer's previous purchase history should be taken into account. This customer should be accommodated in a higher-level rewards program, and it should be made much easier for him to achieve his previous loyalty status.

After this decision to reward has been made, the next question is this: What is the best way to approach Luke with a promotion/offer, in which product category, and what should be the ceiling on the spending on this promotion? In other words, what should be the "type" and "value" of the reward? To answer these questions, the customer profile information and the CLV score of the customer can be used. The customer profile information gives information about which product category Luke is most likely to buy from. (This can be decided based on his age group and on other demographic information.) After the "type" of reward has been decided, the CLV score can be used to decide the total value of the reward. The spending of the promotion should not be greater than the expected future spending of the customer, and care should be taken that such marketing efforts have a positive return on investment for every customer. A forward-looking metric such as CLV can be used to determine this, and thus help in managing both the loyalty and the profitability at the same time. In evaluating a customer's value, the CLV metric takes into account all cost and revenue components of the customer, including the value of the previously awarded Tier 1 rewards. Hence, CLV helps in setting a ceiling for the total dollar amount to be spent on a particular customer.

Characteristics of Tier 2 Rewards

Unlike Tier 1 rewards, Tier 2 rewards are highly differentiated rewards, awarded to selective customers with the goal of sustaining their loyalty. Because Tier 2 rewards are not explicitly divulged to the customers (the program is executed by the firm on a customer-to-customer basis), it is very difficult for the competition to replicate these programs, giving the loyalty program a sustainable competitive advantage. Under this framework, both Tier 1 and Tier 2 rewards are represented in tandem, and they mostly have complementary effects. Tier 2 rewards are designed over and beyond the Tier 1 rewards and are used to further specific goals that are not met with the Tier 1 programs. If used effectively, Tier 1 and Tier 2 programs, implemented concurrently, could yield significant flexibility to any loyalty program.

Evolution of Loyalty Programs

As discussed previously, loyalty programs try to build and sustain profitable loyalty. Also, a framework was introduced that can be used to proactively reward customers *today* for their *future* spending. Advances in database management techniques have made it possible for firms to collect and maintain extensive information about customers. This can be used to design customer-centric loyalty programs, instead of the conventionally used program-centric approach. These steps can be used to reevaluate the various reward mechanisms, options, and schemes to formulate new approaches to create and sustain a profitable customer loyalty program. This new approach to customer loyalty programs is characterized by personalization and customization at the individual customer level. Table 6.1 summarizes the changes in customer loyalty programs that show a discernible evolving dominant logic. The description of the various dimensions are provided here:

- **Operational level.** With the introduction of advanced database management systems, loyalty programs are increasingly implemented at the individual customer level as opposed to the “aggregate” level. Loyalty cards and other methods (frequent-flyer numbers, customer IDs, and so on) are used to collect information and represent loyalty programs at the individual customer level.

- **Program type.** Conventionally, customers are rewarded based on the total amount spent, irrespective of their level of profitability. For example, a customer who buys a discount airline ticket will get the same bonus miles as the customer who buys the ticket at its full price. Whereas, according to the evolving dominant logic, customers will be rewarded based on the profitability aspect, not just on the total amount spent, and based on this approach, the customer who buys the airline ticket at full price will be rewarded at a higher level when compared to those buying at a discounted price.
- **Reward schemes.** Instead of just giving a standard reward to all customers, firms should personalize rewards to influence specific behavioral or attitudinal changes. This could be achieved by rewarding customers based on their customer profile information, their personal interests, and their purchasing behavior.
- **Reward options.** When implementing loyalty programs, customer heterogeneity should be taken into account. Because different customers perceive different value for the same reward, multiple reward options could be offered to accommodate different customer needs. This could be achieved by striking partnerships with other firms and including their products/services in the reward basket. This could enable the firm to offer rewards that are not part of its product profile and satisfy different customer needs at the same time.
- **Reward mechanisms.** Traditionally, loyalty programs were confined to rewarding customers just based on their past and current spending levels. This reactive reward mechanism is similar to the Tier 1 level rewards. In contrast, the evolving loyalty programs attempt to proactively reward customers to influence future purchasing behavior and motivate higher and sustained spending levels.
- **Reward types.** Companies should look beyond just offering tangible rewards and include intangible and experiential rewards for their customers, in addition to the traditional rewards. This is done to influence the attitudinal aspects of customer behavior that might not be covered by the traditional tangible rewards.
- **Program objectives.** Traditionally, loyalty programs sought to increase revenue and build market share. But these efforts might not result in a proportional increase in profitability. Also, the traditional

programs were tuned to influence behavioral loyalty alone and were implemented at the aggregate level. In contrast, the evolving loyalty programs have shifted to accommodate the multiple goals of linking loyalty to profitability and cultivating attitudinal loyalty. Also, firms try to influence certain aspects of customer behavior by using the customer behavior data.

- **Metrics used.** As highlighted in previous sections, one of the crucial aspects of the new dominant logic is to have a forward-looking approach and to reward customers proactively to influence their future purchasing behavior. A forward-looking metric such as CLV enables managers to implement such loyalty programs in an efficient manner. The CLV metric, apart from taking into account the profitability of the customer, also helps in allocating marketing expenditure to maximize profit.
- **Technology and analytics usage.** With the advancement in database and information technologies, obtaining and maintaining customer information has become much easier for firms. And technology is poised to play an important role in the future evolution of loyalty programs. With the arrival of cutting-edge technological tools such as radio-frequency ID (RFID) and smart cards, the accuracy and efficiency of obtaining customer-related information is poised to increase tremendously.

Table 6.1. Changes in Customer Loyalty Programs

Source: V. Kumar and D. Shah, "Building and Sustaining Profitable Customer Loyalty for the 21st Century," *Journal of Retailing* 80(4) 2004: 326.

Number	Dimension	Earlier Loyalty Programs: Program-Centric	Evolving Loyalty Programs: Customer-Centric
1	Operational level	Aggregate level	Customer level
2	Program type	Standardized, based on usage or spend	Customized, based on type of usage or type of spend
3	Reward scheme	Standard and uniform, aimed at repeat purchase	Personalized and relevant, aimed at influencing specific behavioral change or attitudinal gratification
4	Reward options	Minimal	Multiple (usually made possible through partners and alliances)
5	Reward mechanisms	Reactive	Reactive + proactive
6	Reward types	Tangible	Tangible + experiential
7	Program objectives	Build market share, increase revenue, build behavioral loyalty through repeat purchase or usage	Link loyalty to profitability, influence behavioral loyalty, and cultivate attitudinal loyalty
8	Metrics used	Recency-Frequency-Monetary value (RFM), Past Customer Value (PCV), Share of Wallet (SOW)	Customer Lifetime Value (CLV)
9	Technology and analytics usage	Minimal	Extensive

Conclusion

Establishing customer loyalty through loyalty programs and other means is very important for firms because it serves as a means to build relationships with their customers. A fresh approach should be taken when designing and implementing loyalty programs. Programs should be designed to maximize both the behavioral and attitudinal loyalty of customers. Customer segmentation can be used as a powerful tool to implement efficient, well-directed marketing efforts. The framework proposed in this chapter can be used to guide the marketing initiatives that seek to maximize both loyalty and profitability simultaneously. Tier 1 rewards are a great tool to establish customer loyalty across all customers, and Tier 2 programs can be used to sustain loyalty among the more profitable customers. When used judiciously, these tools can yield spectacular results, maximizing profit and ensuring sustained growth of the firm.

7. Optimal Allocation of Resources across Marketing and Communication Strategies

Relevant Issues

- Is investing on customers who are easy to acquire a sound strategy?
- Is trying to retain all customers a profitable customer management strategy?
- How do we tailor marketing strategies that accommodate the responsiveness of customers toward different marketing channels?
- How do we optimally allocate marketing and communication resources to maximize Customer Lifetime Value?

Often, managers function under a limited marketing budget and have to make decisions as to where, how, and on whom they are going to spend those resources. Given these limitations, contacting all customers is logistically impossible. Therefore, managers must prioritize their customers and contact only high-priority customers with their product promotions and offers. Several measures are used to prioritize the customers, and managers often fall into the trap of using misleading measures to make such decisions. Mostly, managers target customers who are easy to acquire and retain without considering how profitable these customers are. This is a seriously flawed approach because it could lead to firms using their limited marketing budget to chase unprofitable or low-profit customers while neglecting and ignoring high-profit customers. In a recent study involving a catalog retailer, it was observed that when customers were segmented according to their cost of acquisition and retention, the largest segment (32%) of customers, those who were easy to acquire and retain, accounted for only 20% of the total profit.[1] In contrast, the largest share of profit (40%) came from the smallest group of customers (15%), those who were expensive to acquire but cheap to retain.

As such studies reinforce, a prudent marketing strategy will evaluate customers based on their profitability, not on how easy it is to acquire and retain them. The optimal allocation strategy described in this chapter evaluates customers based on their future profitability and recommends appropriate marketing initiatives. Customers are chosen based on their Customer Lifetime Value (CLV) and future profitability. After the decision as to whom to contact has been made, the next question to be answered is this: How responsive are these customers to various channels of contact (email, telephone, direct mail, and so on), and what is the right mix of these channels?

Before answering these questions, consider this scenario: A customer walks into a toy store to buy a gift for his young niece's birthday, and while purchasing he gives his contact information to the sales clerk. In the next few months, the customer will be inundated with toy catalogs and promotions. How relevant or efficient is this marketing move, and what effect will this have on the customer? This is a classic case of "overcontacting," in which firms (retail, catalog-based sellers, and so on) send a flood of mostly unwanted information to existing customers without ever analyzing what the customer wants, and without realizing what effect this behavior has on the customer's future purchasing behavior. Actually, such an approach of sending promotional material unrelentingly and at high frequency has been found to alienate existing customers and force them to terminate their relationship with the firm.[2]

Another problem faced by firms when deciding on a marketing strategy is when to stop chasing customers. As discussed in the preceding chapter, some customers are profitable only in the short term and cease to buy from the firm after a few transactions (butterflies). If the firms keep investing in sending promotional material to these customers, it could severely drain the firm's limited marketing resources. In the example cited previously, if the customer who buys a toy for his niece is a butterfly, the firm needs to determine when to stop sending promotional material.

When the firm determines that a customer is likely to be profitable in the future, and in turn decides to contact that customer, the firm must next decide on the most appropriate mode of communication. Should it contact the customer through email, make a promotional telephone call, or should a sales representative contact the customer? If a mix of communication strategies is used, how does the firm extract the most out of every communication effort made by the firm? What is the sensitivity of each customer to these communication efforts?

These are some common issues faced by firms when implementing marketing initiatives. This question of how to optimally allocate the limited marketing resources and generate the greatest impact or maximum "bang for the buck" spent is addressed in this chapter.

Communication Channels

To simplify the approach of optimally allocating resources, the channels of communication used for marketing purposes can be classified into the following modes:

- **Rich modes.** Including face-to-face meetings, trade event meetings, and telephone calls. These modes can be 50 to 100 times or more expensive than standardized modes. Also, communication via these modes may seem like more personal service.
- **Standardized modes.** Including direct mail and email contacts.

Why do we split them into two modes of communication?

- Cost (both in dollar terms and in human capital resources)
- Personalization (speaking with a person versus impersonal communication)

Each of these two modes of communication has significantly different costs associated with it, and different customers have different levels of responsiveness. These factors will dictate the modes of communication managers choose and the frequency of communication.

Type and Frequency of Communication

Rich modes are associated with high costs, and they have to be used sparingly and when the situation warrants it. Rich modes are preferred when there is a high level of uncertainty in the relationship with the customer. Also, rich modes can be very useful in converting transactional customers to relational customers (as discussed in Chapter 2,

"Maximizing Profitability"). Standardized modes are the most cost-efficient channels of individual-level communication with the customers. They can be used to identify customers who are interested in the current promotions initiated by the organization. For transactional customers, standardized modes can be used in conjunction with the rich modes to improve the effectiveness of marketing initiatives. For example, direct mail (standardized) can be used along with telephone sales (rich mode) to improve the return on investment. In the case of relational customers, standardized modes can be used to maintain commitment and trust by regularly communicating the relationship benefits to these customers.

The Risk of Overcommunicating

Even though the rich and standardized modes are very effective in communicating with potential and current customers, managers should be careful not to overdo it. It has been shown that overcommunicating with customers can cause a relationship to be dysfunctional. For example, bombarding customers with catalogs and other promotions will lead customers to ignore any further communication from the company and might even lead to a deterioration of the relationship. Also, with regard to using rich modes of communication, it has been shown[3] that the marginal response to a higher level of communication isn't always higher and in some cases could even be negative.

Each additional marketing communication yields only diminishing returns, and even if the customer's relationship with the firm is not deteriorating, managers can achieve a better return on investment (ROI) on their marketing expenditure by investing more wisely across customers. Based on these observations, it can be said that there is an optimal frequency of communicating using the various channels of communication. Too much or too little communication is not effective. Initially, as the number of marketing interventions made by the company increases, the customer's purchase frequency also increases, and it maximizes at a particular point. And, any further communication or marketing investment on that customer will only result in a reduction in the purchasing frequency. Therefore, companies should find this optimal level of communication for each customer and design their promotions accordingly, to maximize profit.

Inter-Contact Time

The inter-contact time between the suppliers and buyers should be maintained at an optimal level. Contact with customers at regular yet sufficiently spaced intervals will help to maintain relationships. But too much communication could harm relationships. Also, the marginal utility of contacting the customer in a short period is low. If too much time elapses between two communications, customers may forget about the company. If too many efforts are made to contact customers in a short period, the customer may ignore any promotions from the company. Once again, companies should find the optimal inter-contact time and contact customers when necessary. The best approach is to evaluate when customers are most likely to buy based on past purchasing behavior and send communications through the appropriate channel to induce them to purchase.

Bidirectional Communication

Bidirectional communication is an important measure of customer involvement. This shows that the customer is willing to maintain relations with the company and that the customer is comfortable using the various channels of communication. It has been shown[4] that higher bidirectional communication is associated with channel structures that are highly relational. In the business-to-consumer (B2C) setting, customer-initiated contacts are predominantly associated with complaints. This is not the case in a business-to-business (B2B) setting, where customers can initiate contact with the suppliers for various reasons:

- If they have new needs that the supplier might be in a position to provide
- If they need the supplier's assistance to conduct training programs
- If the customer is invited to participate in product development sessions

Predominantly, bidirectional communication strengthens the relationship between the customer and the company, increases customer involvement, and increases the interdependence between the customer and the company. These factors indicate that the higher the level of bidirectional communication, the higher the customer's predicted purchase frequency.

Frequency of Web-Based Contacts

Companies need to pay special attention to web-based contacts because they are initiated by customers and show a high degree of customer involvement. There are various advantages to tracking web-based contacts:

- Web-based contacts are the most cost-efficient mode of communication.
- Web-based contacts provide companies with an idea about the customer's relationship orientation.

It has been shown that[5] organizations motivated to improve their transaction efficiency actively participate in web-based initiatives. Therefore, it is clear that the higher the number of web-based contacts from a customer, the higher the customer's predicted purchase frequency.

The Need for an Optimal Allocation Strategy

As you can understand already from this chapter, a company's contact strategy and the frequency and modes of communication significantly affect the customer's predicted purchase frequency. Traditional marketing methods of just inundating customers with product promotions and catalogs will not only prove a drain on the company's limited marketing resources but will also lead to customer alienation. Different channels of communication have different costs associated with them and have to be used at the optimal frequency and time intervals to maximize a customer's purchase frequency.

Resource-Allocation Strategy and CLV Maximization

In the previous chapters, the use of CLV to select the right customers and to manage loyalty and profitability simultaneously was discussed. A forward-looking metric such as CLV can be used to effectively allocate marketing resources to maximize profit. This framework also provides managers a guideline to evaluate the return on marketing investments; they can identify the optimal channels and frequency of communication for each customer to maximize CLV. A detailed resource-allocation guideline can be generated by following this framework: the number of contacts to be made through each communication channel and the frequency and inter-contact time that should be followed for each customer to maximize his/her CLV. The following factors influence resource-allocation decisions:

- Cost involved in communicating through a particular channel
- Customer's response when contacted through a particular channel
- Frequency of communication
- Customer contact levels across different channels
- Expected profit level from each customer

All these factors are balanced and optimized to generate a comprehensive resource-allocation strategy that can be used to maximize the CLV of a customer.

By linking all resource-allocation decisions to the CLV of the customer, managers can be well prepared for projected transitions and changes in the customer purchasing behavior. For example, a customer's/supplier's transition through the various stages of the life cycle (exploration, evaluation, maturity, and decline) can be accommodated by evaluating their CLV; in turn, this will help to optimize resource allocation.

To illustrate how resource optimization is operationalized using the CLV model presented in Chapter 3, "Customer Selection Metrics," we need to focus on the marketing cost part of the model. The original CLV equation is as follows:

Equation 7.1.

$$CLV_{it} = \sum_{t=1}^{T_i} \frac{GC_{i,t}}{(1+r)^{t/frequency_i}} - \sum_{l=1}^{n} \frac{\sum_m MC_{i,m,l}}{(1+r)^l}$$

The second half of the equation represents the marketing cost to the firm, where $MC_{i,m,l} = c_{i,m,l}$ (unit marketing cost) * $x_{i,m,l}$ (number of contacts). For example, if a firm wants to optimize its marketing contact strategy to maximize profits from each customer, it has to consider how many contact channels (m) it has and how many times it wants to contact each customer in each channel (x_m).

Suppose a firm has two contact channels: email and direct mail. Each customer will likely respond differently to different types and amounts of communication. For example, one customer might be most responsive if contacted three times through email and one time through direct mail. However, another customer might be most responsive if contacted one time via email and five times through direct mail. To determine the optimal contact strategy from this model, you have to follow these steps:

1. Calculate each customer's CLV based on the technique described in Chapter 3.
2. When you understand the relationships (coefficients) that affect the customer's frequency of purchase and gross contribution margin per purchase, you can fix the weights (coefficients) of the CLV objective function and optimize the number of contacts in each channel to maximize each customer's CLV.

The problem with the optimization is that it is complex due to the fact that each of the models is potentially nonlinear in nature. However, there are methods such as genetic algorithms that can determine the optimal marketing contacts per channel per customer.[6]

A practical demonstration of how the resource-allocation strategy can be practiced is provided here. Figure 7.1 shows a schematic representation of the recommended approach.

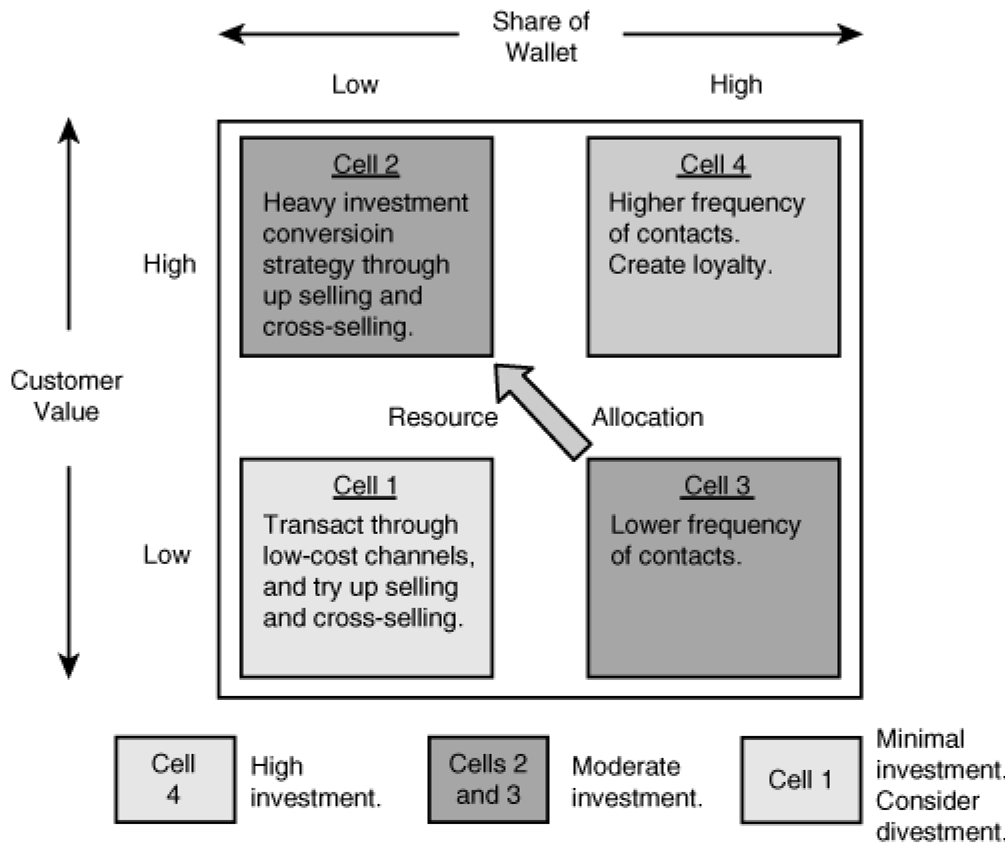


Figure 7.1. Optimal resource-allocation strategy

Here, the customers are segmented based on their Share of Wallet (SOW) and their value to the firm, and appropriate strategies are recommended to manage different types of customers. SOW by itself is not an effective metric to measure and manage customer loyalty and profitability. But by using SOW and CLV to categorize customers, several of these shortcomings can be overcome. For instance, SOW takes into account only the *share* of the customer's wallet, not the *size* of the wallet. Also, it only considers historical spending by the customers in calculating their value to the firm. By combining it with CLV, however, firms can effectively categorize customers based on their loyalty and profitability, and thus an effective resource-allocation strategy can be formulated. Also, by using CLV (which includes the future spending potential of customers), managers can ensure a higher return on their marketing investments.

In the matrix in Figure 7.1, customers in Cell 1 have a low SOW and a low customer value. They are of little value to the firm, and managers should refrain from investing in these customers to avoid loss. Customers in Cell

2 have a high customer value and a low SOW. Firms should adopt a conversion strategy in this case, and should invest in upgrading and cross-selling products to these customers. Customers in Cell 3 have a very high SOW but exhibit low customer value. Firms should shift resources from Cell 3 to Cell 2 with the goal of increasing the SOW of the customers in Cell 2. Customers in Cell 4 have a high SOW and a high customer value. They should be the main targets for customer loyalty programs, and firms should heavily invest in these customers to maintain their loyalty and maximize the profitability.

Optimal Resource Allocation: A Case Study

This optimal resource-allocation strategy was applied to a B2B technology firm, and the results demonstrate the efficacy of this strategy. Traditionally, the customers were categorized based on their SOW. To implement the optimal allocation strategy, a CLV-based framework was used, and customers were further classified based on their CLV. Hence, the customers in the B2B firm were segmented into four sections based on their SOW and CLV (as shown in Figure 7.1). For each segment, detailed recommendations were made as to the optimal use of face-to-face meetings, direct-mail contacts, telesales, and so on. Figure 7.2 summarizes the results of these recommendations; the original level of profitability and marketing spending of each segment is given along with the results generated by switching to an optimal allocation strategy, as recommended in this book.

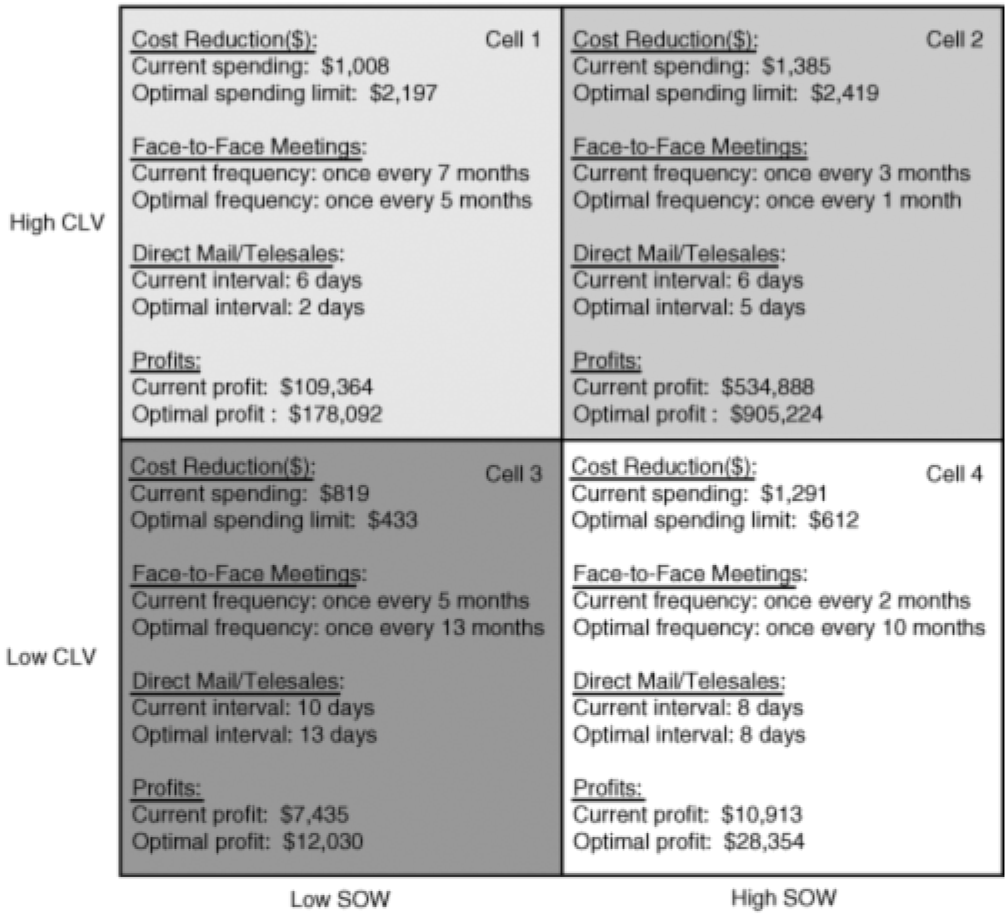


Figure 7.2. Optimal resource-allocation strategy for a B2B technology firm

As you can see from the results, the B2B firm was consistently overspending on the low-CLV customers (Cell 3 and 4 in Figure 7.2). This is a classic example of how firms pursue low-value customers and spend their valuable marketing resources on them. Particularly, the firm was using the expensive face-to-face channel of contact frequently, thus increasing the marketing spending dramatically. (This approach could be justified if they are high-CLV customers.) By adopting a CLV-based approach, the firm reduced spending by half, while increasing profits by more than 200% for these customers. Specifically, the face-to-face contacts for customers in Cell 3 were reduced to once in 13 months rather than once in 5 months (the original frequency), and a similar measure was adopted for customers in Cell 4.

The firm was consistently underspending on the high-CLV customers (as represented in Cells 1 and 2 in Figure 7.2). This prevented the firm from fully exploiting the profit potential of these high-CLV customers. Based on the firm’s new CLV-based approach, it decided to implement a comprehensive strategy that involved almost doubling the marketing spending on these customers by contacting them more frequently (both using face-to-face contacts and direct mail/telesales). These measures unlocked the true potential of these high-value customers and resulted in a tremendous increase in profit from them.

By implementing this CLV-based strategy of reallocating the marketing resources, the firm generated 100% more revenue. Total profit increased by 70% by adopting optimal frequencies for face-to-face meetings and direct mail/telesales in all four cells. As you can see, by carefully monitoring the purchasing frequency of customers, the inter-purchase time, and the contribution toward profit, managers can determine the frequency of marketing initiatives to maximize CLV.

Conclusion

This optimal allocation strategy provides a comprehensive CLV-based framework to design an effective marketing strategy. This strategy suggests which customers to acquire and retain based on their predicted CLV. Detailed recommendations are made as to how to use the different channels of communication based on how responsive each customer is to these channels. And an optimal level of communication across the right mix of channels is recommended to achieve maximum profitability. As demonstrated in the case study involving a B2B firm, firms can increase profitability significantly by adopting an optimal resource-allocation strategy (as discussed further in Chapter 12, “Acquiring Profitable Customers”).

8. Pitching the Right Product to the Right Customer at the Right Time

Relevant Issues

- How does understanding the purchase sequence of products/services of individual customers help firms structure their marketing strategies?
- What is the next product/service that a customer is likely to buy?
- When is the customer more likely to make the next purchase?

Previous chapters in this book have stressed the need for firms to collect and maintain extensive customer buying behavior databases. These databases can be used to track the purchasing behavior of customers—that is, when and what each customer purchases. When this information is available, the next step is to predict the future purchasing behavior of each customer. Predicting customer behavior is a crucial step in designing an effective marketing strategy. These predictions enable managers to not only target the customers who are most likely to make a purchase, but also to pitch the right product. Making the right marketing decision will help managers avoid those customers who are unlikely to follow through and enable them to spend their limited marketing resources on customers who are most likely to purchase something. Also, the predictions help firms avoid alienating customers by inundating them with unwanted or inappropriate promotions and offers. The benefits derived by reducing the mailing and other marketing costs more than compensate for the cost of customizing the promotions sent out, thus ensuring a higher return on investment (ROI) from the marketing budget.

The preceding chapter outlined several strategies that firms can use to optimally allocate resources across various communication channels. After the channel mix and the frequency of communication have been decided upon, the next step is to figure out what message is to be delivered by understanding what the customer is most likely to buy and when.

What Companies Have Been Doing

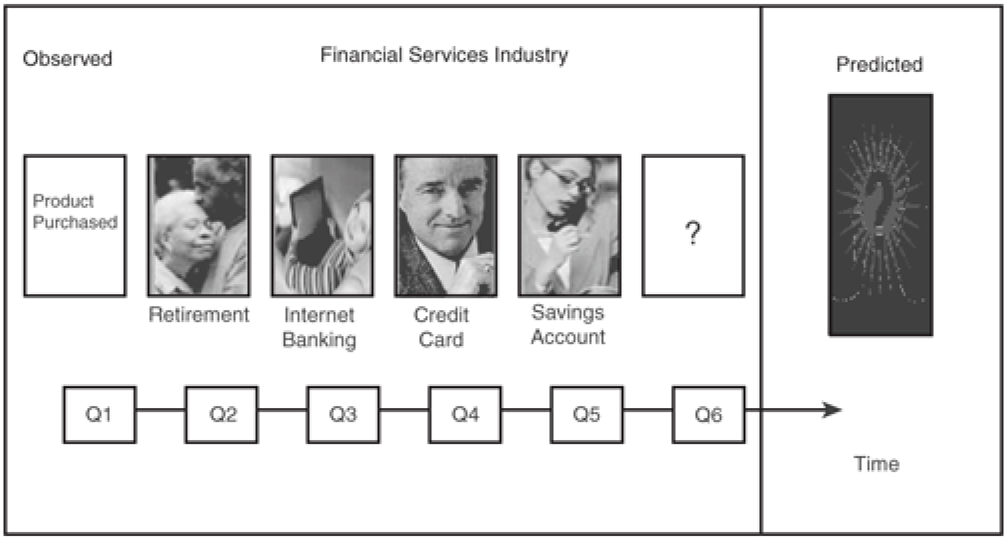
Companies have been using various strategies to contact customers with their messages and product promotions. One of the most common strategies is mass marketing to all their customers without discrimination. This strategy, apart from draining the company's marketing resources, could also lead to customer alienation. The second strategy followed is to use choice models at the product level; that is, firms find out which product a customer is going to buy next and pitch those products. The disadvantage of this method is that the company could be pitching the right product, but the timing of the message might be completely off track, and therefore have no effect on the customer. The third method used by companies is to use timing models at the product level. In this case, managers know when the customer is going to make a purchase and pitch all the relevant offers at that predicted purchase time. The limitation of this strategy is that customers will receive a lot of special offers to buy products, which might turn them off (and thus again minimize the effect of the marketing message). *The most effective strategy is to predict what product a customer is going to buy and when and approach him with a customized offer or promotion for all the products/services he is likely to buy.*

Various approaches have been suggested to effectively solve this problem. One method that has been used is to build a *timing model* for each product offered by the company and make a prediction as to when the customer is likely to purchase that particular product.[1] By adopting this method, firms can minimize poorly targeted cross-selling initiatives and predict the customer's next purchase choice. Another method to implement a *cross-selling strategy* in a financial services firm was recently suggested.[2] This study used an advanced model to study how customer demand for multiple products evolves over time and how it affects the purchasing patterns and its applications in a financial services firm.[3] However, the method suggested in this chapter is more efficient and flexible in predicting customer behavior and takes into account the context of product offerings, such as the nature of the industry, frequency of purchase, and so on. In this methodology, the timing of a customer's next purchase is predicted first, and given this information, the product most likely to be purchased by the customer is identified. This method allows managers to more accurately predict customer behavior and pitch the right products to the right customers at the right time. The following sections discuss this strategy in detail.

The Question of "What Next?"

All businesses face the dilemma of predicting what their customers will purchase next. Consider the example of a financial services firm that offers a range of services ranging from banking to credit card services to retirement planning and mortgages. If a customer opens a savings and checking account with the firm in the first quarter, can the firm predict the services the customer might need in the following quarters? Will the customer need a mortgage, or should the bank approach him with a credit card offer? Or, does the customer need a retirement plan? Figure 8.1 illustrates this problem. If the firm can predict this, it can customize its message and offer the customer products/services needed and increase its sales. Even though making this prediction seems like a tough call, it is possible to make a reasonable prediction based on the purchasing history of customers who have similar financial profiles and based on other demographic factors. The following sections discuss in detail how to approach this problem.

Figure 8.1. Predicting what products/services the customer will buy next



The Accuracy of Current Predictions

Even with extensive information about customer purchasing behavior, companies do a poor job of predicting future customer behavior. A recent study of the purchasing behavior of thousands of customers from two large companies found that predictions about when a customer will buy a particular product were accurate only about 60% of the time (only marginally better than predicting the result of a coin toss).[4] This does not mean that more accurate predictions are not possible. More robust methods are needed to make these predictions, and this chapter identifies those methods and how you can use them to design effective, precisely targeted marketing campaigns that yield great results that help to maximize profit.

Where Companies Falter

To predict customer buying behavior, companies generally follow a two-step approach:

1. Estimate the probability that a customer will choose to purchase a particular product.
2. Estimate the probability that a customer will make a purchase at a particular time.

Many firms stop at the first step, and thereby limit their ability to accurately predict the timing of purchases. However, even those companies that follow the process through might not be successful. In a multiproduct firm, it is not easy to accurately predict what product a particular customer is going to buy next. But, from the firm's point of view, this is a valuable piece of information; firms want this information because it can enable them to tailor their message and timing (that is, customize their communication strategy).

Another problem with this traditional approach is that companies assume that the timing of purchase and the product purchased are independent of each other. Often, this is not the case. A customer's decision to buy a particular product influences the timing of the purchase and vice versa. By assuming these two decisions are independent, firms end up with misleading predictions.

Too Small Samples

As mentioned previously, when predicting customer behavior, the timing of the purchase and the product to be purchased must be forecasted. But, firms face a major hurdle, sampling error, for a couple of reasons:

- They rely on a relatively small sample size from which to make their predictions.
- They rely on the same sample of customers to predict the timing of a customer's purchase and the product category to be purchased (often because they have limited information about their customers and have to rely on that information from a small set of customers in their predictions).

To overcome this problem of sampling error, marketing research is turning to a technique called Bayesian estimation. This methodology has been around for more than two decades, but it is just recently becoming a mainstream choice in marketing research due to the constant increases in available computing power and improvements in software applications. Bayesian estimation overcomes this sampling error problem by iteratively calculating the most probable values for the customer behavior data instead of just trying to find a line of "best fit." By doing this, the accuracy of the customer analysis does not suffer by having a small sample size.

An Integrated Approach to Predicting Customer Behavior

In the model presented in this chapter, it is assumed that a customer's decision to buy a particular product is linked to the decision of when to buy it. The purchase sequence is predicted by analyzing the customer's purchasing history and estimating the likelihood of future purchases. This model involves two steps:

1. Estimate the probability that a customer will make a purchase at a particular time.
2. Estimate the probability of a customer purchasing a particular product at the predicted purchase time.

The probabilities in steps 1 and 2 are multiplied to arrive at the final probability. The final probability of a customer purchasing a particular product at a predicted time is then used to devise an ideal contact strategy, as is illustrated in Figure 8.2. To devise an ideal contact strategy, the firm must engage in purchase sequence analysis, as follows:

1. The "right" customer must first be chosen based on his/her Customer Lifetime Value (CLV).
2. After the right customer has been chosen, the firm must predict what product the customer will buy next.
3. Then the firm must predict when the customer is going to buy this product. With this information, the firm can send the promotion through the appropriate channel at the right time (an ideal contact strategy).

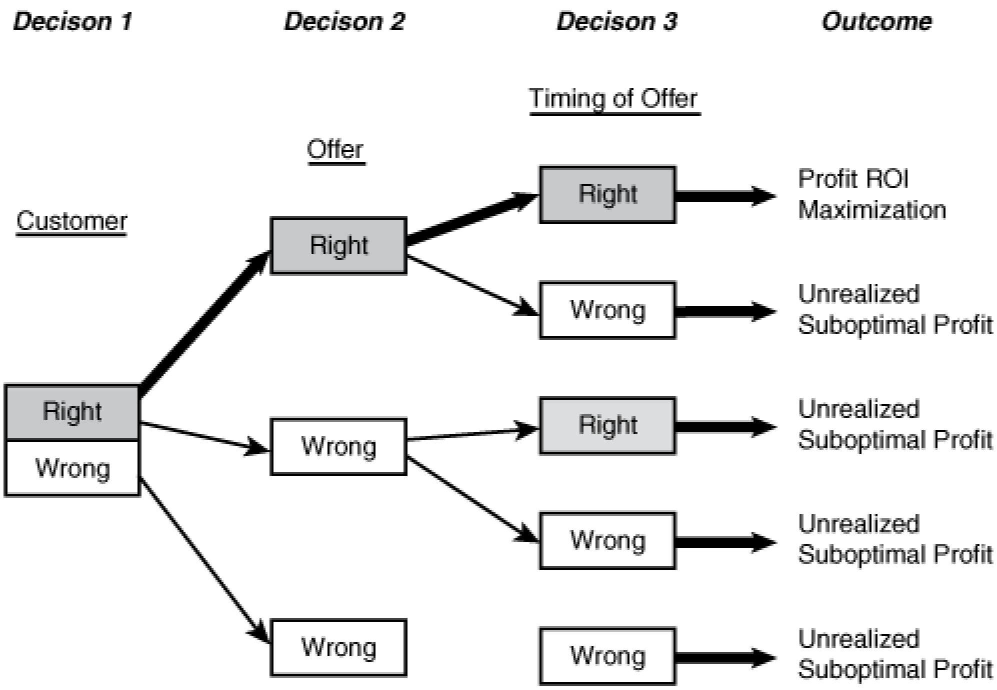


Figure 8.2. Purchase sequence analysis

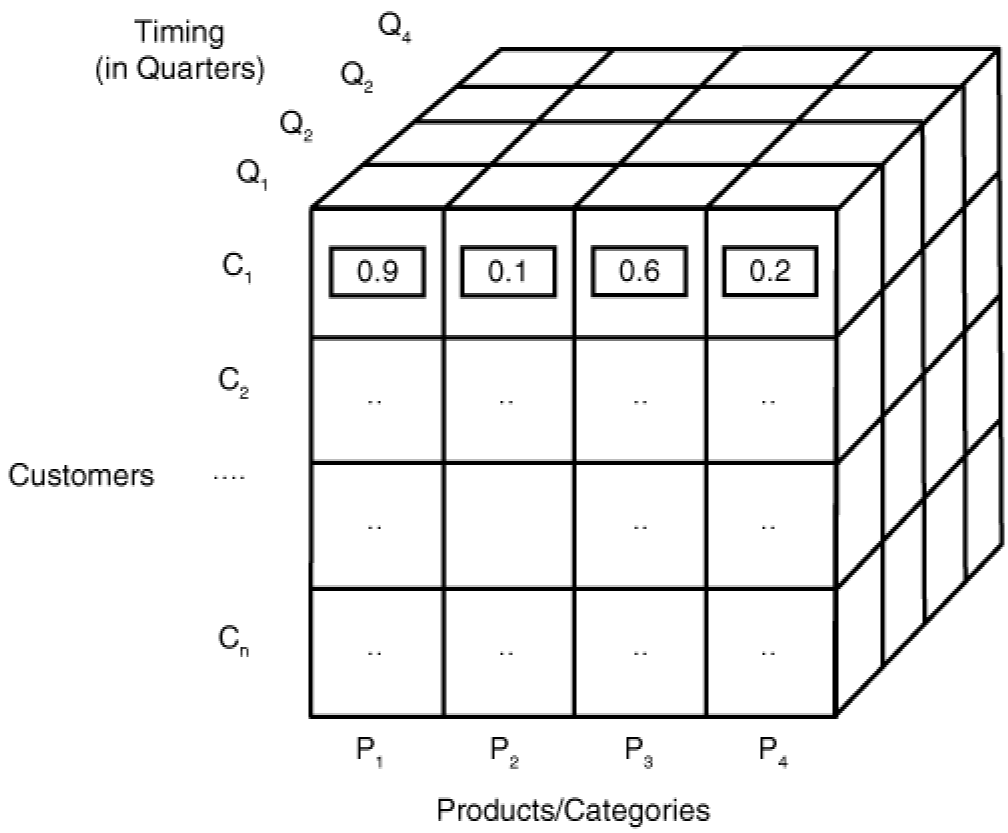
In other words, a customer's decisions of what products/services to buy and when can be modeled simultaneously.

Estimating the Likelihood of Purchase

To predict the likelihood that a customer will purchase a product during a given period of time, we need to use a likelihood function. The function estimates the likelihood (L_i) that the customer or household (i) will purchase in a given time period. To formulate the likelihood, the first step is to understand the two models at its foundations: a choice model and a timing model. The choice model predicts the probability that a customer will buy a given product. The timing model predicts the probability that a customer will buy a product at a particular time. By estimating the joint probability of the two models simultaneously, the firm can then determine *which* product a customer will buy *when.* The details of the likelihood estimation procedure can be accessed through www.drvkumar.com/mcp.

The Customer Probability Cube

As discussed previously in this chapter, to effectively design marketing initiatives, firms should know what a customer is going to buy and when. To predict this, a customer probability cube is generally used to predict the probabilities of purchase in three dimensions: customers, products, and time. The probability cube shown in Figure 8.3 is for a firm selling four products (P1 through P4), and the probability of the customers (C1 through Cn) buying these products across four quarters (Q1 through Q4) is given. From the numbered cells, you can see that there is a 90% chance that Customer 1 will buy Product 1 in the First Quarter, a 10% chance that he will buy Product 2, a 60% chance of him buying Product 3, and a 20% chance that he will buy Product 4. Firms can use this cube to approach the problem from the product/category side, too. Firms can use the predictions to see which customer is most likely to buy Product 1 in a given quarter and approach that customer with an appropriate message.



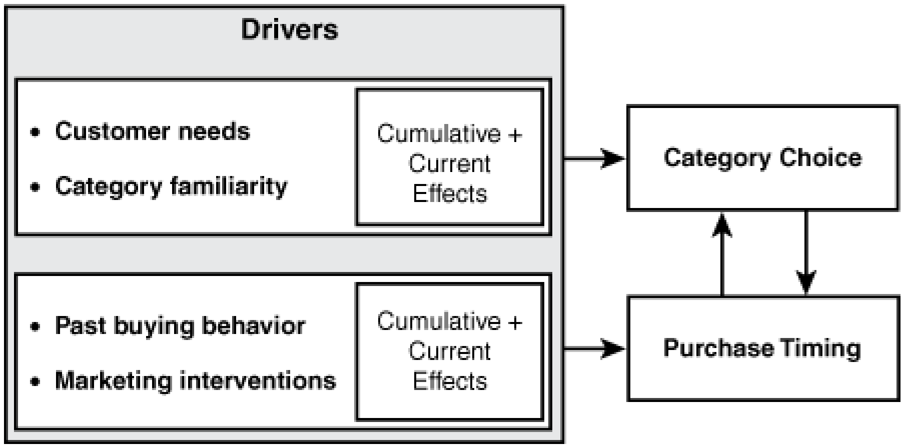
Source: V. Kumar, R. Venkatesan, and W. J. Reinartz, "Knowing What to Sell, When, and to Whom," *Harvard Business Review*, March 2006: 131–137. Printed with permission from the Harvard Business School Publishing.

Figure 8.3. The customer probability cube

Predicting the Next Product/Service: A B2B and B2C Case Study

To prove the merits of this model, we tested it against the marketing initiatives of a large multinational high-tech manufacturer. This firm serves businesses, and its product profile necessitated constant maintenance and frequent upgrades. From the firm's product mix, three different product categories were chosen for this study. Here is a summary of the case study:

- **Current marketing strategy.** Under the status quo marketing strategy, each product category had a dedicated sales force. Salespeople with that force actively pitched products from their respective categories when calling upon customers. Customers were ranked based on the probability of their purchase in that product category, and the timing of contact was left to the discretion of the salespeople. Therefore, a particular customer might be contacted multiple times by salespeople representing different product categories. This approach could lead to an inefficient mechanism whereby customers are contacted irrespective of when they might purchase something.
- **Testing the model.** From among a sample set of 434 business customers, half the customers were assigned to a control group where no changes were made; customers were catered to based on the firm's existing marketing strategy. The other customers were included in the test group and were catered to based on the predictions obtained from the joint-probability model shown previously. Based on this approach, in a given year, customers were contacted only in the quarter in which they were predicted to make a purchase, and by the salespeople from the relevant product category (see Figure 8.4). If a customer was expected to purchase across different product categories, coordinated sales calls were made. In other words, using the model to predict purchasing behavior involves answering the following questions simultaneously:
- Who is most likely to make a purchase in the next planning cycle?
- When is a given customer expected to make a purchase?
- From what product category is the customer likely to purchase?



Source: V. Kumar, R. Venkatesan, and W. J. Reinartz, "Does Marketing Improve Effectiveness and Efficiency of Sales Campaigns?: Experimental Evidence," 2007, Working Paper, University of Connecticut.

Figure 8.4. Conceptual model to predict customer behavior

- **Results of this case study.** Table 8.1 shows the results of this case study. The values represent the increase/decrease in the levels observed during the study. The values in parentheses represent the levels from the preceding year. The model was implemented in four successive quarters, and the results were compared to the results from the respective quarters the preceding year.

Table 8.1. Results from the B2B Case Study[*]

Source: V. Kumar, R. Venkatesan, and W. J. Reinartz, "Does Marketing Improve Effectiveness and Efficiency of Sales Campaigns?: Experimental Evidence," 2007, Working Paper, University of Connecticut.

	Test Group	Control Group
Revenue ($)	1,463 (12,085)	689 (11,740)
Cost of communication ($)	–1,457 (5,626)	50 (5,052)
Number of contacts before purchase	–3 (10)	1 (12)
Profits ($)	2,735 (6,644)	472 (6,429)
ROI	1.1 (1.1)	0.1 (1.2)

The results shown in Table 8.1 indicate that a significant increase in profit can be realized by predicting the purchasing behavior of customers based on this methodology.

As you can clearly see from Table 8.1, the joint-probability strategy results in a significant increase in ROI. The results show the following:

- There is a significant increase in the revenue for the test group, whereas no such increase was observed for the control group. This result indicates that the revenue increase was, in fact, due to implementing the joint-probability model.
- There was a significant decrease in the cost of communication for the test group, whereas there was no such reduction observed in the control group. Also, note that there was a significant drop in the number of contacts made by the salespeople for the test group.
- Hence, there is a significant increase in the overall profit and ROI from the customers in the test group. In contrast, no such effect was observed for the customers in the control group.

These results indicate that a significant increase in profit can be realized by predicting the purchasing behavior of customers based on this methodology. Also, the return on the marketing investments improves tremendously. This indicates that this strategy not only allows for effective utilization of marketing resources, but also cuts down on extra marketing expenditure by optimizing the timing of customer contacts; that is, the right customer is contacted at the right time.

How This Model Compares to Traditional Methods

The predictive capabilities of this model were tested in comparison to the traditional methods used to predict customer behavior in a large high-tech firm.[5] When compared to the traditional methods, our model was much more efficient in predicting customer purchasing behavior. These results underscore the effectiveness of our model, in which both the timing of purchase and product purchased are considered jointly. When a customer was predicted via our model to purchase a particular product, he did make a purchase in 85% of the cases. When a comparable prediction was made via the traditional model, the customer made a purchase only 55% of the time. In addition, when our model was used to predict customers who wouldn't make a purchase, 87% of the customers did not make a purchase. As you can see, companies can improve the accuracy of predicting customer behavior by more than 54% by using our model. This shows the effectiveness of the model in predicting customer behavior, a model that can be used to successfully design appropriate marketing strategies.

Increasing the Cross-Sell Ratio: Path to Profitability

One of the main strategies that firms selling multiple products need to adopt is to cross-sell across different product categories. There are several reasons for adopting this strategy. First, when customers are buying from different product categories from the same firm, their propensity to quit the firm is greatly reduced. For example, when a customer is buying telephone, cable, and Internet services from the same company, it becomes a lot more difficult for him to switch firms as compared to a customer who just uses one of the services. Also, the synergy generated by selling products from various categories to the customer strengthens the customer's relationship with the firm and increases profitability.

Firms typically have product portfolios across different product categories. By accurately predicting customer behavior and pitching the right product to the right customer at the right time, firms can increase the cross-sell ratio and at the same time reduce marketing costs. Consider the example of a personal financial services firm that offers various products and services in personal finance, banking, investments, insurance, credit card, and so on. The firm has to predict the behavior of its customers to decide what to offer them in the future. For example, if a customer opens a checking account in the first quarter and applies for a loan in the third quarter, what is the customer most likely to need in the first quarter of the next year? Figure 8.5 shows how firms can approach this problem. Customers are rank ordered based on their likelihood to purchase a particular product, and this is done across all product categories. In Figure 8.5, customers are rank ordered in the credit card, loan, and savings account segments, and they are divided into three segments: very likely to make a purchase, likely, and not likely to make a purchase. Then customers in the top segment (very likely) are considered. As shown in Figure 8.5, Customer C is most likely to make a purchase in the next segment in all three product categories considered here. The firm, instead of sending three separate marketing messages to Customer C, should offer all three products at a discounted rate and induce him/her to purchase them as a bulk package. This action, apart from reducing the marketing costs, reduces the propensity for Customer C to quit the firm in the future (because his relationship with the firm will be much stronger). Similarly, Figure 8.5 shows that Customer B is highly likely to purchase in the credit card and the personal loan segment. Hence, the firm should contact Customer B with a combined offer with discounts that would induce him/her to buy both the products at the same time.

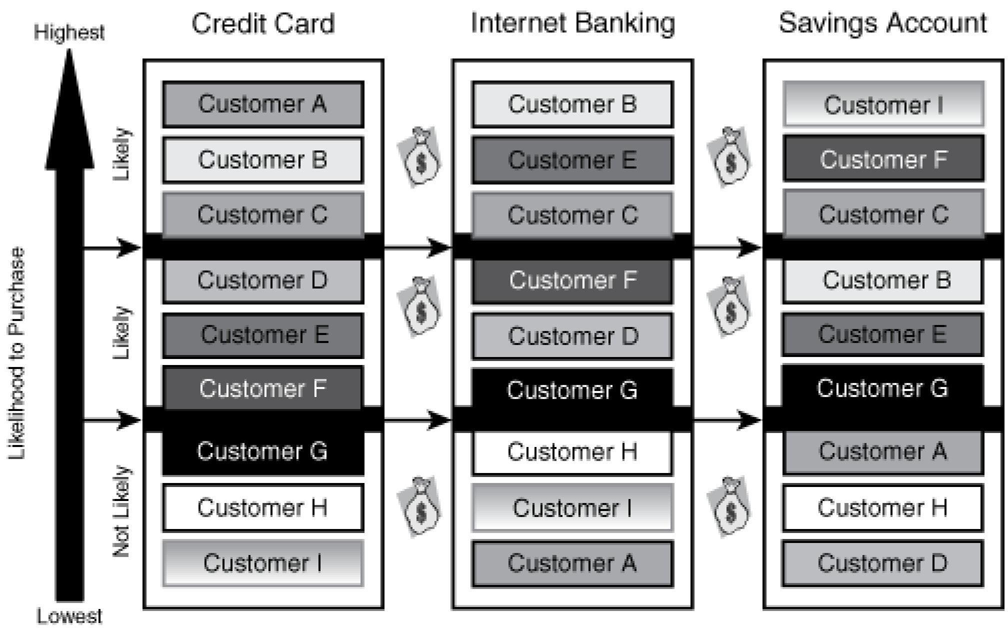
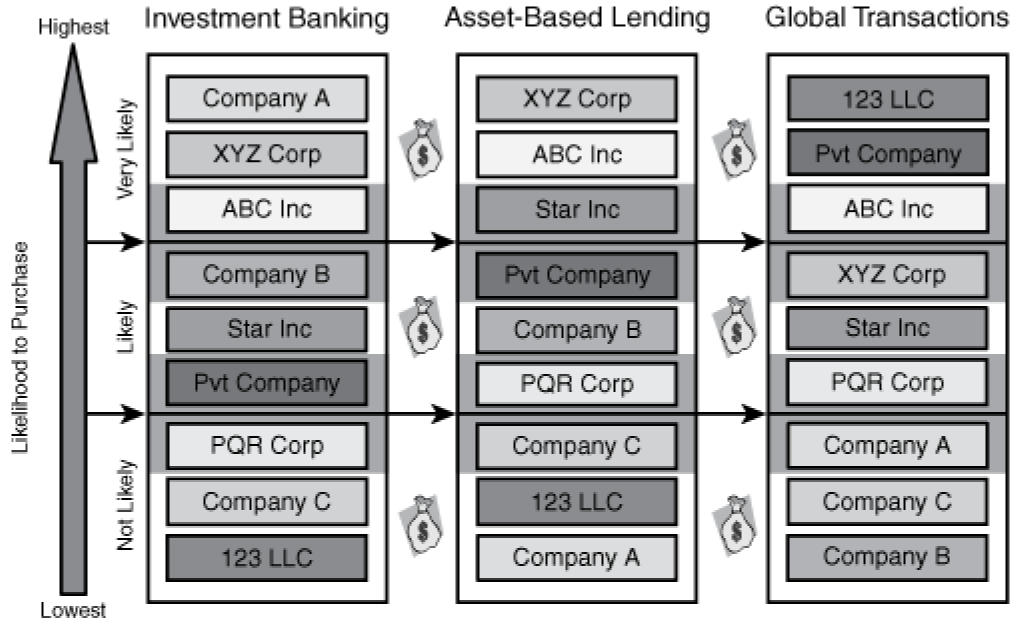


Figure 8.5. Optimal contact strategy in a B2C setting: Customer* rankings based on their likelihood to purchase

Consider a similar example in the B2B setting, where the financial services firm offers services in investment banking, asset-based lending, and global transactions. Figure 8.6 shows the rank ordering of the customers of this firm. Based on their predicted propensity to purchase, ABC Inc is very likely to purchase across all three categories. Therefore, the B2B firm should make a combined pitch that offers a discount for all three products. Similarly, XYZ Corp (per Figure 8.6) is very likely to need investment banking and asset-based lending services, so a combined pitch should be made to XYZ Corp. Such strategies will ensure a reduction in marketing expenditure and increase the lifetime value of the customers.

Figure 8.6. Optimal contact strategy in a B2B setting: Customer* rankings based on their likelihood to purchase



The Impact on Profitability

Table 8.2 shows the impact of using our model to design the right marketing initiatives in a high-tech firm and a financial services firm. As you can see, the ROI for the high-tech firm increased significantly, on average about 160%. By implementing our strategy, the high-tech firm's average ROI improved by about 200%. This shows that if the right marketing strategy is used to communicate the right messages to the right customers at the right time, firms can maximize profit. Also note in Table 8.2 the simultaneous reduction in the level of communication: a 31% reduction for the high-tech firm, and a 26% reduction for the financial services firm.

Table 8.2. Improvement in ROI and the Change in the Level of Communication

	Increase in ROI (%)	Change in the Level of Communication (%)
High-tech company	160	–31
Financial services firm	200	–26

Table 8.3 shows the effect of cross-selling on the revenue, profit, and ROI of the high-tech company (B2B) and the financial services firm (B2C). The numbers in the table reflect the difference between the various metrics across the test and the control groups, when they were pitched as

individual products or product pairs or other combination of product offerings. Some customers were more likely to buy single products, and individual products were pitched to them. For those who were more likely to buy multiple products, appropriate product combinations were offered. For example, in the case of the high-tech company, some customers come to the company just for their software needs or hardware needs. Others look to the firm to satisfy both software and hardware needs, and for them a combination of products was offered. In the case of the financial services firm, some customers just need loans or insurance or investment services. Others need all three or a combination of products. By following this strategy, accurate predictions were made in this regard, and multiple combinations of products were offered at the same time if appropriate. As you can see from Table 8.3, cross-selling significantly increases all three given measures (revenue, profit, ROI). The increases registered in the return on marketing investment demonstrate the cost savings that firms can realize by adopting this strategy. Also, this table shows how firms can maximize profit by cross-selling and pitching the right product to the right customer at the right time.

Table 8.3. Effects of Cross-Selling

	Buyer Of	Revenue ($)	Profit ($)	ROI
High-tech firm	Product 1	605	1,649	1.5
	Product 2	306	1,897	1.6
	Products 1, 2	198	1,273	1.7
Financial services firm	Product 1	208	591	1.8
	Product 2	247	428	1.7
	Product 3	182	397	1.8
	Products 1, 2, 3	164	402	2.1

Conclusion

Accurately predicting which customer is going to buy what and when could be the motor that drives a company's marketing initiatives. The guiding principle in implementing this strategy is straightforward: Understand customers' needs and give them more of what they want. Choose whom you contact, and customize the promotions according to the individual customer's needs. Avoid inundating customers with irrelevant promotions and offers that might only alienate them and destroy their relationship with the firm.

9. Preventing Attrition of Customers

Relevant Issues

- What is the impact of attrition on the firm's business?
- Who is likely to defect and when?
- When should we intervene?
- How much should we spend on preventing attrition?
- Which products should we offer, and which channel should we use to communicate the intervention offer?

Customer attrition has become a critical concern for many industries, such as telecommunication, retail banking, and insurance. With increased competition, a customer has many more choices of products and services from a number of firms. Coupled with increased choices for consumers, firms are constantly trying to acquire high-value customers from their competitors. As a result, firms find it difficult to retain customers as they easily move from one firm to the other (that is, defect). According to a 2003 report published by Celent,[1] the customer attrition rates in retail banking in the United States and Canada are several times greater than those in the United Kingdom. Even in the United Kingdom, the churn rates have gone up to more than 17% in 2005 compared to less than 10% in 2003.

Customer attrition, also known as customer *churn* or defection, is the loss of customers. The rate of churn is the rate of customer loss in a given period, such as monthly or yearly. Depending on the nature of the business, the customer loss can be considered *lost-for-good* or *always-a-share.* Consider two scenarios. In scenario 1, a customer bought a laptop from Dell Inc. six months ago (his first-ever purchase with Dell, and no purchases since then). Dell finds it difficult to know whether it has lost this customer or whether the customer just hasn't yet required a product that Dell offers. The customer might also buy other products from other laptop marketers, such as Apple, and then come back to Dell for another purchase (perhaps a desktop). This is called an *always-a-share* scenario; a customer shares his/her purchase wallet with more than one firm. Always-a-share scenarios are most likely in noncontractual settings, where a customer can move from one firm to another without breaking contractual obligations.

In another scenario, a wireless phone subscriber has terminated his contract or did not renew the contract. In this case, the firm is almost certain that this customer has defected and that the only way to get him back is to win him back. This is called a *lost-for-goo*d scenario. Such a scenario occurs most frequently in contractual settings, such as subscription-based businesses, where customers incur a switching cost when they defect. Because the churn event can be easily identified from a firm's data, it is easier to intervene in a contractual setting to prevent customer attrition.

Even in a noncontractual setting, a firm can intervene to prevent customer attrition or a reduction in the revenue contribution from the customer. For example, in a retail setting, firms usually have information about how often customers purchase and the average amount that they spend with the firm. From this data, the firm can model the *interpurchase time* (IPT) for its customers using appropriate statistical methods. The firm can then use the estimated IPT as a benchmark to predict whether a customer is likely to defect. For instance, if the estimated IPT for a customer is four months, and the customer has not made a purchase for five months, the firm knows from this information the customer is likely to defect. Similarly, the firm can also model the purchase amount for each customer based on past transactions and customer characteristics. If a customer's purchase amount has dropped significantly compared to the estimated purchase amount, this reduction might indicate that the customer has reduced his/her Share of Wallet (SOW) with the firm. The firm should then develop an intervention strategy for the customer depending on the worth of the customer (as explained later in this chapter).

Impact of Attrition

Customer attrition impacts a firm in several ways. One direct impact is the loss of revenue from the customers who have defected. The extent of revenue loss depends on the level of service commitments the customer had with the service provider. The higher the expected revenue from the customer, the more the impact on the firm. Closely related to this expected revenue loss is the lost opportunity for the firm to recover the acquisition cost incurred on the customer. It is a usual practice in many service industries to offer incentives to new customers. Because of competitive pressures, the cost of the incentives offered, coupled with other acquisition costs, is so high that it sometime takes several months to break even. According to J.D. Power & Associates, the cost of acquiring a new customer in the U.S. wireless service industry is $375 to $475, and providers must retain them for more than four years to break even.[1] This breakeven point is several months beyond the contractual period, which is usually one to two years. If a wireless phone customer quits the service provider after completing a one-year contract, the company will not have recovered a major portion of the acquisition cost. Therefore, any customer lost in the initial period will cost more in terms of irrecoverable acquisition costs.

Further, the firm also loses the opportunity to up-sell/cross-sell to customers who have defected, and this loss can be treated as a loss of potential revenue. In addition to the previously mentioned direct financial loss, there are some “lost” social effects. For instance, had the customer continued with the company, his/her use of the products/services of the firm in public would have influenced others to adopt those products/services. Also, the negative word-of-mouth from the customer who defected might discourage many prospects from buying products/services from the firm.

Whereas the previously discussed costs are associated with the value of lost customers, firms must also invest additional resources to replace those lost customers with new customers. As mentioned previously, acquiring new customers costs much more than the average revenue a customer brings to a firm in the initial period. This drains the firm’s resources, which are already impacted by the loss of customers. As you can see, customer attrition impacts both the inflow and outflow of cash adversely.

Because of its significant impact on firms’ resources and their performance, if measures are not taken to reduce customer attrition, customer churn can ruin a company. Many firms have realized the importance of controlling the churn and have adopted or are in the process of adopting analytic tools to predict and prevent attrition.

Case Study: Telecommunication Industry

A telecommunication firm offers the following services: local telephone, long-distance telephone, wireless phone, and Internet. Under each of these service categories, the firm offers a variety of options. With wireless phone services, for instance, customers can subscribe (for an additional monthly fee) to a family plan, additional phones, text messaging, and wireless Internet access. Similarly, with Internet services, the firm offers packages with different download speeds, such as 1.5Mbps, 3Mbps, and 15Mbps. Figure 9.1 shows the complete product line and the options available within each line.

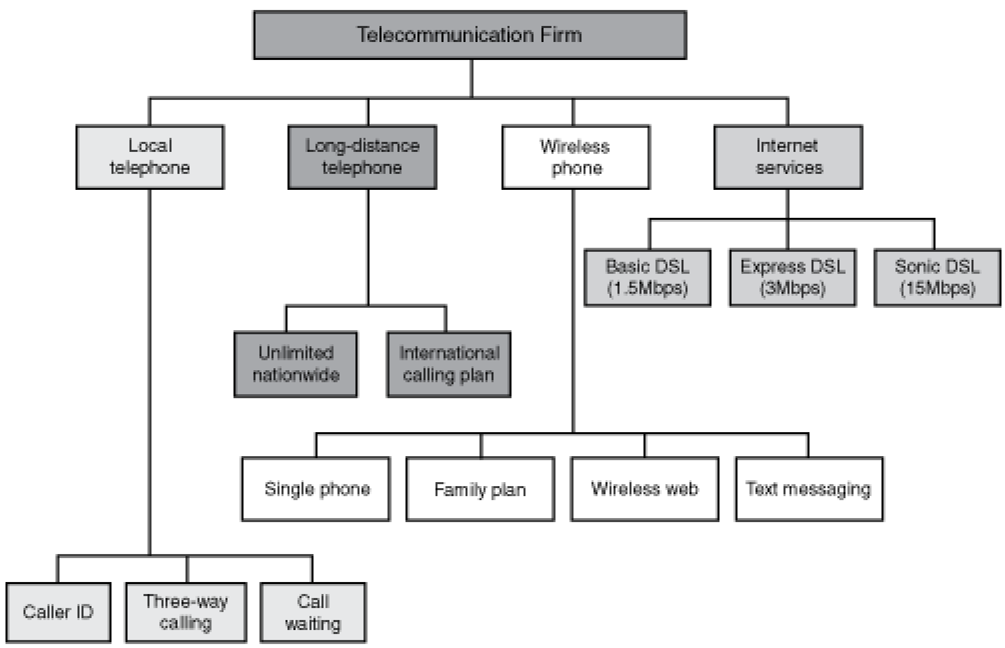


Figure 9.1. Services offered by a telecommunication firm

Customer Don has subscribed for local and long-distance telephone services. The firm has observed from the recent bills that Don's number of long-distance calls has dropped significantly. In addition, a local cable operator is running an attractive promotion for three services as a package: telephone, television, and Internet. The firm has started losing some of its customers to the competitor. It is wondering whether it should intervene to prevent customer attrition. However, the critical question that the firm is facing is this: Who is likely to quit and when?

Preventing Attrition

Many firms in the telecommunication industry are facing similar situations every day. As the competition has intensified, they find that their customers are vulnerable and are likely to defect. Because customer churn has a tremendous impact on the firm's performance, it is critical for the firms to develop a successful strategy to prevent attrition. The important questions that need to be answered before developing this strategy include the following:

- How do we identify the customers who are likely to defect?
- When are they likely to defect? Or, can we predict the time of churn for each customer?
- Should we intervene?
- When should we intervene?
- How much should we spend to avoid the attrition of a particular customer?

Answers to these questions will help firms to develop an effective intervention strategy to prevent attrition and to improve the firm's performance. In this chapter, we discuss the answers to each of these questions.

Predicting Churn

Identifying customers who are likely to defect and their expected time of attrition is the first step in developing the intervention strategy. There are two components to predicting the churn. One is to know the customers who are likely to defect. A simple solution for this problem is to identify the characteristics of customers who have defected in the past and identify customers who have matching profiles to this group. However, we also need to know when they are likely to defect. Most of the models to predict churn can answer both these questions by building a propensity-to-quit model. These models give us the probability of a customer quitting at a particular point in time.

There are two approaches in treating customer defection: the *lost-for-good* approach and the *always-a-share* approach. Figures 9.2A and 9.2B show the difference between these approaches.

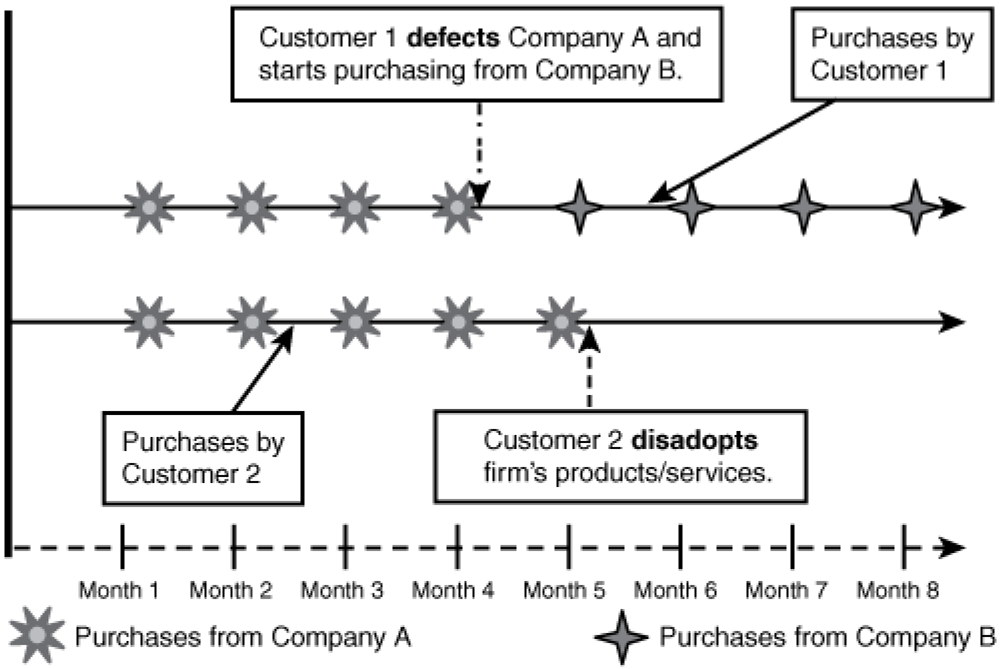


Figure 9.2A. Lost-for-good approach

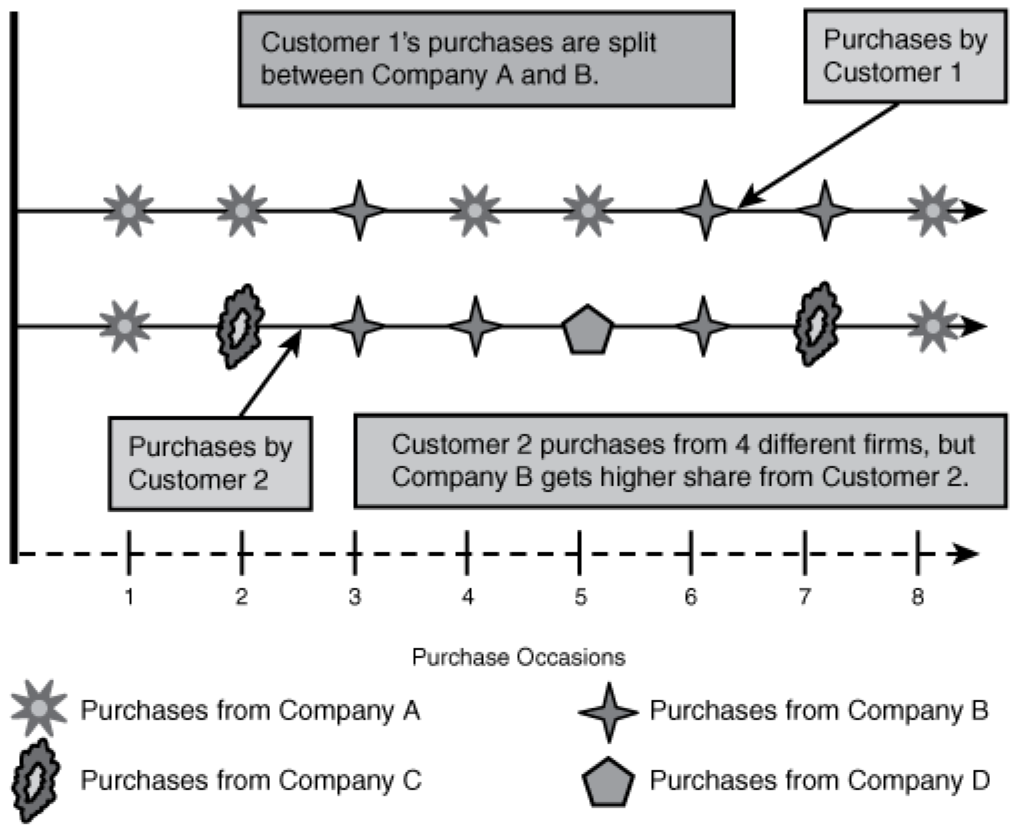


Figure 9.2B. Always-a-share approach

The lost-for-good approach treats customer defection as permanent. As mentioned previously, this is a scenario we find in subscription-based businesses. When a customer terminates a subscription or service, it is unlikely that the customer will come back to the firm. Either the customer has gone to a competitor or has stopped using that particular service (that is, disadoption of a product category). For instance, a customer of dial-up Internet service might discontinue the dial-up service and start using broadband. Such a customer is unlikely to come back to a service provider that does not offer broadband. In this case, he/she disadopts dial-up service. In Figure 9.2A, Firm A loses Customer 1 to Firm B, whereas Customer 2 did not go to any other firm, but discontinued use of the particular product or service offered by Firm A. In both these cases, what is important for developing an intervention strategy is to predict the time of defection for each customer, even though the scope of intervention in the case of Customer 2 is limited. Even in the case of customer disadoption of a service, a firm can intervene by offering the service the customer wants. For instance, AOL realized that many of its customers were disadopting its dial-up services to contract for broadband services. AOL's strategy became to first retain customers who disadopt dial-up services by offering its broadband services through partnerships it holds with BellSouth, Quest Communications, and AT&T.[2] AOL also offers premium packages such as Privacy Wall, Premium Computer Check Up, and backup dial-up access to customers who have subscribed to other broadband service providers. Such premium packages help AOL to compensate for the loss of profit from its dial-up services.

On the other hand, an always-a-share approach considers customers' switching to competitors as transient. In the earlier example of a customer switching between Dell and Apple, the customer continues to transact with both Dell and Apple. Hence, neither Dell nor Apple completely loses the customer, but they lose/gain a share of the customer's purchase, as shown in Figure 9.2B.

Both Customer 1 and Customer 2 transact with more than one firm. However, their share is split unevenly among different firms. There is no specific time of attrition in such cases. Many consumer goods purchases fall in this category. In this approach, what is modeled is not the time of defection, but customers' transition probabilities associated with each firm or brand. Migration or Markov models are usually used to estimate transition probabilities of customers.

Popular Churn Models

In the lost-for-good approach, the model predicts the probability of a customer defecting. Among many models that can predict the probability of customer defection, two statistical models are commonly used to predict churn in the lost-for-good scenario: logistic regression and hazard models. Even in an always-a-share scenario, firms can effectively use logistic regression to predict the upward or downward migration of customers, as explained later in this chapter.

Logistic Regression

Logistic regression is a form of a regression model in which the dependent variable is binary and assumes only two discrete values (zero or one). In a customer churn model, the dependent variable is whether a customer quits during a particular period. That is, if a customer quits, the value of the dependent variable is one; otherwise, it is zero. The independent variables of the model usually fall into four categories: transaction-based characteristics (or exchange characteristics), customer characteristics, product characteristics, and marketing effort by the firm. Some of the key exchange characteristics used in a churn model are time from the first purchase (duration), time from the last purchase (recency), number of product categories purchased (cross-buy), number of products purchased from each category (focused buying), average IPT or purchase frequency, and average revenue. The customer characteristics usually consist of demographic variables such as income, age, and education. The important product characteristics are the type of products and the current ownership of certain products. The marketing effort that plays a key role in predicting churn includes the number of marketing communications and the contact channels (such as email, telephone, and face to face) used to communicate to the customer.

The firm uses the transactions data and the marketing communication data for a particular duration (for example, for three years) to build the model. This sample data is called the *calibration sample.* The firm also sets aside similar data for a shorter period (for example, one year) to test whether the model estimates obtained using the calibration sample hold good for a different sample. This sample is called the *validation sample.* Both calibration and validation data contain information about whether a customer has quit during this observation period, which gives the values of the dependent variable. This data also has information pertaining to the exchange characteristics, customer characteristics, product characteristics, and marketing communication (that is, all independent variables) corresponding to each value of the dependent variable. The logistic regression model can then be built using the calibration sample to obtain the parameter estimates. In simple terms, logistic regression identifies a set of independent variables that are likely to influence the value of the dependent variable and the weights associated with each independent variable (that is, coefficients that tell us the extent to which each independent variable affects the dependent variable). After the relevant variables and their coefficients have been identified using calibration data, the firm can then predict the value of the dependent variable for all observations in the validation data and compare these values to the actual data. If the model fits the validation data, the firm can predict the values of the dependent variable for future time periods. All the predicted values of the dependent variable in a logistic regression are between zero and one. These predicted values are treated as probability of defection or the propensity of a customer to quit.

Hazard Models

Hazard models used in the analysis of failure time (or time to the occurrence of an event) are built based on the survivor and hazard functions. Even though hazard models were initially developed in the field of biomedical sciences to study the effectiveness of certain treatments on the lifetime of individuals, they are widely used in different fields to study the time of occurrence of particular events. (The events may be failure of machinery or a customer making a purchase, depending on the situations.) Survivor function is the probability of an individual surviving (without the event occurring) until a particular time (t). In the context of product purchase, it is the probability of a customer not making a purchase. (In this case, the event is making a purchase.) Hazard function, on the other hand, specifies the instantaneous rate of failure at time t given that the individual survives until t. In the context of churn, given that a customer has not quit until a particular time period, the probability of him/her defecting from the firm in the immediate time period can be treated as the hazard rate or hazard function. One advantage of a hazard model is that it treats the cases where the event has not occurred as censored observations. For instance, in the sample used for estimating the model, 20 customers have not defected, and the remaining 80 defected during the observation time period. The hazard model treats those 20 observations as censored and includes in the model only the survivor function for these customers because the event has not occurred until now. For the remaining 80 customers, the model includes both the survival and the hazard functions. When a model such as logistic regression is used, 20 customers in the sample are treated as nondefectors and the remaining 80 as defectors. Such a treatment ignores the fact that some of these nondefectors would have defected had the time window been larger.

Although there are a number of different methods for estimating hazard models, one of the most commonly used models is the proportional hazard model. In this model, a baseline hazard rate gives us the shape of the hazard curve. The shape of the hazard curve shows how the probability of defecting for an average customer of the firm increases/decreases or stays constant over time. The model also includes the exchange characteristics, customer characteristics, product characteristics, and marketing communication variables. The effect of these variables is to shift the baseline hazard function up or down. This is like multiplying the baseline hazard by a factor, as can be seen in the following expression for the proportional hazard model:

The probability of a customer defecting in the immediate time period given that he/she has not defected until now (or until time *t*) = baseline probability × impact factor

Baseline probability can be considered as the probability of a customer who is not influenced by any of the variables defecting in the immediate time period given that he/she has not defected until time *t.* The effect of all customer-specific variables is captured in the second part of the equation: impact factor. The impact factor shifts the baseline probability upward or downward depending on whether the impact factor is greater than one or less than one (but greater than zero). Thus, the product of baseline hazard rate and the effect of customer-specific variables (that is, the impact factor) for a customer is the hazard rate for that customer. Therefore, when we estimate how each of the variables affects the value of the impact factor and the baseline hazard rate, we can predict the probability of a customer defecting at a particular time period. The details on the estimation of hazard models can be accessed through www.drvkumar.com/mcp.

Both logistic regression and the hazard model can be effectively used to predict the probability of a customer defecting or his/her propensity to quit. However, the way we use each of these models to predict attrition probability differs. If a telecommunication firm wants to predict the propensity to quit for all its customers in the next 12 months (for instance, from January to December) and it wants to use logistic regression, and if the model is built using time-varying variables with a time lag up to 1 month, the firm will first use the model to predict which customers are likely to quit (that is, probability of defection > 0.5) by the end of January. Then, the firm can decide whether it wants to intervene. A similar exercise needs to be done for every month to predict those likely to quit by the end of the month. The main disadvantage in this case is that it is difficult to predict customers' propensity to quit beyond one month (or the time lag allowed in the model). This means the firm has less than one month to intervene. In contrast, when a proportional hazard model is used, the firm can predict when a customer is likely to quit based on the shape of the survival curve and customer-specific variables. This means the firm has more time to intervene.

Logistic regression can also be used effectively to model the upward or downward migration of a customer in an always-a-share scenario. The first step in modeling migration is computing the Customer Lifetime Value (CLV) of every customer and grouping the customers into deciles based on their CLV. Customers in the two deciles can be classified as high value (high CLV), those in the bottom three deciles as low value (low CLV), and the remaining as medium value (CLV neither very high nor very low). This exercise is done for the subsequent year. Comparing the group to which a customer belongs in two consecutive years, we can see whether he/she has migrated upward or downward. For instance, if a customer in the high-value group in the first year has moved to either the medium-value or low-value group in the second year, the migration of that customer is downward. A customer who moves from the medium-value group or low-value group to the high-value group is migrating upward. A logistic regression model can be used to identify the factors influencing the upward/downward migration of customers. The dependent variable in a downward migration model is whether a customer has migrated down to a lower value group. The independent variables are the customer-specific variables, as mentioned previously. Using the estimated coefficients of the model, the firm can predict which customers are likely to migrate downward and when. Then, the firm can decide whether it needs to intervene.

Statistical Issues in Modeling

In the logistic and hazard models previously discussed, the coefficients for each of the covariates (exchange variables, product characteristics, customer characteristics, and marketing communication variables) do not vary for each customer. This means that these models do not account for *heterogeneity* among customers. In other words, the underlying assumption is that the impact of the covariates on churn is the same for all customers in the data. This might not be true. For instance, a price-sensitive customer might react to an increase in product price more adversely than a customer who is less price sensitive. Therefore, a price-sensitive customer should have a bigger (in magnitude) coefficient for price than a less price-sensitive customer. Similarly, customers might react differently to marketing communication. Therefore, it is necessary to allow for different coefficients for each customer. Researchers have addressed this issue by using advanced estimation techniques such as Bayesian and Random coefficient methods, both of which allow the coefficients to vary across customers.

Intervention Strategy

After the firm has the probability of defection for each customer, it is easy to decide whom to target for intervention, as shown in Figure 9.3

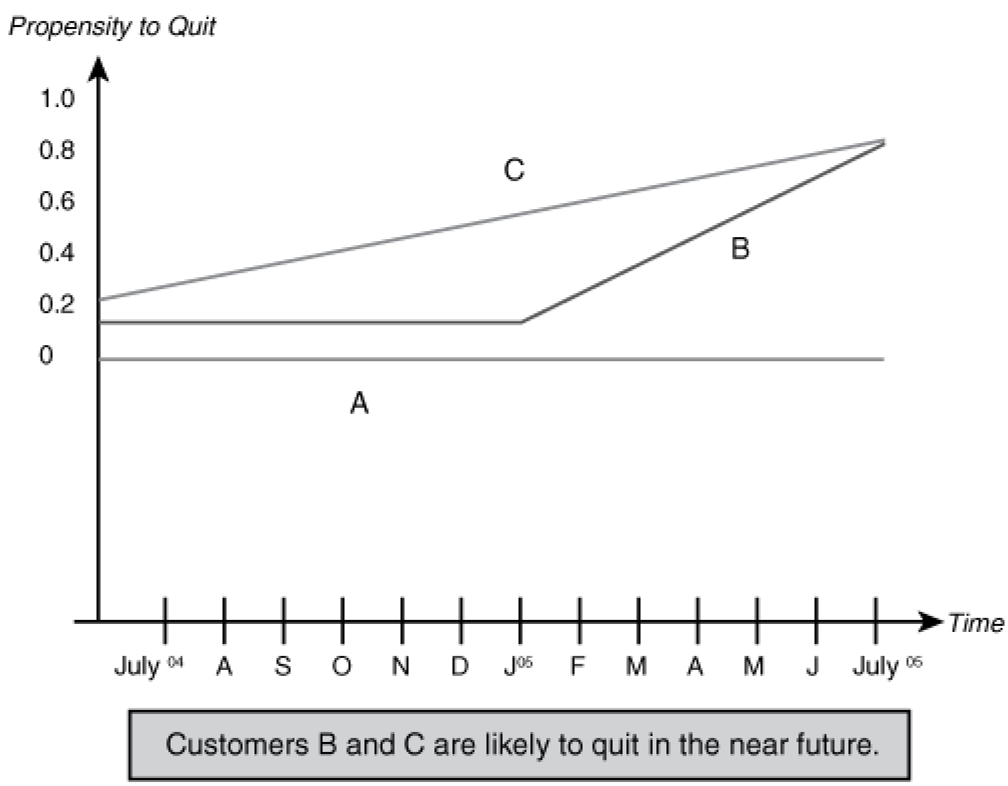


Figure 9.3. Predicting propensity to quit

Figure 9.3 shows the propensity to quit for three customers of the telecommunication firm mentioned in the case study. The propensity to quit of Customer A is 0 for the 12-month forecast period. Customer B's propensity to quit is 0.2 in the first 6 months, but thereafter it increases steadily until it reaches 0.8 in the twelfth month. In contrast, for Customer C, the propensity to quit increases continuously and reaches close to 0.8 at the end of the forecast period. Here, clearly, the firm is not at risk of losing Customer A. However, it is likely to lose Customers B and C if it does not intervene. The time of intervention depends on when their propensity to quit becomes a predetermined value. (Usually it can be taken as at least 0.5.)

Should We Intervene?

When we know *when* a customer is likely to quit, the next important decision is whether we should intervene to prevent attrition of that customer. For instance, should we intervene to prevent attrition of both Customers B and C? The answer to this question depends on whether the customer is worth retaining. This is where CLV plays an important role. As explained in previous chapters, CLV gives us a fair idea of the worth of the customer to the firm, because both the expected revenue contribution from the customer and the cost of serving the customer are taken into account in computation of the CLV. In the context of retention of customers, CLV is the net contribution that a firm can expect from a customer if he is retained. Therefore, any prudent company should spend its resources to retain only those customers who have positive CLVs. If a customer has a negative CLV, the company is spending more to serve the customer than the revenue the customer is generating for the company. For instance, if the cost of maintaining customer records, generating and processing bills, and mailing is $15 a month for a customer who does not use a credit card, the credit card company is spending the resources for this customer without any revenue contribution from the customer (a negative CLV). It does not make sense to retain customers such as these. Therefore, when deciding upon whom the firm should spend resources to retain, the first criteria is that the CLVs of the selected customers should be positive. In the scenario shown in Figure 9.3, if Customer B's CLV is negative, the firm should not be spending its resources to retain that customer.

Whereas the decision might be fairly straightforward in the case of a customer with a negative CLV, it might not be so clear in the case of profitable customers or customers who have positive CLVs. A profitable company might have a large number of customers who have positive CLVs but are likely to defect. In addition, there might be a huge variation in the actual value of their CLVs. Some of them might be high-CLV customers, the others might have low CLVs. Therefore, it doesn’t make sense to spend the same amount to retain all customers. The key decision in this case is not whether to retain but when to intervene and how much to spend on each customer. We will first address the question of when to intervene.

Intervention Timing

Suppose both Customers B and C in Figure 9.3 are customers with positive CLVs, and therefore the telecommunication firm decides to spend resources to retain both of them. The time of intervention, however, might not be the same for both, as illustrated in Figure 9.4.

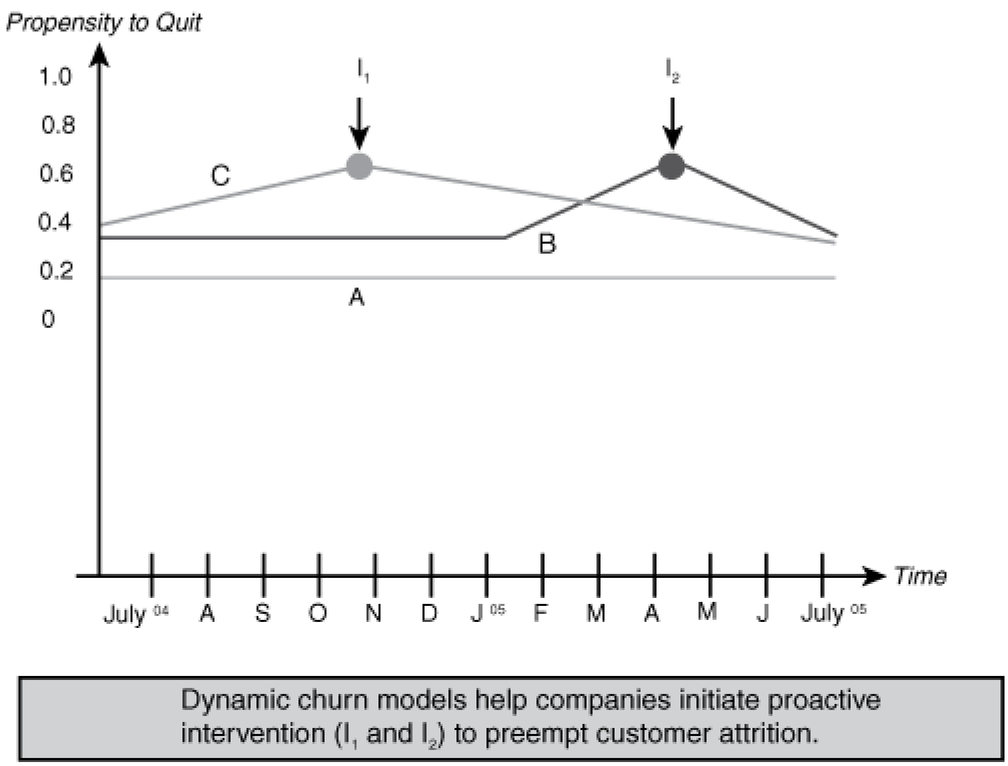


Figure 9.4. Proactive intervention strategy

In Figure 9.4, the propensity to quit for Customer C reaches 0.5 in October 04. At that time, Customer B does not show signs of attrition. Therefore, the proactive intervention in October 04 should be targeted to Customer C, not Customer B. This intervention is shown as I_1 in Figure 9.4. An effective proactive intervention will help to regain the customer’s confidence and trust in the firm and can reduce the customer’s propensity to quit. The intervention strategy I_1 therefore reduces Customer C’s propensity to quit, as shown in Figure 9.4. Meanwhile, Customer B’s propensity to quit increases and reaches 0.5 in April 05 and becomes the likely target for intervention. The time of intervention should be decided in a similar way for all profitable customers who show a tendency to defect.

In the preceding example, the firm intervenes when the propensity to quit becomes greater than 0.5. This need not be the case for all other firms. Depending on the industry, the response time (or the time needed for decision making) of customers may be longer. Also, in some cases, the propensity to quit may increase at a very high rate. In both these cases, it might be necessary to intervene even before the propensity to quit reaches 0.5 to give more time for customers to respond to an offer. Another challenge in deciding the time of intervention is changing propensities. Some industries are so competitive and volatile that the competitive promotions change frequently. As a result, customers are bombarded with attractive offers from competing firms that make them vulnerable. Therefore, it is critical for firms to constantly update the propensities to quit for their customer base to capture changing propensities, which is the basis for an effective proactive intervention strategy. In other words, the churn models should be dynamic, and the periodicity of updating churn probabilities should be based on industry characteristics.

Intervention Cost

Another key element of the intervention strategy is the amount of resources to be spent on each customer. This is directly linked to the worth of the customers or their lifetime value. Suppose the firm has an intervention strategy in which the cost of intervention (that is, the cost to the firm) is $100 per customer. It does not make business sense to offer this promotion to a customer whose CLV is $50. The firm should instead intervene with an offer that costs less than $50 to the firm. Ideally, firms should design a number of different intervention strategies with varying costs so as to cater to all customers. For instance, the telecommunication firm mentioned in the case study can offer caller ID for three months for free to a low-CLV customer (for example, a customer with only the basic local phone service). On the other hand, the firm can offer a free upgrade to Sonic DSL service for a customer with wireless phone and basic Internet services (or other moderate CLV customers). The simple rule of thumb in deciding the amount to be spent on intervention is that the cost of intervention should not exceed the CLV.

Products to Offer

An intervention strategy is not complete without specifying what products are to be offered. When a firm deals with a number of product/service categories within which there are different options, the important decision the firm has to make is whether the intervention offer should be for additional features in the already subscribed-to service or for additional services. In the case of the telecommunication firm, one of the intervention offers for a customer with basic local telephone services may be adding caller ID at a discounted price. Another offer could be free long-distance calling for three months. Although the first offer is for adding a feature to the existing service, the second offer is for adding a new service. Firms need to decide which of the two options are best for a particular customer, considering customer needs, his/her worth to the company, and the competitive scenario. In another example, a movie rental firm such as Blockbuster can either offer an option of more movies at a time or the convenience of downloading movies directly to a PC/laptop. This is adding a new feature to the subscribed-to service: movie rental. A publishing company such as Time Inc. offering online access for a limited time to *Fortune* to a subscriber of *Time* magazine who shows signs of attrition is an example of offering an additional product/service.

Intervention Channels

When a firm finalizes the cost of intervention and the products to be offered to a customer, it has to decide which contact channel to use to communicate the offer to the customer. Often, this key decision determines how a customer will respond to an intervention offer. The available contact channels often include email, website, telephone, and face to face. The choice of the contact channel depends on the worth of the customer and his/her past response to marketing communications through various channels. Even though email might be cheaper in terms of cost of communication, customers' response rate to email communication may be poorer compared to other channels. If a customer is a high-CLV customer, it is not a good idea to communicate the offer through a channel for which the response rate is low. Instead, the firm should use the telephone or the face-to-face channels. For instance, if a telecommunication firm were likely to lose the business of a large public university, which is one of its largest B2B customers for telephone and broadband services, the best channel for communication is face-to-face contact. At the same time, if the firm is to intervene to prevent attrition of a residential user, it might use email or telephone channels.

Results of Intervention

The telecommunication firm mentioned in the case study adopted the steps mentioned previously to prevent customer attrition. In a pilot study, the firm first computed the propensity to quit for all its customers using three years of transaction and marketing communication data. Then, it created two groups of matched customer pairs who were similar in terms of their propensity to quit and their exchange characteristics, such as their revenue contribution to the firm and duration. In other words, the customers in both groups had the same probability of quitting. The average revenue per customer in both groups was $600 per year. Figure 9.5 shows the design of the study.

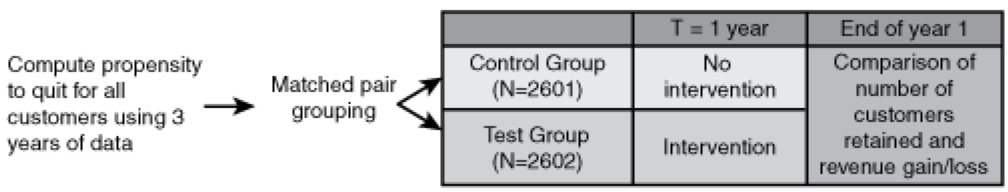


Figure 9.5. Study design (telecommunications firm)

As you can see in Figure 9.5, the study was for a period of one year; at the end of the study period, the performances of both groups were compared. Table 9.1 lists the results of the study.

Table 9.1. Empirical Results (Telecommunications Firm)

	No Intervention	Intervention
Number of customers sampled at the beginning of the study	2,601	2,602
Time period of study	1 year	1 year
Number of customers at the end of the study	1,768	2,412
Number of customers lost	833	190
Number of customers saved	—	643
Revenue gain	—	$385,800
Retention cost	—	$ 40,000
Incremental profit	—	**345,800**

At the beginning of the study, one group had 2,601 customers, and the other had 2,602, as shown in Table 9.1. The first group (2,601 customers) was used as a control group to see the impact of intervention on the other group. For the first group, there was no intervention. For all customers in the second group, however, the firm predicted a propensity to quit and identified those customers who were likely to quit. Based on the CLV of each customer, the firm designed customer-specific intervention strategies for all vulnerable customers. The total cost of intervention (cost to the firm and not the actual value to the customer, which is much higher) was $40,000 for the second group. The number of customers at the end of study period and the revenue contribution from customers during the study were compared to see whether the intervention had any significant impact. The number of customers in the control group at the end of study period was 1,768, indicating a loss of 833 customers in 1 year. The group for which the firm intervened retained 2,412 customers, which means that the number of customers lost was only 190 (compared to 833 in the control group). Considering the fact that both groups were behaviorally the same, the intervention could have saved 643 (833 − 190) customers. By multiplying the number of customers by the average revenue contribution per customer, we get a total revenue gain of $385,800 for the group with which the firm intervened. Therefore, even after taking into account the cost of intervention, the firm had a net revenue gain of $345,800 by preventing attrition, and the return on investment was close to 860% (a revenue contribution that was 8.6 times the investment).

Conclusion

No business can afford to ignore the impact that customer churn can have on the profitability and even the survival of the business. The key to retaining customers is to identify early the customers who are likely to quit and intervene with them to prevent attrition. The churn models discussed in this chapter help to identify the customers who are likely to quit. With that information, firms can take affirmative steps to develop an intervention strategy based on CLV to effectively intervene to retain valuable customers, as shown in the case study.

10. Managing Multichannel Shoppers

Relevant Issues

• Should multichannel shopping be encouraged?

• Are multichannel shoppers more profitable?

• How can firms profitably manage customers for multichannel adoption?

In March 2007, Wal-Mart introduced a new program called Site-to-Store, which is an online service that allows customers to choose from a wider variety of products that will be shipped to their local store for free pickup.[1] The goal of this program is to add convenience for the customer, who can now choose from a wider assortment of products (tens of thousands of products in more than 100 categories) without paying any shipping costs. All the customer has to do is order the products online and pick up the products at his or her local Wal-Mart store. Wal-Mart hopes that this program will convince regular shoppers to consider purchasing new products from Wal-Mart that are not usually available in the store, and still come to the local store to purchase items they purchase during regular shopping trips. So, does this program have a chance to mutually benefit Wal-Mart and its customers?

Several recent marketing studies have found that more than 60% of customers not only want to use multiple channels for making purchases,[2] but also more than one-third of customers who regularly buy products already use at least three or more channels to make purchases.[3] Also, because of the arrival of complex distribution systems for various industries and sectors and the growth of web-based sales, firms are spreading themselves across various channels to appeal to diverse customer segments. Each distribution channel services a different set of customers and provides varying levels of services. This can lead to a reduction in the overall service cost, resulting in an increase in profitability for the firm.

However, many firms worry that increasing the number of channels will only spread the same revenue across multiple channels—that is, each new channel will cannibalize sales from other channels. But, is the reduction in service cost by moving lower-profit customers to lower-cost channels the only benefit of increasing the number of distribution channels? The clear answer to this question is no. Increasing the number of channels also leads to many other positive outcomes for businesses, including giving customers more searching and purchasing options and giving firms synergistic effects on customer profitability across channels; that is, customers who buy across more channels buy more products in total from the firm. Therefore, this chapter shows why it is profitable for firms to start operating business across multiple channels (even if some channels offer only search information and do not allow purchases) and discusses the difference between single- and multichannel shoppers and how firms can strategically manage customers across multiple channels. This relationship between multichannel shoppers and profits is examined by using several marketing case studies from firms in both the business-to-business (B2B) and business-to-consumer (B2C) industries.

Search First, Then Purchase

Today, most firms have ventured into at least a few different channels to serve customers. In many cases, these channels not only offer customers a chance to make purchases via multiple channels, but they also offer customers the chance to search for product information in one or more channels and purchase in a completely different channel. A recent marketing study by DoubleClick showed that almost half the customers who bought from a particular retailer did research on the Internet before going into the brick-and-mortar store to make a purchase.[4] This means that even if a firm is unable to manage the Internet as a product distribution channel, posting products and product descriptions on the Internet can potentially serve the purpose of locking a customer in on a specific retail store. For example, a customer is interested in buying a new pair of athletic shoes but is unsure about which brand and model to purchase. That customer might choose to go online to a store's website to check out the store's athletic shoe selection and get descriptions about each of the shoe styles the store has to offer. If the customer can find the shoe he wants at the price he wants, he still may not choose to buy the product online. Instead, this customer might want to go into the store directly and try on different sizes of the shoe before deciding to buy it. This is a common example where a customer uses one channel, the Internet in this case, to search for product information and then uses a different channel to make the purchase.

So, how does the research shopper (a customer who searches in one channel and purchases in another) give us insight as to the potential of multichannel shoppers to provide the firm a significant increase in overall profit? Even in the case of research shoppers, the findings from these studies suggest that firms benefit from introducing multiple channels to their customers. These cross-channel synergies offer the firm a better chance to lock customers into their brick-and-mortar retail store, where it is much easier to convert a shopper into a customer. For example, firms should not necessarily worry that setting up a website with information allows customers to search on their website and buy from someone else. Although the Internet doesn't always entice customers to purchase online and from a particular firm (after all, customers can quickly check out many different websites), when firms effectively provide customers with enough clear product information in their preferred searching channel (for example, Internet), customers are more likely to actually buy the products in their preferred purchasing channel (for example, a brick-and-mortar retail store). Firms that sell products that require some level of customer involvement (for instance, trying on apparel or shoes) or whose products are complex (perhaps the product needs to be visually inspected or tested) may find that shoppers visit their brick-and-mortar sites armed with more information and ready to purchase. However, to understand a little more about customers who are likely to shop in multiple channels, we need to understand which customers are typical multichannel shoppers and, in turn, determine whether multichannel shoppers tend to be more profitable than single-channel shoppers.

Who Are Multichannel Shoppers?

To answer this question, it is necessary to understand the following:

- **Customer characteristics.** For example, how many categories a customer purchases in

- **Supplier-specific factors.** For example, how often a customer receives marketing communications
- **Customer demographic information.** For example, income levels

This information helps us to generally identify the differences between multichannel and single-channel shoppers. In turn, we can determine whether these multichannel shoppers are more profitable and more frequent customers than single-channel shoppers.

We can empirically evaluate the association of customer-specific and supplier-specific characteristics and demographic information with multichannel shopping using an ordered logistic regression. This statistical model captures the differences in the effect of each of the preceding drivers on the probability of a customer buying from a single channel or multiple channels. For details on the model specification, please access www.drvkumar.com/mcp.

After we obtain the weights for each of the drivers by estimating the model, we can see how each driver influences a customer's decision to shop in a single channel or multiple channels.

To understand how these drivers and outcomes relate to the behavior and characteristics of multichannel shoppers, we consider a recent marketing study done with a B2B firm that identifies the drivers and customer-based metrics (for example, customer value and Share of Wallet [SOW]) of multichannel shopping (see Figure 10.1).[5]

Figure 10.1. Typical drivers of multichannel shopping behavior

Source: V. Kumar and Rajkumar Venkatesan, "Who are Multichannel Shoppers and How Do They Perform?: Correlates of Multichannel Shopping Behavior," *Journal of Interactive Marketing* 19(2) 2005: 44–62. Printed with permission from the American Marketing Association.

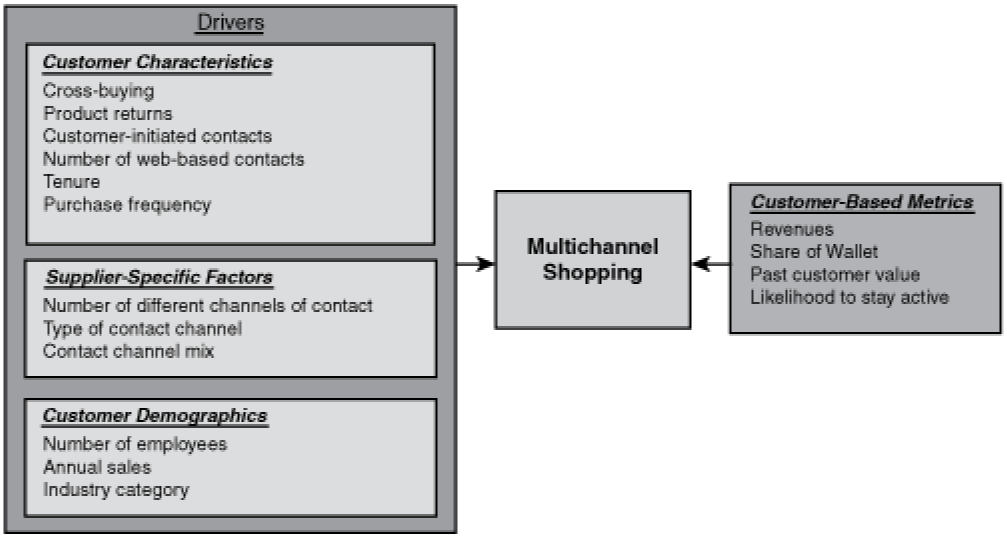


Figure 10.1 lists different factors that are likely drivers of multichannel shopping behavior, including customer characteristics, supplier-specific factors, and customer demographic information. It also compares the results of some customer-based metrics of single-channel and multichannel shoppers. An understanding of how these drivers will enable firms to better identify who the multichannel shoppers are will give managers insight into how to properly manage multichannel versus single-channel shoppers.

Customer Characteristics

- **Cross-buying.** As noted in previous chapters of this book, cross-buying occurs when customers buy products in different categories. It is widely believed by marketers that customers often choose different channels to buy different product categories. For example, a local bank may offer various products such as a savings account, checking account, and home mortgage. Customers may choose to manage and use their checking and savings accounts through an online interface but apply for and manage their home mortgage through a direct salesperson. Customers do this because different products from this bank have different attributes. This customer may choose to manage the savings account online because it is a straightforward, simple-to-use product. However, because the mortgage is so complex and customized to each customer, this customer may feel more comfortable if there is a direct salesperson to talk to about the details of the mortgage. Therefore, it is more likely that customers who buy across multiple product categories (those who rate highly on cross-buying) are also customers who are buying across multiple distribution channels or are candidates to venture into new channels of product distribution that a firm might introduce.

- **Product returns.** Customers who return products are not necessarily bad customers. In fact, a company that can offer a satisfactory return process can actually use this as another "touch" point with the customer and continue to strengthen the firm-customer relationship. To this extent, it makes sense that as customers begin to return some of the products (up to a point) that they purchase that they are becoming more familiar with the retail store's different product offerings and distribution channels. Often, firms can use product returns as a way to migrate customers into different channels. For example, if a customer purchases a product online and wants to exchange it, he might be able to return the product to a local brick-and-mortar store. If the customer had only previously made purchases online, this introduces the customer to a new distribution channel (the brick-and-mortar store) and potentially encourages him to consider products in the store he was less likely to buy online. However, this does not mean that a firm should necessarily encourage customers to return more products; after all, no firm wants to have customers returning most of the products they buy. But, a customer who is given the opportunity to return or exchange unsuitable products (usually this turns out to be around 5% to 15% of the total number of purchases) will be more likely to venture into new distribution channels to make purchases because he will feel less threatened about buying products. In other words, knowing that they can easily return or exchange any unsuitable products makes customers feel a lot safer about buying products in the first place.
- **Customer-initiated contacts.** Customer-initiated contacts occur when customers contact the firm with regard to any aspect of using or purchasing a product. Many marketing field studies have shown that customers who initiate contact with firms exhibit higher levels of customers' loyalty, involvement, and dependence on each of the other product distribution channels. For example, if a customer takes the time to send an email or call a firm on the phone (and that customer receives satisfactory support), the customer has shown the willingness

to take an initiative to contact the firm. Often, these customers are looking for the firm to assist them because they want to continue their relationships with the firm. It is the customers who choose not to contact the firm who feel less of a connection with the firm and are more likely to begin buying from other firms. Therefore, if a customer initiates the connection with the firm, he is signaling the desire to have a relationship with the firm and is more likely and willing to buy across multiple distribution channels.

- **Frequency of web-based contacts.** Web-based contacts are similar to other customer-initiated contacts. However, when customers use the web to initiate contact with companies, it also shows that these customers have a stronger grasp of technology, in general. These more tech-savvy customers show that they trust the Internet as a way to securely communicate with a firm. Not only does this mean that they are more likely to buy through an online channel, it also means that they believe that the firm is properly handling their relationship. So, customers who communicate with you through email are not only signaling a desire to have a relationship, but are also telling you that they trust your firm (because the communication is coming through what is normally considered the least secure and most impersonal communication channel). Therefore, these customers are usually more likely and willing to shop in multiple channels because they have a higher level of trust with the firm.
- **Customer tenure.** Customer tenure refers to the duration during which a customer has been purchasing products from a company. Customers who have longer tenure are usually considered more behaviorally loyal. In addition, customers who regularly purchase over time are customers who are likely to be more familiar with a firm's product offerings and purchase channels. These "loyal" customers have already established that they desire to purchase mainly from one firm. So, if the firm can introduce them to a new channel that offers different services and conveniences, these customers are more likely to venture into that new channel than a customer who is less behaviorally loyal. For example, a customer who has been making regular trips to Stop & Shop for the past ten years might be interested in automating part of their weekly shopping list by considering Peapod as a grocery-delivery option. Because this customer already

has shown that he or she trusts Stop & Shop for the weekly grocery trip, helping him/her to automate part of the list might seem like an attractive prospect.

- **Purchase frequency.** In this case, frequency refers to how often a customer purchases from a firm. Customers who buy frequently are likely to desire efficiency in their transactions and therefore become quite familiar with the firm's offerings and distribution channels. Because of this, customers who purchase frequently are also likely to shop through multiple channels. Just as in the previous example with customer tenure, customers who buy frequently are also likely and willing to venture into new channels that might offer them a higher level of convenience. These customers may be interested in simplifying part of their purchasing behavior and are more likely to consider other channels as purchase options.

Supplier Factors

- **Number of channels used for contact.** Retailers can usually choose from many different contact channels when contacting customers. These can include direct mail, email, telemarketing, sales personnel, and retail stores. These marketing pieces not only give customers information about the products that they can purchase, but they can also guide customers to purchase through difference channels. For example, Sephora sent out an email to its customers allowing them to shop the online catalog, download a printable copy of the catalog, request a catalog be sent to them, order online, order by phone, and even find store locations (see Figure 10.2).

Figure 10.2. Sephora multichannel email

This email from Sephora exposes customers to all its products through multiple distribution channels, enabling customers to do some research. It also gives them access to information about places where they can buy the product. So, when firms can communicate to customers through different channels and about different channels, the customer is more likely to be a multichannel shopper.

- **Type of contact channel.** Just as the number of channels used for contact makes a difference in the customer's willingness to multichannel shop, the type of channel through which the communication is received by the customer also impacts the likelihood of multichannel shopping. For example, when a consumer is contacted through highly personal contact channels (for example, face-to-face interaction), he has a higher likelihood to buy across multiple channels. This is because firms that contact a customer through a highly personal channel can customize the message and reduce the customer's perceived risk about purchasing from the company. Consider, for example, a customer who has been purchasing in your brick-and-mortar retail store. Based on this customer's purchasing behavior, you know that he is a likely candidate to buy through the Internet during the next sales event. If you send a customized message to this customer giving him an incentive to buy online, it is more likely that he will respond to the message and buy in the new channel.

- **Contact-mix interactions.** The number and type of channel contacts can help to predict whether a customer is a multi-channel shopper or a single-channel shopper. However, when there are different interactions between the number and type of contacts, synergistic effects can happen with relation to multichannel shopping (perhaps because marketing message received from different channels may reinforce that message in the customer's mind). This reinforced message is not only likely to cause a customer to make purchases in multiple channels, but it is also likely to lead the customer to buy incrementally more from the firm given the appropriate channels and the appropriate message in that channel for that customer. Just as in the last example, if you know that based on a customer's previous transactions he is likely to buy in a new channel (for example, the Internet), and if you can contact him in multiple channels with the same message, the customer will be more likely to respond. For example, if you send a direct mail to the customer that gives him the incentive to buy in the new channel and then follow up with either an email or a phone call, this customer is more likely to remember this message and is more likely to act upon it and buy in the new channel.

Customer Demographics

Customer demographics are used mainly to try to help profile the different customers who buy in multiple channels. For example, in the case of the B2B firm used in the marketing study described in this section, annual sales, firm size, and firms that resided in particular industries were positively related to multichannel shopping. This information would vary based on the products being offered and the firms who were likely to purchase these products. This means that it would vary in each situation. Customer demographics included in any analysis of customers helps managers understand not only the profile of their own customers who are likely to purchase in multiple channels but also the profile of prospects that are most likely to buy in multiple channels. Armed with this knowledge, this firm can identify new prospects that are more likely to be multichannel shoppers based on their profile information alone and achieve a higher success rate of acquisition of multichannel shoppers. This can prove helpful when a firm has limited resources and has to make key decisions about which customer is most likely going to be profitable in the future.

Are Multichannel Shoppers More Profitable?

Much of the previous section focused on the relationship between a set of drivers and their relationship to customers who are multichannel shoppers. Now that firms can identify multichannel shoppers, are multichannel shoppers really more likely to buy in the future, do they spend more money, and are they more profitable than single-channel customers? To the right side of multichannel shoppers in Figure 10.1 is a list of customer-based metrics commonly measured by firms. These include how much a customer spends (revenue), the percentage of money a customer spends on that firm's products versus a competitor's products (SOW), the customer's past profitability (Past Customer Value [PCV]), the likelihood that a customer will buy in the future (likelihood of staying active), and the Customer Lifetime Value (CLV). These customer-based metrics were compared for customers who shop in one, two, three, and four channels for a specific firm. Table 10.1 lists the results of this analysis.

Table 10.1. Comparison of Customer-Based Metrics

Source: V. Kumar and Rajkumar Venkatesan, "Who Are Multichannel Shoppers and How Do They Perform?: Correlates of Multichannel Shopping Behavior," *Journal of Interactive Marketing* 19(2) 2005: 44–62.

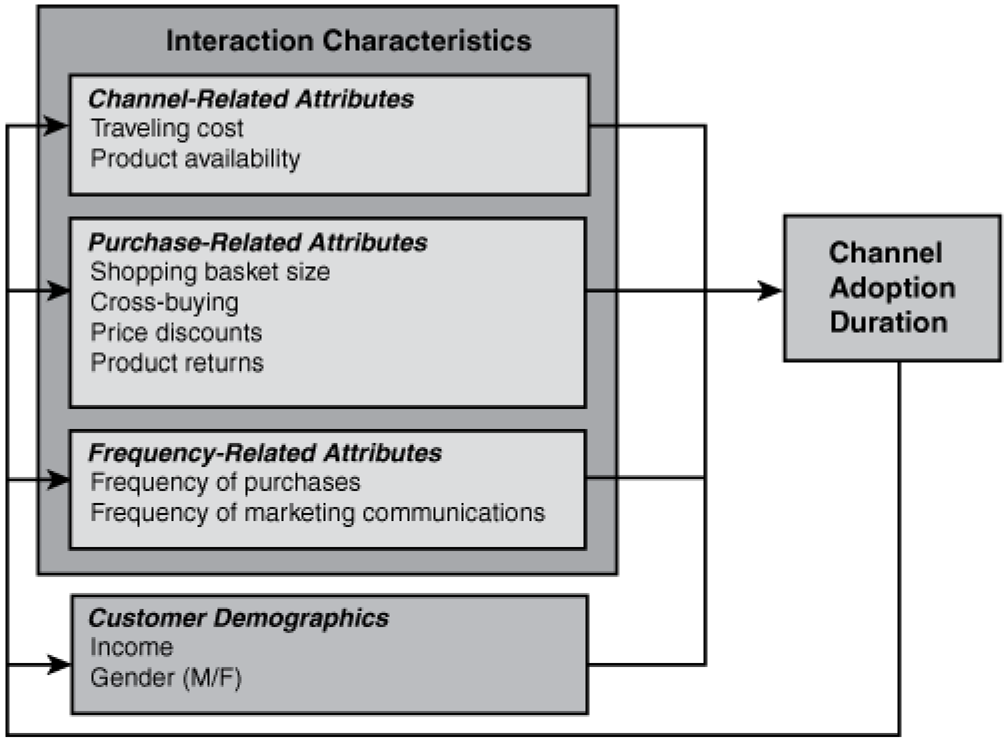
	Shopped in Single Channel	Shopped in Two Channels	Shopped in Three or More Channels
Revenue	$4,262	$5,736	$16,100
SOW	20%	35%	60%
PCV	$6,681	$10,874	$25,625
Likelihood of staying active	11%	15%	54%
CLV	$7,672	$10,325	$28,980

Table 10.1 explicitly shows that as a customer shops across more channels (from one channel to four channels), he spends more revenue with your firm, spends a higher proportion on your firm (rather than with a competitor), has a higher past profitability (which is correlated with future profitability), and has a higher likelihood of buying in the future.

Therefore, if a firm wants to identify candidates to encourage to shop in multiple channels, that firm needs to see which customers show the right signs of being potential multichannel shoppers based on the drivers in the previous section and try to leverage those drivers to encourage multichannel shopping behavior. However, although this shows how multichannel shoppers can be identified by their drivers, it does not necessarily identify actionable strategies for firms to identify which channel a customer is best suited to adopt next.

Determining the Next Channel a Customer Adopts

Based on the previous results, we know that multichannel customers tend to be more profitable than single-channel shoppers. However, when firms want to encourage customers to shop in multiple channels, it is important to identify which channel a customer is likely to adopt next and when he will adopt that channel. This knowledge helps firms to send the right marketing message at the right time to that customer. By doing so, a firm can optimize its marketing spend, increase its return on marketing investment, and in turn encourage the right customers to adopt the right channels at the right time. Therefore, in this section of the chapter, the drivers of channel adoption are identified for a set of customers in a B2C firm that mainly sells apparel in discount stores, full-price stores, and through the Internet. Although these drivers differ slightly because they are in a B2C setting, they are quite similar to the drivers of the B2B firm (see Figure 10.3).



Source: Adapted from Rajkumar Venkatesan, V. Kumar, and Nalini Ravishanker, "Multichannel Shopping: Causes and Consequences," *Journal of Marketing* 71 2007: 114–132.

Figure 10.3. Typical drivers of channel adoption

Channel-Related Attributes

To calculate the time frame until the next channel is adopted, you have to consider that each channel has different attributes, which include the time between when the product is ordered and when the product is received (product availability) and the accessibility and convenience of obtaining the product (travel cost). These channel attributes are key factors of when a customer is likely to venture into a new channel:

- **Travel cost.** In this study, the travel cost is the distance between the customer and the retail store. In the case of an actual retail store, the travel cost (in time and effort) involves the customer actually traveling to the store to make a purchase. In the case of an online store, this travel cost is negligible, especially if the customer has access to the Internet at his home or office. Because of these varying travel costs across channels and the incentive for customers to always reduce their total travel costs, a customer who travels a lot to make purchases is more likely to venture into a channel that requires less travel cost than a customer who travels very little to make purchases. In a nutshell, this means that it is more likely for a customer who travels to the retail store to shop to enter into a new channel of purchasing (for example, the Internet) than it is for a customer who already shops in a channel with a very small travel cost. For example, if a customer lives an hour away from a key shopping destination (for example, a shopping mall), the customer will make fewer trips because the cost to travel there is so high in both time and effort. This does not mean that the customer will never travel to shop; but if a firm could enable this customer to purchase between shopping trips in a setting that requires fewer traveling costs (for example, online or catalog), this customer will be more willing and ready to adopt the new channel more quickly.

- **Product availability.** The immediate availability of a product refers to the time frame between which a customer chooses to purchase a product and when he can actually use the product. When some customers make purchases, they want to have the product in their hands immediately. In addition, some customers want to have a richer experience with the product (that is, the ability to interact with the product). For example, a customer who buys a pair of shoes through a retail store can go in and try the shoes on before purchase (interaction) and then receive the product immediately after the decision to purchase has been made. On the other hand, a customer who makes a purchase through a mail-order catalog has to wait for the product to arrive after the order has been placed. That customer can interact with the product only when it arrives in the mail. Because of this, customers who are not able to have their product immediately available are more likely to adopt a new channel sooner that can offer them immediate product availability.

Purchase-Related Attributes

- **Shopping basket size.** In this case, the size of a customer's shopping basket refers to the number of items a customer purchases in a single shopping trip. Different-size baskets are often related to different patterns of shopping behavior. For example, a customer who always has a small basket size (fill-in trips) often has an immediate or unplanned shopping trip for which only a couple items are needed to fill the basket. This customer is usually more willing to pay higher prices for the products because the need and immediacy of the shopping trip is so urgent. For example, a convenience store often charges higher prices than a larger grocery store, but customers who only need to buy one or two items find the convenience worth the price premium. On the other hand, a customer who tends to have a large basket size is more likely to plan the shopping trip and make consistent visits to a particular store. This customer is usually satisfied with the particular store because he is behaviorally loyal (making consistent trips over time) and buying a large basket each time. However, the customer who buys only a moderate amount each time usually is the customer who is the most sensitive to the price of the products. This customer tends to purchase items that are on sale or display. This implies that these customers are more deal prone and have a transactional rather than a relational focus with the firm. That is, if another firm offers him a better deal, there he will likely switch. For these reasons, the general size of a customer's shopping basket can give firms different signals about channel adoption. Customers with very large or very small basket sizes are more likely to adopt new channels sooner because they are looking more for convenience and the automation of regular large shopping trips than are deal-prone customers with an intermediate basket size.

- **Cross-buying.** Similar to the previous section on the typical correlates of multichannel shoppers, cross-buying refers to the number of product categories from which a customer purchases. Because a customer who buys across more channels is more likely to be a multichannel shopper, it is also the case that a customer who buys across multiple channels tends to adopt new channels sooner. The reasoning for this is similar because customers who buy across more product categories are more familiar with the firm's offerings and distribution channels and in turn may find that different channels offer different benefits for different product categories.
- **Price discounts.** The level of price discounts refers directly to the depth of the price discounts that a store puts on its products. Firms that place higher discounts on products are more likely to encourage customers to adopt new channels sooner. This is especially the case

when customers are offered discounts in channels that they have yet to adopt. When customers venture into a new channel with this price discount incentive, they are not only more likely to adopt the channel sooner, but they are also encouraged to buy more across multiple channels. Consider the case of a customer who has been buying regularly from Best Buy, for instance. If Best Buy sends that customer an offer to purchase through the online store with a 15% discount if he buys within the next two weeks, the customer is more likely to adopt the new channel than if he receives a similar message that does not offer a discount.

- **Product returns.** Product returns are not necessarily bad; they can help build the relationship between the firm and the customer when handled in a satisfactory manner. To this extent (similar to the previous study), the number and timing of product returns by a customer can signal the willingness of a customer to adopt a new channel. For example, if a customer buys a product through the online store, the firm can tell the customer that the product can be returned (if it’s not satisfactory) to the local brick-and-mortar store. This policy gives the customer a chance to work with a salesperson face to face (in case of a return) and may introduce the customer to the brick-and-mortar store as a potential new channel for purchases. Customers who are comfortable returning unsatisfactory products tend to be more willing than customers who do not return products to adopt a new channel of purchase (especially when the purchase and product return occur across different channels).

Frequency-Related Attributes

- **Frequency of purchase.** Just as in the previous study, customers who purchase more frequently are more familiar with what the firm has to offer and what its distribution channels are. To the extent that the purchase occasions are satisfactory for the customer, the customer begins to feel less threatened when buying from that company and is more willing to adopt new purchasing channels. Therefore, the higher the purchase frequency, the shorter the duration until the customer adopts the next channel.
- **Frequency of marketing communications.** The marketing communications that a firm has with a customer plays a significant

role in the channels that a customer adopts. Referring back to Figure 10.2 (Sephora email), a firm that can help guide the customer to new channels can get customers to venture into new channels sooner by just making them aware of the channels and giving them incentives to purchase in those new channels. However, a firm needs to be careful not to saturate the customer with too many marketing communications. A customer who receives too many marketing communications will begin to tune out the firm and ignore the purchasing incentives. Therefore, a firm needs to send a moderate number of marketing communications with the “right” messages to get the most out of the marketing communications. For this reason, marketing communications are related in a U-shaped manner to the time until a customer adopts a new channel.

Customer Demographics

Just as in the previous section, customer demographics are again included in the study to help firms identify the types of customers who are most likely to adopt a new channel sooner. In this study, gender and income were used to help classify customers to identify multichannel shopping prospects. The results of this study showed that male customers with lower incomes were more likely to adopt a new channel sooner than female customers with higher incomes. Although this result may vary for different industries and firms, by using customer demographic information in the framework of this study, the focal firm can better identify prospects who are more likely to adopt new channels sooner and in turn acquire prospects who are more likely to adopt new channels faster.

The duration to adopt a channel by a customer can be modeled using a modified proportional hazard model. For each customer, the duration to adopt the second channel and the third channel, respectively, may be influenced by a common factor that is specific to that customer. We need to take into account the effect of such a customer-specific factor, which is called *shared frailty.* Incorporating the impact of shared frailty and those of the drivers of channel adoption, we can express the modified proportional hazard model as follows:

The probability of a customer adopting j^{th} channel in the immediate time period given that he/she has not adopted the channel until now = Baseline probability × impact factor × shared frailty.

The details of the model specified can be accessed through www.drvkumar.com/mcp.

The coefficients (or weight for each driver) of the model are estimated using maximum likelihood estimation, which selects the coefficients such that the duration of adoption predicted by the model matches best with the observed durations of adoption of second and third channels. Because the shared frailty terms are customer specific, the model accounts for customer heterogeneity.

Channel-Adoption Duration

Knowing the timing and adoption patterns of each customer is a key piece of information that enables managers to target certain customers at certain times for multichannel marketing. In fact, the average time it took for a customer with this firm to adopt a second channel was around 15 months, and then an additional 10 months to adopt the third channel. However, the results of this marketing study with the B2C apparel company showed that it did matter which channel was adopted first, when considering which channel is most likely to be adopted next and when that channel will be adopted. For example, when adopting a second channel, customers who first adopted the full-price store took 27% longer than the customers who first adopted the discount store and 6% longer than the customers who first adopted the web channel. So, managers should not necessarily assume that it will take each customer the same amount of time to adopt the second and then the third channel.

So, how close was this study able to get in accurately predicting the actual time until the next channel adoption? The mean absolute deviation between the predicted time to adopt and the actual adoption time for each customer is about five months for the second channel adoption and about four months for the third channel adoption. These results show that managers can accurately assess the time and channel that each customer is most likely to adopt next. Therefore, managers *can* target selected customers with the right multichannel marketing message at the right time to encourage timely new channel adoption.

Implementation

The model to predict the channel-adoption duration was applied to a sample of customers from this B2C retail firm consisting of single-channel and two-channel shoppers. A marketing campaign was developed to target the single-channel shoppers, encouraging them to adopt the second channel. Similarly, the two-channel shoppers were targeted to adopt the third channel. The sample size chosen for this specific implementation was 3,800. From this base, a test group and a control group were formed of approximately equal size.

The campaign offered a discount certificate to encourage the customers to purchase from another channel. This incentive ranged from $5 to $25 depending on the CLV of the customer. The higher-CLV customer was given a higher level of incentive. Based on the campaign, of the 1,902 customers in the test group who were targeted, 77% of them adopted the additional channel. In the control group, of the 1,898 customers, only 12% adopted the additional channel during the campaign period of 6 months. The shopping behavior of the customers in the test group was monitored for a period of 12 months. The net gain in revenue due to the addition of one more channel was on average about 80%. In other words, if the customers were spending on average $400 in one channel, they were now spending about $720 when another channel was added to their shopping portfolio. The average marketing campaign cost, including the discount, was about $40. The increase in revenue was about $320. Therefore, the return on investment was about 8 times (or 800%). As you can see, contacting the right customers at the right time to encourage adopting another channel results in higher profitability.

Are Multichannel Customers More Profitable?

The results of the two field studies in this chapter explicitly show that managers can grow customer profitability by encouraging them to shop in multiple channels. By creating this multichannel experience for customers, managers derive several benefits, especially with regard to customer relationship management (CRM) initiatives: customer retention and customer growth. One of the main reasons managers see multichannel shoppers as more profitable is because a customer can get so much more out of multiple channels. For example, the attributes of channels provide different incentives to purchase from a firm. A customer who only seldom makes trips to a specific retail outlet might begin to purchase more if encouraged to enter the online or mail-order catalog channels. Even if customers enter these other channels, they can still make regular trips to the retail store (and make add-on purchases in the online environment that they would not usually make).

In addition, by providing customers with multiple channels to purchase and research, firms have the chance to create some channel lock-in and channel synergies that are not available with only one channel. An online channel, even if direct online purchasing is not available, may encourage some customers to visit the store to make a purchase. In some cases, enabling a customer to buy online and pick up in the store can even give more channel synergies. This scenario combines online research (convenience) and retail store pickup (immediate product availability).

Finally, customers who purchase in multiple channels tend to have a deeper relationship with the firm and are more loyal to the firm, because the customer is exposed to more of the products/services a firm provides and can get more utility out of doing business with the firm. Therefore, the strength of the relationship increases, and in turn the customer will rely more on that firm for his or her purchasing needs, thereby increasing the customer's spending and profitability with the firm.

Does Order of Channel Adoption Matter?

As the latter study showed, the order in which a custumer adopts a new channel and when depends on the attributes of the channels in which the customer currently shops and the attributes of the channels that the customer has yet to adopt. If a manager can understand the relationship between customers and specific channels, the firm can better target customers for multichannel (existing and potential) marketing campaigns.

For example, perhaps a firm currently has a brick-and-mortar store and a mail-order catalog and is considering introducing a new Internet channel. The firm must ask whom it should target to buy in this new channel. To answer this question, the firm needs to understand which of its customers are most likely to adopt a new channel with attributes similar to that of the web channel (low travel cost and low immediate product availability) and how this channel can potentially fit in with the existing channels offered (for example, buy online and pick up in the store). Targeting the right customers with the right incentives can provide a big payoff for the firm.

Managing Multichannel Resources

How does a firm manage its resources when it comes to multichannel shopping? A firm that wants to implement a campaign to encourage customers to adopt new channels should consider running a field experiment on a sample of its own customers before reaching out to the entire customer base. By doing so, a firm can first determine which of its own customers are multichannel shoppers and which customers are most likely to adopt this new channel. Then, the sample customers' responses to the field study can be used to assess the return on marketing investment of a potential campaign to all the customers and whether the customer-firm interactions changed after the customer adopted the new channel. Based on a successful field study, the firm will better understand multichannel shoppers and be able to identify not only its own customers who are most likely to adopt new channels, but also new prospects who are likely to be multichannel shoppers.

Conclusion

Increasing the number of channels leads to positive outcomes for businesses—including giving customers more search and purchase options and giving firms synergistic effects on customer profitability. Therefore, it is profitable for firms to operate businesses across multiple channels. The framework discussed in this chapter provides managers with several demographic variables that profile customers who are likely to shop across multiple channels. Higher profitability results from contacting the right customers at the right time—and encouraging the customers to adopt another channel. Finally, managers can investigate the benefit of designing reward programs to offer incentives to customers for purchasing across multiple product categories and channels.

11. Linking Investments in Branding to Customer Profitability

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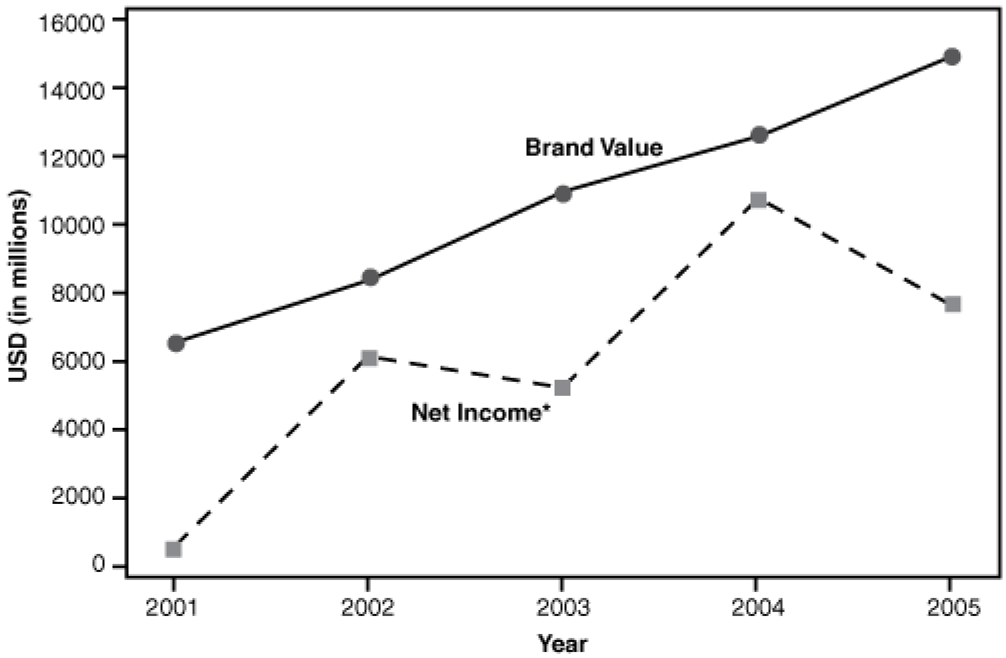
Relevant Issues

- Should we invest in building brand equity or customer equity?
- How does building Individual Brand Value (IBV) maximize customer profitability?

A typical dilemma faced by any corporate board is whether to invest in building brands or to invest in building the customer base. Which of these routes ensure maximum profitability? The obvious answer is probably to invest in both. However, it is difficult to estimate how investing in brand building contributes toward attaining higher profitability.

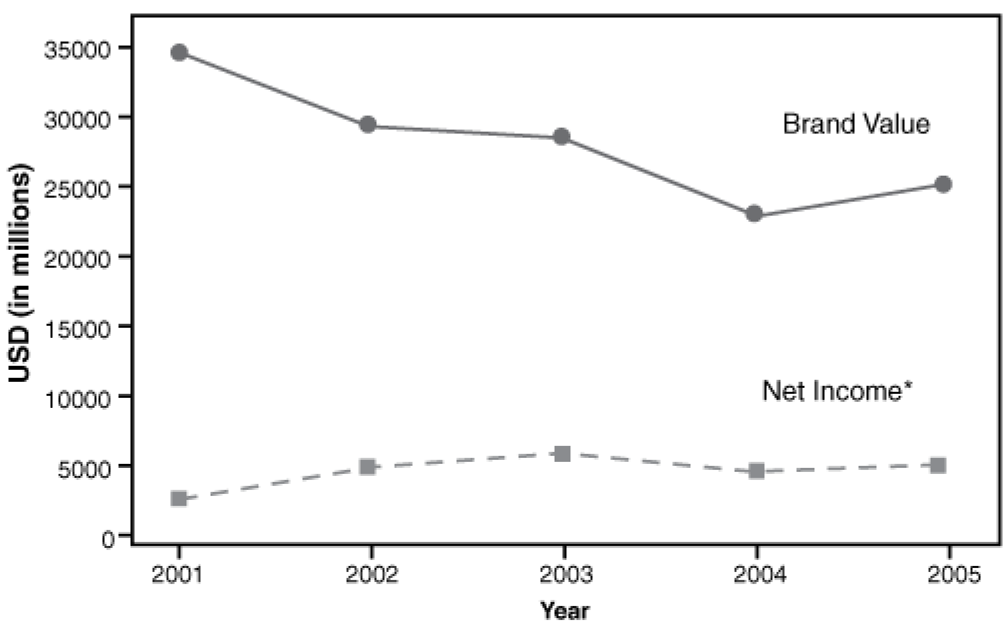
Consider the example of two leading electronics manufacturers, Samsung and Nokia. The change in brand value and the net income for Samsung and Nokia (2001 through 2005) is shown in Figures 11.1 and 11.2, respectively. Figure 11.1 shows that Samsung's brand value has been steadily increasing over that period, and the net income for this period has been following an upward trend. This correlation shows an association between a firm's brand value and the firm's net income.



Source: The data for this figure was obtained from http://bwnt.businessweek.com/brand and Annual Reports from www.samsung.com.

Figure 11.1. Relevant Issues: The change in brand value and net income for Samsung (2001–2005)

**** The net income has been scaled by a factor of 1,000 to make it comparable.***



Source: The data for this figure was obtained from http://bwnt.businessweek.com/brand and Annual Reports from www.nokia.com.

Figure 11.2. The change in brand value and net income for Nokia (2001–2005)

**** The original values of net income in euros (million) have been converted to U.S. dollars (million).***

Figure 11.2 shows that Nokia's brand value has been following a declining trend between 2001 and 2005, and the net income is almost stagnant over the same period. This correlation shows that declining brand value can affect a firm's overall performance. Even though these trends clearly demonstrate the importance of building brand value and how doing so will affect the bottom line, firms do not have a clear set of guidelines as to how to structure their marketing and brand investment strategies to boost their brand value. Typically, what they have is the aggregate-level brand value perception. To design and execute effective brand management strategies, firms need to understand exactly how each of their actions will affect the customer's Individual Brand Value (IBV). In this chapter, we forward a framework that firms can use to effectively link an IBV to the Customer Lifetime Value (CLV). These strategies help firms better understand this link and redesign their strategies to suit the needs of the individual customer.

Brand equity and customer equity have traditionally been viewed as two separate marketing assets. However, building a brand through traditional approaches does not necessarily achieve growth in the CLV. Traditionally, the effect of brand was measured through immediate change in sales, after implementing a marketing initiative. This cannot be a good measure for evaluating the brand because brand building also seeks to influence customer behavior in the long term. Brand value has an effect both on the "behavioral" (demonstrated by short-term purchase behavior) and "attitudinal" (long-term behavior) loyalty of the customer, and any brand evaluation measure should incorporate both these factors to obtain a comprehensive picture. Customers with greater attitudinal loyalty have a greater likelihood of future purchase and are more likely to recommend the brand to others. Hence, when evaluating a brand, it is not only the financial value generated by the brand that should be considered, but also how the customers perceive the brand.

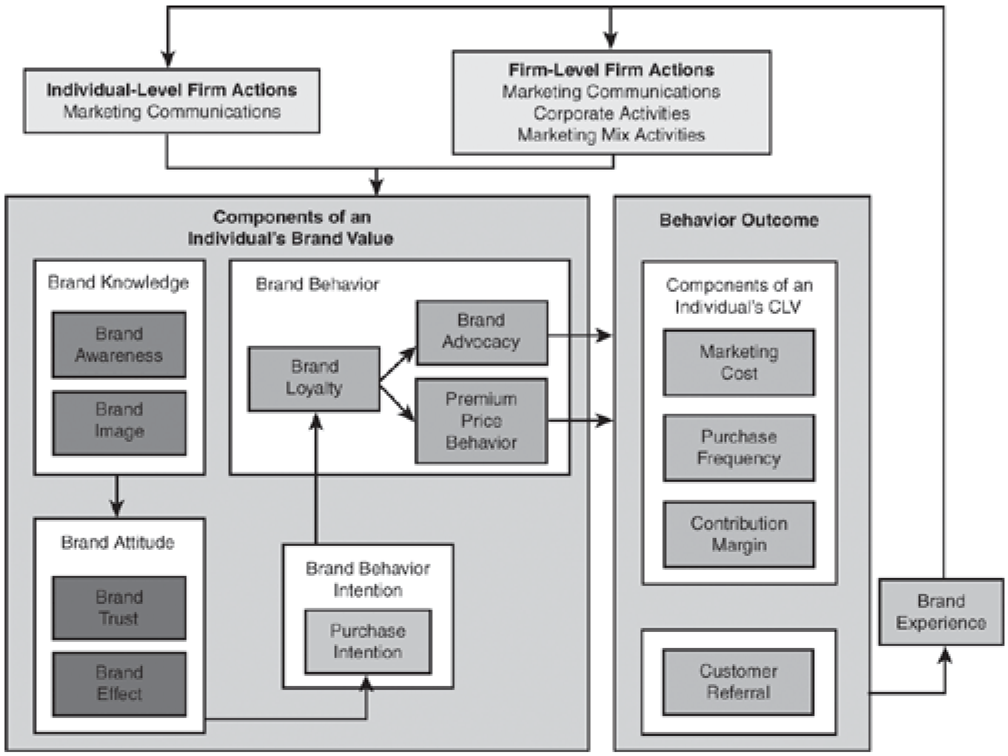
Aggregate versus Individual Brand Value

To address the question “how does brand add value to a firm?” we need to understand how a given brand is perceived by its customers and how customers react to the brand. Traditionally, this customer-brand relationship has been explored only at the aggregate (or collective) level. It was believed that by shaping a strong brand idea in the marketplace, all the customers would react in a similar manner. In reality, the value of a brand is individual based, and different customers have a varied perception of a brand. Therefore, if a firm focuses solely on managing the brand value at the aggregate level, it severely limits the firm’s ability to reach each of its customers effectively.

Various factors affect a customer’s brand perception; therefore, firms shouldn’t restrict themselves to sending a uniform brand message to all the customers. Also, firms should understand that not all customers are equally profitable. Therefore, firms should specifically attempt to target such profitable customers and send specialized brand messages.

Framework for Linking Brand Value to CLV

A key to address these issues is to establish a link between an IBV and CLV to manage individual customer brand value. CLV is particularly well suited to address this issue because when calculating the CLV of a customer, firms must consider both the short-term and long-term “attitudinal” and “behavioral” loyalty of a customer. Linking CLV to IBV can help to maximize the lifetime value of customers. Therefore, this chapter explores the link between IBV and CLV and explores the relationship between IBV and CLV. First, a conceptual framework is introduced, as illustrated in Figure 11.3, which can be used to link IBV to CLV. This framework enables a firm to optimize a customer’s lifetime value, thereby allowing simultaneous growth in brand equity and customer equity.



Source: V. Kumar, M. Luo, and V. R. Rao (2007), "Linking an Individual's Brand Value to the CLV: An Integrated Framework," Working Paper, University of Connecticut.

Figure 11.3. Framework for linking an individual's brand value to the CLV

According to this framework, linking the IBV to the CLV is a dynamic process, in which each aspect of the individual's brand value such as brand knowledge, brand attitude, brand behavior intention, and brand behavior contributes toward the individual's lifetime value with the firm, as shown in Figure 11.3. A customer's brand knowledge plays an important role in this process. Brand awareness and brand image are the two aspects that make up a customer's brand knowledge. A customer's brand knowledge contributes toward building his/her brand attitude, which consists of the customer's trust in the brand and brand effect. By influencing the brand attitude of a customer, the firm can influence the brand behavior intentions of the customer, and in turn affect the brand behavior. The brand behavior is driven by building brand loyalty, which in turn influences brand advocacy and premium price behavior of the customer. By following this framework, the firm can effectively manage the brand value associated with each customer, and thus influence the overall lifetime value of the customers. The following sections discuss each of these components of IBV in detail and explore their link to the overall CLV.

Brand Knowledge

The true value of a brand lies in how customers perceive the brand, not in the brand itself. Hence, a positive brand knowledge held by the customers will positively impact the brand value. Brand awareness and brand image constitute the two components of brand knowledge:

- **Brand awareness.** Awareness of a particular brand has multiple effects on the customer's purchasing behavior. Brand awareness guides new customers into purchasing a particular product, even if the customer is new to the product category. This will continue even after the customer has made the first purchase. Thus, increased awareness of the brand increases the purchase probability. Hence, repeated efforts should be made to make the brand a part of the customer's consciousness. Also, such repeated exposure to the brand will generate a positive outlook in the customer. Therefore, the greater the brand awareness for a customer, the greater his/her brand value.

Coca-Cola is a good example of a firm that enjoys extraordinary brand awareness throughout the world. At the moment, Coke's products are sold in more than 200 countries around the world, and Coke has almost 100% brand recognition in the Western world.[1] In the words of Asa Chandler, Coke's first proprietor, "We are firmly convinced that wherever there are people and soda fountains, Coca-Cola will...win its way quickly into the front rank of popularity."[2]

- **Brand image.** Brand awareness represents only the first level of brand knowledge. Brand image is affected by how customers perceive a particular brand and what they associate it with. Hence, brand image is not only influenced by how a firm markets its brand, but also by all other brand-related activities undertaken by the firm. Also, note that a customer's brand image changes with time, as the customer becomes more familiar with the products/brand. So, as the customer's expertise and knowledge about the product and brand increases, the customer becomes more aware of how effectively the brand could satisfy his/her needs. Brand image assumes an important role in building brand knowledge, and it can lead to a negative brand value if the customer has an unpleasant brand image associated with it. Therefore, the greater the brand image for a customer, the greater his/her brand value. Samsung has, over the years, created a hip image among its customers with its cutting-edge technology and world-class design from a low-end brand image. Recently, it organized a competition to invite members of its brand community to come up with designs for its upcoming MP3 gadgets. This, apart from involving the members of the brand community, reinforces Samsung's brand image of being hip and cutting-edge.[3]

Brand Attitude

Brand attitude is the attitude each customer forms about the brand, and it is mainly formed by brand trust and brand effect:

- **Brand trust.** Brand trust refers to a customer's willingness to trust the brand to satisfy his/her needs. Brand trust assumes particular significance when customers cannot objectively evaluate the quality of a product. Brand trust is developed over time, as the customer acquires positive brand knowledge through experience and through information from external sources. As the customer becomes more familiar with the brand, brand trust moves into the next level of brand intimacy. Brand intimacy is important to cultivate attitudinal loyalty with the customers. Therefore, the greater the brand trust for a customer, the greater his/her brand value. BP's practice of moving into solar and hydrogen energy has established its brand image as environmental friendly. However, its accidental oil spills from the trans-Alaskan pipeline could easily break consumers' trust and cast doubts on the company's real philosophy on environment issues.[4] It is essential for a firm to be consistent in practices to build brand trust.
- **Brand effect.** Brand effect is a customer's positive emotional response toward a brand. Whereas brand trust generates a positive rational response toward a brand, brand effect tries to generate a positive emotion toward the usage of the brand. Brand effect can be demonstrated in different levels of the relationship between the firm and the customer. Brand effect is created by positive associations and past experience and indicates a deeper relationship between the brand

and the customer. One standout example of brand effect is the strong negative reaction incited among customers when Coke Classic was changed to New Coke.

The greater the brand effect for a customer, the greater his/her brand value. Several years ago, British Airways developed a beautiful advertising campaign with the slogan “It’s the way we make you feel that makes British Airways the world’s favorite airline.” Many people might take such a message to heart: It is the journey rather than the destination that counts. It serves as a perfect example of selling the product to the heart of consumers.[5]

Brand Behavior Intention

Brand behavior intentions constitute the brand advocacy of customers, the brand loyalty, whether customers are willing to make a purchase at a premium price, and the actual brand purchase behavior. This reflects the actual effect of the marketing actions on the brand behavior of the customers:

- **Purchase intention.** Brand behavior intention shows how much a customer values a brand and is demonstrated by the brand purchase intentions. The purchase intention of a customer gains importance when there are multiple competitors in the market and gives the focal brand an edge in various purchasing situations. Therefore, the greater the brand purchase intention of a customer, the greater his/her brand value. Wal-Mart increases the purchase intentions among its customers by offering low prices and through its marketing slogan “everyday low prices,” which has attracted shoppers around the world. In 2003, 138 million shoppers visited Wal-Mart stores every week. In 2002, 82% of all American households made at least one purchase at Wal-Mart.[6] These numbers show how successful Wal-Mart has been in creating purchase intention among customers.

Brand Behavior

- **Brand loyalty.** A customer has brand loyalty when he/she makes repeated purchases of a preferred brand and shows both attitudinal and behavioral loyalty to the brand. Fluctuations in the market and competitors offerings will have little effect on a customer’s brand loyalty. The higher the brand loyalty toward a brand for a customer, the higher his/her brand value. Apple Computers (now Apple) is known to have a customer base with strong loyalty to the Apple or Mac brand. Its customers go beyond brand loyalty and exhibit a religious-like zeal toward Apple and its products.[7] Building and maintaining such devotion toward the brand has been crucial for the recent success of Apple's products.

- **Brand advocacy.** Brand advocacy refers to the customer establishing a relationship (through joining a brand community and encouraging other customers to do so) with other customers who use the brand. Harley Davidson is a good example of a brand with a strong brand advocacy forwarded by a community of customers who are very loyal to the brand. The company-sponsored Harley Owners Group has 886,000 members, who regularly organize rides, training courses, social events, and charity fund-raisers. About a quarter of a million of them went to Milwaukee on Labor Day to celebrate the brand's centennial in 2003.[8] Such brand communities share information, promote a subculture, and provide assistance to other customers. Therefore, the greater the brand advocacy for a customer, the greater his/her brand value.
- **Brand price premium behavior.** Brand price premium behavior refers to the customer's willingness to pay a premium price to buy a preferred brand over other products. This behavior reflects the customer's brand loyalty and a willingness to pay extra to maintain the quality. This also proves that the customer will be less willing to switch to a competitor's brand. Therefore, the greater the brand price premium behavior of a customer, the greater his/her brand value. For example, customers from all over the world spend about $1,000 or more for a Louis Vuitton handbag in the new Murakami line.[9] Because Louis Vuitton has built such an exclusive brand image over the years —through exclusive brand-building events, stringent quality control, and other measures—its customers are willing to pay a great price premium for its products.

Predicted Behavior Outcomes

Customers with greater brand value, it has been found, are more likely to engage in activities that result in an increase of CLV when compared to customers with low brand value. The various factors that constitute the individual's brand value, such as brand knowledge, attitude, and behavior intentions, affect the behavior of customers, and they are linked to the CLV through the following customer behavior outcomes:

- **Lifetime duration.** Various factors, such as the purchase frequency, profitable lifetime duration, and contribution margin in every purchase occasion, are used to measure the lifetime value of a customer. The word-of-mouth behavior of customers also factors into the calculation of the CLV. The various factors that affect IBV, such as brand knowledge, attitude, and behavior intentions, affect the CLV. Therefore, the greater a customer's individual brand value, the greater his/her lifetime value.
- **Purchase frequency.** Purchase frequency is a measure of the intensity of the customer's relationship with the brand. The more frequently the customer purchases a brand, the greater utility the customer perceives in the brand. Purchase frequency can also be increased by positive brand knowledge. The better the customer can recall the brand and its attributes, the more he/she is likely to purchase from the brand. A customer familiar with the brand also seeks out additional product information, and this creates opportunities for the firm to sell more. A customer with a higher level of brand advocacy is more likely to resist offers and promotions from competitors, and therefore is more likely to come back to the focal brand for more purchases (and thus increase the purchase frequency).
- **Contribution margin.** A customer who pays a premium price for a brand drives up the contribution margin. Another method of increasing the contribution margin is brand extension. By building on the core image of the parent brand, firms can introduce new products/services. This is aided by the customer's knowledge of the brand and awareness. Because this involves a lower cost of introduction, an increase in contribution margin results. Therefore, the greater the brand value of a customer, the greater his/her contribution margin.

- **Customer referrals.** Customers tend to recommend a brand to others when they are more aware of it. Customer satisfaction and trust also play a great role in generating positive word-of-mouth. Brand satisfaction and brand advocacy are factors that directly and positively influence customer word-of-mouth behavior. Because one of the main functions of brand advocacy is to propagate information about the brand through building relationships with other customers and through brand communities, it directly contributes to a positive word-of-mouth behavior.

How to Link the IBV to CLV

The various components of the IBV and the CLV were discussed in the previous section. The next step is to link these components by using the existing data and the modeling techniques. First, information regarding the various components of the IBV can be obtained from survey data, and customer transaction data can be used to obtain the information required to calculate the various components of CLV. After this information has been gathered, the next step is to use sophisticated estimation techniques to estimate how these components affect each other. The components of IBV are obtained using a ten-point scale from a sample of customers. For the same customers, CLV is computed at that time. The following equations map out the interaction between these components.

Equation 11.1

How the various components of IBV are linked:

Brand Attitude = function of (Brand Knowledge)

Equation 11.2

Brand Behavior Intention = function of (Brand Attitude)

Equation 11.3

Brand Behavior = function of (Brand Behavior Intention)

Equation 11.4

How IBV and CLV are linked:

CLV = function of (Brand Behavior)

These equations show the dynamic process of transferring an individual's brand knowledge (brand awareness and brand image) to his or her brand attitude (brand trust and brand effect), brand purchase intention, and brand behavior (brand loyalty, premium price behavior and brand advocacy), and then ultimately to his or her lifetime value to a firm.

The equations could be simultaneously estimated using Seemingly Unrelated Regressions (SURs). To improve the regression estimates, SUR utilizes the correlations among the errors in equation 1 through 4. When the coefficients from the system of equations are obtained, genetic algorithm can be used to achieve the optimal level of IBV so that a customer's lifetime value is maximized under the budgetary constraint.

To obtain the optimal level of CLV, brand behavior such as brand advocacy and premium price behavior need to be optimized, too. Therefore, appropriate brand message should be sent to increase a customer's level of brand awareness and favorability of brand image. Such favorable brand knowledge would shape a customer's positive attitude in terms of brand trust and brand effect. Brand purchase intention will be affected and revealed through behavioral brand loyalty (manifested as higher purchase frequency). Finally, a truly loyal customer would not only advocate a brand but also be willing to pay a premium price for the quality of the product.

Therefore, it is essential to monitor the components of an individual's IBV. Most important of all, it is necessary to understand the process of building brand knowledge that eventually leads to brand behavior, which induces favorable behavior outcomes such as longer duration, higher purchase frequency, higher contribution margin, and customer referral. A customer's lifetime value is calculated based on the behavior outcomes, as mentioned earlier. In summary, the components of IBV will be simultaneously optimized so that CLV is maximized.

By following these steps, managers can devise an overall strategy to deal with each of the components of IBV and CLV and to maximize the brand value of the customer so that CLV is ultimately improved.

The Role of Communication in Linking IBV to CLV

Communication plays an important role in linking IBV to CLV. This communication includes both planned and unplanned marketing initiatives. These include word-of-mouth, product messages, corporate activities, marketing-mix activities, and marketing communications. Business practices, overall philosophies, mission statements, and so on can be communicated through corporate events. These activities have an important role to play in building a brand. The product performance, price, choice of distribution channel, and so forth form the core of the product message. But the satisfaction derived by the individual customer by using the brand moderates the relationship between the brand communication and the IBV. The new information gathered by the individual through using a brand will lead to the formation of a complex form of brand knowledge. Customer satisfaction (or dissatisfaction) goes a long way in deciding a customer's brand knowledge.

Implications of Linking IBV to CLV

To successfully implement this strategy and achieve positive growth in both IBV and CLV, the following seven steps are suggested:

1. Calculate the CLV of customers at the individual level (as described in Chapter 3, "Customer Selection Metrics").
2. Rank order the customers based on their CLV.
3. Segment the customers into ten deciles, from the highest to the lowest CLV scores.
4. Take a small percentage (say 10%) of customers from each decile and obtain information about the components of their brand value.
5. Using this information, link the components of the IBV to the CLV and obtain an importance or weight for each component of the brand value.

   Consider this example where the focal firm is measuring the brand value of one if its important customers, Bob.[10] Bob's IBV and its various components are shown in Figure 11.4. You can see from the figure that Bob has an acceptable level of brand awareness and brand image, and he trusts the brand, but he has no attachment to it. However, Bob has lower brand behavior intentions (because he scores low on premium price intention, brand loyalty, and brand advocacy).

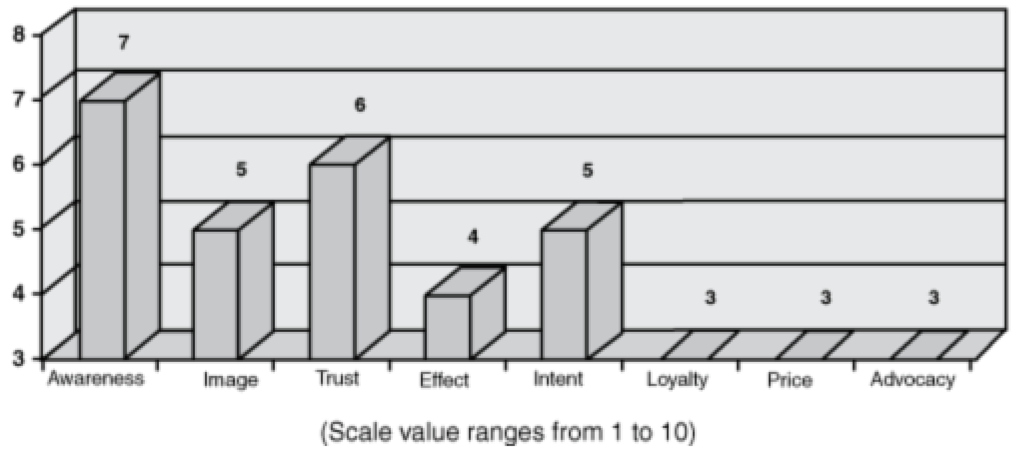


Figure 11.4. Bob's measured individual brand value

6. After the individual attributes of Bob's brand value have been measured, the firm can take measures to optimize the value of the various factors of his brand value to maximize his CLV.

   Implementation of this strategy will be subject to the budget constraints of the marketing resources allocated to Bob based on his CLV score. Such optimized values of the components of Bob's brand value are shown in Figure 11.5.

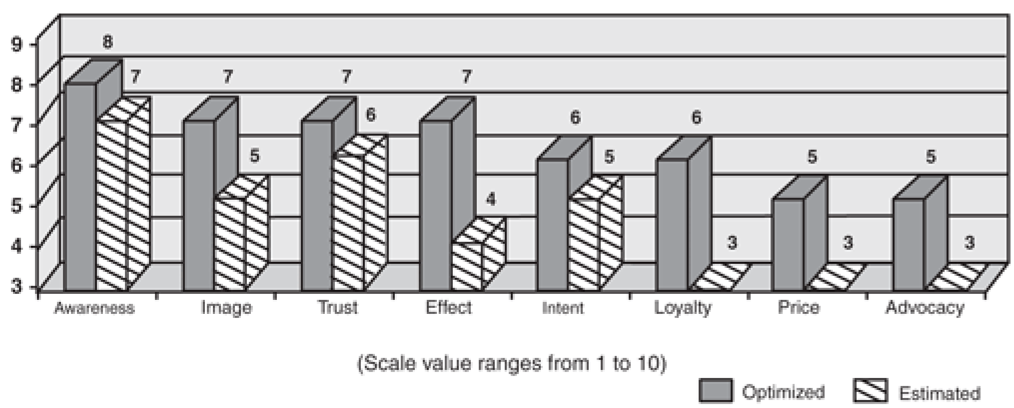


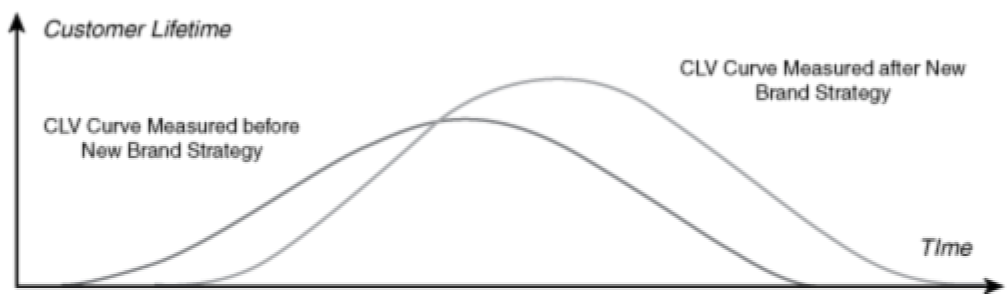
Figure 11.5. Bob's estimated and optimized IBV

7. After the components of brand value have been optimized, the firm can translate these optimized values to concrete brand management strategies.

   For instance, it is shown in Figure 11.5 that Bob's brand value increases tremendously with his brand effect and loyalty. Therefore, the focal firm can send personalized marketing messages to enhance Bob's emotional connection with the brand. If the firm finds out that there are other high-CLV customers who share Bob's view of the brand, the firm can enhance its brand effect by initiating a suitable advertisement campaign.

The firm sent out an invitation for Bob to join the loyalty program to build his brand loyalty. After implementing the new brand management strategies, the focal firm found that Bob's CLV curve (as illustrated in Figure 11.6) improved greatly, and such an increase was driven directly by increasing Bob's brand value. By the firm implementing these brand value strategies, Bob's CLV score increased from about $12,000 to about $18,000, and the cost of implementing these customized strategies to Bob was about $600. The ROI on implementing these strategies for Bob is 10, or 1,000%. This demonstrates the effectiveness of these strategies and how implementing these will directly lead to profit maximization.

Figure 11.6. Bob's CLV curve measured at different times



The goal of a successful individual brand management strategy is to maximize a customer's lifetime value, driven by a brand in all three stages of the customer life cycle: acquisition, retention, and attrition, as shown in Figure 11.7.

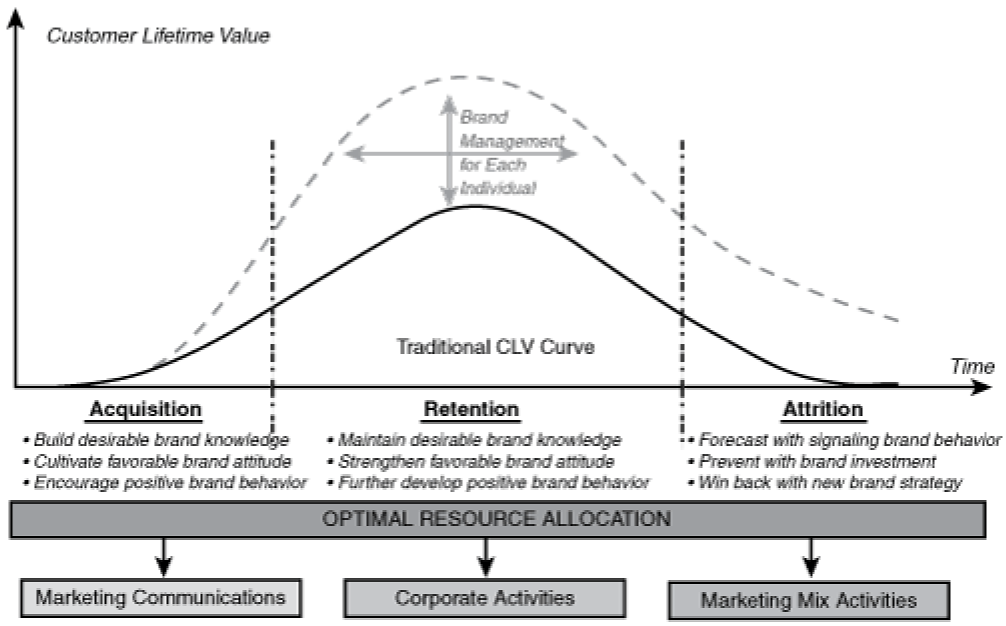


Figure 11.7. Customer life cycle brand management: An integrated framework

When approaching a potential customer, the firm's goal should be to build the brand knowledge of the customer, cultivate desirable brand attitude, and encourage positive brand behavior intentions. When the customer moves into the intention stage, a firm should try to maintain or update the existing brand knowledge of the customer by sending personalized brand messages. The customer's brand attitude and brand behavior intentions can be further developed by inviting the customer to participate in brand communities and loyalty programs. More crucially, firms should predict when a customer is reaching the attrition stage by closely observing the downward trend in the components associated with the IBV. The firms should take measures to prevent the customer from leaving, and in the case of customers who have left, efforts should be made to win back those customers.

As shown in Figure 11.7, there are three main paths for reaching a customer: marketing communications, corporate activities, and marketing-mix activities. In adopting a successful brand management strategy, the firm should optimally allocate its marketing resources across these three paths to attain maximum value.

How to Acquire Customers with Potentially High CLV

To acquire customers with potentially high CLV, firms can first prioritize their existing customers based on IBV. Then, by analyzing the profile of customers with high brand value, firms can target potential customers with similar profiles. When a new customer purchases from the firm, his potential brand value can be predicted by comparing it to an existing customer with a similar profile, as outlined in Figure 11.8.

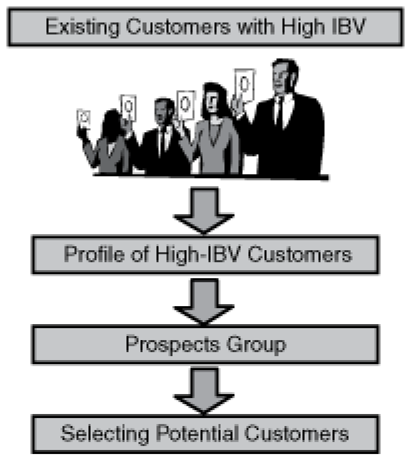


Figure 11.8. Acquiring customers with potentially high CLV

Conclusion

By understanding the link between IBV and CLV, firms can efficiently allocate their resources to generate maximum value. Several factors affect the IBV, such as brand knowledge, brand attitude, and brand behavior intentions. By linking these factors to the final customer behavior outcomes, firms can thus link the IBV of their customers and their CLV. A clear understanding of the various factors that affect IBV and its link to CLV enables firms to take appropriate corrective measures to simultaneously build both the customer's IBV and CLV.

12. Acquiring Profitable Customers

Relevant Issues

- Is it prudent to use acquisition and retention rates as a measure of overall marketing efficiency?
- Will a firm's profits be maximized by optimizing customer acquisition and customer retention expenditures, separately?

Each year companies are spending more and more on advertising to try to acquire new customers. In March 2007, Nielsen reported that spending on advertisements in 2006 rose by around 4.6% from 2005, to a total of $139.07 billion.[1] With the increased ability of firms to collect and analyze data that includes each customer's purchase behavior and demographic information, firms can now better customize marketing campaigns to individual customers and increase the overall effectiveness of those marketing campaigns. However, evidence shows that many firms are still struggling to justify their direct marketing expenses, partly because they are not properly allocating the right amount of resources between customer acquisition and retention.

A field study was conducted with three companies—a B2B firm, a pharmaceutical firm, and a catalog retailer—to determine optimal levels of spending on direct marketing to maximize profitability. Table 12.1 shows the results.

Table 12.1. Relevant Issues: Optimizing Direct Marketing Expenditures

Source: J. Thomas, W. Reinartz, and V. Kumar, "Getting the Most Out of All Your Customers," *Harvard Business Review*, July-August 2004: 116–123.

Company	How Much More/Less Should Be Spent on Direct Marketing to Reach Optimal Levels?	How Much Profit Would Increase If Spending on Direct Marketing Were at the Optimal Level?
B2B	–68%	42%
Pharmaceutical	31%	36%
Catalog retailer	–31%	29%

The results of this study show in all three cases what each firm was spending from the optimal amount on direct marketing to maximize profitability (68%, 31%, and 31% off of optimal). The firms did not have to decrease their spending on direct marketing to maximize profitability. The pharmaceutical firm, to achieve maximum profitability, had to increase its spending on direct marketing by 31%. In addition, the impact of the changes in optimal spending on direct marketing shows that by not spending close to the optimal amount on direct marketing, these firms were falling short of maximizing their profitability (by 42%, 36%, and 29%). Why is it that these firms are so far from maximizing their profitability even with the increased customer information?

Too often when marketers make decisions about allocating resources for direct marketing, the customers targeted by these campaigns are those who are inexpensive (easier) to acquire and inexpensive (easier) to retain. This mindset overemphasizes the short-term gain of cheaply acquiring and retaining customers, instead of going after customers who are going to be most profitable in the long run. In addition, managers are too quick to try to maximize each stage of the acquisition and retention process, thereby failing to look at the bigger picture of balancing acquisition and retention together. This, in turn, means that they are managing the whole customer relationship instead of just focusing on one aspect. In the next section, we take a closer look at how a firm's efforts to manage the acquisition and retention process tend to go wrong and what the firm can do to overcome these issues.

Pitfalls to Balancing Acquisition and Retention

1 Law of Diminishing Returns

All too often, firms look to a single metric within a process to determine the overall success of acquisition and retention. In many cases for acquisition and retention, this metric is the acquisition rate and retention rate. The acquisition rate refers to the percentage of people targeted by a marketing campaign who actually become customers. The retention rate is the percentage of people who are retained as customers at any given time. Managers use these two metrics mainly because they are simple and easy to understand and track, mostly because companies are interested in the outcome of these metrics: higher market share. In some cases, a higher acquisition and retention rate (and in turn market share) are reliable predictors of business performance. For example, a local cable operator is likely able to use acquisition and retention rates as a predictor of firm performance for basic cable. As the local cable operator acquires and retains more customers for the basic cable service, it can directly relate each newly acquired customer and each additional month a customer is retained to a higher market share and higher profitability. This is because the product being offered (basic cable) costs the same for each customer and is contractual in nature. In many cases, however, firms do not have a contractual relationship with all their customers. Even if a contractual relationship exists, the many different types and numbers of products offered make the benefit of adding one additional customer vary greatly. So, let’s reconsider the situation with a cable company. Many cable companies offer more than just basic cable, such as digital cable, telephone service, and Internet service (with each product offering different levels of service at different price points). There is no clarity as to whether one additional customer adds the same profit as the next customer. As a result, when the cable company has to decide how to evaluate the success of a marketing campaign, should it look at maximizing the acquisition rate, retention rate, or profitability?

The answer to this question seems straightforward: The cable operator would want to maximize profitability. This is not always clear because it goes against the current mindset that achieving the highest acquisition rate possible is ideal. What every firm needs to understand is that as acquisition rates and retention rates increase, firms’ profits do not always increase. After a certain point, the cost of acquiring an additional customer outweighs the future stream of profit that acquired customer will bring to the firm. How does a firm find a balance between acquisition rate, retention rate, and overall customer profitability? To get a fairly straightforward answer to this question, we look to a marketing study by

Robert Blattberg and John Deighton.[2] The goal of their study was to examine a potential solution to the problem of balancing acquisition rates and retention rates with customer value. In this study, they asked a manager how much was spent in the past year to acquire customers and how many of those customers were actually converted from being prospects to actually making a purchase. The manager was asked how much was spent in the previous year to retain each customer and what was the percentage of customers still with the company. Based on the responses to these questions, the authors were able to derive the optimal level of spending on acquisition and retention for that particular firm (see Figure 12.1).

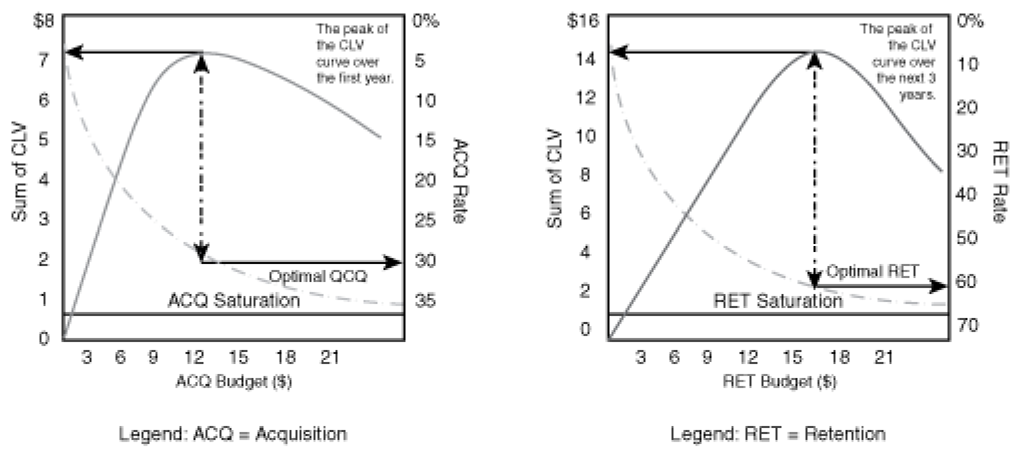


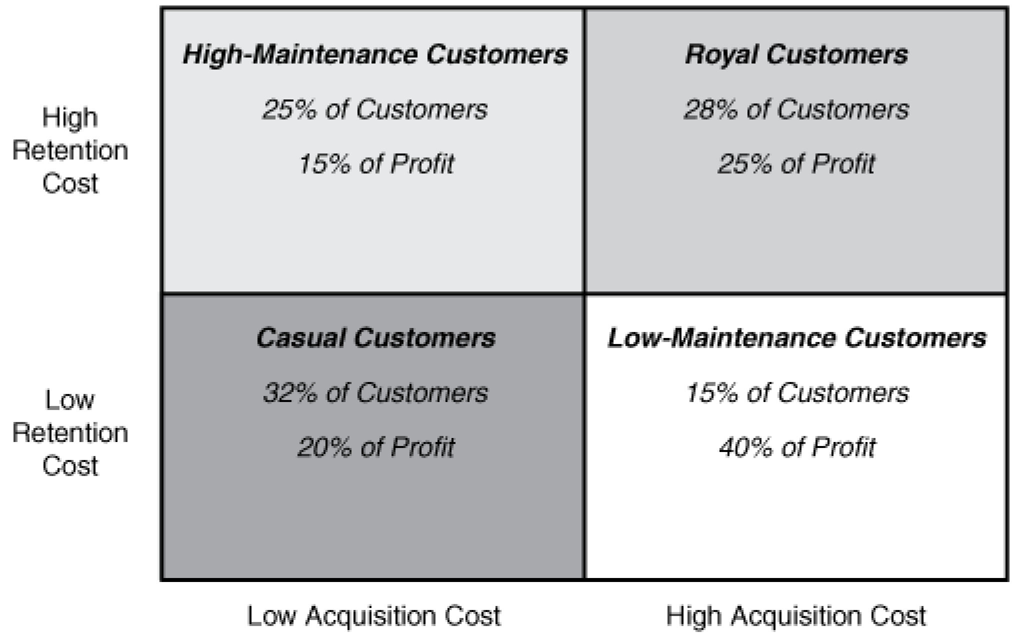
Figure 12.1. Acquisition and retention rates versus CLV

These results show that in the cases of both acquisition and retention, there is an optimal point at which the firm can maximize its profitability by having the right acquisition rate (around 25%) and retention rate (around 50%). These numbers will vary from firm to firm. The purpose of the study is clear. There is a diminishing return in profitability as each additional customer is acquired and retained, and at some point in time continuing to increase the acquisition or retention rate only leads to a diminishing level of overall profitability. This is because it becomes harder (more expensive) to acquire or retain the "next customer." Firms should only make decisions to acquire or retain the next customer if the cost of doing so is less than the value the customer brings back to the firm, either through his own future purchases (Customer Lifetime Value [CLV]) or by helping the firm gain new customers through word-of-mouth and referrals (see Chapter 13, "Managing Customer Referral Behavior"). Many firms have already started to realize this and have taken steps to reward managers who are profitable and not the ones who only maximize metrics such as acquisition and retention rates. This can lead directly into the next pitfall of balancing acquisition and retention: focusing too much on short-term profit.

2 Short-Term versus Long-Term Outlook

Because firms are beginning to realize that customer profitability is the desired outcome (and not necessarily acquisition or retention rates alone), managers are looking to get the most out of each customer. This means that they do not consider the long-term profitability of the customer, only what they can get out of the next transaction. Usually, this problem surfaces when managers begin to group their customers into one of four buckets: those customers who are easy or hard to acquire and those who are easy or hard to retain. Then, to maximize short-term profitability, managers look to the customers who are easy to acquire and easy to retain to get the most customers at the lowest overall cost. This would not be a problem if each bucket of customers were equally as profitable. This approach of targeting the easiest customers to acquire and easiest customers to retain makes the false assumption that acquisition costs and retention costs are the major driver in customer profitability. The results show otherwise.

A recent marketing study with a catalog retailer was undertaken to analyze the relationship between acquisition costs, retention costs, and customer profitability.[3] In this study, a cohort of customers was tracked over a three-year time period. This cohort was split into one of four buckets based on how expensive it was to acquire and retain the customers. Then, based on the transaction behavior of these customers, this study determined how much each of the four groups of customers contributed to the overall profitability of the cohort of customers. Figure 12.2 shows the results of this study.



Source: Adapted from Thomas J., W. Reinartz, and V. Kumar, "Getting the Most Out of All Your Customers," *Harvard Business Review*, July-August 2004: 116–123. Printed with permission from the Harvard Business School Publishing.

Figure 12.2. Do acquisition and retention costs drive profits?

As expected, the largest segment of the group comes from the customers who are easiest to acquire and easiest to retain (Casual Customers). However, this group only contributed 20% of the overall profitability of the entire group. The customers who were hard to acquire but fairly easy to retain (Low-Maintenance Customers) were actually contributing the most to the profitability of this cohort (40%) and only made up 15% of the total number of customers. In fact, even the group of customers who are hard to acquire and hard to retain (Royal Customers) contributed more in profit (25%) than the Casual Customers and was made up of fewer customers than the Casual Customers (28%). These results are not unique to catalog firms. Many firms are seeing the same breakdown of how acquisition and retention costs drive profits.

It is not ideal for managers to solely focus on short-term profits by acquiring and retaining the customers who are easy to acquire and easy to retain. The additional costs of acquiring and retaining customers who are more costly to acquire and more costly to retain seem justified from a long-term view of customer profitability. Now that managers have the tools to identify profitable customers, as discussed in the earlier chapters in this book, managers can dive into each of these cells and pick out the profitable customers. Managers can target these customers for marketing campaigns with the added benefit of knowing how much they will need to spend to acquire or retain the customers.

3 Treating Acquisition and Retention Strategies as Independent

Many companies have tried to address the first two pitfalls mentioned but are trying to do so with acquisition and retention departments that are independent of one another. This inevitably leads to the acquisition department trying to acquire the most customers possible, which inevitably leads to attracting some customers who are not profitable in the long term. If the retention department works on retaining all the customers acquired by the acquisition department, they will be trying to maximize the retention budget on many customers who are not very profitable in the long term. What's worse is that none of the customers who are highly profitable but hard to acquire (Royal Customers and Low-Maintenance Customers) will be targeted by the acquisition department because of their high acquisition costs.

This behavior is more common than we might realize. Many firms still practice this strategy today. For example, many credit card companies spend a lot of money on acquiring every possible customer who is out there. These companies send a lot of direct mail, set up booths at airports and college campuses, and call many potential customers via the telephone. The acquisition departments of these credit card companies are looking to acquire as many customers as possible without thinking about how many of these customers will actually be retained and profitable. Then, after all these new customers have been acquired, the retention departments of these credit card companies spend significant resources trying to retain all these customers, in many cases spending a lot of resources on customers who will never be profitable.

What can be learned from this example? It is a good idea for firms to integrate their acquisition and retention departments. This integration allows the departments to take a long-term view of customer profitability. Then, they won't spend too much time acquiring only those customers who are easy to acquire and then trying to retain all those customers. This long-term view allows managers to identify the most profitable customers and spend the right amount of resources acquiring and retaining them. This example also shows that linking the acquisition and retention strategies will produce a more profitable result. In some cases, firms are already taking this approach. However, in almost every case, firms that try to predict the best customers to acquire are relying on the wrong information.

4 Relying Too Much on Current Customers

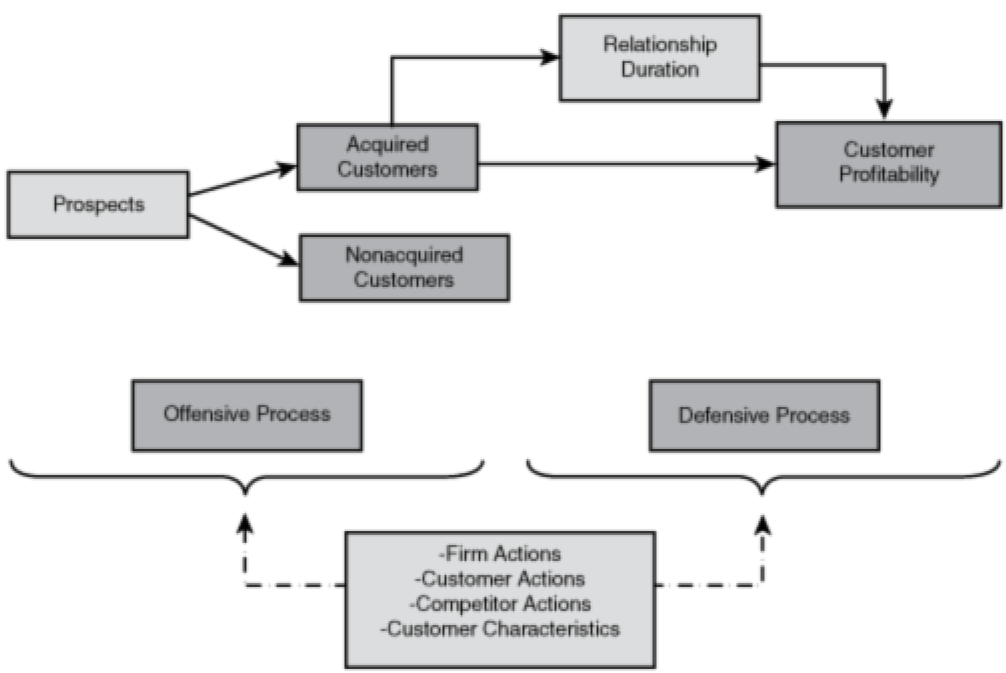
Firms that try to predict the potential profitability of prospects often fall into the final pitfall of acquisition and retention. Many of these firms try to use information from current customers to predict the profitability of prospects. The problem that arises is referred to by statisticians as *selection bias*. Selection bias occurs when the customers used in a modeling exercise to predict the behavior of another set of customers aren't a representative sample. In this case, it means that the current customers are used to predict the potential behavior of the prospects. The inferences made from these predictions can be very misleading, causing managers to incorrectly allocate resources to a set of prospects and thus lead to a suboptimal level of profitability. However, this pitfall of acquiring and retaining customers can be solved. In the following section, we present a framework called Allocating Resources for Profit (ARPRO) that enables managers to properly balance resources between acquisition and retention to maximize profitability.

5 Solution to Balancing Acquisition and Retention: ARPRO

When a company is able to avoid the previously discussed four pitfalls, three key questions need to be answered to achieve an optimal allocation of resources to maximize profit between the acquisition and retention of customers. These questions concern how a firm should allocate resources across different modes of contact (face-to-face, telephone, email, and so on), because different contact modes offer different levels of interpersonal interaction, whether it is more critical to focus on acquisition or retention expenditures when considering customer profitability, and whether acquisition and retention rates are maximized at the same point as customer profitability. The three questions are as follows:

- Given the budget constraint, how does the profit-maximizing strategy allocate resources between the contact modes that vary in their degree of interpersonal interaction and costs?
- Which is more critical for profitability, acquisition or retention expenditures?
- Does the contact strategy that maximizes customer profitability also maximize acquisition and retention rates?

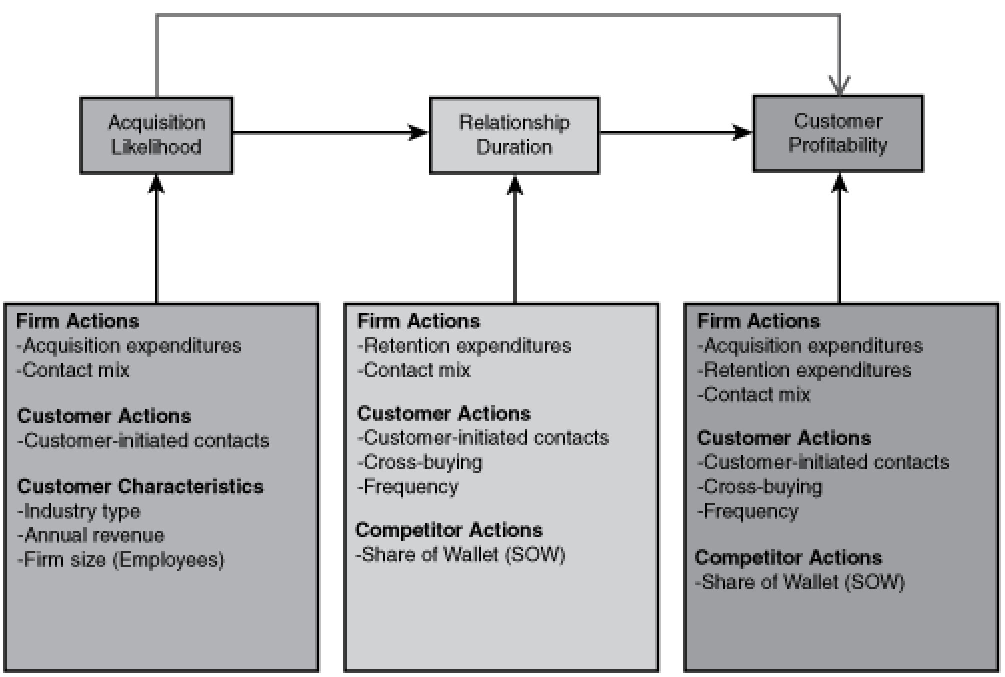
To answer these questions, firms need to adopt a framework that can reveal the true relationships between acquisition, retention, and profit. This can be done using a model we call ARPRO, Allocating Resources for Profit. This model involves complex regression analysis, with long-term profitability as a function of several key factors, and with factors that are weighted and corrected for sample selection bias.[4] However, it is important to understand how the framework can be operationalized for a specific firm and how the implementation can impact the bottom line of the firm. Figure 12.3 illustrates this framework.



Source: Adapted from Werner Reinartz, Jacquelyn S. Thomas, and V. Kumar, "Balancing Acquisition and Retention Resources to Maximize Customer Profitability," *Journal of Marketing* 69(1) 2005: 63–79. Printed with permission from the American Marketing Association.

Figure 12.3. Linking acquisition, retention, and profitability: A framework

The objective of Figure 12.3 is to identify the relationship between prospects, acquired customers, relationship duration (retention), and customer profitability, by analyzing how firm actions, customer actions, competitor actions, and customer characteristics play a role in driving customer profitability. This is done by first considering "offensive" strategies to go out and acquire customers, and then following this up with "defensive" strategies to try to retain these customers from switching to competitors. Because of the ability of this framework to link together all these processes within a firm, it allows managers to identify different trade-offs between how much and how to invest in the acquisition of customers and in turn how much and how to invest in the retention of customers to maximize profitability. To determine the values of these trade-offs, it is important to understand what the drivers of acquisition, retention (duration), and profitability are and how they can be leveraged to achieve maximum profitability (see Figure 12.4).



Source: Adapted from Werner Reinartz, Jacquelyn S. Thomas, and V. Kumar, "Balancing Acquisition and Retention Resources to Maximize Customer Profitability," *Journal of Marketing* 69(1): 63–79. Printed with permission from the American Marketing Association.

Figure 12.4. Drivers of acquisition, retention, and profitability

The drivers listed in Figure 12.4 come from a recent marketing study with a B2B high-tech manufacturer.[5] The customer firms in the data included firms that sell to both B2B and B2C firms. For each of the three parts of this model (acquisition likelihood, relationship duration, and customer profitability), the drivers were seen as significant predictors of the outcome. However, it should also be noted that these drivers are somewhat generalizable, because similar drivers were found to be important in predicting each of the three pieces of this model for a pharmaceutical company, too.[6]

For each part of this framework, the model identifies drivers that can help predict the acquisition likelihood, relationship duration, and customer profitability and are broadly defined into four main categories: firm actions, customer actions, competitor actions, and customer characteristics.

In this case, firm actions refer to the different controls that a firm has when marketing to customers. This can include various expenditures on each customer to acquire or retain the customer or any changes to the general marketing-mix variables to each customer (for instance, promotions). Because these are the drivers that the firm has direct control of, managers can focus on how small changes in these drivers affect each aspect of acquisition, retention, and profitability.

Customer actions can be broadly defined as any actions that a customer takes to begin or continue a relationship with the firm. These can include inquiries about products or even product support requests for currently used products. Although a firm has less control over these drivers, when a customer initiates contact with a firm, it can be a strong signal about that customer's future behavior or future desire to build a strong relationship.

Customer characteristics represent either the firmographics (that is, demographics of firms; for example, firm size and number of employees) or demographics of a customer. Although these customer characteristics rarely change, especially in the short term, knowing these characteristics of your customers can help in the profiling of prospects or the profiling of current customers. This in turn allows managers to identify customers for specific marketing campaigns, and it may even help when no information is available to allow you to differentiate between two different customers. For example, if you have two prospects and you have no transactional information about these prospects (only demographic information is available), how do you choose which customer is more likely to respond to the marketing contact? If one of the customers is older than the other, and you know that an older age plays a key role in acquisition likelihood, you would choose to market to the older customer to get a better chance of product adoption.

Finally, competitor actions refer to the amount of access competitors have with a given customer. If you can have a strong relationship with your customer and get your customer to purchase exclusively from you, it is much harder for competitors to convince that customer to switch to a different firm. In the B2B case, this is often operationalized by a driver called Share of Wallet (SOW), which refers to the percentage of a customer's budget for a particular product category that is used to purchase from you, with the remaining percentage used to purchase from a competitor. If the SOW for a customer is high, the customer purchases almost exclusively from a focal firm and likely has a low probability of switching to a competitor. However, customers with a low SOW are already purchasing from competitors and could potentially be swayed to purchase more (or exclusively) from a competitor, because their switching costs are likely to be much lower than the customer with a high SOW.

When you can identify all the drivers for each of the three parts of the ARPRO model, you can determine the relative impact each of the drivers has on profitability by running these three models as a simultaneous regression model. This simultaneous model will resemble the setup shown in Figure 12.5. More details on the model estimation process can be accessed at www.drvkumar.com/mcp.

$$\begin{cases} \text{Profitability} = f(\text{Firm Actions}_{\text{profit}}, \text{Customer Actions}_{\text{profit}}, \text{Competitor Actions}_{\text{profit}}) \ (\text{Model 1}) \\ \text{Duration} = f(\text{Firm Actions}_{\text{duration}}, \text{Customer Actions}_{\text{duration}}, \text{Competitor Actions}_{\text{duration}}) \ (\text{Model 2}) \\ \text{Acquisition} = f(\text{Firm Actions}_{\text{acquisition}}, \text{Customer Actions}_{\text{acquisition}}, \text{Demographics}_{\text{acquisition}}) \ (\text{Model 3}) \end{cases}$$

Figure 12.5. ARPRO regression model

When a manager gets the weights for each of these drivers for each of the models of the framework, determining the amount to spend on acquisition and retention for each customer can be done simultaneously to maximize profitability. You can just plug in the values with the weights, and it will determine the optimal acquisition and retention spending for each customer to maximize profit. How can a firm answer those three key questions, and what is the potential downside of not taking the ARPRO strategy?

The Profit-Maximizing ARPRO Strategy

The ultimate goal of the ARPRO framework is to develop a strategy that will maximize overall profitability in the long term. In the case of acquisition and retention, making suboptimal decisions can severely affect overall profitability. For example, based on the drivers and weights of the drivers computed for the pharmaceutical firm in a recent marketing study, the optimal average acquisition spending across customers should be $10, and the optimal average retention spending across customers should be $60 (see Table 12.2).

Table 12.2. Average Customer Profitability

Source: J. Thomas, W. Reinartz, and V. Kumar, "Getting the Most Out of All Your Customers," *Harvard Business Review*, July-August 2004: 116–123. Printed with permission from the Harvard Business School Publishing.

		Retention Spending				
		$40	$50	**$60**	$70	$80
	$1	$1,423	$1,543	$1,583	$1,543	$1,423
Acquisition	$5	$1,437	$1,557	$1,597	$1,557	$1,437
Spending	**$10**	$1,443	$1,563	**$1,603**	$1,563	$1,443
	$15	$1,437	$1,557	$1,597	$1,557	$1,437
	$20	$1,418	$1,538	$1,578	$1,538	$1,418

This optimal spending on acquisition and retention gives the highest overall customer profitability for the firm. Although the difference between the levels of profitability seems small—around a 1.2% decrease in profitability for about a 10% savings in costs—the loss in profit grows fast when the number of customers in the sample grows.

For example, if a firm cuts its marketing cost by 10%, and the savings in cost is around $250,000, the reduction in profit is around 1.2%. This means that if the base of customers is around 60,000, the resulting loss in long-term profits would be around $1.2 million. This clearly shows that when firms choose suboptimal amounts to spend on acquisition and retention, the impact on profit can be drastic.

In addition, acquisition and retention spending should not be done in isolation. For example, if the same firm only tried to maximize relationship duration (retention) by itself, the optimal spending level would be at $70 per customer (see Table 12.3). However, the previous example showed that the optimal spending was actually $70 on both acquisition and retention: $10 on acquisition, and $60 on retention per customer. By optimizing the relationship duration by spending $70 instead of splitting the $70 on acquisition ($10) and retention ($60), the profitability would decrease from $1,603 to about $1,543 (a drop of 3.7%). See Table 12.2 for values.

Table 12.3. Average Customer Relationship Duration

Source: J. Thomas, W. Reinartz, and V. Kumar, "Getting the Most Out of All Your Customers," *Harvard Business Review*, July-August 2004: 116–123. Printed with permission from the Harvard Business School Publishing.

Retention spending (per customer)	$40	$50	$60	$70	$80
Estimated relationship duration (days)	122	135	142	143	138

This shows that spending too much on marketing is detrimental, but it also shows that spending too little on marketing can be just as or more detrimental to profits than spending too much. This question of spending on acquisition and retention creates a problem as to whether it is more important to spend on acquisition or spend on retention.

Which Is More Critical: Acquisition or Retention Spending?

The differences in the impact of acquisition and retention spending on profitability make it difficult to decide how much to invest in each customer. This critical question arises often in marketing when budgets are constrained and decisions have to be made about whether to cut acquisition spending or retention spending. For example, if the firm in this study had to cut its marketing budget by 5%, one simple way to do this is to cut 5% from the acquisition budget and 5% from the retention budget.

However, the firm could also choose to cut only the acquisition budget and not touch the retention budget. This would cause the acquisition spending to drop by 33% from the previous example based on spending $10 per customer before and $6.5 per customer after. Deviating from the optimal spend will cause a decrease in profitability, but is it better to cut 5% in each or 25% in acquisition spending?

In this case, the results showed that every $1 underinvested in acquisition and retention spending led to profitability being reduced by $1.25. If the entire cut were in acquisition, for every $1 decrease in spending the resulting decrease in long-term profitability would be $3.03. This obviously shows that if these two strategies had to be considered (equal decrease in acquisition and retention versus decrease only in acquisition), the equal decrease in spending for acquisition and retention would result in a higher long-term customer profit. However, these results might change based on many different factors, making it necessary for each firm to analyze how deviations in spending affect overall profitability.

Maximum Profits, Acquisition Likelihood, and Relationship Duration

What does all this mean for acquisition spending, retention spending, and overall profitability? It means that it is not only necessary to consider acquisition spending and retention spending at the same time, but also that profitability is based on how the two interact. Therefore, it is not necessarily important to consider exactly how much to spend on acquisition or retention alone, but instead on how you balance your acquisition and retention spending together to maximize profitability.

In addition, although results were presented at the "average" customer level, in many cases it is necessary to be more granular in your approach. Many firms now have access to customer data at the individual level and can determine the exact allocation of resources to each customer. Although the average spending for the pharmaceutical firm in this study was $10 for acquisition and $60 for retention, it is necessary to find customers in each of the four cells from Figure 12.2 (easy/hard to acquire/retain). This is because profitable customers come from each of the four cells, and it might be worth going after a customer who is very hard to acquire and very hard to retain if the payoff is there in the long term. Managers should be able to allocate the right resources to the right customers by correctly linking acquisition and retention spending to each customer. They can achieve this by using the ARPRO model and determining the right drivers that lead to maximum profitability.

Conclusion

The top priority of marketing managers should be the ability to know when, what and how much resources to allocate in the communications channels so that we don’t overspend or underspend on customers. This will help the firm to invest on the most profitable customers at the most appropriate time—and in the most effective way. However, many companies continue to spend resources on a large number of unprofitable customers. This is because they either invest in customers who are easy to acquire or retain but are not necessarily profitable, thereby leading to wastage of limited resources. Allocating resources optimally to maximize profit between the acquisition and retention of customers is achieved through the introduction of the ARPRO framework. Case studies discussed in this chapter provide evidence that optimal allocation of marketing resources helps companies increase their revenue, balance acquisition and retention strategies, and manage customers profitably.

13. Managing Customer Referral Behavior

Relevant Issues

- How do we account for attitudinal behavior of customers when designing strategies?
- How do we measure the indirect contribution (referrals or word-of-mouth) made by customers toward the firm's profit?

Many firms now use viral marketing programs to harness the power of word-of-mouth and referrals to acquire new customers. For example, Sprint PCS is currently running a referral campaign: If you are a current customer and you refer a new customer to sign up, you get a $25 Visa debit card.[1]

In addition, certain companies are harnessing the power of referral behavior to help spread the word about their current or new products. For example, given the success of their word-of-mouth program, P&G's Tremor, which is targeted at teens and currently has a membership of more than 250,000 teens, P&G has recently launched another word-of-mouth marketing program called Vocalpoint. Vocalpoint has the goal of enlisting women across the country who have children under the age of 18 to serve as advocates for their products. These women receive messages from P&G that are custom designed in such a way that they encourage members to share them with other women they interact with on a daily basis. They are also sent coupons and free samples to hand out to their friends. According to Steve Knox, CEO of Vocalpoint, "We know that the most powerful form of marketing is an advocacy message from a trusted friend." So far, P&G has enlisted more than 500,000 women in the program, and it's still growing. P&G has spent a great deal of time and effort in understanding how word-of-mouth influences individuals and what message content needs to be to drive action.

Many of these same firms are using customer selection metrics such as Customer Lifetime Value (CLV) to identify their "best" customers and then allocating resources to target these customers with the highest CLV for these referral campaigns. In the process, these firms frequently alienate low- and medium-CLV customers because of the lower-level service provided and the differentiated treatment. An important question we need to answer is whether these low- and medium-CLV customers may in fact be of value to a firm because of their word-of-mouth and referrals, and if so, what their value to the firm is.

Although the CLV metric has been shown to outperform all other behavioral metrics, such as RFM (Recency, Frequency, and Monetary value) or SOW (Share of Wallet), in predicting a customer's future value to the firm, it does have one main limitation as a complete measure of a customer's value. Even though all customer relationship management (CRM) programs collect data on transactions and demographics, they fail to directly measure customer attitudes (for example, satisfaction). But, leaving satisfaction out of the CLV calculation is not necessarily a problem because it is already manifested as part of the buying process. However, it is clear that customers can not only contribute value to the firm through their own transactions (direct profits), but they also have an impact on the transactions of other customers through word-of-mouth and referrals (indirect profits) by helping the firm to acquire new customers at lower costs. So, how can managers determine the value of a customer's ability to spread word-of-mouth and make referrals?

Customer Referral Value (CRV)

This chapter introduces the concept of Customer Referral Value (CRV), which is defined as a customer's expected future referral value with the firm. This metric enables managers to measure and manage each customer based on his ability to generate indirect profit to the firm. This indirect impact on the firm's profit comes through savings in acquisition costs and through the addition of new customers by way of customer referral. Then, this leads to the following question: How does a firm measure a customer's ability to make referrals?

Some recent marketing studies have suggested that a link exists between a customer's willingness to make a referral and the growth in a firm's profit.[2] However, it might be short-sighted to think that there is a high correlation between customers' stated intentions to recommend products or services and their actual behaviors. A field study was conducted on customers from firms in two separate industries: a financial services firm (n = 6,700) and a telecommunications firm (n = 9,900). This field study was conducted to better understand what mechanisms were driving growths of new customers from referrals for each firm. In other words, four more questions need to be asked to first determine whether the customers who are willing to recommend new customers actually follow through with it and bring new and profitable customers into the firm:

- If a customer intends to refer a product to a friend or a colleague (prospect), how frequently does that customer actually follow through and speak to the prospects?
- Are the prospects willing to listen if the customer talks to them about the product or the company?
- Do the prospects actually become customers, even if they are willing to listen?
- Even if they become customers, do the prospects spend enough to be profitable for the firm?

Working with managers from a telecommunications firm and a financial services firm, we asked these questions to a set of their customers and tracked their behavior and the behavior of the prospects over time to see whether their stated intention to recommend actually occurred and led to the acquisition of new and profitable customers. The results of this survey clearly show that there is a gap between their stated intent to recommend and following through in making recommendations, as well as in whether a prospect who became a customer is being profitable. Table 13.1 shows the results of this study.

Table 13.1. Intentions versus Actual Referral Behavior

Item	Financial Services (n = 6,700)	Telecommunications (n = 9,900)
% Stated intention to recommend	68	81
% Actually referring	33	30
% Prospects becoming customers	14	12
% Prospects who are profitable customers	11	8

These findings show that there is a definite gap between a customer's willingness to refer and his actual referral behavior. In addition, it clearly shows that using a measure for "willingness to recommend" falls short when it comes to actionable strategies to manage customers. For example, in the case of the financial services firm, only 68% (n = 4,556) of customers intended to make referrals. However, only 33% (n = 2,211) actually did make the referrals. In addition, the results show the difference in the number of referrals to prospects (33% [n = 2,211] for financial services) and how many of those prospects actually bought products and services (14% [n = 938] for financial services). We can also see how many of the referred customers were actually profitable (11% [n = 737] for financial services). Therefore, it is not sufficient to know whether a set of customers is willing to refer your products or services; it is also necessary to understand how the flow of information moves from each customer to potential prospects. Therefore, each customer's CRV was measured using a general equation (see Equation 13.1), where each part of the equation was estimated using a four-step process: determining whether the customer would have bought the product or service anyway, predicting the future value of each referred customer, predicting the future number of referrals, and finally predicting the future timing of the referrals.

Equation 13.1.

$$CRV_i = \sum_{t=1}^{T}\sum_{y=1}^{n1}\frac{(A_{ty} - a_{ty} - M_{ty} + ACQ1_{ty})}{(1+r)^t} + \sum_{t=1}^{T}\sum_{y=n1}^{n2}\frac{(ACQ2_{ty})}{(1+r)^t}$$

where,

T = number of periods that will be predicted into the future (for example, years)

A_{ty} = gross margin contributed by customer y who otherwise would not have bought the product

a_{ty} = cost of the referal for customer y

1 to n1 = number of customers who would not join without the referral

n2 – n1 = number of customers who would have joined anyway

M_{ty} = marketing costs needed to retain the referred customers

$ACQ1_{ty}$ = savings in acquisition cost from customers who would not

join without the referral
$ACQ2_{ty}$ = savings in acquisition cost from customers who would have joined anyway

A CRV is measured by summing up the values in all the time periods during which individuals come to the firm via referrals by the original referring customer. The value contributed by referrals for each customer can include both direct and indirect referrals, which means that we add the value of the referrals that the customer makes (direct) and the value of the referrals that the referred customers make (indirect). It is important to capture both the direct and the indirect referral values under each customer's value to the firm for two reasons. First, it is important because when customers buy only because of the referral, and if the direct referral does not occur, it is also unlikely that the indirect referral would follow. Thus, credit, at least in part, for the indirect referral could also belong to the original referrer and be a part of his value to the firm. This would also help the managers search for customers who will not only make direct referrals, but also those who will refer customers who are likely to refer new customers (indirect) because the cascading value of the direct-to-indirect referrals can be very significant.

In addition, various aspects of a referral need to be considered in this process. First, the timing of the referral is important to determine the proper discounting of predicted value in the future to today's dollar terms. In addition, we must consider the number of referrals that will be made each year and how each of these referrals will contribute to the gross margin of the firm. If a firm rewards referral behavior, we must subtract that cost from any value attached to the referring customer for the referral. Finally, if a new customer emerges from the referral process, the company saves money in the acquisition cost. These savings apply to two different groups: those customers who would have joined anyway at some time, and those who would only join with a referral. It is important to take into account the entire transaction for the latter category of customers because the company would not have realized this sale otherwise. However, the only aspect of the referral counted in the case of a customer who would have joined anyway is the savings in acquisition cost. A CRV to the firm can be calculated when all these components are combined. To estimate the value of each of these components, we use the following four-step process.

1. Determine whether customers would have bought anyway.

   To determine whether the referred customer would have purchased without the referral, a simple question was asked when he became a customer: "How likely is it that you would have subscribed to this service without a referral in the next 12 months?" This was operationalized as a binary (0/1) outcome that separated the customers into the two different groups: the customers who would have bought anyway, and the customers who bought only because of the referral. After these customers were separated into the two groups, we estimated the future value and timing of the referrals from the customers who would not have bought without the referral.
2. Predict the future value of each referred customer.

   To compute the value of all the customers who would not have joined without the referral, we captured their transaction data and the company's marketing communication data for a short period of time after the referral was made and they became a customer, which included amount, category, channel, and demographic information from each referred customer, to estimate the increase in the value each of these new customers will have on the firm's profit in the future. The drivers that we selected to predict the future stream of profit that the referred customers will give to the firm (Contribution Margin – marketing costs, or $A_{ty} – M_{ty}$) were based on past marketing studies that were able to predict the drivers for relationship duration, customer profitability, and marketing costs for retaining newly acquired customers.[3]

   To operationalize this into our CRV model, we used the following approach. First, based on the first three years of data for each customer, we predicted the average referral contribution margin for each customer in each period (see Figure 13.1). This was done for each customer by looking at each of his referrals and computing the average profits that each referral brought to the firm in every time period in the first three years. We then used those values to predict the future profit for each referral per period in the holdout year. Next, we predicted the average cost of retaining each customer's referrals by looking at the past marketing costs for each period and projecting that average marketing cost into the future.

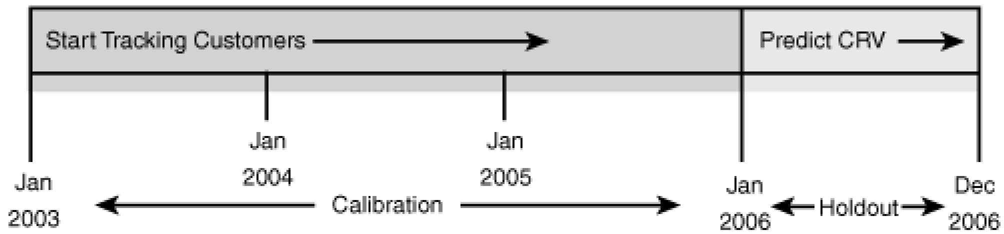


Figure 13.1. Timeline data

3. Predict the number of referrals.

   We used a similar method to predict the future number of referrals that each customer was likely to have. This number is based on using the average number of referrals in the first three years for each customer and projecting that number into the holdout year. We found that the average number of past referrals was also a good predictor of the actual number of referrals that a customer made. When we computed the average number of referrals based on the past referral behavior, we rounded it off to the nearest integer.

4. Predict the timing of customer referrals.

   The timing of the referrals in this case was based on the timing of past referrals by customers from each of the firms in the two industries. For example, because the financial services firm collected data semi-annually, we were able to split the prediction of the timing of referral into the first half of the year and the second half of the year. If the customer averaged six total referrals per year, and all the referrals came in the first half of the year, in the CRV prediction all the referrals would be credited to the first half of the year. However, if another customer referred all six customers in the second half of the year, the CRV prediction would have all the referrals credited to the second half of the year. Splitting up the timing of referrals into two time periods (first half of the year and second half of the year) is important because it can have a dramatic impact on the value of each customer's CRV. A customer who refers customers earlier rather than later not only accelerates the time when the firm receives the profit from the referred customer, but it also allows more time for the new customer to make his or her own referrals.

Calculating CRV: A Typical Customer

To value customers and see how they truly impact the bottom line of the company, we provide another example based on work we have done with a company from the telecommunications industry. For this example, we show how to use the information about this customer's referral behavior to compute his referral value (CRV). We first needed to obtain data from the telecommunications industry concerning both the transactions and referral behavior for a typical customer from Decile 6 from Table 13.3. Table 13.2 shows this information.

Table 13.2. Behavior of a Typical Telecommunications Customer (Quarterly Data)

Statistics (per 6-Month Period)	Typical Customer
Average contribution margin	$70
Number of referrals per period	3
Number of indirect referrals made by referred customers	3
Cost of referral	$20
Acquisition cost savings	$10
Marketing costs	$3
Number of referrals who would have joined anyway	1 out of 3
Yearly discount rate	15%

As Table 13.2 illustrates, this customer will most likely refer three customers for the next three periods, of which one would have joined anyway, and each of those customers will refer three customers in subsequent periods. Therefore, we need to calculate the net present value of the profit that each direct referral will bring to the company over the next three periods. In this case, we take a conservative approach and only value those customers who were directly referred by the original customer and made a purchase. However, in cases where it seems appropriate, a manager could add the additional value of the indirect referrals to the value of the original referrer's CRV, where an indirect referral is a customer who was referred by a customer who was, in turn, referred by the original customer. To estimate the referral behavior value of this customer, we will first show how to calculate the CRV for this typical customer for one period, and then we will display the overall CRV for that customer over three periods.

First, we need to separate our calculation into two parts:

- The value of the customers who would not have joined without the referral
- The value of the customers who would have joined anyway at a later time

Because the first set of customers would not have joined without the referral, we need to consider what they contribute in terms of profit, how much we saved by not spending money ineffectively in an attempt to acquire them, how much it cost us to give a referral incentive, and finally how much it cost us to retain these customers. Going back to Table 13.2, we can find the descriptive data of our typical customer in the financial services firm. We find that this customer is likely to contribute $70 in profit for this period, which we call A_t or the "contribution margin" of customer t. Next, we also need to add the acquisition cost savings to this referral's value. The acquisition cost savings for this customer is $10, which we call $ACQ1_t$ or the acquisition cost savings of customer t. Then, we need to consider the costs incurred when this customer was referred. These costs include the $20 we spent on giving the referral incentive, which we label a_t, and the marketing costs we had to spend to retain this customer in this period ($3), which we label M_t. These values will help us calculate the CRV for those customers who would not have joined anyway. We also need to consider the situation where a customer was going to start buying products or services but had not begun the process. In this case, we only need to consider the value of the savings in acquisition cost because the benefit of the referral was mainly to save the firm's resources from acquiring this customer. Therefore, the value of the customer who would have joined anyway is $10, which we label $ACQ2_t$, or the savings in the acquisition cost for the customer who would have joined anyway. Using these values, this referral behavior value for the first period is calculated as follows:

Equation 13.2.

$$CRV_1 = 2\left(\frac{A_1 - a_1 - M_1 + ACQ1_1}{\text{discount rate}}\right) + 2\left(\frac{ACQ2_1}{\text{discount rate}}\right)$$

$$CRV_1 = 2\left(\frac{\$66 - \$8 - \$18 + \$5}{(1.15)^{0.5}}\right) + 2\left(\frac{\$5}{(1.15)^{0.5}}\right) \approx \$102$$

Now, as we move forward to future periods, the calculations for the referral value of a customer begin to grow rapidly because new customers are referred in the second period and their purchases need to be added to the purchases from the customers who were referred in period 1. The main reason for this is because not only is the original customer referring prospects in each period (in this case, three), but also because the customers from the last period are continuing to purchase in the second period. Therefore, to compute the value for referral behavior across all the periods together, we need to use a general algorithm that allows us to account for the different referral numbers and timings of referrals for each customer. We have had success in using our general CRV equation. This can be implemented by calculating the present value of the CLV of all customers who would have joined only with a referral and adding the present value of all the acquisition cost savings for customers who would have joined anyway later without a referral. This general formula allows you to separate those customers who would not have joined without the referral from those customers who would have joined even without a referral.

As the results show, the impact grows as time progresses. The main reason for this is the growth of the customer base due to referrals in each period. In period 1, there were only three new customers, whereas in period 2 there were five customers in the value of the CRV (three new customers and two customers from period 1 who bought only because of the referral). In period 3, there were seven customers in the value of the CRV (three new customers and two customers each from periods 1 and 2 who bought only because of the referral).

In addition, because this is a conservative estimate of the value of customer referrals (that is, only the direct referrals are used in the CRV), it does not tell the whole story in terms of the number of new customers who have been acquired by the firm and the total value all these new customers are worth to the firm. If we want to see how many new customers came on board over these three periods that stem from the original customer and the value of these new customers, we need to look at both the direct and the indirect referrals. If each of the customers who were referred during a specific period also made some referrals in subsequent periods, we would see an exponential growth in the total number of new customers who were acquired in the first three periods and the total CRV for those customers. Therefore, if we go back to Table 13.2, we see that a typical customer who was referred to make a purchase will make three additional referrals in the subsequent periods. This means that starting in period 2, the three customers who were referred in period 1 will each refer 3 new customers, making a total of 16 customers (the original customer, the 3 customers referred in the first period, the 9 referrals made by these 3 customers, and 3 more new referrals made by the original customer in period 2). In period 3, if each of the referred customers from period 1 and 2 makes an additional referral, the total number of customers will be 55.

Are CLV and CRV Related?

After the CRV of each customer has computed, it is important to understand the relationship between CLV and CRV. Now that we have a measurement for both CLV (from Chapter 3, "Customer Selection Metrics") and CRV, we know the value provided by the actual purchases made by the customer (CLV) and the influence that customer has on other potential customers (CRV). With this information, managers can begin to make decisions about how to treat and market to customers based on the various combinations of whether the customer is low or high on CLV or CRV (high CLV and high CRV; low CLV and low CRV; and so on).

As noted previously, many firms are using CLV as a method for selecting customers for word-of-mouth and referral campaigns. If the customers who rated highly on CLV were the same customers who rated highly on CRV, managers would not need to use both metrics when managing customers. However, because only transactional and demographic data (not attitudinal data) has played an important role in predicting CLV, customers who score highly on CLV are probably not the same as those who are successful at referring new customers. In fact, a recent marketing study suggested that the most powerful word-of-mouth comes from customers who are less behaviorally loyal to the firm.[4] To investigate this further, using the transaction and referral behavior data from a telecommunications firm (n = 9,900), we measured each customer's CLV and CRV and made predictions for CLV and CRV to see whether the two were related (see Table 13.3).[5]

Table 13.3. Customer Deciles of CLV and CRV for a Telecommunications Firm

Deciles (Ranked by CLV)	CLV ($) (1 Year)	CRV ($) (1 Year)
1	**1,933**	40
2	**1,067**	52
3	**633**	90
4	360	750
5	313	**930**
6	230	**1,020**
7	190	**870**
8	160	96
9	137	65
10	120	46

As illustrated in Table 13.3, after ranking the customers by CLV (high to low) into ten deciles, the top 30% of customers based on CLV (deciles 1, 2, and 3) have no overlap with the top 30% of customers based on CRV (deciles 5, 6, and 7). This means that managers who focus on customers based on CLV alone and provide them the best service are missing the high-CRV customers and therefore ignoring these profitable customers. Even worse, they are perhaps alienating these potentially profitable customers, because they do not score highly on CLV, even though they do score highly on CRV. This can potentially lead those customers who are alienated to slow down customer growth by stopping their referral behavior or, even worse, spreading negative word-of-mouth. Therefore, because customers who score highly on the CLV measure are not the same customers who score highly on the CRV measure, firms should measure both CLV and CRV to implement marketing campaigns that focus on customers based on both dimensions. This will allow firms to both increase the profitability of each customer and, in turn, increase the number of new customers buying products and services. To show the impact of measuring and managing these two metrics simultaneously, we conducted a field study with a financial services firm to see how effective a firm could be when measuring and managing CLV and CRV simultaneously.

Typical Marketplace Phenomenon

So, how does a firm implement the CLV and CRV metric? Many companies already have some or all the data needed to measure both CLV and CRV. To start the process, this behavioral or transactional data needs to be integrated with the referral database. If your company does not have the data at hand, you can begin to collect information from new customers by asking them questions such as these: Were you referred, and if so, by whom? Or, to what degree did the referral from Mr. X/Mrs. Y impact your decision?

For example, some companies like Bank of America have introduced a very value-oriented referral incentive program that gives both the referral and the referring customer $25. Bank of America provides $25 for a customer referral, $10 for a student referral, and $50 for a business referral. These incentives seem to be in proportion to the typical value brought in by each member in the respective referral groups. An example of the campaign is shown in Figure 13.2. Similarly, EarthLink company in the technology communication industry has a referral incentive program.[6] In the Airline industry, United Airlines has a referral program where it gives 5,000 miles for each referral, as shown in Figure 13.3.

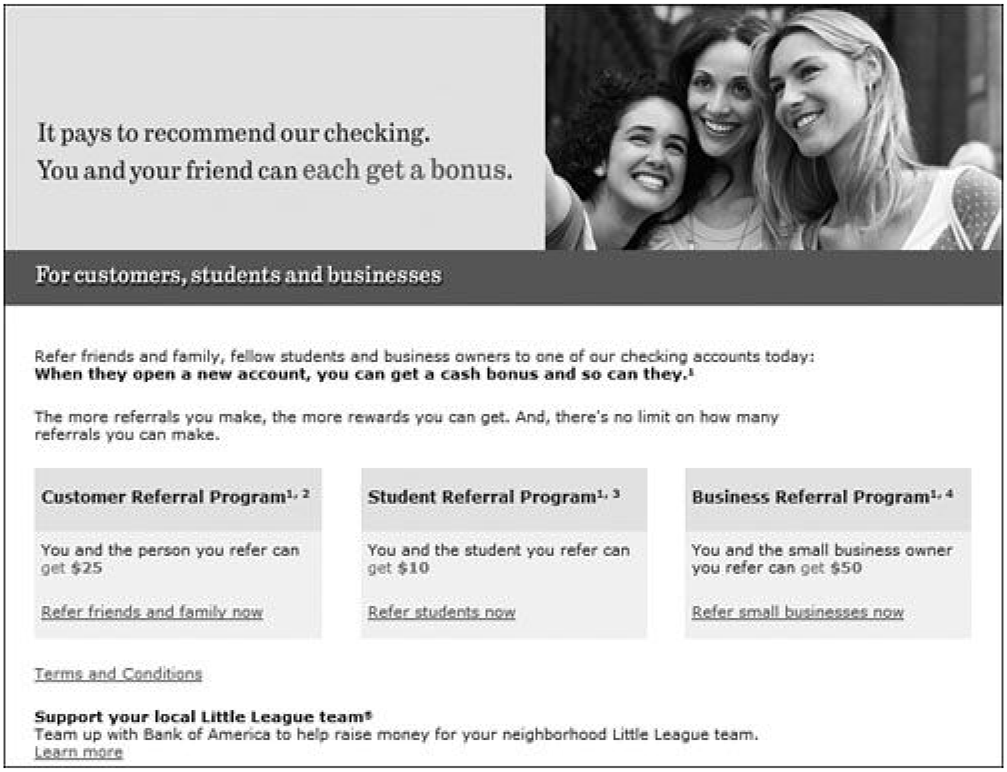


Figure 13.2. Sample referral program from Bank of America

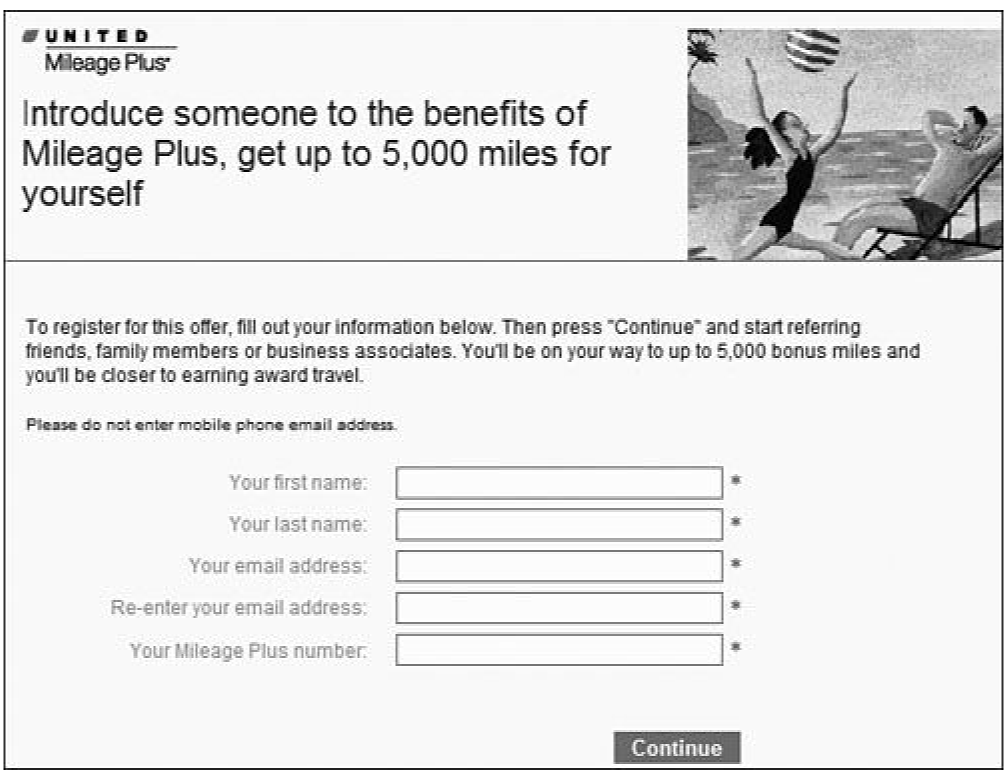


Figure 13.3. Sample referral program from United Airlines

To see how this type of program can actually work for a firm, we will demonstrate an example of the usefulness of measuring the CLV and CRV metric. The telecommunications firm we worked with conducted a field study to identify the independent impact measuring and maximizing CLV and CRV has on a firm's profits. Using two different samples of 9,900 customers (a test sample and a control sample), we first measured each sample's CLV and CRV based on the equations we provided in this book. The customers in both samples were then divided into four cells of a 2×2 matrix based on high/low CLV and high/low CRV. The cutoff points used to determine the low and high CLV and the low and high CRV were determined based on the median value for both the CLV and CRV measures. The results of this are summarized in one table because matched pairs of customers were used for both groups; that is, each group contained 9,900 customers, with almost the same distribution of CLV and CRV scores (see Table 13.4).[7]

Table 13.4. CLV and CRV for a Telecommunications Firm (n = 9,900)

CLV \ CRV	Low	High
High	Affluents *29% of customers* *CLV (1 year) = $1,219* *CRV (1 year) = $49*	Champions *21% of customers* *CLV (1 year) = $370* *CRV (1 year) = $590*
Low	Misers *21% of customers* *CLV (1 year) = $130* *CRV (1 year) = $64*	Advocates *29% of customers* *CLV (1 year) = $180* *CRV (1 year) = $670*

The results of this measurement of CLV and CRV show that there are distinct sets of customers found in the four different cells based on the large differences in the values for CLV and CRV across the cells. More important, a significant difference exists between the customers who are high on the CLV measure and those who are high on the CRV measure. First, we define the labels we have given each cell:

- **Affluents.** These customers purchase a lot of products and services for themselves, but they do not refer many new customers to buy products and services, which is why these customers have a high CLV and a low CRV.

- **Misers.** These customers do not purchase much or refer many new customers. They might never purchase too much because they are brand switchers, they have a small SOW, or they might be waiting to find out from others whether the product is worth purchasing.
- **Advocates.** These customers are less likely to be heavily involved in purchasing products for their own use, but they are active in searching and disseminating information to other customers to encourage them to buy products. For this reason, these customers are low on CLV but high on CRV.
- **Champions.** These customers are more likely to be highly involved with purchasing the product and disseminating information about the product, giving them both high CLV and CRV.

Looking across the high-CLV row, the cell with the highest CLV (upper-left box) is found to have a lower CRV (Affluents) than the adjacent high-CLV cell (Champions). The value of CRV in the Champions cell is more than ten times greater than the Affluents cell. Looking down the second column, which has the high-CRV customers, note that the lower-right box has the highest CRV (Advocates), but it also has a lower CLV (about half the CLV) when compared to the other high-CRV cell (the Champions). Then, there is also the lower-left corner cell that contains those customers who are low on both the CLV and CRV metric (Misers).

These numbers provide strong empirical evidence that customers who score highly on the CLV measure (direct profits) are not necessarily the same customers who score highly on CRV (indirect profits). Therefore, the customers in each of the cells should be evaluated differently with respect to their total value to the company and then approached with different types of marketing offers to get the greatest overall value from them. To show the value of treating them differently, the telecommunications firm initiated three different campaigns over the course of one year to try to get customers to migrate from low CLV/CRV to high CLV/CRV. Each campaign was carried out on the test sample of customers and carried out in each quarter for a one-year period. The control sample did not receive any of these targeted marketing communications. The campaign objectives and results (and details about the campaigns themselves) are explained in the following sections.

Campaign Objectives

Each of the three campaigns was designed with a different goal in mind. The first campaign was set up to target the customers who are Misers (see Figure 13.4). These customers are the lowest-CLV and -CRV customers in the sample. However, this does not mean that these customers do not have the potential to either be strong advocates or high-CLV customers. What may be missing is an opportunity to build a relationship. Therefore, the campaign to target the Misers not only offered incentives for them to buy more products for their own use, which would increase their CLV, but the campaign also offered them incentives to refer new customers, which would increase CRV. By motivating these customers to either buy more products for themselves or refer new customers, the goal of the company is to migrate them toward one of the other three cells (Affluents, Advocates, or Champions), depending on whether the campaign increased their CLV, their CRV, or both their CLV and CRV.

The second campaign was set up to target the customers who are Affluents (see Figure 13.5). These customers are the highest-CLV customers, but their CRV is low because they do not refer (or are not successful in referring) new customers. Therefore, the goal of this campaign was to encourage these customers to refer new customers using referral incentives, while making sure they kept their CLV at the highest level. The result of generating new referrals from these customers will cause them to migrate toward the Champions cell because their CRV will be increasing. Notice, too, that if this campaign is successful, the average CLV of the Champions cell will increase over time, as the Affluents bring their high CLV with them.

The third campaign was set up to target the customers who are Advocates (see Figure 13.6). These customers are already the highest on the CRV metric, but although they are successful in referring customers, they do not spend a significant amount on purchasing products and services for themselves. The goal of this campaign is to encourage these customers to spend more while at the same time keeping their CRV at the highest level. Moving customers from the Advocates cell toward the Champions cell will generate a greater amount of direct profit from these customers.

These customers were targeted withg bundled offers for one or more products, such as savings accounts, checking accounts, and investment accounts, through a personalized communication sent via direct mail and followed up with another direct-mail piece within a two-week period. A phone call was also made to those customers to answer any questions regarding the additional services and the value of obtaining the additional services. In addition, the value of making referrals for new customers was highlighted for these customers by telling them that a $20 incentive would be given to them and the referred customers following a referral.

Figure 13.4. Campaign 1: Targeting the Misers

These customers were targeted with emphasis on the referral incentive for both them and the referred customers. These customers were also sent a direct-mail communication, followed by another direct-mail communication within two weeks. The main goal of the direct-mail communication was to emphasize a $20 incentive each for both the referring customer and the referred customer for signing up for products/services.

Figure 13.5. Campaign 2: Targeting the Affluents

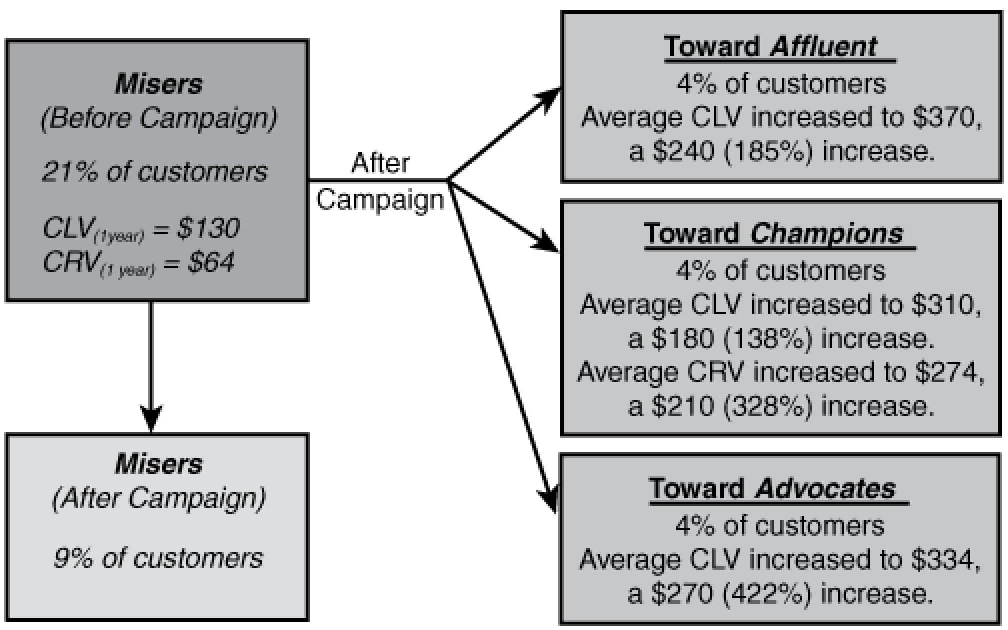
These customers received a personal communication in the form of a direct mail that included offers for bundling one or more products such as savings accounts, checking accounts, and investment accounts. To follow up and make it more likely that the offer was received by the customer, the financial services firm sent an additional piece of direct mail within two weeks and called a sample of these customers via the telephone to answer any questions regarding the additional services and the value of subscribing to multiple products/services.

Figure 13.6. Campaign 3: Targeting the Advocates

Campaign Results

At the end of the one-year period, it was clear that each of the three campaigns had a significant impact on the customers in each of the three targeted cells. To determine whether the campaign was successful at moving customers toward a higher CLV or CRV cell in the 2×2 matrix from Table 13.4, the migration patterns of the customers along with their change in CLV and CRV were followed for each of the three cells (Misers, Affluents, and Advocates) one year after the campaign began. To determine whether a customer migrated toward a better cell in the matrix, the CLV and CRV were measured after the end of the campaign for each of the customers in the sample set. The numbers showing the migration of these customers can be found in each of the following three figures.

Figure 13.7 shows how customers who were originally in the low-CLV and low-CRV cell moved toward each of the other three better cells (higher CLV [Affluents], higher CRV [Advocates], or both higher CLV and CRV [Champions]).



Source: Adapted from V. Kumar, J. Andrew Petersen, Robert P. Leone, "How Valuable Is Word of Mouth," forthcoming, *Harvard Business Review*.

Figure 13.7. Migration from Misers toward Affluents, Advocates, or Champions

Before the campaign started, 21% of the customers in the sample fell into the low-CLV and low-CRV cell based on the median split criteria. After running the campaign, 12% of the customers moved toward more profitable cells, with 4% going to each of the other three cells. Not only did these customers move up to a more desirable cell, the gains made on average were fairly substantial. For example, a customer who moved toward Champions from Misers after the campaign had on average a CLV that was $180 higher and a CRV that was $210 higher. This means that these customers increased their CLV scores by more than 100% (from $130 to $310) and CRV scores by more than 300% (from $64 to $274). Therefore, of the original sample of customers from this cell (2,079 or 21%), 396 of them moved toward Champions and produced increases of CLV of $71,280 and CRV of $83,160. Although these numbers might not seem like large gains for multimillion-dollar companies, if we were to project these gains to a sample size of 990,000 customers rather than 9,900, the gains in CLV and CRV from these 4% of total customers (396 out of 9,900) would generate gains in CLV of around $7 million and gains of CRV of around $8 million.

Figure 13.8 shows how customers from Affluents (high CLV) were affected by the second campaign directed at moving them toward Champions by increasing their CRV while maintaining their very high CLV.

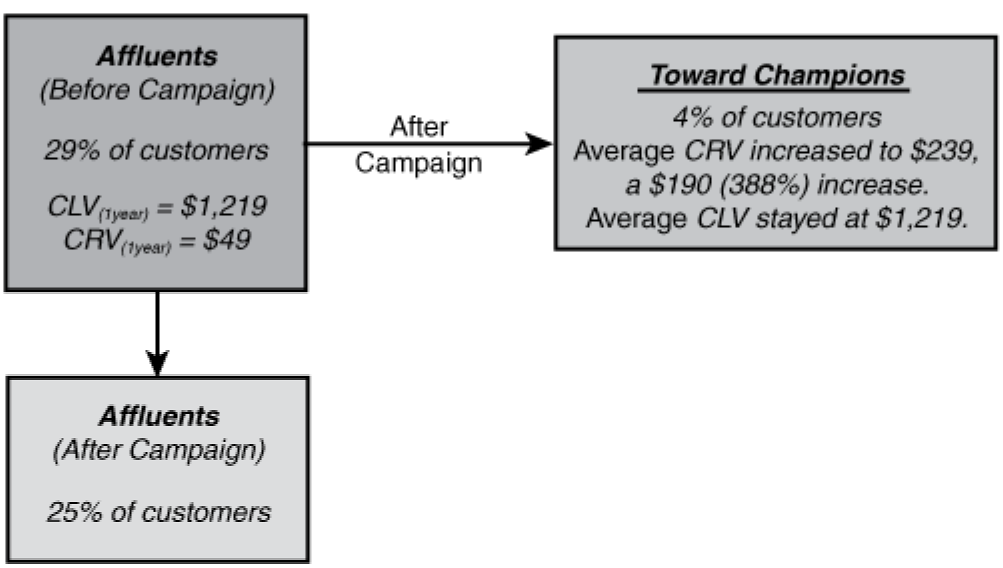


Figure 13.8. Migration from Advocates toward Champions

In this case, of the 29% of customers who were Affluents before the campaign was started, 4% of the customers moved toward Champions (high CLV and high CRV), and these 4% of customers increased their CRV on average by $190, which is 388% higher than it was initially ($49). Once again, the impact of this migration of customers is large when you see that 4% of your customers increase their CRV by that much. This means that not only is the telecommunications firm increasing its revenue from all its customers, but the customer base is growing, too. This allows the firm to greatly expand its customer base and find new revenue sources outside of just trying to cross-sell and up-sell to its current customers.

Figure 13.9 shows how Advocates (high CRV) were affected by the third campaign directed at increasing their CLV.

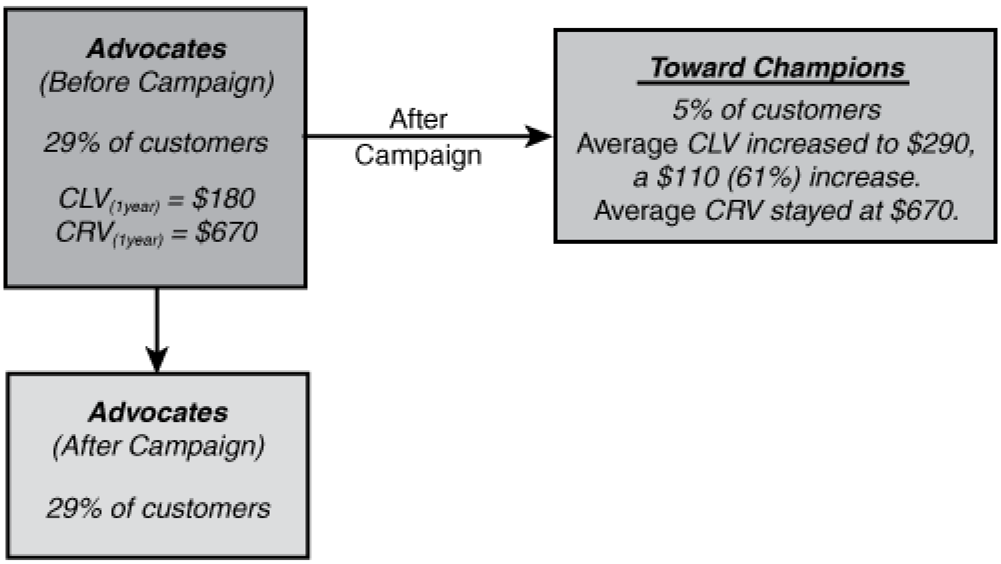


Figure 13.9. Migration from Advocates toward Champions

Source: Adapted from V. Kumar, J. Andrew Petersen, Robert P. Leone, "How Valuable Is Word of Mouth" forthcoming, *Harvard Business Review*.

This cell also started with 29% of the customers, but after this campaign, 5% of the customers increased their CLV and moved toward Champions, and each of the 5% of customers who moved averaged an increase in their CLV of approximately $110. Although this increase in CLV increased by 61% over the original CLV for each customer, the impact is still significant because of its long-term effects. In this case, the telecommunications firm has been able to take customers who it would have initially ignored if they were looking only at CLV because of their low CLV and moved them toward the most desirable cell in the 2×2 matrix (those with high CLV and CRV).

With these results, we can see that each of these campaigns was successful in not only migrating customers toward better cells—with 4% moving toward Affluents, 4% moving toward Advocates, and 13% moving toward Champions, the most desirable cell—but all of these customers who moved to these cells also have significantly higher CLV, CRV, or both CLV and CRV. However, the success of migrating customers from one cell toward another is not the only measure of a good campaign. In addition, we need to factor in the cost of running the campaign and compare it to the amount of profit generated to determine this campaign's ROI. The cost of the three campaigns, which included direct mail, email, and selected telephone calls for the 7,821 customers (these are from the three cells targeted in the campaign: Affluents, Misers, and Advocates) in the sample, was approximately $31,500, making the campaign cost around $4 per customer. The overall profit obtained either from increasing each customer's CLV or CRV from each of the three campaigns was $486,090. Therefore, the overall ROI of the campaign was around 15.5. Table 13.5 shows a summary of the results.[8] We also want to note that a similar set of campaigns was run with a financial services firm, with an ROI of 13.6.

Table 13.5. Campaign ROI (Telecommunications Firm)

	Profit (CLV and CRV)	Cost	ROI
Campaign totals	$486,090	$31,500	15.5

What does this indicate for the telecommunications firm for a much larger sample of customers from their customer database? In Table 13.6, we not only show[9] what the gains would be if these campaigns were projected across 1 million and 10 million customers for the telecommunications firm (their customer base has more than 40 million customers), but also if the period of measuring CLV were moved from 1 year to 3 years.

Table 13.6. Gains in CLV and CRV for a Telecommunications Firm

	1 Million Customers		10 Million Customers	
Projected	*CLV (millions)*	*CRV (millions)*	*CLV (millions)*	*CRV (millions)*
1 year	$22.3	$26.8	$223	$268
3 years	$66.9	$80.4	$669	$804

As evident in Table 13.5, the ROI from running these three customized campaigns has generated significant gains in profit. Note that because these campaigns were customized to a specific firm in the telecommunications industry, these might not fit ideally to every situation, although similar gains were observed for the financial services firm (obviously, from another industry). However, it is clear that there are a lot of opportunities for firms who traditionally have used only CLV as a metric to increase their revenue and profitability by selecting customers for marketing campaigns based on both their CLV and their CRV.

Managerial Implications

Is there a trade-off when maximizing one versus the other? In this chapter, we argue that each of these measurement tools should be managed separately because the campaigns used were customized based on the objective (maximize CLV or CRV). In some cases, however, resources limit managers to selecting one or only a few campaigns. How do you, as a manager, know which campaign to choose? It is potentially unclear whether it is better to maximize CLV or CRV without the knowledge of the impact that either will have on future profit. But, knowing the objective of the campaign, the stage of the product in its life cycle, the potential number of prospects in the pool, and the nature of competition in the market could give some insights on the program that will drive revenue and profit.

For example, in a situation where the goal of a campaign is to get users to buy more in a specific category or buy across more categories, a campaign should emphasize maximizing CLV within the customer base. This is likely to happen in competitive markets where it is tough to acquire new customers or in niche markets where the prospect pool is very limited. However, in cases where the current customers are already spending the majority of their budget with the company, programs to increase cross-selling or up-selling are not as appropriate. In these cases, it is likely better for managers to try to acquire more customers by using their current customers to reach out to new prospects through referral incentive programs. Managers should be careful not to assume that high-CLV customers are the best customers to target. As this case study has shown, current customers who are low-CLV customers can have the highest impact on new customers.

In addition, after running a set of campaigns similar to those in this paper and using the results of the campaigns, a manager will have the ability to select much smaller segments of customers in each of the three cells (Misers, Affluents, and Advocates) who have the highest likelihood of increasing their CLV, CRV, or both CLV and CRV. This can be determined by identifying the differences in characteristics of the customers who increased their CLV/CRV from those who stayed unchanged after the campaign. Managers can then target additional customers in new campaigns who also have the characteristics of those customers who were most responsive to the previous campaigns. Thus, whichever marketing campaign is chosen to increase the overall revenue and profit obtained from customers, we have shown the importance of measuring the value of your customer's own transactions and the value of their impact on the transactions of other customers, and not one or the other in isolation. This is an important point because many sources provide ways to measure only a customer's behavioral CLV or only a customer's attitude (for example, intention to refer or overall satisfaction). As a manager, you should look to measure the customer's future value to the firm through both his or her own transactions (CLV) and the impact that he or she will have on other customers (CRV) because

- Not all behaviorally loyal customers provide referrals.
- Not all customers who provide referrals are behaviorally loyal.
- Targeting only higher-CLV customers for increasing the number of referrals is not an optimal strategy.

The key to success is to encourage customers to build social networks and to trigger them, along with customers who already have strong social networks, to talk to individuals in their network by using marketing programs that reward word-of-mouth and referrals. Thus, without considering referral behavior when deciding how to allocate differential resources to customers, a company might actually ignore customers or give bad service to customers who would offer great returns through direct (CLV) or indirect (CRV) profits, causing degrading customer relationships and poor service experiences. Because managers have been ignoring these customers who score highly on CRV, some have become “turned off,” which causes them to feel alienated from the firm and worse, spread negative word-of-mouth about the company. The consequence could mean monetary penalties if these customers don’t purchase any more or stop referring new customers. In addition, they might even begin to spread negative word-of-mouth, causing potential prospects to not only *not* join via referral, but also to have a negative attitude toward the company, causing the acquisition costs of those prospects to increase. If these customers were to be Champions for the firm, the result of their defections could result in turning many current or potential customers against the firm.

In addition, firms do have opportunities to introduce new products by utilizing the referral base of customers. Just like movies that have sneak previews to generate a “buzz,” one can also generate a buzz for one’s new products by making sure the right customers—those with the large social networks and strong influence on potential customers—have the information and even materials to pass along. (For example, P&G is testing a program that encourages mothers to forward email information and coupons for the new product to other mothers in their social network.) Even if prospects do not purchase the new product, others may reach out to them for their knowledge and opinions to make decisions, so the fact they are equipped with up-to-date knowledge would be a benefit. This even allows firms that are new at entering the market to take leadership in the marketplace with not just an innovative product, but also innovative marketing to harness the power of referrals.

Building a strong social network can be a long-term competitive advantage for both the customers and the firm by causing a series of positive externalities. It becomes harder for the competitors to lure away customers who are tightly locked in to their social network, while at the same time this benefits consumers because a strong social network allows ease of information sharing about products and services and the use of common products and services across a set of customers. We have observed evidence subsequent to this study that not only is the customer base growing for the two firms we studied, but the number of referrals per customers is also increasing as these social networks strengthen. Customers know (or are learning) where they can receive information, such as reviews and recommendations, from trusted sources and also who to turn to when issues arise. This growing cycle adds to the theories on trust and reinforcement behavior in a new way because giving referrals to groups of customers and building trust among these customers leads to much stronger social networks of customers. Finally, whereas the positive benefits of building a strong social network lead to these advantages, the negative impact of word-of-mouth from customers who are "turned off" on the products and services of a firm can be much steeper. Therefore, a firm should view its customers as skilled resources and work with them to build strong social networks through which both the firm and the customer can benefit.

Conclusion

This chapter introduces the concept of CRV, which is defined as a customer's expected future profits obtained through his referrals. Managers need to use both CLV and CRV metrics when managing customers. Customers who rate highly on CLV are not the same customers who rate highly on CRV. Thus, a customer brings in value through CLV or CRV—or both. However, customers should be evaluated differently—with respect to their total value to the company—and then they should be approached with different types of marketing offers catering to maximizing CLV and/or CRV. This allows firms to increase the profitability of each customer and, in turn, increase the number of new customers buying products and services.

14. Organizational and Implementation Challenges

Relevant Issues

- How can a firm change from the product-centric approach to the customer-centric approach?
- What does adopting a customer-centric approach involve?
- How can a firm address the implementation challenges while adopting a CLV framework?

IBM is one leading multinational firm that markets hardware, software, and services to business-to-business (B2B) customers. Recently, IBM tested the effectiveness of adopting a Customer Lifetime Value (CLV)-based framework to maximize overall profitability. For many years, IBM has been using various customer selection metrics to select profitable customers and to develop customer-level marketing strategy. Until recently, Customer Spending Score (CSS) was used as one of the key customer selection metrics to score each customer and to sort customers into deciles based on this score.[1] Customers from the top one or two deciles were selected for future targeting. Although the CSS metric was effective, it focused primarily on revenue from customers and largely ignored the variable cost of catering to a customer. Hence, it was necessary to identify a new scoring metric that takes into account the marketing cost in addition to the expected revenue.

CLV, which considers both marketing cost and expected revenue, was proposed as an alternative to the CSS scoring metric. The CLV metric was adopted to find solutions to three major questions faced by IBM:

- Which customers to select for targeting
- How much resources to allocate to those customers
- How the selected customers could be nurtured to increase future profitability

As part of the implementation of the CLV framework, the customers were first divided into two groups: the Not Touched Group and the Touched Group. The customers who were contacted through salespersons, direct mail, telesales, email, and so on in year 2004 were categorized as the Touched Group. Customers who were not contacted by 2004 were categorized as the Not Touched Group. The CLVs of each customer were then computed, and the customers within each group were sorted to deciles. Based on the CLV of customers in each decile, it was recommended that marketing resources from low-CLV customers in the bottommost decile of the Touched Group be reallocated to the high-CLV customers in the top three deciles of the Not Touched Group. The probability of purchase of different products/services from IBM in the next year was predicted for customers in the top three deciles of the Not Touched Group, and they were selected for targeting.

As a result of an improved targeting strategy, the revenue of the Not Touched Group increased ten times compared to revenue in the previous year. The effectiveness of the model was reflected in the superior performance of the sales revenue metric. The improved profitability was made possible by the successful implementation of CLV strategies.[2] However, implementation of the CLV-based framework posed certain organizational challenges to IBM. One challenge was synchronizing goals and activities of different departments. Before the implementation of the CLV framework, each department had group-specific communication goals, which could make customers feel that they were interacting with different companies. For example, the hardware group might communicate information about their products to a set of customers. Similarly, the software group might reach out to the same customers to sell the same products. However, for successful implementation of a CLV-based framework, a firm has to adopt a customer-centric view—that is, use a single source to market to the customers the product/service they need.

Next, we discuss other organizational and implementation challenges that a company faces when migrating to a CLV-based framework.

Organizational Issues

The key organizational challenges to the implementation of a CLV-based framework can be broadly categorized into two dimensions: business dimension and people dimension.

Business Dimension

The business dimension has to deal with defining and articulating the business case for change and the desired outcome of change. One of the major challenges in business dimension is changing a firm’s focus from product-centric to customer-centric marketing. The basic philosophy of the product-centric approach is to sell products to whoever is willing to buy. In this approach, the organization focuses on universal customers, their needs and problems, and tries to provide solutions for those problems. Thus, a product-centric firm focuses on the product portfolio and concentrates on increasing the product line for its customers. As a result, a product-centric organization tends to ignore specific needs of customers, which can lead to dissatisfaction and defection of customers.

On the other hand, the basic philosophy of a customer-centric approach is to serve specific customers and thereby provide customized services to customers. Customer-centric firms concentrate their strategy on customers rather than products. Several new firms have moved away from the product-centric approach and have gained huge profits by adopting a customer-centric approach. Whereas record labels such as EMI, BMG, and Sony did not focus on individual customers, Apple iTunes has rejuvenated the music industry through an emphasis on the individual customer-centric approach. Similarly, casinos such as MGM Grand and Ceasar’s Palace focus on attracting as many customers as possible, whereas Harrah’s success results from its ability to identify and pursue serious gamers.

Changing from a product-centric to a customer-centric approach also necessitates changes in the organizational structure. The organizational structure for a product-centric firm requires product managers and product sales team managers, whereas the customer-centric firm has customer relationship managers. Firms need to realign their organization structure to successfully adopt the customer-centric approach. Wells Fargo, a leading financial institution, has realigned its organization structure by creating a two-tiered sales structure. Within this structure, a relationship manager manages the relations with customers and is externally focused. A product manager, who is internally focused and provides input for the product development, helps the relationship manager to sell the products more effectively.

Table 14.1 identifies the differences between a product-centric approach and a customer-centric approach.

Table 14.1. Comparing Product-Centric and Customer-Centric Approaches

Source: Adapted from Denish Shah, et al., "The Path to Customer Centricity," *Journal of Service Research* 9(2): 113–124.

Strategic Questions	Product-Centric Approach	Customer-Centric Approach
What is the underlying philosophy?	Sell products; sell to whoever will buy.	Serve customers; all decisions based on customer-level opportunities.
What is the business approach?	Transaction oriented.	Relationship oriented.
How should the product be positioned?	Highlight product features and advantages.	Highlight product's benefits in terms of meeting individual customer needs.
How is the organization structured?	Product-based profit centers, managers, sales team.	Customer-based segment centers, segment sales team, customer relationship managers.
What is the strategic focus?	Internally focused, new product development, new account development, market share growth; customer relations addressed by marketing department.	Externally focused, customer relationship development, profitability through customer loyalty; employees are customer advocates.
Strategic Questions	**Product-Centric Approach**	**Customer-Centric Approach**
How is performance measured?	Number of new products, profitability per product, market share by product/sub-brands.	Share of Wallet (SOW) of customers, customer satisfaction, CLV, customer equity.
What is the management criteria?	Portfolio of products.	Portfolio of customers.
How is selling approached?	How many customers can we sell this product to?	How many products can we sell to this customer?

Texas Instruments is another company that successfully adopted a customer-centric approach. When it was using a product-centric approach, it was constantly having financial pressures and increasing customer frustration. The company could not attract new customers and was losing existing customers. The management was unhappy and attempted to improve results by focusing on customers. They introduced a Customer Loyalty Bootcamp program, which focused on three major areas:

- More time was spent with customers.
- Metrics that reflect customer satisfaction were created to understand the needs of customers.
- Special programs were designed to bring in a cultural change at Texas Instruments.

The payoffs of applying this program, which focused on a customer-centric approach, included the following:

- Marketing gains for three consecutive years
- Efficient and timely services
- Better understanding of customers

As this example shows, companies are changing their focus from the product-centric to customer-centric approach to improve profitability.[3]

For a firm to be customer-centric in its approach, interactions between the firm and the customer, between customers, and between firms are essential. In the current scenario, the timely and efficient management of interactions within an organization is recognized as a major source of competitive advantage. We define these interactions in aggregate as *interaction orientation.* Interaction orientation helps firms develop organizational resources for successful management of customers. Although firms may be following a traditional product, sales, or a market orientation, a compelling need currently exists to evaluate the feasibility of adopting interaction orientation. Interaction orientation is at the center of the customer-centric approach. Whereas the product-centric approach focuses on product orientation and sales orientation, the customer-centric approach focuses on market orientation and interaction orientation.

Firms have gradually moved from a product-oriented approach to an interaction approach. Initially, firms were product-oriented, and the manager’s focus was on making superior products. Then, a selling-oriented approach (with the focus less on the quality of the product and more on the sales interaction itself) became popular. The belief of selling-oriented firms was that aggressive selling and promotional campaigns could lead to higher profitability. The concept is practiced more aggressively with goods that customers do not think of buying, such as insurance. The concept of a market-oriented approach gained popularity in the mid 1950s. Focus shifted from products to customers, and products were designed according to customer needs. Managers were concerned about finding the right product for their customers. Finally, the focus has moved to an interaction-oriented approach, wherein customers are an integral part of the marketing strategy of the firm. The inputs from customers are collected and treated as a firm resource. Table 14.2 shows the different approaches.

Table 14.2. Marketing Approaches and Characteristics[45]

Firms	Key Characteristics
Product oriented[4]	Consumer will choose products that offer the most quality, performance, and innovative features. The product is viewed as a source of business for the firm. Manage a portfolio of products. Transaction oriented. Customer-to-customer linkage is not strategically important. Customer data is considered a control mechanism.
Sales oriented[5]	Sales efficiency and effectiveness is the focus. The relevance of product/market is of secondary importance. Pushing the product is more important than creating the product.
Market oriented	Marketing activities are conducted for a firm's customers. The customer is viewed only as a source of business for the firm. The strategic importance of customer-to-customer linkage is not recognized. The need for coordination is considered limited to the functional departments within a firm.
Interaction oriented	Marketing activities are conducted with the customer. The customer is viewed both as a source of business and as a business resource for the firm. The strategic importance of customer-to-customer linkages is recognized and included in the customer empowerment component. The effect of the network economy on the strategic importance of managing and coordinating outsourced production and service is recognized and included in the interaction response component.

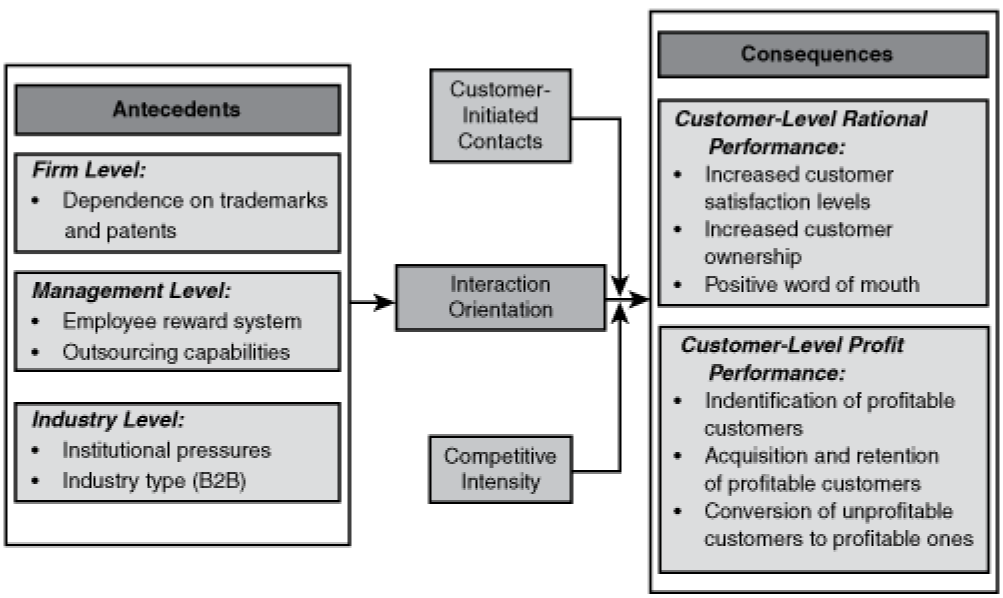
Firms can take a few steps to improve their interaction at different levels:

- Firms can improve their interaction with customers by capturing individual customer transactions and by improving supply-chain logistics.
- Firms should enable customers to obtain information freely, exercise choices, praise or criticize the firm/product/service, and even participate in designing the product/service.
- Marketing should be an activity that is measured and analyzed at the individual customer level. The components of interaction orientation are as follows:

- **Customer concept.** It is the belief that the unit of every marketing action or reaction is an individual customer. Wells Fargo is an example of an organization that believes in the customer concept. It has continuously invested in technologies that help maintain real-time visibility of the firm's customers. According to Danny Peltz, Executive Vice President, Wells Fargo, these efforts have resulted in increased customer involvement compared to the competition and an upward trend in revenue, transaction volume, and services per customer.[6]
- **Interaction response capacity.** Interaction response capacity is the degree to which a firm can provide successive product, services, and interaction experience based on the previous feedback by a specific customer (and all other customers). Boeing is an example of a firm that believes in the concept of interaction response capacity. For its airline customers, Boeing's rapid response center handles technical problems that arise outside of normal business hours. The center uses interactive video, the Internet, and telephone systems that seamlessly allow access to people and data across multiple sites.
  - **Customer empowerment.** Customer empowerment refers to the extent to which a firm allows its customers to do the following:
  - Connect with the firm and design the nature of transaction
- Connect and collaborate with each other by sharing information, praise, and criticism about a firm's product and services

IBM supports Linux, for example, to provide more customer choice (especially appreciated by customers who want to avoid expensive, licensed software). Hewlett-Packard encourages online peer-to-peer service, and the rich information that the members of this online community provide helps HP raise its overall service efficiency. These examples demonstrate that IBM and HP recognize customer empowerment as a strategic activity.

- **Customer value management.** Customer value management refers to the extent to which a firm can quantify and calculate the individual customer value and use it to reallocate resources to customers who will add higher value in the future. IBM has developed sophisticated techniques to assess the future customer value of its institutional customers. This focus on customer value management has helped IBM improve profitability in the U.S. market over the past few years. Figure 14.1 illustrates the process of interaction orientation. Antecedents are factors that affect the level of interaction orientation in the firm. These factors can be moderated by customer-initiated contacts and competitive intensity. Customer-initiated contacts provide vast information about each customer's needs and wants and help firms interact with customers to design a customized product/service for them. Competitive intensity forces firms to differentiate products/services from competitors by providing more offerings (not by keeping interaction with customer in mind). Firms with a high level of interaction orientation avoid falling into these pitfalls. By avoiding these pitfalls, firms can increase customer satisfaction, positive word-of-mouth, and acquisition and retention of profitable customers.



Source: Adapted from V. Kumar and Girish Ramani, "Interaction Orientation and Firm Performance," forthcoming, *Journal of Marketing*. Printed with permission from the American Marketing Association.

Figure 14.1. Interaction orientation: Antecedents and consequences

Firms that are adopting interaction orientation are able to attract and retain the most valuable customers. Also, they can keep competitors away from their customers because of the customers' heightened attachment to the firm. Thus, customers are developed into a skilled resource for the firm; they help the firm acquire new customers by referrals, word-of-mouth, and so on. The firms also start exhibiting superior aggregate-level business performance, by dynamically maximizing the profit function for a firm, at every stage of activity and across all customer segments. The firms can develop a dynamically shifting portfolio of product and services. They also develop the ability to foresee customer response and plan marketing activities for longer time horizons.

Firms that are not adapting interaction orientation to a sufficient degree face issues such as these:

- Obligation by the firm to continue serving a large base of unprofitable customers
- Uncontrolled proliferation of negative word-of-mouth
- Customers directing competitor's attention to the firm's vulnerable areas
- Inability to plan for the future
- Poor marketing accountability, leading to lower profit and lower returns on marketing investments. Firms such as IBM and American Express have successfully adopted the interaction orientation. Their endorsement of practices consistent with the elements of interaction orientation and recent business performance demonstrate the managerial significance of an interaction orientation.[7]

People Dimension

Although the successful adoption of a customer-centric marketing approach and the interaction orientation helps firms to navigate the business dimension of organizational challenge, it is equally important to address the challenges in the people dimension. For successful implementation of a customer relationship, initiative, certain steps should be taken to deal with any reluctance to change (as is typical in the people dimension):

- **Generate awareness of the need for change.** Firms can do this via relevant and specific communication with employees.
- **Create a desire to participate and support the change.** Firms can achieve maximum participation by communicating the initiative's effectiveness and potential benefits.
- **Disseminate knowledge about how to change.** Firms can do this by creating channels of communication and sharing information in a transparent way.
- **Enable stakeholders to implement the change on a day-to-day basis.** Firms can do this by authorizing employees to interactively respond to customers.
- **Reinforce to keep the change in place.** Firms can do this by following up with the management and employees frequently to discuss the initiative's progress (including any benefits derived from such). After sorting out organizational issues, firms might face implementation challenges related to any customer relationship management (CRM) initiative. Therefore, successful implementation depends on firms understanding data-driven factors, on accountability in execution, on transparency in execution, and on understanding the metrics dashboard.

Implementation Challenges

When dealing with implementation challenges, managers have to focus on the following four factors: data-driven factors, transparency in execution, accountability in execution, and metric dashboards. The following sections explain each of these factors.

Data-Driven Factors

Data collection from a relatively large customer group is a tedious and expensive task, and therefore the implementation of a CLV framework in B2B and B2C scenarios presents a great challenge for organizations. The organizations that sell through intermediaries find it impossible to gather data from customers because they are not in direct contact with the end customers. To develop a customer-level strategy, the following four data characteristics are essential:

- The data should be at the customer level.
- To derive the drivers of profitability, the data should contain all the transaction information (including Past Customer Value [PCV], recency, frequency, and contribution margin).
- The longer the span over which the data is collected, the better. At the least, firms should collect data for two or three years.
- Marketing touch information should be included in the data. The data should include all the marketing touch methods used (direct mail, email, and so on) and the date each touch occurred.

After collecting data with these characteristics, firms can develop a customer-level strategy to aid manager decision making.

Transparency in Execution

A well-known telecommunication company was planning to introduce a new CRM initiative. The initiative included the formation of special groups (12 to 16 people from customer interactive, marketing, and sales departments), who were to be responsible for providing users the required inputs during the implementation of the CRM initiative. However, the management decided not to communicate the initiative to its internal and external users until the implementation was near completion. Therefore, the management failed to generate awareness and the desire to participate among the users. By the time management was ready to train the internal and external users, 50% of users said they knew nothing about the initiative and were not enthusiastic about undergoing training. As a result, the initiative was not implemented for another four months, and the company registered a huge loss of $800,000.

CRM initiatives should be well communicated to both internal and external users. Even the slightest discrepancy should be communicated so that errors are eliminated.[8]

Accountability in Execution

In another example, a global publishing company attempted to launch a CRM initiative. It established a special "communications" group that remained active throughout the entire implementation of the initiative. The group even started a Friday "paper" memo to update all internal and external users as to the latest developments. But, when it came to CRM application training, who would receive the training first became a point of conflict. This conflict led to a delay in the implementation of the CRM initiative. The company could have avoided this problem by empowering a group to implement the initiative. Such a group could have still kept users updated, but could also have ensured a smooth training process (and thus a timely and successful implementation of the CRM initiative).[9]

Metrics Dashboards

Organizations create metrics dashboards to identify and implement key performance measures of a customer to help management track and monitor customers for the effective allocation of resources. Traditionally, metrics that reflected the success of product-centric firms were, for example, share of hearts, mind, and markets; and product and portfolio management metrics. However, the shift to a customer-centric approach has necessitated an emphasis on forward-looking metrics, such as Customer Lifetime Value (CLV) and Customer Spending Score (CSS).

Share of Hearts, Mind, and Markets

These metrics try to depict the true picture of key factors in market share, market concentration, and customer satisfaction. The metrics try to identify the correlation between variables behind market share, and try to explore measure of awareness, attitude, and usage, which are major factors while making a decision to select one brand over another. They are designed to measure how well the firm is doing with its customer. Some metrics used to evaluate success in the market are the Boston Consulting Group (BCG) matrix and revenue market share.

Product and Portfolio Management

These metrics provide the optimum solution to the following questions:

- What will be the sales from a new product?
- Does the launch of new products affect the sales of existing products?
- What are the true needs of customers? Is the company able to deliver products and services to cater to those needs?

They are used to determine the sales forecast for new products, growth projections, and compound annual growth rates (CAGRs). These metrics also study the impact of sales of new products on the sales of existing products. Commonly used metrics are volume projections, CAGR, cannibalization rate (percentage of new product sales taken from an existing product line), and brand equity metric (tracking the value of brand).

Customer Profitability

These metrics measure the performance of individual customers. They keep track of changes in the number of active customers and the ability of the firm to retain them. They also allow firms to identify the profitable and nonprofitable customers, and therefore reallocate resources (proportionate to the level of customer profitability) to profitable customers to improve revenue. Commonly used metrics are number of customers, RFM, and CLV. CLV is a forward-looking metric that predicts the future behavior of customers and helps the firm design marketing spending to acquire new customers and retain profitable existing customers.

As stated in the IBM example, IBM shifted from a customer spending metric to a CLV metric in a pilot study. The key steps involved in implementing the CLV framework include the following:

1. The firm rank ordered its existing customers to decide which customers to target and which ones to ignore. The ranking was done using the CLV score.
2. The next step was to identify the high-value customers by understanding their specific characteristics and then develop a unique marketing effort to capture those customers. This also helped the firm to identify future profitable customers.
3. The firm decided on its optimum contact strategy for these highly valued customers, in terms of type and frequency of communication.
4. The firm then used a purchase timing model and a choice model to isolate different time periods when these customers were most likely to buy various products/services.

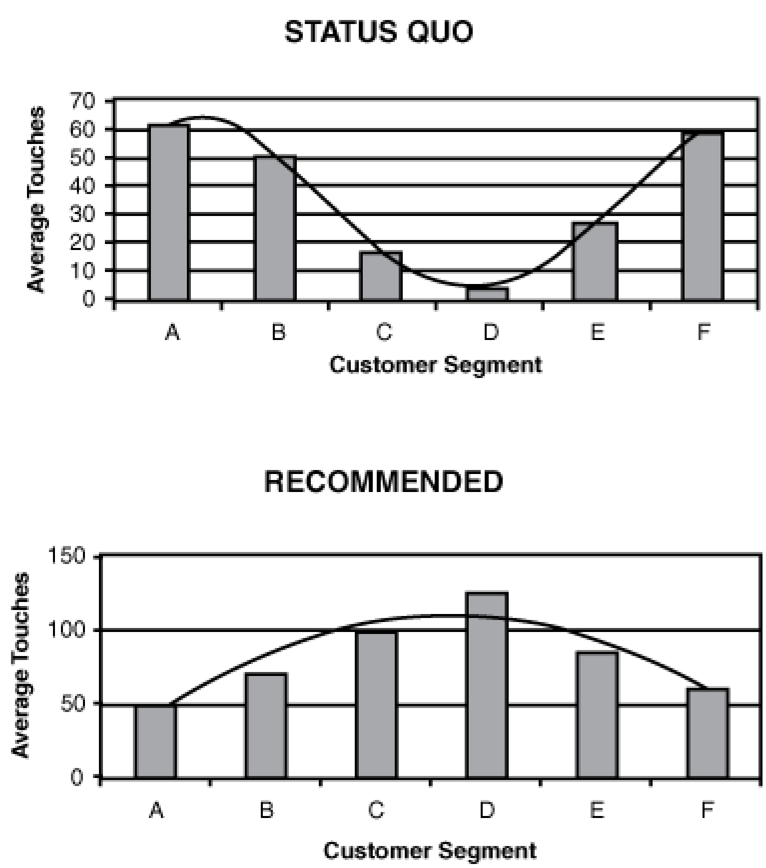
Table 14.3 shows the revenue generated by different metrics for IBM customers, with the CLV metric providing maximum revenue.

Table 14.3. Revenue by Different Metrics for IBM Customers

% of Cohort (Selected from top)		*Using the first 30 months of data to predict the next 18 months of purchase behavior*			
		Customer Lifetime Value	Customer Spending Score (CSS)	RFM	Past Customer Value
15	*Average Revenue*	30,427	21,789	22,622	23,542
	Gross Value	9,184	6,659	6,966	7,185
	Variable Costs	107	114	110	104
	Net Value	9,077	6,544	6,856	7,081

The reported values are in dollars (expressed as a multiple of the actual numbers) percustomer and are cell medians.

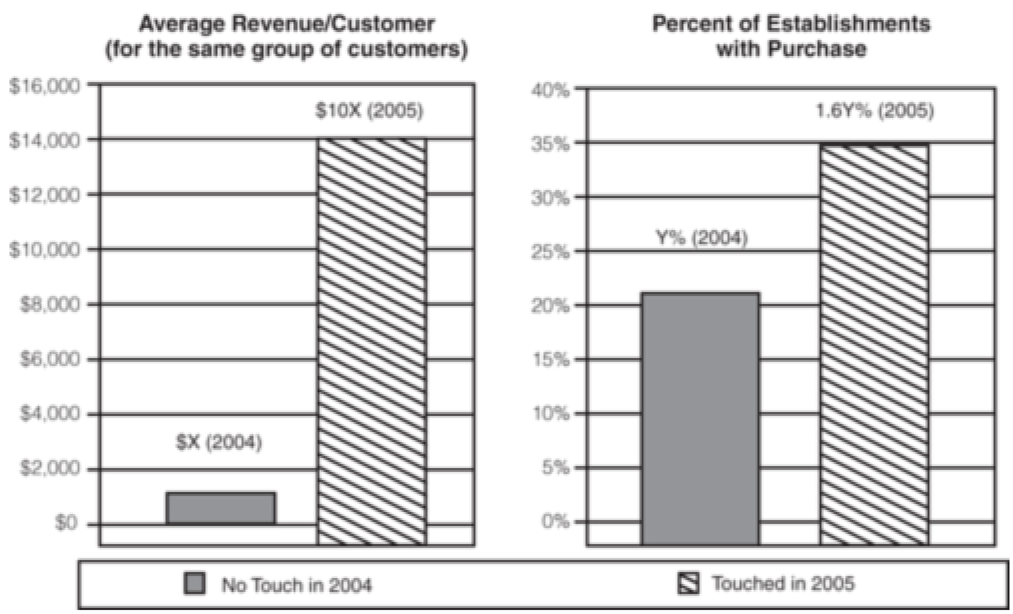
Figure 14.2 shows the reallocation of marketing touches and contacts using the CLV maximization framework.



Source: V. Kumar, Rajkumar Venkatesan, Timothy Bohling, and Denise Beckmann, “The Power of CLV: Managing Customer Value at IBM,” forthcoming, *Marketing Science*.

Figure 14.2. Reallocation of marketing contacts

The net result of using CLV was therefore higher revenue and higher value in 2005 versus 2004 for the No Touch in 2004 but Touched in 2005 group of customers. If the revenue increase is about $12,700 per customer across categories, for about 1,511 customers (for the No Touch in 2004 but Touched in 2005), the total increase is about $19.2 million. Among the customers who were touched in 2004, the CLV-based model recommended touching about 24,000 customers in 2005. The average revenue for this set of customers is at least $14,058. This results in a total revenue contribution of more than $300 million (after accounting for the direct marketing expenses). So, the CLV-based model recommendations did not miss out on identifying existing sources of revenue, and they identified new sources of revenue. Figure 14.3 shows the incremental revenue and new business due to the implementation of the CLV-based strategy.



Source: V. Kumar, Rajkumar Venkatesan, Timothy Bohling, and Denise Beckmann, “The Power of CLV: Managing Customer Value at IBM,” forthcoming, *Marketing Science*.

Figure 14.3. Incremental performance by adopting CLV framework

In other words, although the challenges appear to be formidable, they are surmountable, as shown in the IBM example.

Conclusion

As the example with IBM shows, the organizational and implementation challenges common within most firms are not insurmountable. However, to stay at the leading edge of customer management, firms need to continue to work toward collecting information at the individual customer level. Firms can overcome many of the obstacles they face by better understanding their customers, interacting with their customers, and valuing their customers. Adopting the Interaction Orientation can help marketers maximize profitability for the firm and also gain credibility within the organization—thereby making these organizational challenges easier to overcome.

15. The Future of Customer Management

Relevant Issues

- How has customer management evolved over the years?
- What are the different approaches to customer management?
- What is the future of customer management?

The evolution of customer management has been gradual over the years. Firms initially started with individual customer management and looked at individual needs, but then moved on to mass marketing and tried to target the entire market. Over the years, these firms realized that to gain a competitive edge, they need to concentrate on segmented customers, and now more so on individual customers. Coca-Cola is a company that has gone through this cycle of evolution. It has experienced an entire cycle of customer management since its inception in 1886. In the initial years, also referred to as the "first phase," the competition was low, and competitors could enter the market easily. Coca-Cola wanted to stimulate progress by making itself a national brand by means of national distribution and brand pulling power. To achieve this, the company launched a sales force that catered to the needs of each and every customer (that is, provided customized services). The sales force and their national campaign made Coca-Cola the most powerful brand in the history of marketing. In the "second phase," with the entry of competitors such as Pepsi, the market became stiffer, and price competition emerged. Coca-Cola targeted entire-market customers and adopted marketing strategies to cater to the needs of these customers to gain a price advantage. This strategy helped them reduce production cost so as to gain a price advantage.

Mass-media advertisement is the lowest common denominator appeal, designed to speak to as many potential customers as possible. Coca-Cola was soon known as a brand that is perfect for anyone, anytime, anywhere. The reach derived from this strategy was achieved, but by sacrificing knowledge and awareness of individual needs. During the "third phase," Coca-Cola went back to market-segmentation strategies and segmented customers based on demographic and psychographic factors. Slowly, the attention moved toward individual customers. The company philosophy was to know each and every customer, to know them intimately and know them well. Salespersons or sales managers kept a tabulated record of daily purchases. Thus, a record of what each customer was doing and, more important, a record of what he was *not* doing was always available. That was the pulse of business—and the only way to feel the pulse of the entire business at one time was to know each and every customer. These records enabled managers to intelligently analyze and to describe and prescribe remedies. Coca-Cola thus made a full circle, reverting to marketing strategies for individual customers, with which it started off.[1]

Customer management (CM) changes (definitions and use) do not constitute merely an evolution in business practice, but a revolution. Specific factors lead to this conclusion:

- The reason why companies invest in CM has changed. Traditionally, companies implemented CM strategies to reduce cost and to make CM more efficient. Today, however, CM strategies are implemented to retain loyal customers and to help businesses grow their revenue and profit.
- An increasing number of companies approach CM as a means to an end, not an end in itself. Managers have learned how to successfully implement CM strategies in lucrative business scenarios, set reasonable expectations for returns, and evaluate and understand new business opportunities that will arise.
- How CM is perceived has changed. Initially, companies relied on software that used the traditional backward-looking metrics to manage customers. Now, however, managers use the forward-looking metrics (which are customer-focused and customer-centric strategies) to manage customers.[2]
- Sophisticated analytics now exist to take advantage of available data. This makes CM a more lucrative business initiative for firms because of its ability to produce accurate predictions.

Figure 15.1 shows the various stages of the CM evolution. The figure shows three customer groups and four marketing strategies. The customer groups have evolved from individual customers to entire-market customers to segmented customers and then back to individual customers. Four marketing strategies implemented during this evolution are one-to-one, mass marketing, campaign based, and interactive marketing. These four strategies are aligned with these three customer groups to efficiently manage the respective customer groups. In general, firms started with marketing strategies for individual customers and followed with mass-marketing strategies for entire-market customers to gain a price advantage. After attaining these advantages, they reverted to segment and individual-level CM to gain a competitive edge, as was the case with Coca-Cola. Currently, firms are adopting interactive marketing strategies to help them gain competitive efficiencies in executing customer-level strategies in the market.[3]

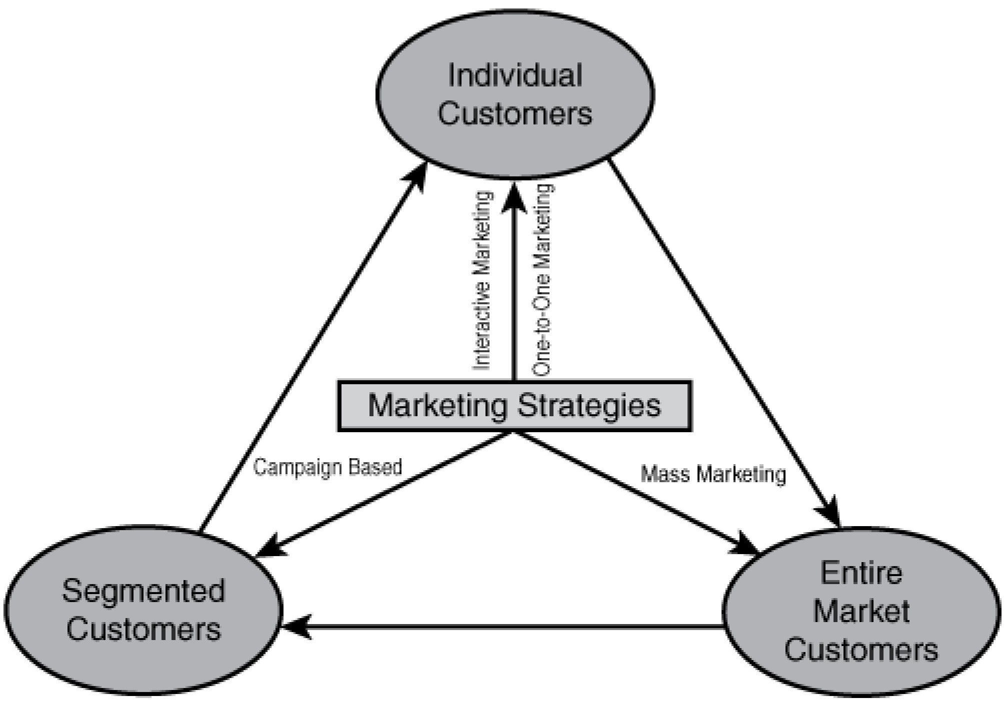


Figure 15.1. Relevant Issues: Evolution of customer management: Aligning customer groups with strategies

Customer Groups

During the evolution of the CM strategies, customers were mainly targeted in three basic customer groups: individual customers, entire-market customers, and segmented customers.

Individual Customers

In this group, each and every customer is treated individually. It is an approach that concentrates on providing products and services to one customer at a time by identifying the customer's needs and wants and then meeting those individual requirements. It aims to provide the customer with services/products over a period of time so that a lifetime relationship can be developed. The individualization of interaction is an important component in building customer loyalty. Better returns on investment are expected as a result.

Entire-Market Customers

Here, the entire market is targeted. The marketing strategy involves marketing of a product to a wider audience. The idea is to broadcast a message that will reach the largest number of people possible. For example, Henry Ford applied the concept of entire-market customers in the automobile industry. His Model T was conceived and marketed as a "universal" car, one that would meet the needs of all buyers. By adopting mass-production techniques and eliminating optional features, he was able to reduce costs and sell his product at an affordable price. Ford viewed his product as being the only one that consumers needed.

Segmented Customers

This group can be defined as a group of customers that helps the firm better understand a customer, its likely direction, and its potential reaction to products. Such an understanding helps managers to make decisions while anticipating expected future returns, product requirements, response to competitive threats, and other strategic issues.

Segmented marketing analysis allows managers to view the customers at an acceptable and sometimes intuitive level of aggregation. Common practice finds customers segmented along certain management realities of running the business: existing or historical partner channels, and product or marketing campaign features. Many marketing-segmentation schemes that were used were based largely on the origination channel or reflected product types. Coke has introduced different flavors over the years to segment customers based on product types. It has different products targeting different segments: PowerAde for athletes, Coca-Cola Zero for those who like calorie-free drinks, Full Throttle for students, and so on.

Others reflect geographic locations of customers or branch locations, which can be tapped to reflect a variation in local market conditions.[4]

Market segmentation started as early as the 1920s. General Motors used market segmentation in the 1920s when it produced different models for different groups of customers to compete with Ford. Pepsi made a series of attempts, beginning in the 1930s, to successfully enter into Coca-Cola's market share through changes in products and targeted promotion strategies. In the 1940s, television provided a powerful tool for both new and old companies to reach segmented customers. By the 1960s, market segmentation had surpassed mass marketing as the primary approach.[5]

Marketing Strategies

Four main marketing strategies are implemented to target these customer groups.

Initially, one-to-one marketing was implemented to target the individual customers. Gradually, firms' focus shifted to a larger customer base, and the entire market became the target group. Mass-marketing strategies were used to target the entire market. This marketing strategy was for the mass audience, and the message was to reach out to as many people as possible. Campaign-based marketing strategies were used to target market segments. The focus of firms again shifted to individual customers. As firms got a deeper understanding of their customers, marketing strategy changed from transaction-based to interaction-based marketing. Therefore, most of the firms are now following marketing strategies targeted at either segmented customers or individual customers.

Aligning Marketing Strategies to Customer Groups

There are four possible alignments between marketing strategies and customer groups: one-to-one marketing and individual customers; mass marketing and entire-market customers; campaign-based marketing and segmented customers; interactive marketing and individual-level customers. The following sections discuss each alignment.

One-to-One Marketing and Individual Customers

Customer strategy began its journey with one-to-one marketing to the individual customer. This was feasible because of the availability of a single product for a smaller audience. One-to-one marketing is a widely used marketing strategy that focuses on individual customers. It is an integrated approach that combines all major departments of an organization: marketing, sales, production, distribution, finance, and so on. It recognizes the fact that the lifetime values of loyal customers who make repeat purchases far exceed those of fickle customers who constantly switch suppliers in search of options and other deals. In other words, organizations provide tailored products to meet customers' needs, thereby making comparative buying difficult for customers and changing their focus from price to benefits.[6]

Apart from the benefits just described, other benefits of one-to-one marketing include the following:

- The cost of retaining a loyal and profitable customer may be higher than the cost of acquiring a new customer, but it may be worth it.
- The knowledge of an individual customer is very precise; therefore, products and services can be more accurately targeted.
- Satisfied and loyal customers (even though they might not be that profitable) can provide excellent references and referrals.
- It helps convert prospects into customers, increases revenue, and builds brand loyalty.
- It helps an organization differentiate itself from competitors.[7]

Harrah's Casino used one-to-one marketing to the individual-level customer management to gain competitive advantage. To stimulate loyalty, it introduced a loyalty-based Total Reward program that rewarded customers with compensations. The reward program sought to gather information about customers and use it to customize the company's marketing program for each customer. The data collected helped Harrah's to keep track of its customers' preferences and thus develop marketing plans accordingly.[8]

Mass Marketing and Entire-Market Customers

As product proliferation occurred and the number of customers increased, firms had to resort to mass marketing. Marketing products to a large audience is referred to as mass marketing. Mass marketing is the best strategy to target an entire-market group. Traditionally, mass marketing has focused on radio, television, and newspapers as the media used to reach this broad audience. Exposure to the product is maximized by reaching the largest audience possible. In theory, this would directly correlate with a larger number of sales. The approach results in a single marketing plan with the ideal mix of four Ps: price, product, place, and promotion strategy for the entire market.

Firms generally use mass marketing to target an entire market because

- It expands volume through lower prices.
- It reduces cost through economies of scale that are achieved by high volume of output.

Mass marketing began around the 1880s, with the introduction of the railroad and the telegraph system.

Manufacturers such as Quaker Oats, Proctor and Gamble, and Eastman Kodak used refined mass-production techniques to establish consistent product quality so that they could mass market their products. Sears and Montgomery Ward developed a mass-marketing niche through mail order. The grocery retailer A&P, on the other hand, established its mass market through private branding and the systematic operation of multiple stores.[9]

Campaign-Based Marketing and Segmented Customers

Campaign-based marketing strategy is often used to supplement segment marketing. It evaluates market performance and then sets the business objectives. The firm proposes making complementary offers to segmented customers to encourage them to maintain their loyalty to the firm. Figure 15.2 explains the functioning of campaign-based marketing.[10]

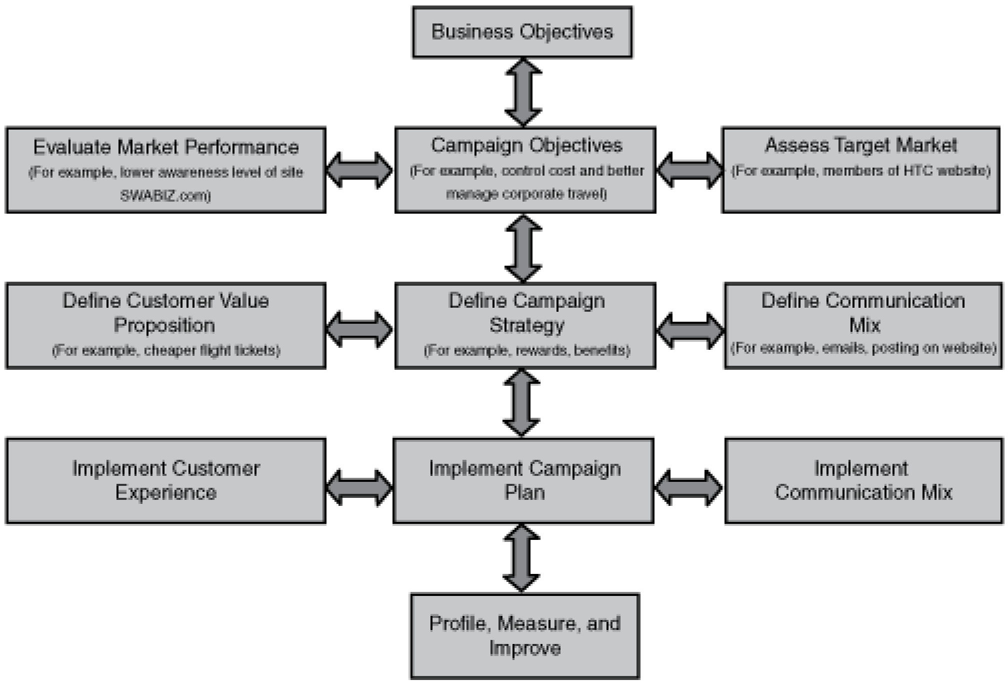


Figure 15.2. Campaign-based marketing process

For a business to grow, managers need to market the products via valuable marketing strategies. By developing marketing campaigns based on the process described in Figure 15.2, managers can keep a record of the creation of new customers from the segmented market and monitor the retention of existing customers. For example, managers can see how much sales have increased because of the new customers during a particular campaign and how many loyal customers made a purchase during the same campaign. (For example, consider the IBM study described in Chapter 14, "Organizational and Implementation Challenges." Of the total profit of $19.2 million, 40% came from incremental purchases of the existing customer, whereas the remaining 60% came from purchases of new customers.) By doing this, managers can check the efficiency of a firm's financial investment.

Southwest Airlines adopted campaign-based marketing to improve the awareness of an online feature its company provided. The business travel site SWABIZ.com was relatively unknown to most customers. SWABIZ provides unique benefits for companies seeking to control costs and better manage corporate travel. With the goal of increasing visibility and ticket sales for SWABIZ, Southwest Airlines combined with Spur Digital and launched a marketing campaign. They integrated a program that utilized email and the HTC (Houston Technology Center) website to promote a campaign for its members. Leveraging HTC's access to its member base, Spur developed a three-month campaign to promote SWABIZ to HTC members. Results from the campaign were convincing, increasing revenue, brand awareness, and brand loyalty.[11] Figure 15.2 provides a sequential flow of the process followed by Southwest Airlines to target segmented customers.

Interactive Marketing and Individual-Level Customers

Currently, firms are adopting interactive marketing strategies for individual customer management. Interactive marketing refers to a trend whereby marketing has moved from a transaction-based effort to conversation- and interaction-based marketing. Interactive marketing is the ability to address the needs of each and every customer, remember what the customer demanded, and address the customer in a manner that illustrates that managers remember what he/she wanted.

Firms that adopt the interactive marketing approach make an assessment of individual customers, including their needs, wants, and ways and means of communication. This assessment includes lifetime value and profitability. It establishes a department that identifies the necessary components and interfaces for delivery of products/services to the customer. Firms try to find appropriate ways to integrate different strategies to the new strategies adopted. Also, they integrate different organizational components. They encourage interaction within the organization and with customers to build trust, encourage collaboration, create demand products/services, create positive referrals, and so on. The department also appoints monitors and measures the impact of any change in the firm's consumer base. Then, it adapts to the changes so that market opportunities can be exploited.

The benefits of adopting an interactive marketing strategy include the following:

- Those customers who acquire the various interactive technologies are more affluent and attach a greater value to their time. They will pay for responsive service and for having their particular needs met.
- Sales conversions increase because of increased customer confidence, and buy-in is induced (through which a number of different product

benefits are interlinked).

- Customers can have access to comprehensive product information to address a wide range of needs.
- By linking with other companies' delivery mediums, one company's products can be cross-sold to another and the linking reciprocated.[12]

Firms such as IBM and American Express are successfully adopting interactive marketing strategies. Their endorsement of practices consistent with the elements of interaction orientation and recent business performance demonstrates the importance of the managerial significance of an interactive marketing.[13]

As mentioned in Chapter 1, "Introduction," the path to profitability for a typical firm begins with acquiring customers and giving them a richer experience so as to increase their loyalty toward the firm's products/ services. This leads to higher retention and enhanced revenue. But, in the current atmosphere, CM has taken a reverse path. In this book, we have discussed how the reverse path can be followed. In other words, it pays to identify profitable customers first and then create a sense of loyalty and satisfaction in them.

Are Some Firms Taking the Practice of CM Too Far?

Although CLV can be used as a metric to manage customers, it is important not to go overboard with it. The following examples might help to get a perspective on whether certain actions taken by a few companies might have any long-term harmful consequences.

Recently, Sprint Nextel decided to dump 1,000 of its 53 million customers for calling its customer service too often (because customer service calls cut into profits). For example, for a typical wireless subscriber who spends about $55 per month, a firm can make about $24. In addition, it costs about $2 to $3 per minute to service a call to a customer service representative. If a customer service call exceeds 8 to 12 minutes per month, the firm does not make any money from that customer. Similarly, AT&T canceled service to customers who make most of their calls in the roaming mode. Verizon canceled service for customers who exceeded 5GB of data usage per month on its network. It is apparent that telecom firms evaluate the profitability of each customer, and firms such as Sprint

Nextel, AT&T, and Verizon “fire” their customers for not being profitable.[14]

ING Direct is an online bank with more than 6 million customers. It shuts down the accounts of more than 3,000 to 4,000 customers each month because these customers need a lot of hand-holding, and that costs the firm. This six-year-old firm will not be able to offer higher interest rates to its customer if it is not able to contain its costs.[15]

It is true that in wireless and banking firms, about 20% to 30% of the customers give 100% of the profits, and the bottom 20% actually induce losses for the firm. The middle 50% or so typically break even. So, a majority of the up-sell/cross-sell marketing strategies are aimed at the middle group to make them profitable.

Is firing customers a good strategy? Given that the cost of acquiring a new wireless customer ranges between $300 and $350, telecom firms typically make a profit only after the first year of service. Therefore, considerable thought and computation have to go into making the decision to fire a customer. For example, about 50% of all wireless users in the United States made a call to their customer service department. Among these customers, 42% contacted their providers with billing issues.[16] If the origin of the problem is with the telecom service provider, calls related to resolving these issues should not be factored into the customer profitability computation. It is paradoxical that the firing of customers is happening even when these firms are losing customers in large numbers every month.

It is also true that a customer received 30 unsolicited telemarketing calls from Sprint over a few months trying to up-sell/cross-sell. How is Sprint able to justify this behavior when it fires other customers for making too many calls? The answer may lie in the potential profitability of the customer (that is, the CLV). For example, consider the airline industry. They know that their most profitable customers are the elite frequent fliers, the ones who buy many profitable goods and services; and it’s these customers who are supposed to receive perks, but the perks are not guaranteed. Although these customers are profitable, they may get fewer free upgrades and may deal with less-accommodating agents if they are too demanding or obnoxious.

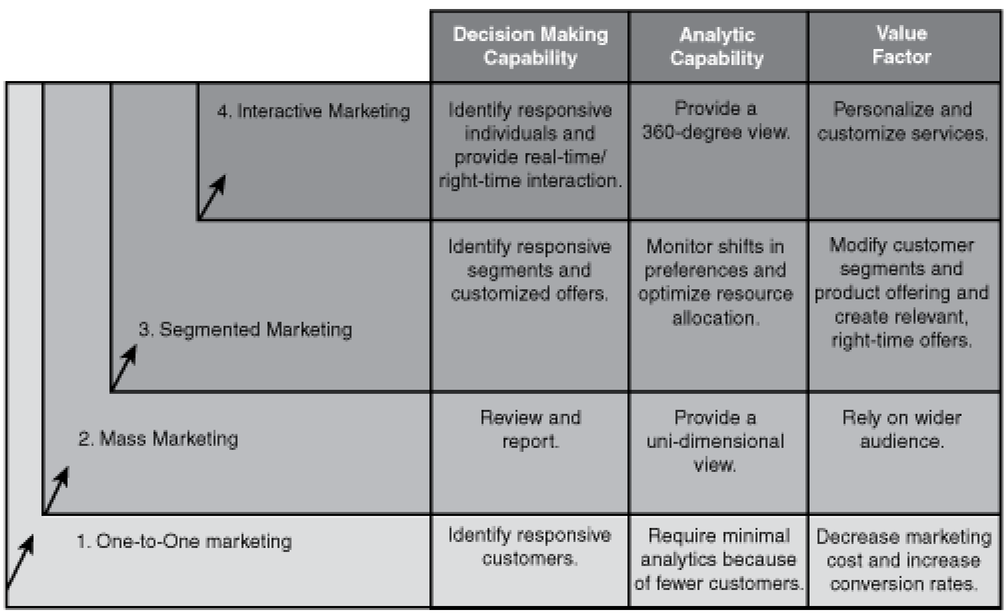
In summary, a better way of practicing CM in the future is to clearly state the benefits for each customer based on his or her level of service. Then, give the customer the option to add a higher tier of service for some additional fee. This way, both the firms and the customers can coexist because the focus is now on profit, loyalty, and satisfaction (in that order). Maximum CLV is possible if customers and firms are able to interact and understand each other well.

Taking Your Company to the Next Level of CM

Firms are trying to step up the ladder of customer evolution, as shown in Figure 15.3.

Figure 15.3. Hierarchy of customer evolution

Source: Adapted from Ron Swift’s CRM presentation.



Providing customized products and services makes customers more loyal to firms and hence increases customer retention. Firms can also further increase the product’s attachment to the customer by processing their feedback and suggestions and trying to incorporate those changes (that is, use interactive marketing targeted at individual customers). That would give customers a sense of attachment to the product and induce loyalty, which thereby would lead to increased retention. Another advantage of interactive marketing is the possibility of generating positive word-of-mouth, the ability to cross-sell, and so on, all of which would help firms to increase profit immensely. Many firms have started adopting interactive marketing, and in the future this level of customer management will be followed widely.

Today, it takes anywhere from 30 days to 1 year for a firm to obtain a 360-degree view of a customer or to reverse the path of profitability. A firm that is able to use this view takes some time to determine the right actionable information in the right format for each customer interaction in the contact center. In the future, can a firm take this marketing action within a day (or perhaps even the instant a customer walks in)? Do we have the right systems in place to effectively control and capture all relevant customer data? Are we indexing and categorizing the captured information so that we can find a relevant solution quickly and easily?[17] If we have the right information system, the data can be processed in real time, and relevant information for the ideal marketing strategy can be provided instantly.

Therein lies the future of CM, where you have a marketing plan for each and every customer, to make him even more profitable as soon as the purchase information is updated.

Conclusion

The continuing evolution of CM is made possible as we understand the interactive relationships that develop between firms and customers and customers with other customers. Firms will increasingly be able to customize marketing messages to larger target audiences based on the customer’s expected response and the customer’s value to the firm. By following the CM strategies previously discussed, firms can reduce overall marketing costs, increase overall customer response rates, and, most importantly, increase overall customer and firm profitability. Therein lies the future of CM—where you have a marketing plan for each and every customer with the goal of making each customer more profitable.

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Smart Retail

Winning Ideas and Strategies from the Most Successful Retailers in the World

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. . . is still dedicated to customers—the people who pay our wages.

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I would like to add this last thing: all the effort, sacrifice, setbacks, and challenges have been worth it. Retail is the best life in the world.

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Introduction to this Edition

How to get the best from *Smart Retail*

Smart Retail is written from an enterprising store manager's perspective—I've done that to make it easier to read but I want to be clear that whatever your role in retail, there is a lot to gain from giving the thing a read. In Appendix I are notes specific to various job roles: Take a look at them before you plunge into the main sections, of which there are four:

1. **You**—*personal tips for honing your retail eye.*
2. **Team**—*how to get the best from your people.*
3. **Customer**—*how to delight them.*
4. **Store**—*getting the environment right*.

Each section can be read in any order, or even on its own. You might want to start with whichever area you feel needs most work. It is fair to say that I believe most solutions to retail challenges can be found from within the team, which is why the "Team" section makes up such a big part of the book.

Above all, this is a working book. I invite you to flick through, to cherry-pick the bits that suit you best, scribble on the pages, tear stuff out, and share it. If I ever came into your store, I would love to see that your copy of the book has a broken spine, page corners turned down, a forest of Post-it notes sticking out the top, and coffee stains on the cover.

Preface—Why retailing?

One thing that hasn't changed is that retail is still physically and mentally hard work. The pressure's always on; we're only ever as good as our last trading day. Every time we open the store, what follows could be a disaster or a triumph.

And that's the thrill of the thing, that's why we do it—get things right, get the team pulling together, make customers happy, and take some money ... well, those are the days that keep us coming back for more. Getting retail right is thrilling—magic, even.

Getting retail right is thrilling—magic, even.

Welcome then to *Smart Retail,* where together we can try to make sure that you enjoy more good days, better profits, a happier team, an improved business performance, and a boost to your retail career. I love selling things in shops, it is my passion, and this book is all about sharing retail excellence so that we can all enjoy the good bits of that more often.

That there Internet thing

Selling online has had a massive impact on what we do and it is an impact that will continue to grow, not just through e-commerce but in how easily-available information and price-comparision forces change in the way retail works overall. Nowhere in the book though do I make much distinction between retailing on the Internet and retailing in a store—and that's because they are the *same* activity. Both forms are about selling products people want in nice, shoppable, environments—supported by robust systems, great customer service, and effective communications. Retail standards apply in the same way across both.

Where distinctions do apply is in the suitability of your product, positioning, and format to either form. The rule of thumb is this: If you are a bricks-and-mortar retailer then you are unwise to be without a credible online outlet—it's another store and one with a big potential catchment area. The other way around though and it's less clear-cut: The Internet allows smaller retailers to reach far more people, more directly, and more powerfully than a few physical stores might.

As Internet retailing has matured, so too has an acceptance that both forms can learn from each other. Internet retailers have begun to understand better the principles of the complete customer experience, while bricks-and-mortar retailers have slowly begun to learn how to communicate better and how to give customers more reasons to come back. Reminding us that they exist, telling us about good things we might like to buy, and reminding us to come visit is something the best Internet retailers do superbly well—better than any high-street store. Internet retailers say "thank you" better than traditional ones too and that's more powerful than you might think.

Asking the questions

Each edition of *Smart Retail* has been put together on the back of a simple question that I've asked the world's best retailers: "What makes you so good?" Maybe it's a surprise that they would reveal the answer to that question? That they have, over and over to me, is, I think, because great retailers have a passion not just for their own success but a determination that the more retail businesses out there who get retail right then the better off we all become. A vibrant retail sector plays a critical role in the success of economies and, as it goes, the UK in particular owes much of its last decade of success to the superb performance of some of the best retail businesses on the planet. Equally, when customers stop spending ... 2009 and 2010 were tough: We lost a few businesses but others strengthened and learned. I've experienced three recessions in 25 years of retailing now and I'm sure I'll experience future ones too. We push through and we survive by continuing to give customers what they want, need, and didn't know they were looking for.

Is it rocket science?

Because the book is founded on examples of best practice and because, as we will explore later, there are few "new tricks" in retail: Much of what we cover has been done before; I make no secret of that. You will already know lots of it and you will easily understand all of it. This isn't a bullshit fairy-dust consultants" book: This is a collection of answers to your challenges; it is a professional self-help resource—it's not about doing the impossible and being one of the tiny handful of people who invent something new; it's about helping you to make the best use of your own retail instincts and to benefit from the experiences of others.

Brass tacks

The essence of *Smart Retail* is about helping you to make more money, to win the sales battle, and to help you and your team stand out from the competition.

Stars of the shop floor

A good store manager can make a huge impact on the success of an individual store, much more so than a clever marketing director or number-lovin" finance chief can. With a good manager at the helm, great sales teams can make a big and immediate impact. Although I've presented the ideas here in straightforward terms, that doesn't mean they're not sophisticated: We're talking about best practice learned from time spent with the world's best retailers—everything here is accessible to store teams and everything is potentially incredibly powerful.

Much as I'd love the bosses to use *Smart Retail* to make positive changes, I'm hoping that grafters out there on the shop floor will read it too. I've had a lot of feedback from so-called "lowly" checkout people and sales assistants who have been inspired by *Smart Retail* to push themselves forward. So much for "lowly"—I'm really looking forward to the day when my agency is ringing you ex-checkout people and asking if we can come and work for you in your retail empires. It's been fun writing this edition but if just one more person, maybe you, uses the book to realize their true retail potential, well, that's worth more than gold to me.

That gives me masses of hope for your success too. There is nothing to stop you pushing yourself—good ideas, retail ability, and energy are valuable—use the ideas and strategies in *Smart Retail* to make the breakout and to create momentum for yourself.

At the risk of this all going a bit Tony Robbins, you can do it!

Part One—You: *Starting at the beginning.*

Choose your own direction.

Source: Koworld

Chapter One. What do you want for yourself?

Why do you come to work? It's a cold wintry morning in a small town and you've got a store to open, a cash register to man, or a desk to get to. Why do you bother? It's an important question—it's worth thinking about and worth taking a grown-up look at the answers.

Whatever the specific answers, there's likely to be in there things like: our desire to feel good about ourselves through being good at stuff, to create a little security for our kids, to give our partners reasons to be proud of us, even material things like wanting enough money for a nice house or a great car—or to get enough cash together to stop working for a bit. All of that is good—what's important is that we be honest with ourselves. Once you work out why you're really hauling yourself into city center in the dark of a December morning—then you have a chance to understand how to get the best out of that day, the next week, and the next year.

It's a simple human thing: If I want a nice house I've got to earn money, if I've got to earn money I need to have a good job, if I'm going to have a good job then I need to perform and get noticed, if I'm going to get noticed then I need to do the numbers, if I'm going to do the numbers then I have to keep my team and customers happy ... you can keep this process winding back all the way to the one small thing—maybe something you hate doing—that you need to do right now, right after you've had five minutes of reading this. That small thing you do next—that's earning you that nice house. It is.

This process, this way of thinking, doesn't just apply to material stuff: Let's say your personal goal is a creative one, the work you do, the nasty bits in particular, can be linked, by stepping back this way, to getting your play written, or to quitting retail to go to art school, or whatever. There is pride to be had in grafting in retail in order to use the results of that graft to move you forward toward a non-retail goal. Give the best you can to get the thing you want. Simple stuff.

Give the best you can to get the thing you want.

Action-planning means doing stuff

Most action planning is a load of old trash—action plans and reality are rarely aligned. It's simple v. complex: A good action plan is one that starts with a goal and then steps back from that goal, practical-step-by-practical-step, until it arrives at the very next thing you must do to move things along.

But just thinking about what you want to achieve is useless without a practical plan: I was taught the techniques of visioning by legendary trainer Bob Caton, and his practical technique is a cracker. Bob is more content with life than pretty much anyone I've ever met. His favorite visioning story is of the house he built for himself in Thailand—he bought a patch of land as soon as he could afford to and then every night at home in England, imagined himself sitting on the veranda at a house that didn't exist. He would describe to himself how it would feel, the taste of the cold beer in his mouth, the warmth of the breeze on his arms, the comfort of the chair, and so on. Then in the morning, he would picture the house once again, and this time he would run a very fast step-back from the beer on the veranda and right to the things he needed to do that day, like call a prospect or get on a 6:45 a.m. train. Two things happened for Bob—he felt better about things he wasn't all that keen on having to do and he got his house built.

So it's not just the end-goal that you think about—it's all those steps that link from there back to the right now. Here's a simplified rundown of Bob's vision:

- I want that first ice-cold beer on the veranda of my own house in Thailand.
- I need to build that house.
- I need to have the plans drawn up.
- I need to have the funds in place.
- My business needs to have been successful enough to generate *x* profit over *y* years.

- That means I need to have taught an average of *xxx* days training per year.
- Which would have come from three permanent clients and ten casual contracts.
- To hit those numbers, I need to have pitched nine major projects and developed one hundred good prospects.
- That means *x* phone calls and *y* letters over *z* period.
- I need to write four letters and make six calls today.

Of course, there are also technical steps I've left out for expediency such as understanding what you're selling, commissioning marketing material, and so on. You need to include all that in your plan. But you get the idea—it shows how the grind today, right now, can get you something cool and important in your life.

One of the best things you can do to get yourself motivated is to read Prof. Richard Wiseman's excellent *59 Seconds* (Macmillan, 2009)—in the motivation chapter, he'll tell you all about where visioning can go wrong and how to stop that from happening. He'll also tell you how things like sharing your goals make a provable difference to achieving them.

I'm not about to turn into some hokey self-help twonk here and ask you to stand on your chair and shout "I can." All I'm asking is for the moment's hesitation before rejecting an idea and for you to couple that to achieving your own personal ambitions.

At its simplest, all this is about being open to achieve things, being slower with "no," "impossible," and "just can't happen," and quicker with "let's find out," "let's try it." Thinking this way clears the path to achieving your personal goals.

Raw passion makes us great

All the best retailers are naturally passionate about their businesses. I would suggest it's the one single thing that unites them—without passion, you cannot achieve long-term success in retail. Sure, loads of other skills are important: leadership, an eye for product, team-building, accounting, service, and design. But all of these can to a greater or lesser extent be learned from a book. If you are weak in one or two of these areas you can still usually get by. But without passion, you just won't make a life in retail work for you.

Passion is what drives great retail; and customers, as well as colleagues, love it. Passion is the magic ingredient that helps you to bring surprise, drama, great service, exciting products, and delight into the store.

Passion is what drives great retail; and customers, as well as colleagues, love it.

Customers leave a store run by a passionate team feeling like they want to come back. The team looks forward to coming into work, knowing that today might be the day to break some records, have some fun, and create something great. You could be a cashier at ASDA or the head honcho at Target—as long as you feel that passion, the retail world is your oyster.

Passion to make things better

Passion is not about sales; it is about improvement. Mahendra Patel is one of the finest passionate retailers I've ever met. MP, as we all know him, worked most of his retail life as a store manager and then as a senior field manager. Before that, MP was a teacher in Uganda. In 1973, MP and his family had to flee for their lives in the wake of Ide Amin's murderous purge of the Ugandan Asian population. Arriving in the UK with nothing had, as you would expect, a deep impact on Mahendra. Many people would sink. MP didn't; he started out all over again, this time as a sales assistant in a Dixons store. After more than a quarter of a century in stores, and his having gone through so much, I couldn't understand why the ultra laid-back Mahendra always refused the offers of promotion into head office that regularly came his way (including one invite, I remember, that included a retail CEO sending down the company jet to bring MP back for lunch and a chat). He could have been running the whole show, I would often, exasperated, tell him. I'll admit that I began to question where exactly Mahendra's passion was.

Then over a meal one evening, Mahendra told me: "I am a teacher, I always was. My job is to make as many people as I possibly can feel that they can be better than they are now, that they can improve their lot. Life is about hope and I’ve been lucky enough to give some of the people who have worked with me some of that hope.”

I don’t think I ever saw MP actually sell anything, but his stores, and regions, always performed better when he was at the helm. MP’s passion was for improvement: not to create teams of sales animals but to make things better—better for colleagues and better for customers. That passion is what makes this retail business great.

Chapter Two. Rising above the crowd

So, passion, then, is massively important but so is being able to direct that passion into achieving stuff. Part of the challenge is getting yourself noticed—showing the wider business that you are a bit special and a person worth backing. I'm specifically talking here to those of you grafting inside a big retailer: If you work for, say, Tesco, you would be a single voice among 148,000 colleagues. If you are going to accelerate your career, or you just want to get good ideas heard, acted upon, and producing benefits for the whole business, then you have to raise your profile in the company. You have to become the one in 148,000 that everybody notices.

You have to become the one in 148,000 that everybody notices.

These are my top suggestions for raising your profile in a multiple-store environment.

Volunteer for things

Put your name forward for projects at all levels. You hear that your area manager wants someone to look after a roll-out? Stick your hand up for that one. Help open new stores, get onto special projects by volunteering for them every time. Getting involved will bring you into contact with senior members of the team, who value and appreciate the help. Such projects often turn out to be good fun and hard work but a nice break from the normal routine.

Introduce yourself to people at every meeting

Go up to the marketing director at the next annual conference and say "hello." Tell him or her who you are and where you work. If you have a useful point to make about the business or the presentations you have seen at the conference, even better. Try not to corner them though—or you'll get a reputation for being a bit scary.

Make good use of the ideas program if there is one

If there's a proper ideas program in place, use it. Put clear sensible ideas into the program whenever you can. Make each submission separately—that way you increase your chance of the evaluation committee noticing you. Offer to help apply the idea too.

Give people your cell phone number

Whenever a senior person comes into your store, engage them. Give them your cell phone number and mention that you are always happy to have them bounce ideas off you. The best people at head office know the value of having people in stores they can turn to for "reality checks" on ideas and projects.

Form an opinion

If you have something interesting and cohesive to say, that will help you to appear more credible when you introduce yourself to senior people. Don't be afraid to research and then to rehearse an opinion. Both those things help to make you worth talking to.

Specialize

Become an expert in a particular area, especially one in which you have experience. Read up on that subject, start to bring it into conversations, and let people know that you are an information source and that you are happy to share your knowledge.

Become an expert in a particular area, especially one in which you have experience.

Produce the goods

Success does your talking for you: In whatever role you occupy, make sure that you are delivering the very best possible performance. That's what this book is for: to give you lots of ways in which to meet and exceed your targets.

Chapter Three. Keeping it simple

Selling stuff in shops is incredibly straightforward. It’s not easy—easy and hard are different things to simple and complex—but it is straightforward. You’ll come across retail businesses all the time that tie themselves in knots of complexity, you might even work for one of them, and it almost always leads to eventual disaster.

Equally, retailing isn’t about inventing brand-new ways of doing things, have a look in the “History” section in Chapter 16 and you’ll see that there have only ever been four genuine innovations in retail history. That’s liberating: You don’t have to be the fifth person in history to come up with something brand new to be a great retailer. Rather it’s about creatively applying simple principles: like understanding who might want to buy the stuff you’d like to sell; working out where they might like to do that; and presenting a shop that gets them all excited about being in it.

The world’s best retailers all, without exception, do “simple” brilliantly: They communicate simple ideas clearly and quickly and they meet obvious straightforward needs in simple, straightforward, ways. You want a cheap T-shirt—you go to Primark; you want a tasty and fresh sandwich—you go to Pret A Manger; you want honest help and advice—you go to John Lewis.

Brilliant retail businesses do “simple” brilliantly: They make it clear what they are for, they sort things out, they make things happen through heavy application of common sense and “the obvious.” It pains me to see retailers drag their businesses through horribly complex processes of organizational change, branding transformation, and culture-shifting without really understanding the common-sense issues and without having a clue who their customers are. And it happens all the time.

Case study 3.1. Net Smart Retail: Woolworths doesn’t understand you anymore

Blimey, but the Woolworths story upsets me: thousands of dedicated staff out of a job, lots of suppliers with a big hole in their accounts, a great heritage lost and, worst of all, loads of communities suddenly missing a really important retailer from their local towns. Why was Woolies important? Because it was a great place for lots of us to get all those nice little treats and sundries without having to get in the car or on the bus to get out of town, it was cheap—we could afford to get the kids a toy there, we could afford a can of paint to make the house look a bit nicer, we could do simple and easy things in simple and easy ways without busting our budgets.

The reality is that Woolworths officially blamed their demise on Tesco and Primark having better buying power than they had themselves. I don't think this is quite right. Woolworths over-complicated their business, forgot who their customers were, and stopped giving real people what they actually needed. And the proof of that hypothesis? Simply that Woolworths isn't really dead at all—their customers found a new Woolworths that understood them better, and it's called Wilkinsons. Wilkinsons swiped Woolies" lunch from right under the noses of Woolworths senior management.

I can remember sitting down with one of the Woolies marketing team a few years back and damn-near screaming at him to stop waiting for consultants to give him profiles of his "six magic customer types" and instead go talk to staff and customers in some of his shops. To go talk to the people walking past his stores and to ask them what they loved and hated about Woolworths. Ask them what they want, what they liked about his rivals. To get to know them in the simplest way possible: by talking to them face-to-face. Now, this chap is a nice guy but he just didn't get it and so he and similarly minded colleagues ran one of Britain's best-loved stores off the edge of a cliff. It was unforgivable and, yes, I'm angry. Angry for those staff, suppliers, and customers who have lost out. Old tough and gnarly F.W. Woolworth himself would be in tears, he really would.

It didn't need to happen. A Woolworths that went back to its roots, that talked and listened to its customers and store staff would have pulled itself around. Probably after some drastic change, sure, to pare things back as Woolworths did in the 1980s under the wise stewardship of Sir Geoff Mulchay, a man who never has lost touch with real people and real needs. But it would have succeeded—Wilkinsons proves that.

Talk is cheap but it's worth lots

I mentioned talking to store staff there, and can't stress enough how crucial that is: No matter how hard you try, the cleaner in your lowest-profile store knows your business and your customers better than you do. So, talk to them and learn—you'll run the company better if you do.

You've all heard the acronym KISS, right? "Keep It Simple Stupid." It's advice I often get from my mate Kevin McNally at Sony during his briefings. It's good advice too—forcing you to come back to the basic truths of any given situation.

Retail is simple things—simple principles, strongly executed. Those principles are about human things. And that's what this book is about—reconnecting with the human, the simple, the foundation stuff that retail is really all about. We're not going to chuck out the numbers but we most certainly are going to learn how to use them to our advantage as proper emotion-driven retailers.

If we do this, we will achieve more success—the evidence within the world's best retailers proves that time and time again. Carphone Warehouse, amazon.com, Wal-Mart, Tesco, IKEA—they don't complicate, they simplify: They get on with things and they make huge amounts of money.

Chapter Four. Rolling those snowballs

You'll get fed up of reading me declare that there are no secrets to retail, so I thought I ought to chuck at least one sort-of-secret into the pot early doors: It's the one about change. Rather than having to unlock some massive total change to improve your business, the secret is to recognize that lots of small changes are just as useful. Retail is about trying things: constantly adapting, nudging, and improving parts of the store. Sometimes you *will* do that all at once, when creating a new format, but most of the time it's small changes strung together that result in big improvements.

One thing changed can be the start of something big. Change one detail noticed by one customer, who mentions it to five others, who each tell five more, and you can see that one change can make a big impact. Your team too begins to see things starting to happen, just from one idea. Employee attitudes begin to improve. Baby steps: Do one thing brilliantly today, another tomorrow, and maybe change the world next week. Remember rolling snowballs as a kid? It's like that; you start small and with a bit of effort you soon have something big going on.

Baby steps: Do one thing brilliantly today, another tomorrow, and maybe change the world next week.

Case study 4.1 Not Smart Retail: Observation, change, and simplicity

In the last edition of this book, I had a case study here about an anonymous retailer that included this quote:

> This business tries to solve that problem [of not understanding their customers] by trundling off down incredibly twisty consultancy roads and arriving, more lost than ever, at crazy conclusions. The one thing they never do? Stand in their stores and watch who comes in. They never talk to their customers face-to-face. Conversations on the spur of the moment can tell you so much. Detailed research is important and is useful but

it's no replacement for pounding the shop floor (in your competitors' stores as well as your own) and talking to people.

Well, I can safely reveal now that the anonymous retailer went bust and that it was Woolworths in the UK. You've read earlier how angry I am (as are plenty of others) that the senior management there were so deaf to the obvious. So you don't suffer the same fate, the following is probably the simplest but most powerful store-assessment tool you'll ever use. It's about looking, listening, and doing, and it's incredibly easy to do all the time.

Reading stores the practical way

Regularly run this assessment of your own store but also of competitors and non-competitors alike—you'll uncover loads of ideas and possibilities each time you do. There are three areas to observe:

A—The store

B—Its staff

C—Its customers

A—Store

I'll bet good money that you already do this when you walk into a shop: you look around. You look at the fixtures, the offers, the dirt on the carpet, and you spot the display gaps. You might even see those gaps and suck your teeth a bit and feel relieved that some other manager is under pressure for once.

Start outside the store—over the road if possible:

- Watch people walking past.
- How many glance at the window?
- How do they react if they do?
- How do they move if they then come into the store?

Now find a place inside to stand still and observe:

- Watch where customers are going.

- Which part of each section do they enter first?
- Look at people's eyes.
  - What do they see?
  - What do they miss?
- What things do they touch?
  - Which items do they pick up and from where?
  - How long do customers linger over each display fixture?
- How many lookers at each display take something to the counter, or to the changing room?
- What sorts of people are shopping the store? Moms with strollers, office workers, or mechanics? (This profile will be different at different times of the day.)
- Pay special regard to what happens in the transition zone, that area near the door that transfers customers from the outside and then into the store—how do people move through this area?

Most of us make a really basic mistake when we shop our own store. We tend to look at it from back to front. We usually see the store from the back staff area or warehouse through the shopfloor and out of the front doors. It's a natural mistake but incredibly unhelpful. We just aren't seeing the store in the way our customers do.

Then take a look at the basic store components, including:

- Window displays
- Promotions
- Range
- Pricing logic
- Fixtures and fittings
- Lighting layouts
- Added-value ideas

Make a special note of the bits of the store in which a lot of customers seem to be picking stuff up—that physical interaction is one of your best starts to converting a browse into a sale. What is it that you've done in these areas that customers seem to be reacting to?

Go through this in your competitors' stores and in other stores that interest you too. I believe firms should not only encourage you to go out reading your competitors' stores but they should even give you a paid session, every week, to go off and do so. In fact, they should even give you a fiver to go get a latte to slurp while you walk around improving your business through learning from your competitors and other retailers.

B—Staff

Talk to staff every time you go into a shop. An easy icebreaker is to ask "What's it like working here?" You will usually get a plain answer along the lines of "It's not too bad," which doesn't tell you much but does give you a chance to then ask "What do you like about it?" Nearly every time you ask that, the assistant will let slip a nugget of useful information:

- "There's a nice team spirit."
- "The pay is good."
- "It's a laugh."
- "We're treated with a bit of respect."
- "Every day is different."
- "I like customers."

Each of those answers allows you to unobtrusively ask further questions that help to get to specific employment practices in play at that store. Try to chat with the store manager too. Tell them what you do. Share some thoughts and ideas with them and they often will with you.

C—Customers

Listen:

- What do customers say to each other?
- What do they say to assistants?
- How are customers being approached?

Talking to customers in your own store is easy: You've got a badge on that says you are okay to talk to. Talking to customers elsewhere is a bit harder to do. We tend to be a little wary of strangers asking questions but it can be done without you appearing to be a crazy person. Most people do love to share their opinions—turn that to your advantage.

Most people do love to share their opinions—turn that to your advantage.

In your own store, you can ask lots of open questions such as:

- "How well have we looked after you today?"
- "What do you think about how we've changed our displays?"
- "How easy was it to find what you were looking for?"
- "What do you think of these new products?"
- "How easy is it to shop in my store?"
- "What was the first thing you noticed when you came in today?"
- "What's your opinion on how I've set up my register area?"
- "What am I missing in my store, do you think?"
- "What sort of things do other shops like mine do that you really like?"

When I'm in my plainclothes and out in somebody else's store, I find the most successful question tends to be "I run a store like this one; what do you like about this shop?" and I'll be asking that usually while waiting in a line at the checkout. Lots of other opportunities to open up a conversation usually present themselves while wandering around the store too.

If the customer starts to chat happily, be conversational and don't try to sound like you're doing a survey. People tend to respond along the lines of "Oh, I like the way they do X but I really wish they would sort out that damn Y." Maybe we just like complaining but I have found over and over again that these little chats can uncover a glaring problem for you to look out for in your own store. Of course, some customers will also happily give you a rundown of what it is that attracts them to the particular store you are in, and that's extra useful.

Street Time

As a consultancy we do a cracking version of exactly this process: We send teams of senior retailers, each clutching a twenty, out into shops. We call this program "Street Time" and those retailers are targeted with visiting a selected set of stores and reporting back on them. They talk to staff (we've had at least a dozen staff hired by our clients after having had great in-store conversations), they talk to customers, and occasionally they get escorted out by over-zealous security guards. The most useful part is always, they tell us, the standing back and watching customers bit—we give ourselves that essential time too infrequently.

You'll find the very simple notes for our Street Time exercise in Appendix III—read the sections on Big Idea, Discovery, and Mission before taking a crack at it.

Turning the things we see into things we do

Reading stores is powerful only if you do it with a purpose. That purpose is to find one thing to change in your own store or business today. Write down your notes as soon as you can and then do a bit of simple analysis: set up three headings "benefit," "effort" and "cost." Mark each idea out of ten for each of those headings and then pick out the ones that look most attractive and get on with them!

All of these you would consider doing:

- Lots of benefit, easy to do, no cost
- Useful benefit, easy to do, no cost
- Lots of benefit, bit of effort required, some cost
- Useful benefit, bit of effort required, some cost

These you would not do:

- Some benefit, easy to do, lots of cost
- Little benefit, hard to do, lots of cost

Part Two—Team: *Make us happy and we will make you money.*

Source: Koworld

Chapter Five. What’s the Big Idea?

The most important bit in the whole book is this part. Big Idea: Knowing what the hell you actually are; this is the absolute foundation stone of a great retail business. Once you work out what you are, you can get really good at being that thing and get really good at telling people what that thing is and why they might like it: You can build a store that people want to come to and spend money in because they explicitly understand what you’re giving them.

Every great retail business is built around a Big Idea—a reason for existing, the thing that business is for; it informs absolutely everything that the retailer does and says, and informs every decision made within it. It is the starting point for everything in the business. I’ve put it in this section of the book because it has a big impact on the team—you can recruit, motivate, and inspire people around a great Big Idea.

Every great retail business is built around a Big Idea.

Big Idea is the thing that has Hotel Chocolat growing and, for the want of a Big Idea, has Thorntons shrinking. It’s what makes IKEA so compelling and Wal-Mart so powerful. Let’s look at Wal-Mart’s Big Idea, which is “Every item in the store will be offered at the lowest possible price.” That’s Wal-Mart’s reason-for-being and it’s an idea that customers and staff alike understand utterly and fundamentally. It is the Big Idea that has driven Sam Walton’s company since the moment he articulated it one day when he did a bulk deal on ladies” pants and realized he could be more competitive by passing on the savings to customers.

Don’t confuse Big Idea with a marketing strapline: Sometimes they will say broadly the same thing but the idea itself is more than a throwaway creative frippery—it will inform the strapline but will rarely use the exact same words.

Differentiation

Take Wal-Mart's Big Idea and contrast it with Target's, which is to offer "cool things at lower cost." Both sell in roughly the same categories, in the same types of stores (they're classed as "discount variety retailers"). Now, what these two different Big Ideas mean in practice is that Wal-Mart must always opt to sell a 10¢ glass tumbler because it's the cheapest possible price a glass tumbler can be sold for. Target, on the other hand, are able to say "Hmm, that 10¢ tumbler is a bit cheap and nasty. We're about selling at lower cost so we can't stock the really swanky 30¢ tumbler but we've found one that's 12¢ and is a nicer shape, with more consistent molding and heavier glass than Wal-Mart's, so we're going to sell the 12¢ option; it's cheap but it's nice too."

What this has meant is that Target have been able to use their Big Idea to drive a space for themselves to compete against the world's biggest and most powerful retailer. Customers are surprisingly attuned to this sort of subtlety and the result is that Target's customers are younger, wealthier, and better educated than Wal-Mart's.

Let's look at some more Big Ideas in a bit of detail. I'm going to start with more on Wal-Mart because they are so amazingly focused on their Big Idea, and it gives good insight.

Wal-Mart (U.S.)

> Every item in the store will be offered at the lowest possible price

Wal-Mart invented the philosophy of "Everyday low pricing" and do more than any other company on earth to drive cost out of their business and to harness the power of bulk purchasing. At one point, Wal-Mart accounted for a staggering 10% of all Chinese exports to the U.S.—buying power demonstrated on a mind-blowing scale. Indeed, Wal-Mart is the biggest company on the planet (by revenue). Because the Big Idea is so clear—in any given product case—Wal-Mart buyers know that they must always choose the option that means they can sell it at the lowest possible cost. Meanwhile every employee understands that cost-reduction is the critical activity—this influences how stores look, where they are and how business is conducted.

Aldi

> Simple presentation of an edited supermarket range at the best possible price without compromise on quality

Aldi might be cheap but it isn't nasty and the middle classes across the U.S. and Europe have recognized that quality bargains are a sensible part of the family spend. The stores are plain and very efficient and it costs far less to manage the inventory at Aldi than it does to manage the exponentially larger range at Tesco or Sainsburys. "Edited" is the key word here—Aldi is essentially saying "Trust us, we will stock only the low-cost products that work well, taste nice, or last a long time." This is such a powerfully logical Big Idea that Aldi was able to chase Wal-Mart back out of the German market.

Space.NK (UK)

> A carefully edited selection of high-quality, original, and effective beauty products from innovators and specialists around the world

Nicky Kinnaird is an instinctive, natural retailer and Space.NK is brilliant as a result. She recognized that customers want independent advice and recommendations free from single-brand evangelism, that they want help to find the products that do the best job and that are absolutely on-trend. You can't get that at the Clinique or Chanel counters in a department store—you have to do all the work yourself to work out which bits from whose ranges are the best combinations. So Space.NK is almost a living recreation of the "beauty secrets" part of Cosmopolitan or Vogue. It's an incredibly well-focused Big Idea that customers love.

eBay (U.S.)

> Connect buyers and sellers, for any product they can imagine, and make that connection easy and safe

It might look like just an auction site, of which a dozen sprouted in the early days of the web, but eBay's success comes from a Big Idea that recognized what buyers and sellers really wanted: to do their buying and selling in the easiest possible way without fear of getting ripped off. It's not really about the mechanics of purchase at all—as the popularity of "Buy it Now" proves. There's a chicken and egg here: eBay's founders understood that they had to attract huge numbers of both buyers and sellers quickly to make other buyers and sellers want to use the site. Again, simplicity and safety were critical—make it easy for people to list their stuff, drop as many barriers to that as possible, and do the same for sellers. Build trust in both and make it scale fast.

MPREIS (Austria)

Local supermarkets built around local produce and each with distinct architectural identity

As well as a focus on local product from the Tyrol region of Austria (each store carries at least 15% Tyrolean products), this one is interesting because the Big Idea affects the very fabric of the stores—each is designed by hot local architects and has a distinctive feel, even though the products inside are consistent between stores. The stores look awesome but it's not design for design's sake: Local customers see their MPREIS as *their* store, not an identikit bland corporate. That's valuable—if a store like MPREIS opened here, you'd shop it.

Apple Store (U.S.)

Taking the Apple brand to the high street in a hands-on and exciting way

Make no mistake, the Apple store is essentially a single-brand PC World, and yet you'd be loath to make the comparison. Apple's Big Idea for their store identity came from outside of electrical retail, from Ron Johnson, former VP of Merchandising at Target. That’s crucial to the story because Ron was able to throw away the baggage of electrical retail—hide things away to minimize theft, look but don’t touch, cram it in, concentrate only on price—and create a format that reflects Apple’s focus on using your technology to do cool stuff. He dovetailed that with lots of support and advice on how to do those things and delivered a format in which the Big Idea means the customer gets to play, become enthused, and be supported in their enthusiasm.

Lush (UK)

A celebration of fresh, natural, and ethically produced body products

Lush are one of the UK’s best retail businesses and one of the most genuinely principle-driven—they prove that profit and a conscience are compatible. It’s the Big Idea that’s interesting here: we’re talking vegetarian products, minimal to zero packaging, ethical sourcing standards way above almost anyone else’s, public support for controversial direct-action organizations, and an incredible degree of corporate transparency. But do the stores look or feel like campaigning centers for an alternative lifestyle? No, they are a brilliant riot of color, a tidal wave of nice smells, a celebration of great products that work brilliantly and that staff are incredibly proud of. You don’t go to Lush hugging a tree and apologizing for wanting to be clean—you go ready to have fun, to be served with passion and laughs, and to come away feeling awesome.

IKEA (Sweden)

Democratizing design: great design, low prices, and accessible to all

Okay, so the flat-pack furniture jokes we used to make about MFI are now directed at IKEA but that’s just a by-product of popularity. Actually, what IKEA isn’t, and this might be hard to swallow, is a furniture shop—the whole business is built around a set of principles that focus on one thing: making it easy for people to create nice spaces that look good and don't cost too much money. It's a people shop. Building on typically Swedish principles of function before form and simplicity—the store works by first showing customers how to easily group things together, pricing everything in round numbers, filling the journey with fun basics, accessories, and extras to personalize spaces with and then finishing off with an easy collection and payment process all in massive tertiary locations. Yes, it's murder on a weekend but that's because lots of ordinary people like you and me are in there buying cheap things that work well and that look nice doing it. Contrast the experience of buying a first sofa at IKEA now to when you bought your first sofa twenty years ago from a traditional British furniture store ... six to eight weeks for delivery, costs a month's wages, probably needed credit to buy it, and it wouldn't have looked much different from your Mom and Dad's. Or your Grandma's. IKEA means everyone can have nice design that functions brilliantly without costing an arm and a leg. That's retail revolution.

Subway (U.S.)

Sandwiches made "fresh" to order

This is an incredibly successful perversion of the idea of fresh food as healthy—Subway invests heavily in promoting the healthy options on its menu, it uses images of crisp hunks of lettuce and juicy fresh tomatoes to lead customers into believing that a sandwich made from scratch in front of them is somehow magically healthier than one wrapped in plastic at the gas station. Every man, woman, and child in the U.S. recognizes Jared, the student who lost half his body weight on a mostly Subway diet for a year. It's so pervasive that people have come to subconsciously see Subway as the healthy fast-food option, even though they actually order meatball marina with extra cheese every time. It's a powerful use of Big Idea but a bit sneaky too.

Costco Wholesale (U.S.)

Limited range in vast depth, serving trade, and employee groups

Easy to see the Big Idea in action here—massive warehouse stocking few lines but each in massive quantity, turning over inventory incredibly fast at low prices. You have to be a "member" to get in and be prepared to buy products in big pack-sizes. For the small-store trade, for offices, hotels, and restaurants, it's another cash and carry but the extension to employee groups is the bit of genius—putting pressure on companies to allow employees access to Costco and giving those employees what feels like a bit of secret access to a part of retail that beats the system.

Media Markt (Germany)

The customer is not stupid and they live where we do

Europe's largest electrical retailer employs a refreshing approach to advertising itself—openly declaring that customers aren't stupid and so should be looked after by knowledgable staff. To deliver great service, Media Markt recognized long ago that store teams who have real say in their store, who get a chance to make decisions, and directly influence outcomes are more likely to want to commit to giving customers great experiences. So stores here are structured as if they were individual businesses—with managers having 10% equity stake and, together with their store team, having a say on assortment, pricing, and advertising based on their local knowledge. People take pride in things they feel ownership of and are able to deliver on Media Markt's Big Idea because of that.

Case study 5.1 Smart Retail: How Hotel Chocolat has helped sideline Thorntons

I like Thorntons. I've got nice memories of buying little bags of Continental truffles as a treat, but the Thorntons I see now ... something is missing. It's lost its way and that's reflected in a decline in trading performance. On the one hand, Thorntons is actually the UK's largest independent chocolate company; on the other, it's a general confectioner. There's confusion. That confusion follows through to stores where over the door you'll read: "The Art of the Chocolatier." But inside you'll find what appears to be a muddled array of messages and sweets.

And into that confusion, a handful of years ago came the bricks-and-mortar incarnation of catalog chocolate-retailer Hotel Chocolat. And they are wonderful stores pulling off an incredible trick: to be at once cost-effective and mainstream but to appear high-end and authentic. And that's because the business they represent *is* authentic and has set out a Big Idea that defines it as "The Authentic Chocolatier." Now then, that's something everyone can understand and get behind—Hotel Chocolat even own and run a cocoa plantation in St Lucia and aim to not just grow the beans but also to refine the chocolate there. That deep involvement with the fundamental roots of the product shines through to the stores themselves where passion and deep understanding of, and appreciation for, chocolate shines through. You're offered tasty samples by well-presented staff, product is displayed with breathing-space, pride, and care, and lower-priced packs of exciting flavors and combinations of ingredients make the store price-accessible to everyone.

To the customer, Thorntons appear to be about volume and commodity where Hotel Chocolat is about indulgence and authenticity—and is thriving. Thorntons does not have an obvious Big Idea and it's stalling their business. The original Thorntons store was opened in Sheffield in 1911 by Joseph Thornton—when he later handed it over to his two sons, he left them with a Big Idea ringing in their ears "Make this the best sweet shop in town!" And Thorntons *was* that for many of us through the decades, but it isn't *now* and hasn't been for some time. If it was, Thorntons stores would be magical places you'd go to whenever you wanted a special confectionary treat. But they're not—which is sad because there is still room for an evolved Thorntons.

The story of these businesses in a similar market sector shows again how powerful a great Big Idea is.

Case study 5.2 Not Smart Retail: No Big Idea

WHSmith is a fascinating case because the retail company actually consists of two separate businesses: WHSmith High Street and WHSmith Travel, which isn't a travel book shop but rather the WHSmith stores you see at airports, motorway services, and train stations all over the world. One of these doesn't have a Big Idea and one does. One isn't profitable and one is ...

WHSmith High Street stocks books, magazines, cards, sweets, stationery, DVDs, CDs and gifts but lead in just one sector—there are better stationers, better book stores, and better music shops; only the magazine section is a leading department. High Street is a business that for more than a decade has had no real idea of what it's actually for. Nobody inside the company actually knows—I've asked.

But WHSmith Travel is brilliant—it's basically the same departments but in highlight form, so you'll have top books with some eclectic promotions, a great range of magazines, batteries, film and camera memory cards, sweets and drinks, and headache tablets—its Big Idea is to reliably equip every traveler with everything they could want to make their journey a better one. The ranges are perfect, the merchandising spot-on, and the checkout-process efficient and pleasant. The Big Idea guides everyone: you know exactly what to look out for as a buyer, exactly what to range as a marketer, and exactly how to present it as a merchandiser. You know because the Big Idea is so clear it drives an obvious and practical mission.

Recently, WHSmith has admitted publicly that High Street is a trading problem while Travel is booming and profitable. Like Thorntons earlier, WHSmith High Street is a business without a Big Idea—they don't know what they're for and neither do customers.

Your Big Idea

What's the Big Idea that drives your retail business? Is it clear? Does it make sense? How does it position you relative to the market and to your competitors? If you're the top person at your place and you answer "no" to any of these questions, please stop reading and go sort it out now. Without that clear understanding of what your business is for, well, there's nothing we can do for you! If you're a team member in-store and you have the misfortune of working for a business that has no Big Idea, see if you can work out what it should be. Make it relevant to your local customers and share it with the team—see if you can use it to at least make *your* store a high-performer. Once you've proved that it has a positive effect, share it with senior management too.

Chapter Six. How to build great teams

So, you’ve got your Big Idea—you know what the business is for and why customers might want a piece of that. Now it’s the exciting part—shaping a team that can deliver on that Big Idea. First task is to plan to make that team a happy one ...

Happy teams make you more money. The best customer service is delivered by happy, motivated people. You cannot be a great modern retail business without happy and motivated teams. The best performance improvement strategy I could ever recommend is “make your team happy.”

A happy team of friendly motivated people, pulling together, having fun with customers, bristling with ideas and enthusiasm, people with passion for the job, can build huge performance improvements. Like so much in retail, the recommendation to create a happy team is very, very obvious, but is also a massive challenge. The best of us still struggle to get every new hire right, to always make the best decision in a given situation, to not drop the ball when the going gets tough. Management is hard to do right—that is why business rates good managers so highly.

Because managing people is hard, great teams are still the exceptions rather than the rule. That’s actually a good thing for you. Think of it as competitive advantage through team building.

A consistency I’ve seen through great retail businesses is that they understand their Big Idea, tend to be very clear on what the business is trying to do (mission), allow people to behave like grown-ups (respect) and are very good at recognizing positive behaviors (recognition). Let’s call these three things “cornerstones”: Mission, Respect, Recognition. Wherever the three are in evidence, great team and store cultures emerge and I firmly believe that this is a bit of a secret, if there is such a thing, of great leadership:

> Cornerstone 1 Mission: We understand what we want to do for our customers.
>
> Cornerstone 2 Respect: We make sure our people know they are empowered to do those things.

Cornerstone 3 Recognition: We reinforce those positive things by recognizing them when they happen.

The three then exist as a self-reinforcing loop: the clearer we are about what our business is for and the better we enable our people to do those things, and the more we notice and say “thank you” when they do them, then the better we become.

I’ll go into each cornerstone in more detail over the next few pages but first I want to illustrate the value and importance of a great store culture. I would also like to show you that your individual store culture can still be a great one even if the wider company culture isn’t.

Leadership

Things get a little bit tricky when we start to think about leadership and teams. I have a heartfelt belief that leadership cannot be taught—indeed we once lost out on a large bit of consultancy business because I fundamentally disagreed with the notion that leadership could be taught: A UK retailer with 1300 stores was looking to improve store cultures and was very proud of the expensive leadership program they had pushed 1300 managers through. But when we peeled back the detail of what had actually happened, it became clear that any gains they’d seen as a result of this leadership program were pretty much down to the fact that those 1300 managers had spent two days out of their stores and were hyper-aware that senior people were watching them like hawks post-course. It was also clear that those gains would evaporate quite quickly. And here’s where we lost the relationship: I’m not sure that the role of Human Resources is to teach a fundamental in-the-genes skill such as leadership. No, I believe its job is to find the best existing 1300 leaders out there within the total 48,000-strong workforce and then to put those natural leaders in the right roles. Pointing that out led to a huge disconnect from that particular client and we’ve not been back since. When I say “disconnect” I do, of course, mean “hissy fit”; as expected, their leadership program didn’t work and this company has experienced flat or declining performance in the seven years since I first wrote about them. I don’t want to be crowing “I told you so”—that doesn’t generate invoices—but, well, “I told you so.”

So, do you have to be a good leader to be a great retailer? Do you have to be a good leader to create a strong store culture? The painful answer is that to a large degree, yes, you do. You might want to do a bit of soul-searching for a moment on that. It might help if I define leadership—it's really about answering one question: Are you able to inspire others to line up behind your chosen course of action?

Now—having got you through that (I'm hoping you answered "yes"), we get to the notion that great leaders can, and sometimes do, still fall on their behinds. Being able to lead is essential to the job at hand, but understanding where to lead and how to structure the journey is essential too. And that's where your Mission–Respect–Recognition cornerstones come in handy; it's like a leadership map: Follow those steps and you'll get to where you want to go.

Let's look at why it's worth making a great store culture one of your destinations.

Why bother building a great team?

Improved customer service

Customers prefer to be served by happy friendly people—every observational study proves that conclusively. Tied in to improvements in employee retention (see p. 38) are corresponding improvements in employee effectiveness and knowledge. People who stay with you longer tend to get better at their jobs and that filters through directly to the customer experience.

- Customers come back more often and they rave about you.

> **Customers prefer to be served by happy friendly people—every observational study proves that conclusively.**

- Customers return to stores that feel good to be in—the "people" part of a store is critical to that feeling.
- Customers share their great experiences, most of which relate to how your people have looked after them.

Cost savings

- Reduced shrinkage—happy people don't steal from you and they care more about reducing customer theft as well

- Reduced employee turnover—happy people, and people who feel valued, stay with you longer and that means savings not only on advertising for replacements but also savings on training and your time.

Walking the talk

We cover values and mission statements later (don't yawn, we're talking practical advice, not management consultant waffle), when I'll explain why these are so important to the success of your business. A great store culture makes an excellent starting point for making values and mission statements really work for you. Walking the talk also means that new ideas tend to be adopted more readily and more happily by the team: Everybody is up for driving the team forwards.

Support

You could create a happy team by letting everyone run riot, throw parties whenever they want, and help themselves to whatever they fancy from the stockroom. That of course wouldn't do anything for the performance of the business. A great store culture still encompasses the unpleasant things such as firing people who don't make the grade and reprimanding staff when they let the team down. However, if you have that great culture built and you have a happy team, they will tend to be far more supportive of you in those difficult decisions. That's useful because it helps keep the disruption of such moments down to a minimum and the team gets over it more quickly.

Fun is a powerful component in a high-performing team.

Enjoyment

Happy teams are nicer to work within. Fun is a powerful component in a high-performing team. Shopping is in itself fun: In all but a few circumstances, customers like getting to go out and buy stuff so it's reasonable to aim for a fun store culture too.

Reasons not to?

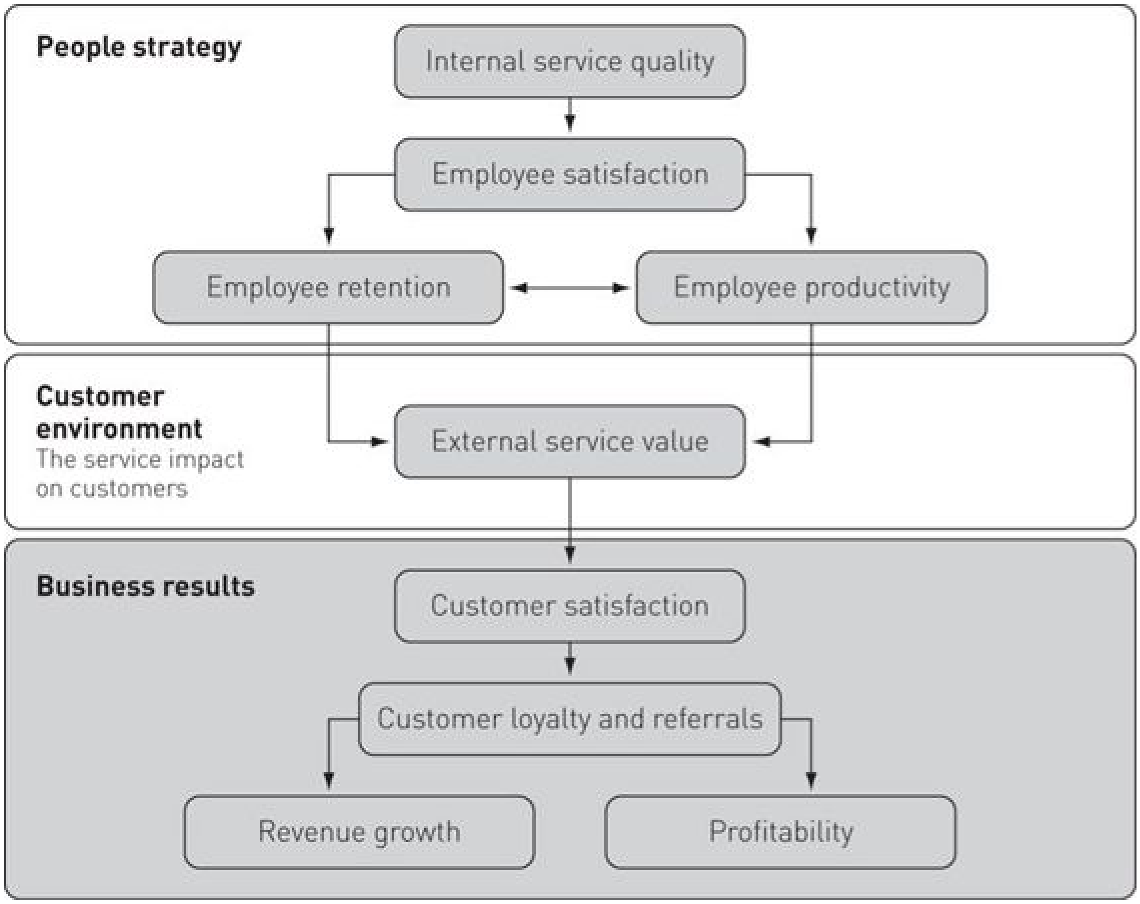
A lot of managers say “the company culture is so awful that I can’t make a difference here in my store.” Although I’m sympathetic to the additional pressure a bad company culture puts on its store managers, I can’t accept this as a real excuse to avoid building a great store culture. Retail superstar Julian Richer has this to say about the ability of a store manager to lead culture in their own store: “The culture of the store is determined by the manager and then we try to get our company culture on top of that.” It’s managers who create the store culture, not head office.

Why assistant managers must become “keepers” of the culture

Richer also remarked that “it is sad whenever a store manager leaves.” It is indeed sad when a great store manager leaves, and it can often mean the death of a team. This is why store managers should work closely with their assistant managers in planning and building a great culture. Aim to leave a little bit of yourself behind so that whoever takes over, ideally your assistant store manager, can strengthen the culture further, building on your work. For most of us, and I include myself in this, there is massive pleasure to be had from discovering that something you helped build is still solid and in play years later.

Service Profit Chain

I’m not keen on theory for its own sake and I get irritated by diagrams that have more to do with consultants trying to be clever than making a clear point, and that’s why there’s just the one diagram in the whole of this book. It’s a pretty important one though—some years ago, I was introduced to the basic idea that within retail and service organizations, it’s employees who have the biggest impact on customers” experience of the brand. Sounds obvious when you put it like that, and it’s true. What Service Profit Chain theory does is turn the fluffy bit of that equation into a way to measure the pound-note impact of treating your employees with respect, care, and integrity.



"Nice" means profit.

Source: Smart Circle Limited

Let's step through those boxes then:

Internal service quality

- Treating your people well is good.

Employee satisfaction

- Because happy, motivated, and respected staff are more satisfied.

Employee retention

- They stay longer with you.

Employee productivity

- They get better at their jobs.

External service value

- And happy, stable, and productive teams tend to deliver the best customer service experiences.

Customer satisfaction

- Which makes customers happy.

Customer loyalty and referrals

- And they come back more often, spend more money with you, and they recommend you to their pals.

Revenue growth

- Which means you stuff your registers with wads of cash.

Profitability

- Goes up and up and we all start to have baths filled with money instead of water.

And the thing is, the logic of this process is inescapable and can be seen at work inside the world's best retailers—yet it's rarer than it should be. Putting Misson, Respect, and Recognition at the heart of your management style will deliver this good stuff. Great employment experiences drive great customer experiences and that probably equals promotions all around.

The three cornerstones

Let's just recap on those three cornerstones I mentioned earlier:

Cornerstone 1: Mission

We understand what we want to do for our customers.

Cornerstone 2: Respect

We make sure our people know they are empowered to do those things.

Cornerstone 3: Recognition

We reinforce those positive things by recognizing them when they happen.

So now on to the detail!

Cornerstone 1: The Mission

Practical people slaving away at the worksite have a rational dislike of mission statements. We tend to think of them as nothing more than marketing waffle. I suspect that is because we have been subjected to so many awful mission statements that just didn't mean anything. That's a shame because a good mission statement is an incredibly powerful tool. It becomes a rallying point for the whole team.

Has your company got a mission statement? If it has, does it make sense? Does it make clear what it is that the business wants you to do? Does it help you to make choices and decisions? Above all does it reflect the Big Idea (for really good ones, they are exactly the same—same words, same meaning)? If the answer to those questions is "no" then you are going to need to re-write the mission statement yourself. Once you have done that, you must make that statement live and breathe; refer to it in every team meeting and offer up every decision and choice you make against it.

A strong, clear mission statement can be a fantastic tool for improving and securing best performance. Make it simple, obvious, reinforcing, and make sure too that it addresses practical objectives.

Case study 6.1. Smart Retail: Best Buy some trust

Best Buy has a powerful mission statement—indeed, it's so strong they don't even bother to call it a mission statement. It's just something bred so deeply into the company that it's become a natural reflex answer to the question "How come you're so successful then, Mr Best Buy?"

Our formula is simple: We're a growth company focused on better solving the unmet needs of our customers—and we rely on our employees to solve those puzzles. Thanks for stopping by.

You work for Best Buy in one of its stores? You know that mission statement means the company wants you to actually talk to customers and find out what they really need and want and then do your best to match those needs and wants with the right product. To help you do that, Best Buy put you through an unprecedented nine-week training and induction program before you get anywhere near a customer. More than sales-staff though—it's a mission that tells you how to merchandise a store, what products to look out for as a buyer, and how to present them. It's a mission that helped shape remuneration packages (no commission), training (making training central to delivering the Big Idea), and recruitment (hiring people good at listening as well as talking—not sales jocks). These are things that aren't common currency in electrical retail and that's why customers love Best Buy.

Fits really well with the Big Idea at Best Buy too—which is to create massive electrical retail stores in which staff can be trusted to be as honest, relevant, helpful, and accurate as staff in a small independent.

Values

This is another area where a lot of awful trash has been spouted by management gurus. It means that talking about values can feel a little ridiculous. This is a shame because a set of defined values becomes the practical tool that helps you to apply the mission statement to the everyday running of the store. Where the mission statement tells you what the company does, the values tell you how it wants to go about doing it. They are a reflection of what the company stands for. We're talking about a list of words such as innovative, fun, honest, and inspirational. The trick is to mold these values into a set of practical sentences that tell us how to apply the values to the jobs we do every day.

A great way to think about values is to fix in your mind the perfect customer experience in your store, then imagine talking to that customer outside afterwards; what five emotions might they tell you they felt during that experience? Write down that list of emotions and then ask yourself this question: If my customers leave my store feeling those five things—are they likely to come back again? If the answer is "yes" then you're on to something good.

Walking the talk

Defining a good mission statement and then living the values in-store —"walking the talk"—is good for you because it improves the customer experience and builds stronger teams; this in turn increases business performance. In a case such as the Best Buy one, walking the talk in store is doubly powerful because everything the central team does, such as advertising, promotions, and store investment, is also right in line with the mission and values. They strengthen each other.

Big Idea and mission perfectly expressed right there.

Source: Koworld

If you work in a business that has a clear and consistent set of values, use them to your advantage. Live and breathe them: "walk the talk" will improve performance. In an independent store, you too must define a mission and a set of values—everything else flows from them.

A good set of mission and values reads naturally: It uses language that a normal person can easily make sense of. Simple things—strongly stated.

Case study 6.2. Smart Retail: Values in action at a leading fashion store

Here is a solid practical example of the way in which values can make a significant difference to the everyday functioning of your shop. This case study is about a British clothes retailer. One of the very obvious values that applied to this business was that buying or selling clothes was about fun: It's a fun thing to do. Customers wanted a happy environment and staff wanted to enjoy their jobs. In fact, that was one of the things people told us had attracted them to the business; working in fashion retail looked like it might be more fun than stacking shelves. So we included fun as a value. It really supported the company mission too. That mission statement read "To delight our customers by giving them affordable access to great high street fashion."

Fun is a value that many people believe, and I agree, should be part of the working environment for almost any retailer. I don't mean mindless larking about but the generation of genuine "this is cool" moments for customers and staff alike. Fun helps make shopping enjoyable. We are all in the business of making shopping fun, whether we are selling washing machines or watches.

Fun with job descriptions

One of my favorite methods for making values work every day in-store is to rewrite job descriptions. Out goes the dry HR-speak and in comes practical stuff about what to do and why. In the case of this retailer, we had identified one particular group of employees who were really hard to engage. There was a set of 16–18-year-old girls who all worked one weekday evening and then all day Saturday. They are notoriously hard to engage. You hardly see them all week and then suddenly they are there on your busiest day when you've got little time to give them. It's crucial that you have these girls on board and pulling for the team or they can become a disruptive and negative element in the store. They are also famous for degrees of lateness and for being uncommitted when they do finally arrive. This was especially true on hung-over Saturday mornings!

We looked at their job descriptions which, and to be honest I can't blame them, I doubt any of the girls themselves had read. One of the most important responsibilities, in fact the first task they were supposed to perform on Saturday mornings, read like this: "You will ensure all merchandise rails, shelves, and/or islands are fully filled and merchandised in accordance with the prevailing marketing planogram for your store grade and profile." Of course what this actually meant was simply "Make sure there are no gaps on display when we let the shoppers in." The girls regarded this responsibility as a real chore: boring. Not the sort of thing they wanted to do when arriving tired after a big Friday night out.

So we changed it—we introduced that value of fun. The same line from the job description now read: "Fashion is fun, remember that as you dive into the stockroom and pull out your favorite, most exciting fashions. We want you to take your choices, the clothes you think customers should be wearing out tonight, onto the sales-floor. Get them onto the racks, anywhere there are gaps, and get your choices noticed." When we tested it, the effect was fantastic.

Because we had asked the girls to think for themselves—and who really is best placed to say what the trendiest clothes for 16–18-year-old girls are than a group of 16–18-year-old girls—they actually got excited by the task, even beginning to come in early to get the best picks. They also got competitive with each other and would jostle for space and monitor each other's selections like hawks. Very healthy stuff indeed with the unexpected side effect that the girls also began to sell proactively. They would make sure every customer saw their personal picks and they would ensure a constant supply of sizes and colors was always out on display. That's how a mission statement and a clear set of values can have a direct effect on the performance of the team.

Street Time

Now that you've read about Big Ideas, Mission, and Values—please have a look at the Street Time tool in Appendix III. As well as being good fun to do, it's something that will help you to go out and find many ways to improve and change your businesses.

> **Cornerstone 2: Respect**
>
> Treat people how you yourself would wish to be treated. My Grandma used to say that to me—and like a lot of the wisdom of her generation, it's absolutely on the money. In today's retail landscape, you have no option but to treat your people with respect. Here's why ...

A disrespectful market

The mobile-phone retail business enjoyed, or suffered, a yo-yo sales curve during the 1990s and into the 2000s. Excellent businesses such as Carphone Warehouse (CPW) were not immune when the market first dipped sharply. But when picture messaging and color-screen phones (wow, sounds like the sort of phone my Grandad would have used) helped re-ignite the market, CPW benefited more than most. Carphone Warehouse is the honest phone retailer that emerged out of a time when the sector was dominated by sharks and cowboys. This is a retailer that prides itself on looking after everybody's needs: customers and staff alike. It is a retailer whose successful employment policy is built on respect. It is also a retailer that has benefited from the very positive knock-on effects of such a policy.

Talk to an employee of CPW and they will tell you that the work is hard, the hours long, and the standards are stretching and rigorously applied. They will also tell you that they enjoy it enormously. Push a little harder: ask them "Why do you enjoy it here?" A consistent story emerges:

- "We get treated with respect."
- "I'm trained so well that I never look stupid in front of customers."
- "My ideas are worth something."

- “I’m allowed, no I’m encouraged, to use my brain.”
- “It’s made clear that I can have a proper career at Carphone Warehouse if I want one.”

So, now how are things for CPW? The company thrived, has pushed through another recession, and continues to lead with its principles of respect, fairness, and honesty intact. It’s no coincidence that they have also aligned themselves closely with another leader that is built on similar principles—CPW and Best Buy now have a number of joint ventures, including 50/50 ownership of Carphone Warehouse and Best Buy stores in Europe. Respect and honesty, it seems, pays.

An alternative approach can be seen in the same marketplace. Back in 2003, Phones 4u was featured in a fascinating TV documentary. In one now infamous scene, a manager was shown enjoying the dubious honor of receiving what could be considered as quietly threatening phone calls from the then millionaire chairman John Caudwell. These phone calls were to remind that manager that he had but one week to improve the numbers or face the sack. That’s a classic example of management by fear rather than management by respect. I asked Phones 4u at the time how they felt about the picture portrayed in that documentary. They told me the result had been an upsurge in job applications from people they called “real go-getters, the sort of people who respond to a bit of pressure.”

When I wrote the first edition of *Smart Retail*, I said I was keen to see how this attitude would pan out for customers over the long term. The short answer is that Carphone Warehouse ran away with the prize, John Caudwell sold Phones 4u (for a tidy profit, mind) and the business has spent the last seven years working hard to improve its customer service standards as well as improving the way it manages its people. And guess what—it’s working but perhaps too slowly to significantly dent Carphone Warehouse’s lead. Customers have long memories ...

Flight to quality

In a fast-growing market, where price and availability are the overriding considerations, many customers will happily buy from the cheapest outfit regardless of reputation. The situation then changes quickly when market conditions tighten and saturation is reached. In the slowdown, customers gravitate to quality, they think a little more carefully about what they want, and they look for reliable sources of good advice. Then, when things begin to pick up again, customers often stick with the new relationships they've formed. They value those relationships with retailers who have looked after them knowledgeably, honestly, and with a smile. More than that—in an era in which customers have lots of choice, they tend to vote with their feet and go where the best overall experiences are. Technically it's called a "flight to quality"—which is jargon, but it's jargon that makes sense.

We saw this in 2010 as the UK ground out of recession—sales at Waitrose, of Tesco's "Finest" range, of premium brands such as Sony and L'Oréal all grew where lower mid-range brands saw shrinkage. Right now, being a retailer who has proven to be a provider of great customer experiences is showing real sales benefits: Customers get fed up with austerity shopping and, while still spending less overall, they start to put what they do spend into nice purchases: "We'll have nice week at the seaside this year but then a big family adventure to the Caribbean next year—instead of our usual annual trips to Spain."

The 1980s retail legacy

Back in the 1980s, there was a surge in consumer-spending. In the UK, this surge ran alongside unprecedented levels of unemployment—for some everything was rosy and for others desperate. A group of UK retailers became incredibly successful off the back of the surge but some chose to exploit their workforces, knowing that the threat of unemployment loomed large. With demand for fashion, food, and consumer goods outstripping supply at times, leading stores were able to sell almost everything they could present. The best of these looked after their staff well and saw background unemployment as a reason to be a good employer rather than a bad one. On the flip side were those retailers who saw people as disposable, an expendable resource to be bullied into line. Customers were blind to the effects of this as they scrambled over themselves to buy, buy, buy and so the bully-boy retailers got away with treating staff badly.

I started in-store in 1985 and witnessed the worst of this first-hand: a management style emerged, and it was called JFDI, or "just flipping do it" (you and I both know that I've changed one of those words to a print-friendly alternative). JFDI was anti-respect: It was all about conformity and subservience. I first entered retailing in the middle of these years and it was mean at times. Nasty even. It was an atmosphere that chewed people up, burnt them out, took advantage of job insecurity, and made some people's lives a horrid experience.

But come the early 1990s and the boom and bust cycle was beginning to flatten; with that flattening came a calming in the rabid consumerism and large reductions in levels of unemployment—a longer-term sustainable prosperity was established. And something happened in the way people, especially in the UK, shopped: They became more discerning, as if the hangover of the 1980s was accompanied by an understanding that spending for the sake of spending wasn't a great idea any more.

And customers appeared to begin to notice that those businesses run on the principles of JFDI weren't nice places to shop. Customers aren't stupid: They might not be able to define what it is that they notice in a JFDI-led store, but it does affect them.

This effect is just one very good reason to invest in and show respect for your staff. Forget even the straightforward cost benefits of keeping your staff longer; the simple reality is that teams built on respect and passion ultimately bring more profit into your business. Teams built on fear and unreasonable pressure do often create short-term sales gains but they always crack, and usually this happens very quickly. What is more, they leave customers feeling negative about their interaction with the brand and less inclined to ever come back again. In an age of real-time access to live sales numbers, it can be easy to fall back, under pressure, into a JFDI management style. Don't. What your business gains today it will lose tomorrow and next week.

> **Teams built on respect and passion ultimately bring more profit into your business.**

The respect deal

Respect, thankfully, is a two-way street. Yes, you will still have to deal with under-performing colleagues. Yes, you might find yourself having to exit people from your business. That is always hard to do but in a team that has been built on respect, you will have worked hard with that person to make things right. The people in your team will know that and will support your decisions rather than becoming unsettled by them.

We have that phrase "You have to earn respect"; well, in retail management that gets warped a little. You, as a manager, have to earn respect from your team, sure—but you must respect them from day one! People are always wary of change, which is why you will have to work hard to earn their respect. But this is not a mutual deal. Even before you first meet your team you have to respect them. If you didn't, if you came into a new store with an attitude that said "I'm in charge and until I know you I am reserving my judgement," then people tend to turn off.

Luckily, the most effective way to earn respect is to give it! If you systematically go about building trust, recognizing people's contribution, sharing training and creating opportunities for personal growth, then you will build a strong successful team that likes and respects you. You will have gone a long way to building a brilliant culture.

For some great tips on how to build respect, read Chapter 5 which is on Motivation; I've listed a whole series of them there.

Case study 6.3 Smart Retail: Top Shop instinct, respect, and risk

> I have this thing about men in suits, you know. People who drone on about the principles of retail. What bollocks! There aren't any principles of retailing.[1]
>
> Jane Shepherdson—former brand director, Top Shop.[2]

Top Shop is the British retailer born as a concession in a Sheffield department store in 1964. Gloriously it has never held itself to be anything more than a store selling cheap and cheerful clothes to young women. Shepherdson took on the top job in 1999—Top Shop's thirty-fifth year—and transformed it utterly, not in terms of market position, or, necessarily, the type of clothes it sells but by making the store exciting, unpredictable, passionate, and anti-marketing. By that I mean that she has drilled into her entire team that they must ignore the rules and do what feels natural instead. This was, at the time, a huge risk—a proper gamble.

Top Shop’s Big Idea is brilliantly simple: Be our own customers, forget the needs of the business. That’s shocking but it’s an attitude, a revolution indeed, that has put Top Shop among the world’s most high-profile and successful retailers.

Here’s an example of how Jane forced the rules to be broken by thinking like a customer: “I would go into meetings and say ‘Yes, I know that’s selling and it’s selling two thousand units but I don’t care, it’s awful and we’re not going to buy awful things any more regardless of whether or not they will sell.’ If you’re going to earn people’s trust, you have to set a standard. That set the standard—all the buyers now know that, and all the buyers now stand by every single thing in their range. Compare this to ten or twenty years ago when some buyers would sit there saying, ‘have you seen this, isn’t it horrible? Guess how many we sold last week ... isn’t that great?’ I thought it was outrageous. How could they do that? It’s not right, there’s no integrity.”

How often have you dropped a profitable product because you don’t think your customers should be buying it? “Never” is the answer for most of us. What that kind of thinking has done at Top Shop, together it has to be said with modern just-in-time logistics allowing fast stock turn, is to create a store that feels utterly in tune with customers. It’s risk that is at the heart of that transformation.

The power of standing for something, of building the retail business around that Big Idea, then living and breathing it, is the best-kept secret in retailing. It’s a passionate, instinctive thing and at the heart of every successful retail business.

Ownership—the value of mistakes

Mistakes are great. Mistakes are brilliant—get on with making things happen, make mistakes and learn from them, and try more stuff.

People make mistakes when you let them make decisions. They get a lot right too. Being as close as they are to where the action is, your team is absolutely the best people to be making more decisions for the business.

And yet, providing local decision-making tools to individual stores is something that fills most retail directors with horror. It is easy to see how senior central management can get scared about letting their store managers loose. But all the evidence tells us that this is wrong. Wherever proper decision-making power has been delegated down to individual store teams, it has led to increased sales and profit. Yes, it has also, sometimes, resulted in more mistakes being made. But mistakes are only unlearned lessons. You make one, you learn from it, and you move on.

Maybe that sounds a little too much like a homespun philosophy but it also happens to be true. Think about the early careers of people like Richard Branson, bankrupt in his teens, or Ray Kroc, the genius behind McDonald's, who had a string of mistakes, false starts, and lean times behind him when, at 62, he spotted the potential for franchised fast-food. Mistakes are made when you try something new, different, or difficult. Sure, you reduce your errors down to zero if you never try anything, but just see what happens to your business when you do that.

Cornerstone 3: Recognition

Recognition is the bit that happens when you are saying "thank you" to somebody you've caught doing good things. It is the single most powerful motivation tool in life, let alone in business. Teams used to receiving recognition give better customer service, work happier together, are more efficient, are more stable, and they make life at work more enjoyable for all. That is because when you recognize an employee's contribution you send out a very strong message that says "I'm glad you came to work today, you made a difference." There's more to motivation than just recognition but it is recognition that is most important—we'll deal with the other parts in the next chapter.

Most people want to do the best job they can in any given situation; recognition is the tool that tells them it has been worth making the effort. Recognition is self-reinforcing: People want to do a good job, you recognize them for it when they do, they feel good, so they repeat the recognized action because they like feeling good. Maybe this is a simplified representation of what actually goes on in our heads, but do you see how small moments of praise can escalate into improved performance?

Given that recognition is so powerful, why is it that retail managers are almost never trained in or assessed on their ability to effectively recognize? I believe there are some simple reasons, mostly relating to how hard it is to both measure recognition and to definitively define a list of exact things that should be recognized: They might include such things as improving team spirit, giving exceptional customer service, or going the extra mile. Recognition is less about direct sales numbers, although you will want to recognize contribution in that area too.

I suspect that it's the free nature of recognition that puts number-obsessed chain retailers off using it. This is a trust issue, head office not being prepared to trust that it is managers in the store, on the spot, who have the best view of the people around them. Recognition is free—it doesn't cost a penny and can drive store performance more effectively than almost any other management tool I have ever seen. You simply must use it.

Please don't make a fuss

One of the issues that makes recognition hard to do at first is a cultural one. The British are embarrassed by praise, we struggle to accept it. Indeed the most common response among British workers to receiving praise is to blush and to break eye contact. The strange parallel to that praise response is that we generally do not have the same problem when receiving criticism. When on the receiving end of criticism, most British workers will listen, if not always graciously, but they will listen. We all tend to have a system for receiving criticism, maybe not always a positive system but it is nonetheless a system. When it comes to receiving praise, although we really like the feeling, we are a little unsure of how to react.

There is also a crucial difference between the delivery of praise and of criticism. We tend to be specific when criticizing but only general when praising. It is this lack of clarity, I believe, that makes people so bad at giving and receiving praise. We give usefully specific criticism such as "the budget you did isn't right, where are the print costs?" whereas praise would be vague, "nice work on the budget." This is important because the whole point of praise and recognition is that we do it in such a way that recipients understand exactly what they did well so that they can repeat that behavior. In the budget example above, the person who has been criticized knows they have to now go and sort out the print costs. The other person, praised with the "nice work on the budget" comment has no idea why this budget was better than the last one, or what it was exactly that they ought to repeat to get some more praise next time. Better praise would have been "I like how you've laid out the budget. That's going to make it easier for me to get it approved. Thanks."

"Doing" recognition

"Little and often" is a brilliant management maxim. It's absolutely perfect when applied to recognition. To make too much of a moment of praise can make everybody feel uncomfortable. It can even sometimes encourage resentment from the team toward whoever you have singled out for extra-double helpings of praise. You are not attempting to make an individual feel like they are God's gift to retail. If the thing they've done is really special then by all means mention it at a team meeting. But for the rest of the time, the best way to "do" recognition is this: spot something good, mention it quickly, say "thank you," and be specific.

The bad recognition-habits we managers get into, often because we're embarrassed by praise, include: worrying about singling out individuals, delaying praise, over-blowing praise, concentrating on catching people getting it wrong, and the inability to be specific with our praise. Delaying praise reduces the effectiveness of recognition. Recognition works best when fresh.

Too many people build their management style around spotting staff making mistakes and then correcting the errors. If you are one of them, try catching people doing good things instead. Do that and you will quickly find that staff actively attempt to repeat those good things and that they look for more and more good things to do. Recognition taps into so many crucial psychological needs. The easy bit to accept is that recognition, done properly, makes people feel good.

Recognition taps into so many crucial psychological needs.

It is nice also to link recognition to small rewards, but this isn't at all critical. Study after study shows that the part employees actually value is that moment where their manager, or a colleague, or a customer, says "thank you for ..."

Behaviors

Although a good recognition habit is all about being spontaneous, saying "thank you" whenever you see the need, it helps to have in mind a list of the sorts of things that you will be looking out to give praise for. At the risk of sounding like I've been snacking on a jargon cookie, what you should be basing your recognition on are "observable positive behaviors." Essentially that's all the good stuff people do that you can spot them doing.

When you first decide to introduce recognition, putting together a list of these "observable positive behaviors" helps the whole team to get a handle on what it is that you are looking for. Once you've sat down and really thought about these behaviors, you can stick a list up on the noticeboard. Give a copy to new starters, and use it as a basis for review meetings.

"Observable" is the key word in this bit of jargon. It tells you that the behaviors you are looking for are those that you actually have to "see" happen. Sales is not an "observable positive behavior" because it is an activity that (a) you already measure closely in the performance numbers, and (b) you will be discussing the sales action with each member of the team anyway. How a person makes a sale though—that could easily include a positive observable behavior: going out of their way to find a bit of information for a customer, or selling an item that was right for the customer but that had a lower commission-rate on it for the salesperson.

Those "observable positive behaviors" that relate to helping make customers happy are important. With any luck, such behavior will show up as a sale, but even if it doesn't, that customer has left the store with a good feeling about your business. That is worth its weight in gold but in a way that is very hard to see from looking just at the hard performance numbers.

Take a look at the "Great moments" section in Chapter 9 for a little set of illustrations of observable positive behaviors in action.

Easy ways to "do" recognition

There are two easy routes you can go down to build recognition into your team culture. Doing specific recognition needs to be learned, so don't be embarrassed that it might not be part of your current style. You will get there by practice. Equally, don't assume that because you do often say "thank you" that you are getting recognition right. I'll lay down good money that, when you are honest with yourself, you will find that 90% of those "thank you" moments are non-specific.

In the years between the first edition and the one you're reading now, loads of managers have fed back that this part of the book is the one they were most skeptical about but that once done had been the most rewarding. I guess I'm saying "disconnect the cynicism for a bit and give this stuff a go—you'll be glad you did."

Method one—The 20-second ceremony

Use a couple of team meetings to make up your team's list of "observable positive behaviors." A good way to get a great list together is to start with the Big Idea, the mission, and values too, and think about the kind of things you can do to support them.

Now make up some "thank you" notes. These should have space on for the recipient's name and a bigger space for you to write down why you are pleased enough to want to say "thank you." Print out a bunch of these and keep some in your pocket at all times. Whenever you see an opportunity to say "thank you," fill one out quickly and go put it into the hand of the person you want to say "thanks" to. You don't even have to say "thanks" if you don't feel you can. You don't have to make a song and dance of it, you don't even have to speak if you feel uncomfortable. What is important is that the exchange of this note is something both of you understand: It tells the recipient that you have noticed and that you are pleased, nothing more, nothing less. Takes about 20 seconds to do.

Dish out blank "thank you" notes to the team as well. Encourage everyone to use these "thank you" notes. Workmates recognizing each other's efforts has almost as much power as when you do it. You have really cracked it when you get customers to fill in "thank you" notes.

The 20-second ceremony works so well and is unobtrusive: I've seen this work successfully in a tiny KFC that was processing 50,000 lunch transactions a week. People really do respond to it. The notes can feel a bit silly at first but that soon goes and the process of recognition becomes part of the everyday team culture. You will never find a cheaper or more effective way in which to transform your team's performance.

Method two—The Heroes Board

Allocate a piece of wall space to recognition. Make up some "thank-you" notes similar to the ones mentioned above. Start giving them to people under the same criteria, and tell recipients to hang them up on the wall. This method introduces a little bit of peer pressure because everyone can see who is being praised, but you might find it more comfortable for you than recognition method one.

In both methods, you can use the best examples to determine what you do with your non-cash rewards (which we go through in Chapter 5). It's quite nice to build in a little focus at team meetings for recognition. It's even more effective to use one such meeting, each week, for a little bit of extra recognition. Take the best "thank you" or "hero" example from that week and give the person a decent bottle of wine, a case of beer, flowers, or good chocolates. Not too much, but it feels great to receive, and it really sets the scene for a rousing and effective team meeting.

Case study 6.4. Smart Retail: KFC and the 20-second recognition ceremony

KFC transformed their business in the UK in the late 1990s and have strengthened their position ever since. It is a fantastic retail business. One of the major transformation focuses was on the way in which they treated their people. As part of that process, they introduced a recognition program based on observable positive behaviors and on the 20-second recognition ceremony.

A beautiful example of how this tiny, simple, ceremony could affect the way people felt about themselves and their performance came to me at a post-launch regional meeting. A manager, Mike, told me what had happened when he went through the 20-second ceremony for the first time. In fact he told me he'd made somebody cry doing it, so I thought we might be in trouble. Dawn had worked at her KFC outlet for nearly 10 years. She had seen managers come and go but had never been keen to take on that sort of extra responsibility for herself. She liked being one of the team and that was that. Mike had been her manager for nearly six months.

One morning Mike spotted Dawn showing a new member of staff how to "double-bag" a waste bin. Double-bagging means putting in two bin-liners at a time so that at lunch, when the bin is full, you only have to throw one bag of waste away and the bin already has its next liner in place. Now this is a tiny thing, saves maybe a minute at peak time. But Mike saw Dawn do this and it occurred to him that he had seen Dawn help new people learn the ropes on countless occasions. She didn't have to, it wasn't part of her job, she just liked to do it. So Mike decided to use one of his "thank you" notes. He wrote it out and ticked a box that said "For making new members of the team feel welcome" and, in his own words he "shyly handed it to Dawn."

Dawn burst into tears. Mike reassured her that it wasn't a P45 he'd just given her and asked what the matter was. So she told him "You've never said 'thank you' to me before." Mike became quite indignant and replied that he had, often, at shift meetings. Dawn put him right. "No, you've said 'thanks' to the team, and that's nice but you've never come to me, looked me in the eye, and made it so clear that something good I do has been noticed. And actually none of my managers over the years has either."

Dawn felt great about that moment of recognition—that's why there were tears. Most people feel the same way. What's so nice about this approach is that its effect snowballs. Slowly but surely, more people begin to repeat the good things they do more often, and that gently spreads throughout the business.

Why recognition works

Why does specific recognition like that work so powerfully? It’s about clarity: You say to somebody “Well done, good job today” and it feels good to that person for a bit, but when they later ask themselves “What did I do different that meant I got praise today?” it’s difficult to actually know for sure. When instead you say “Well done, thanks—you’ve made that new person feel welcome and I appreciate it, helps to bring us closer as a team” that staff member walks away knowing exactly what behaviors to repeat in order to get nice praise again.

Chapter Seven. How to get people out of bed

Motivated staff are critical to the success of your store. Hopefully you will have already read the previous chapter on store cultures (the mission and values stuff). If you have, then you are already on the way to enjoying the benefits of having a motivated team around you. In this section, we're going to get a bit deeper into the nitty gritty of motivation. In particular, I'd like to suggest some practical moves you can make to improve the motivation of your team.

If you're going to build a great culture in your store, a motivated team is essential. Just to recap, the benefits of a great store culture include cost savings, customer service quality improvements, people pulling together to deliver the company values, better support for your decisions, and a more enjoyable time at work.

The components of motivation

Individuals are motivated by a combination of:

- **Financial reward**
- **Implied sanction**
- **Self-respect**
- **Non-financial reward**
- **Recognition of value contributed**

Of course, the importance of each motivating component will be different for different people. Factors such as age, personal circumstances, and social considerations all have an impact. Most of these, with one exception, make for only really subtle changes in your approach. The younger members of your team are often disproportionately motivated by cash. You might think "well, isn't everyone"—over the next few pages, I'll show you why that's not quite true.

Show me the money—financial reward

A common mistake we all make on motivation is to assume that financial rewards are the most important and most motivating thing we can offer. The truth is—and this might be hard to accept because it is counter-intuitive—that money has very little motivating effect beyond a certain point. So long as the wage is fair, anything over that such as special bonuses or massive cash competitions has very little additional impact on employee motivation. People love getting it, sure, but it can even be counterproductive because the payment of large bonuses tends to condition staff to only ever put in extra effort if they can see a wad of cash in it for themselves. Pay too little, however, and money becomes an astonishingly important demotivator.

Those retailers with the most motivated workforces have observed that offering significant cash rewards in exchange for performance improvements has three effects:

- It drives too much focus into short-term revenue generation at the cost of falls in customer service quality.
- It conditions employees to only go beyond the job description when they are offered a cash incentive to do so.
- Bonuses become absorbed quickly into the employee's general budgets and as such are not remembered over the longer term.

There is a whole filing cabinet full of research that suggests that cash triggers only very short-term satisfaction in the mind of the recipient. It boils down to cash being, by its nature, ephemeral—here today and gone tomorrow. I know you probably still don't believe me but this effect has been observed time and time again. Money is important but it doesn't create long-term motivation. You might need just to trust me on this one.

Money is important but it doesn't create long-term motivation.

Incidentally, you can measure employee motivation by looking at factors such as employee satisfaction, employee turnover rates, and customer service quality scores.

The stick to your carrot—implied sanction

Implied sanction is the stick to your reward carrot. It is the rulebook. It's "implied" because you may never have to use it but the team knows you would if pressed. It's "sanction" because it's what happens when the list of minimum standards is not met. Implied sanction is a strong motivating factor but one that requires significant skill to manage effectively. It takes a lot of common sense too, and certainly sympathy with the concept of "treat others how you would like them to treat you."

A sales assistant, for example, needs to know that a drop in customer satisfaction will lead to a serious chat. Furthermore, they must know that the serious chat will generate a set of actions that, if not carried out, will cast serious doubt over their future in the store. That's the sanction part.

The team needs to know that sanction is possible, but at the same time they must not be working in paralysed fear of that sanction. It's a tricky balancing act sometimes but much better than the alternative, which is to manage by fear. Management by fear generates lots of problems such as decreases in service quality. Frightened staff don't work well with customers. Fear can also lead to increased employee turnover and even industrial disputes.

In the 1980s, hard-bastard macho managers dominated retail management. Fear was a powerful motivator then because unemployment hung over pretty much everyone all of the time. Times have changed; there have been retail vacancies going unfilled for some years now. Management by fear is a poor technique, but we must recognize that we're all human. A lack of sanction for those times when we let standards slip lets us become lazy. To motivate, you must ensure that the team knows you have set standards for a good reason and that you will maintain those standards vigorously.

Successful one-to-ones

When you have to actually use sanction, be quick, be clear, and be fair. Here's the best format for a one-to-one in which you have to discipline a member of your team:

- 10 minutes to explain the general principles of the situation.
- 5 minutes to very specifically discuss the weakness or failure of the individual.

- 15 minutes to then explain why you have faith in that person's ability to turn around the situation. This is time to rebuild that person's belief in themself and their abilities. Make sure you finish the meeting with the person feeling on a high.

You can probably see a lot of the 1-minute manager in that process, and that's fine. This is the practical way for retailers to do the same thing. Over the years, a number of store managers have recommended variations on this method to me, but I'd like to specifically credit Umesh Vadodaria for this version.

Treat me like a grown-up—self-respect

The default position for the majority of workers is to do the best job we can. If you create the right conditions, most people will work hard to deliver a good result. What stands behind that reality is self-respect. I've already talked about how the best teams are built on respect, and self-respect is a crucial component of that. It's what makes people feel like it's worth making the effort.

The opposite is also true: Put individuals into situations where they are robbed of their self-respect and they will react accordingly. People will steal and treat customers with contempt, and why not? If you take away somebody's self-respect, how can you ever expect that person to in turn respect your customers?

Without getting horribly political, I'd like to ask you to take a look at what poverty and unemployment do to communities. Take away jobs, put people in shoddy housing they don't own or ever could, then crime, drugs, and malcontent flourish. The truth is that if I don't respect myself, I'm not going to respect you. You can do such a lot as a store manager to encourage self-respect to grow among the members of your team.

Share information

Tell the team the confidential stuff: state of the cash flow, company health, costs, losses, and profits. Show that you trust them with such sensitive numbers. Yes, some of it will find its way to your competitors, but the losses will be vastly outweighed by the benefits.

Delegate power

Allow team members to make decisions for themselves, especially on discounts and customer service issues. Give people the confidence to make these decisions by ensuring that you have a good set of practical and sensible guidelines in place. Good procedures help people to make good decisions.

Delegate responsibility

Make members of the team responsible for the performance of specific departments. Responsibility is a powerful source of self-respect especially when combined with a variable such as profitability or sales revenue.

Encourage training

Make sure everyone who wants it has access to all of the training opportunities available. Make a habit of promoting manufacturer-sponsored training and seminars too. These are often of a high quality and they make a welcome break from the usual company formats. You are saying to the team members who go on these courses "I value you and I want to give you access to skills you'll find useful."

Share the good jobs

Make members of the team responsible for specific tasks, especially those "cushy" jobs managers sometimes keep for themselves.

Dive in

If you expect the team to polish and dust, do it yourself too; show that it is not a job that's "beneath you."

Listen to both sides

When a customer complains, listen to both sides of the issue. Don't blame the salesperson in front of the customer; you are responsible for service quality, so you make the apology. Then go talk with the salesperson and if there really is an issue, give them an opportunity to suggest ways in which to solve it.

Don't wash your dirty linen in public (even if you run a dry cleaner's)

Never embarrass or dress-down a colleague in public. I once observed a frustrated manager in Sainsbury's having a go at a cleaner in front of customers. This cleaner had been skipping work, but that didn't matter;

the manager ended up looking like a bully. That reflected badly on the shop.

Consider the rulebook

Is there anything really daft in the rulebook that just forces people to do stupid things? If there is, then get rid of it.

Let others do the talking

Give everybody who wants to a chance to run team meetings. Encourage staff to present ideas at these meetings too. Go with the three-slide rule to prevent meetings becoming too competitive or boring: one to set-up the “what it is,” one to explain the “how it is,” and a final slide to summarize “why it is.”

Listen

Shut up and listen to what people are telling you before you go making up your mind. Ask questions and allow people to give you the whole story. People respond better when they feel they are being listened to.

Encourage every opportunity for feedback

Get and give feedback on ideas, interviews, worries, suggestions, and concerns. Do this in an honest, active way. Take things on board. If the answer to an idea or issue is “yes,” then get on and do it. If the answer is “don’t know,” go find out what you need to know. If the answer is “no,” explain why. Offering a shrug and a “because it just is” is never acceptable. Always do these things within a short time frame.

Build people back up

If you have ever have to pull somebody up, discipline them, or criticize their performance, then always build that person back up again afterwards. Leave people on a high—if instead you send them back onto the shop floor feeling poorly about themselves, that will show.

Don’t badmouth people

Every time you say “so and so is an idiot” in front of your team, you send a negative message about your attitude to colleagues. Negative talk infects your team—just don’t do it!

Negative talk infects your team—just don't do it!

Recognize contribution

Learn to give specific praise as well as specific criticism. This is really very hard to do at first but is the most powerful motivating force of them all. Recognition is free and makes a real difference. By giving recognition, you are giving person X a reason to feel that "getting out of bed and coming to work today was worth it." The keys to recognition are to be specific, to do it as soon as you think about it, and to do it little and often.

Celebrate success

Absolutely essential to the strength of the team is making time, and plenty of it, to celebrate success. I don't mean the embarrassing forced stuff such as ringing a bell every time somebody makes a sale. Celebrating success means saying "well done" to people. It means making a small fuss of good things in the daily team meetings. It means going off for a pizza or a beer together. Toasting a hard-won target feels great. It feels even better if you've talked one of your suppliers into paying for the beer.

People need to know that the effort they've put into achieving something had a point to it. Celebrating success is one critical way in which you can do that. It says "I'm proud of us, we took on a challenge, and we beat it together." I cannot stress enough that you will gain many times more benefit from putting aside a proper budget for doing this.

Be ready to admit your own mistakes

If you get it wrong, be honest about it and move on: "Okay, I got this wrong, now how can you help me to do this right next time?"

Put the customer at the center

Show your people that you respect them by showing them that you're all working together for the same boss: the customer. It is the customer that we really work for. They are the ones who pay our wages. Teams need to have focus and in retail the customer is the best target for that focus. Everything you do must be built around the notion of helping customers to leave the store with a smile on their face.

Let’s have a laugh now—using non-financial rewards

“Non-financial rewards” is just a name for the fun stuff. They can include all sorts of things such as extra days off, gift certificates, freebies, and holidays. Now there is a really, really, fine line here between exciting and tacky. It’s so easy to make rewards embarrassing. Worse, lots of retailers go for the big dramatic holiday-type incentives where only one person can win anything significant. Maybe the best-performing store manager gets to go to Bermuda for a vacation. I’ve often worked with clients, employing thousands of people, who have insisted on running these demotivating incentive structures. They launch huge incentive programs worth big money but concentrated into maybe only five major prizes. Fantastic for the lucky five but really all this succeeds in doing is turning off the thousands who are pretty sure they won’t win. Worse, out of the 200 who think they are in with a chance, 195 high-achievers are left feeling positively demotivated when they don’t win that holiday.

When it comes to all motivating rewards, including cash bonuses, recognition, and non-cash bonuses, little and often is best. In this case, “little” because that means you can spread the budget much further and in doing so touch far more people. “Often” because it keeps things fresh and gives you lots of opportunities to boost performance without incentive programs going stale.

It’s how you use the little non-financial rewards that’s critical. As either an owner of an independent or as a chain-store manager, you have lots of freedom to do what you think will work best. Buddy-up with the manufacturer’s reps. Let them do some training at your store one evening and suggest they give the expense account a workout by taking the team for a pizza afterwards. I’m always pleasantly pleased by how consistent manufacturer’s reps are in this regard. They always say “yes” eventually.

As an owner of a store, you should be doing these things anyway, out of your own pocket. Incidentally, building in an ideas session before you eat is a good way of recouping the cost. I understand too that running a little meeting like this before eating has a positive effect on how you later have to account for the expense tax-wise, but check with your accountant in case I’ve got that wrong.

The wrong way to use non-cash rewards is to over-hype the reward or to use inappropriate rewards. So, for example, offering to give someone a CD for doing 200% of their target is an insult to you both. Wrong too would be to make a shy person stand on a chair to receive a commemorative "Top Guy" plaque. Use your best judgement and knowledge of the individual—what works for one might well turn off another.

Buy the team a gift each at Christmas but hand-write a thank-you note on each package. It reminds people that they are important to you. Always generously mark people's birthdays, weddings, and new babies. Preferably do so out of your own pocket rather than via a staff pitch-in.

Try to include your employee's partners on social invites. Partners have a massive influence on your people and on their view of you. A career in retail features strange and challenging hours that take people away from their families. Don't make that worse by extending this exclusion to the team's social occasions. Getting partners involved in idea generation can be very effective too.

Shopping is fun; we should all remember that.

Source: Koworld

Great non-cash incentives produced out of almost nothing

A good tip is to save any freebies you receive as a manager and pass them on to the team rather than keep them for yourself. Some managers save up these goodies to use in one go. Others dish them out right away. Either way, you must ensure that you don't fall into either of the following traps:

1. Only ever giving stuff to the loudest members of the team because they are the ones you notice.
2. Showing favoritism to a person who the team could, conceivably, suspect you of having more than a professional interest in.

Here are two ways of avoiding these freebie pitfalls and at the same time bringing some fun to the proceedings.

Team ballot

Say you’ve been lucky enough to find yourself with four bottles of champagne, two boxes of Belgian chocolates, and a stack of good promotional T-shirts. It happens! Over a week you have the team agree to nominate a colleague each for a thank you. All they have to do is write down the other person’s name and a line on why they should be thanked. The key to participation is that anyone who doesn’t make a nomination is disqualified from winning a prize themself.

Then you all pile down to the bar after close-of-business one evening. Get a round in, then read out the “thank-you” notes. Everyone who has been nominated gets to choose a random envelope. Try to make sure that everyone who should have been nominated *has* been nominated. Inside each envelope is a note telling them which of the freebies they’ve earned.

This is effective because the team sees that you could have held on to all the stuff yourself but preferred them to have it—people love that, they really do. Asking them to select worthy recipients gets people focused on their place in the team too. Team ballots are not heavy affairs but they really do work—aim to run one every six months or every quarter at a minimum.

Balloon day

This method of giving away all your freebies can be hilarious, great fun, nicely competitive, and very motivating. On one of your busiest days you fill your office with balloons. Each balloon contains confetti and a little envelope that has the name of a prize in it. To spice things up a little, I usually throw in some envelopes with fivers in them and some with a token for something silly like a coffee in them. Then you draw up a big chart with the names of all your team on it.

Now you need to set a challenge. Challenges can include such things as:

- To sell a specific item
- To gain an “excellent” score on a customer service questionnaire (do this as an exit survey, having someone stand at the door with a clipboard gathering answers)

- Selling add-ons, scoring a point for every transaction that includes a legitimate add-on ("legitimate" meaning the add-on was actually something that the customer will have been glad to have been sold)

Each time a person completes a unit of the challenge, they earn a "pop."

You can also award random "free pops" to members of the team, especially to anyone who isn't actively involved in selling. Do this whenever you observe a positive behavior. Those positive behaviors could include such things as solving a customer complaint or helping out a colleague. Each time a person earns a "pop," they get a token. These tokens are sticky and you can encourage people to stick them on the poster as the day goes on.

At the end of the day, after the punters have gone home, everyone gathers outside your office. Maybe you open some refreshments to help get the team revved up for the popping to commence. Starting with the person who has earned most "pops," you let each person into the room to pop the number of balloons they've earned during the day. Then they get to keep whatever falls out of the balloons.

I've run this one many times and it always gets everybody going. It's nice too if you can make the balloon day coincide with a team night out afterwards too. There are lots of variations on this theme such as having the prizes in lockers or in a sandbox and so on. I'm sure you can think up some yourselves too.

Recognition and motivation

Each of the motivating factors we've gone through here does in itself also have a recognition component. Giving out prizes is recognition, trusting somebody to make decisions is recognition, and bonuses are also a form of recognition.

Team meetings

In the previous pages, you'll have seen how important communication, team-building, recognition, respect, and trust are. One of the most useful opportunities to make things happen in these areas is your daily team meeting.

Yeah, I said "daily" team meeting.

I recommend you hold a 5- to 15-minute team meeting every single day. You don't have to do this but all the best retailers do. It's hard to build a team spirit if the team never gets to stop to spend a few minutes focusing together. Equally, what better way is there to swap ideas, to jump onto opportunities, and to share responsibilities?

Daily team meetings are the missing ingredient in many an otherwise great store manager's repertoire. Grab your store schedule now and write five headings into tomorrow's date and run a meeting around those five things. Some of the items worth covering in team meetings include:

Daily team meetings are the missing ingredient in many an otherwise great store manager's repertoire.

- Customer service issues and how these were solved
- Forthcoming events
- Promotions
- New products just in
- Bargains identified
- Review competitor activity
- Review new best-practice ideas identified
- Discuss incentive schemes
- Review any challenges
- Introduce new employees
- Review targets and performance
- Celebrate success
- Recognition
- Consider improvement ideas—even if you can only do this one, it will have been worth having the meeting—the next section talks you through how to find loads of these ...

Please do this daily—I don't mean to nag, and I know shifts and part-timers and such mean you'll need to juggle a bit, but the effect is hugely positive. You’re a leader, yeah? You can only be that if you set down plans, review those plans, and keep everyone up to date with what’s going on and what’s expected of them.

Chapter Eight. All we need is a little better every time

Ideas are the fuel for organizations. What you do with those ideas, how you convert them into action and improvements, is what then makes the organization grow and prosper. Space for improvement can be readily found in all areas, especially in technique, systems, presentation, recruitment, and performance. All retailers can benefit from a culture of everyday performance improvement but few try to. Don Taylor and Jeanne Smalling Archer, authors of the very helpful *Up against the Wal-Marts*, call this "kaizen," as does Julian Richer in his awesome book *The Richer Way*. Others use different names for the same thing. Kaizen is Japanese for "continuous improvement involving everyone."

I don't think we need to slap a Japanese jargon word onto the making of improvements. For me the task is as simple, and as vital, as "let's do it a little better every time." That sets up a very simple question for your team members: "How could I do this again but even better?" Your mission statement comes in here because it helps define what "better" means for your organization.

Improvement in this sense isn't necessarily about massive earth-shattering changes. What we are looking for are those everyday improvements: improvements in the ways in which we look after each other, our relationships with customers, and the quality and relevance of our processes. A typical example might be the discovery that one piece of paperwork can be integrated with some other process rather than be dealt with separately. Combining the two will save money and time—so that's an improvement. It could be the realization that the rules of a promotion we've created can be simplified to the benefit of the customer, and that is an improvement too.

Gathering improvement ideas

You will need to have two things in place:

1. A way to gather ideas.

2. An improvements slot on the agenda for discussion at team meetings.

If you were to look at just one task or process in each daily team meeting you will have 7 improvements each week, 30 for the month, and 365 over a year. That's awesome. Okay, so maybe you won't get into this every day but you will still generate a significant store of improvement ideas every month. Working in this way is easy. You are not attempting to change the world in a day, you are just looking to change one little thing at a time. Every journey starts with just a single step—remember that.

Every journey starts with just a single step—remember that.

Do you currently change anything each month? Does change only ever happen dramatically once a year? "Let's do it a little better every time" puts you in the driving seat of change. Your team becomes a valuable engine of change.

Statistics can make you go blind—the measurement trap

Plenty of otherwise sensible people believe that you cannot improve that which you cannot measure. That's dangerous, wrong even, and here's why: Some of the most effective customer satisfaction-improving tools are un-measurable in a conventional sense. Smiling at a customer turns out to be one of the most effective ways to make them feel better about you and your company—how do you measure the number of smiles your team gives out?

Here's something to think about: a number of aspects of sexual performance can be measured. Factors such as duration, the dimensions of various body parts, room temperature, heartbeats per minute, can all be easily recorded and measured (you might need somebody with a clipboard to come in and write this stuff down for you though). But do any of these factors automatically add up to guaranteed great sex? Of course not.

Measuring the wrong things is a real trap. This is a grim example but its worth telling; a U.S. Army general noticed that the daily success of the Vietnam War was being measured by relative casualty rates. A measure as crude and unpleasant as “if we kill more of them than they do of us then we must be winning.” Convinced this measure did not convey a useful picture, this general instead created a set of metrics that also took into account territory, specific objectives, and economic cost.

It is what the general said about his reasons for doing this that is absolutely relevant to retailing. He said, “We are only making important that which we can easily measure when instead we should be measuring only that which is important.” Just because you can measure unit sales easily, for example, does not make that the most important part of your business to concentrate your improvement efforts in. Customer satisfaction is harder to measure but far more important because it relates to unit sales made today, tomorrow, and next year.

Case study 8.1. Not Smart Retail: The classic measurement mistake

In the early 1980s, the Coca-Cola Company had become incredibly twitchy about the strengthening performance of Pepsi, their nearest rival. Pepsi had made big strides into Coke’s market and one stat, in particular, had the execs at Coke sweating: in 1972, 18% of drinkers said they drank Coke exclusively against just 4% choosing Pepsi. By the start of the 80s, this ratio had moved to 12% favoring Coke exclusively and 11% Pepsi.

And that’s when Pepsi pulled its genius move and unleashed “The Pepsi Challenge.” Pepsi targeted committed Coke drinkers and presented them with two small cups of cola, one marked “Q” and one marked “M.” Almost without fail, drinkers would take a sip and choose “M”—which would of course then be revealed as Pepsi.

Initially the team at Coke attempted to claim that Pepsi’s campaign was fixed. But when they then ran similar experiments themselves, they discovered a 53% to 47% split in favor of Pepsi. For the market-leader, this was a bombshell—the impact of a six percentage point spread could be measured in millions of dollars in potential lost revenue.

The team were horrified and commissioned a slew of additional market research projects. Each came back with similar results and attempts to qualify the choice for Pepsi began to suggest that Americans had fallen out of love with Coke's distinct "bite." What was once described as "refreshing" became "harsh"; the same tasters began to associate words like "smooth" and "rounded" with Pepsi and went on to suggest they preferred these attributes.

Roy Stout was the head of Coke's consumer marketing research team and is the man who made the connection between losing market share and product taste. He reasoned, "If we have twice as many vending machines, have more shelf space, spend more on advertising, and are competitively priced, why are we losing [market share]? You look at the Pepsi Challenge and you have to begin asking about taste."[1]

This bombshell drove the board at Coke to make an extraordinary decision—they would change the hitherto sacred and world-famous secret Coke recipe to take account of the perceived change in America's cola preferences. And thus was born "New Coke," which had a lighter and sweeter taste, a taste more like Pepsi in fact.

Early test results were good—New Coke pulled level with Pepsi on blind tasting preferences. A little more tinkering followed and New Coke began to pull out a persistent 6–8% lead. The board then took the decision to take it to market and launched a massive campaign behind the new formula.

All the research said New Coke would be a winner.

It failed and failed dramatically. Tens of thousands of Coke drinkers rose up in protest, sales of the new drink faltered, and, cutting a long story short, the company were forced into a humiliating climbdown and reintroduced the original formula as Classic Coke. Very shortly afterwards, sales of New Coke all but evaporated.

Why?

The flaw was, in hindsight, a very simple one. Coke has a predominantly citrusy-burst flavor, whereas Pepsi has a more raisiny-vanilla taste.[1] Take one or two sips of Coke and the experience is quite sharp, the bite is very strong; do the same with a can of Pepsi and the first gulps are much smoother, sweeter, and gentler on the palate.

But! Drink a whole can of either cola and the experience changes completely. And this is the flaw—Coke drinkers like the way a can of coke tastes, but they don't entirely like the first few sips. Coke drinkers who prefer the first sips of Pepsi when tested blind, often complain of a cloying sweetness when they then go on to drink the whole can.

New Coke is a fantastic example of an entire company both putting too much emphasis on the research and ignoring instinct and emotion. So what were the real reasons for Coke's slipping market share?

Consensus of opinion is that Coke had allowed their marketing spend to mature along with their product. They had failed to sell to the younger, hipper, cola drinkers Pepsi had become so adept at communicating with. Coke's customers were leaching away to a preference for coffee and later bottled waters whereas Pepsi's were still enjoying rotting their teeth on "The Choice of a New Generation."

I'm not entirely discrediting management by numbers, but stories like this one go a long way to proving that without the emotional context, you don't have the full story.

Go with your gut feel

Use your gut feel and allow yourself to apply improvements even to those processes, tasks, and interactions to which you are unable to attach numbers. I'd like to ask you to consider valuing the power of your gut feel more highly. Gut feel isn't random. It's a guide, an instinct that tells you a certain path may be the right one to take. It is also that good sense which tells you not to do something. But it needs tuning: Books like this one exist to help you separate out correct gut feel judgements from other emotional factors such as fear or laziness.

Even science is now beginning to come round to seeing gut feel as something real and valuable. There is a credible theory that suggests decisions made on gut feel are more often than not the carefully calculated result of our experience and knowledge and that instinctive gut feel decisions get better as we add new experiences and knowledge to our memories. Think of your gut feel as a potent business weapon, a weapon that is unique to you.

Think of your gut feel as a potent business weapon, a weapon that is unique to you.

I wish I had more space here to go into instinct and gut feel in more detail but you want to read more about shops and that. Luckily there are already two brilliant books out there you can read instead: *Blink* by Malcolm Gladwell (Penguin, 2006) is really good at explaining the process at work in instinct-led decision-making and *See, Feel, Think, Do* by Andy Milligan and Shaun Smith (Marshall Cavendish, 2008) is even better at helping you to build your confidence in using gut instinct to make decisions. If you only fancy reading one, get Andy and Shaun's—it's really very, very good and you'll get a lot from it.

Making improvement work for you

Let's do it a little better every time. As well as running through ways to apply this idea at team meetings, you will need to create an environment in which the team feels comfortable to try things, and to suggest things. If you are the kind of person who greets every new idea with "I'd love to change that but ..." or "I can't see that working" then soon people will stop trying and suggesting. Equally, if members of the team feel that you are likely to discipline them for making mistakes then no one is going to want to try anything new for fear of punishment.

Get the culture of improvement established. Allow your people to question how they do things and you will benefit enormously. Make that an everyday occurrence: little steps but lots of them, and you and your customers will feel those improvements take hold.

Room for improvement

The best retailers do not stand still when successful. They strive to keep the momentum, to keep growing and to keep moving forward. That growth and movement is inspired by tiny little everyday improvements just as much as it is by sweeping change.

Here are some of the categories in which you will always be able to find lots of opportunities to improve things. The thoughts listed here are a deliberate mix of actual ideas and of pointers to get you looking in the right places for ideas of your own.

You might like to pick out a single line during daily team meetings and have the team come up with some thoughts and ideas on that theme.

Improvement and customers

- Consider everything from the customer's perspective.
- Encourage customers to tell you their complaints (the most cost-effective research you'll ever do).
- And listen to them sincerely when they do.
- Think about the type of people who come into your shop—who are you missing?
- What do customers prefer about your competitors (ask them)?
- Talk to customers all the time (ask staff to tell you one thing at each meeting that they've heard from a customer).
- Aim to improve average transaction values.
- Use eye contact more.
- Walk your store like a customer would.
- If you can, get hold of former customers and ask them why they don't love you any more.
- Use email, Twitter, Facebook, YouTube, and similar to communicate with customers; it's cheap, powerful, and very direct.
- Whenever you are resolving a customer complaint, ask customers how they would improve your service.
- Remember names.

- Think carefully about the integrity of your pricing.
- Send them stuff they might actually like to see.
- Where can you add value to the customer experience?
- What can you promise today that is better than yesterday?
- Run surveys.
- List the benefits of doing business with you and then tell customers about these benefits.
- What do other people do well that you really ought to be ripping off for yourselves?
- List all the things in your store that regularly delight customers—then think about how to double the list.
- Are you leading by example?
- Write down a list of all the processes that touch customers directly—all of them.
- Then do a list of all those that don't—can you strip any of these out?
- Make it easy for customers to give you feedback—use the internet, suggestion boxes, receipt surveys, telephone aftercare calls, open evenings, and everything else you can think of.
- Get customer opinion on new products before you put those products into your range.
- Ask customers to tell you "what's missing."
- Ask customers to tell you what they like about your store.

Improvement and you

- Read stuff.
- Get involved in the business community—join your street or shopping centre advisory committee or the chamber of commerce.
- Talk to your business neighbors.
- Ask people about your management style (and listen openly when they tell you).
- Learn from those below you as well as above you.

- Seek out examples of great retailers and learn from them.
- Sign up to every Internet resource you can find—here are three useful sites to start: www.theretailbulletin.com, www.nrf.com, and the fashion-biased but still very useful www.Racked.com. Equally, there are loads of great retail Twitter feeds—mine is called TheseRetailDays, if you would like to hear more from me.
- Get a subscription to *Retail Week* and learn to read between the lines. (Why did so and so make that choice? Why is X thriving? Why is Y on its uppers?)
- What things do you do outside of work that might be useful inside?
- Make an honest list of your strengths.
- Then one of your weaknesses.
- Go on courses.
- Sign up to every training and seminar resource you can initially—the more you go on the better you will become at recognizing which ones are going to be truly useful in future.
- Naff as it might seem, set life goals and then yearly goals for yourself—what do these goals tell you about the areas in which you will need to concentrate personal improvements?
- Listen to people more than talk to people.
- Open your eyes!
- Go shopping more often—do things your customers do.
- Read the trade press.
- Learn from competitors.
- Learn from people outside your sector.
- Maintain your standards.
- Get rid of the "yes" men and surround yourself with people who challenge and inspire you.
- Appoint an honest and strong assistant manager—they will soon let you know where you have room for improvement.

- Improve the balance of your life: You look after shops—shopping is fun, try to see it more that way.

Improvement and colleagues

- Reward people for improving things.
- Consider issues from your team's perspective.
- Don't get mad with people for trying.
- Let grown-ups think for themselves—empower people to make their own improvements.
- Encourage talk, talk, and more talk—leave every feedback channel open all the time.
- Give people a look at these lists.
- Buy employees a copy of *Smart Retail* for Christmas—remember to wrap it up nice; in fact, get your Dad a copy too, and all your friends.
- Recognize people's contributions.
- Don't rip off your staff.
- Never criticize employees in front of anyone else.
- Build a great culture founded on trust and respect.
- Tell people you are upset with them whenever they make you feel that way.
- Are your job descriptions a jargon-filled sack of nonsense?
- Feel free to build friendships but never forget that you are the boss—keep a perspective.
- Encourage the team to be open with mistakes.
- Have a laugh together.
- Always, always celebrate success.
- Be human in your relationships—if someone is going through a life crisis help them cope with it.
- Share the numbers—let the team own them as much as you do.
- Pay a profit-related bonus.

- Pay a customer service-related bonus.
- Smile when you walk through the door every morning even if you don't feel like it.
- Make sure everyone knows about all available courses and seminars.
- Put aside cash for training.
- Let good people go on courses you've been on—use training as a reward.
- Be specific with instructions.
- Sales assistants get closest to your customers—listen to what they tell you about those customers.
- Challenge people and encourage them to challenge themselves.
- Teach by example.
- Show people that the best way to do things is to consider solutions rather than dwell on problems.
- Get the team involved in all the big decisions.
- Help employees to see that it is customers, not you, who pay their wages.
- Hold regular one-to-one appraisals but be prepared to allow employees to tell you what they think of you, of your business, and of the team too.
- Have a team meeting every single day—just 15 minutes' worth but make those minutes count.

Improvement and costs

- Take a firm and consistent line on employee theft—always fire proven thieves and prosecute wherever possible.
- Walk the fine line between minimizing customer theft and creating an unappealing high-security atmosphere.
- Prosecute shoplifters.
- Anything the customer doesn't see only ever needs to be functional and cost-effective—but don't short-change staff on a place to eat their lunch or get five minutes to sit down and catch up.

- Try to get stuff done right first time—especially the solving of customer complaints.
- Negotiate everything.
- Pool resources with your neighbors.
- Swap cost-saving ideas with them.
- Keep track of all supplier rebates and discounts.
- Tell the team when you’re close to earning a rebate and explain what needs to be done to get there.
- Get more than one quote!
- Find the special group rates negotiated by your trade association.
- Listen to what customers tell you they think is important—anything they don’t rate highly is probably not worth spending so much cash on.
- Cut out the middleman wherever you can.
- Recent design graduates are a much better and more cost-effective option for your advertising and direct marketing than an ad agency is.
- When placing print orders, or booking a TV or radio ad, always demand the agency discount—this is a 10–20% discount that printers, radio stations, and TV channels give to agencies; just because you book direct doesn’t mean you shouldn’t get the discount too.
- Make good use of government employment programs but listen to your conscience—if it looks like slave labor, it probably is slave labor.
- If an employee isn’t pulling their weight and you have tried hard to help them, you have to let that person go.
- Do any members of the team have any skills that might mean you can avoid hiring in a tradesman? Pay the employee a proper bonus for any above-and-beyond jobs that they do though.
- Be sure that you understand how your customers have found out about you—improve or cut any activity that is not driving traffic.
- If you pay employees a profit-related bonus then that will in itself help limit some of the unnecessary expenditure—so long as you are

also sharing the store profit-and-loss information.

- Use your ideas program to harvest all the cost-saving ideas the team can come up with.
- Consider sharing savings with the employee who identified them.
- Be nice to suppliers and let them pay for stuff if they want to.
- Get rid of the waste—any process that does nothing for customers, or for you, just has to go.
- Look at these processes all the time.
- Reuse things whenever you can.
- Teach employees how to promote the business when they are outside of work.
- Ask the team if they know a way to get hold of something cheaper—years ago when we bought a horribly expensive color photocopier, it wasn't until the behemoth was delivered that one of the warehouse workers said "New copier? I could have got you a discount, my Dad's regional director for Canon."
- Talk to your landlord as much as you can, get a relationship going, and negotiate support when you need it.

Part Three—Customer: *Make me happy and I will give you my money.*

Source: Steve Bowbrick

Chapter Nine. We love shopping here!

Give customers the best possible experience when they visit your store—that's how you'll make more money. There—the most blindingly obvious sentence in the whole book! Yeah, of course such things as cost control, the basics of margin, and pricing have to be right too, but the starting point for everything we do in retail is the customer. How they feel about us, what they want from our stores, and how we meet those needs. Sending customers out of your stores with a big smile on their faces, a smile that lasts through getting their new stuff home and using it, is your absolute priority. So, how do we paste that smile on their happy chops? Read on, my friends, read on!

Great customer service

I often talk about how customer service isn't an add-on activity—that great service quality comes from everything you do as a retailer. Some clients, understandably, feel that I'm hiding the secret to great service quality ... well, thing is, there isn't one. What I can do here though is to point out more of the places in which you can work to create overall improvements in the customer experience.

That word "experience" is important: Great customer service is made up of lots of individual customer experiences and I much prefer using the word "experience" rather than "service." It's not a nod toward consultant blather—I reckon it's easier to understand how to improve things if you think at the individual level: "What can I do for each individual customer? How can I make their specific experience of my store a great one?" But when you talk about service, it feels like a nebulous thing—it's general and non-specific.

First and foremost, it's worth talking about why most initiatives focused on service quality fail. Sometimes a marketing team will take a look at their list of "things to do" and one of the bullet points will read "make customers love us again" and they'll commission an agency, or two, to come over and create some sort of "service event." They'll then have good fun taking this event around the store estate and they'll say to people "we order you, albeit in a nice way, to smile at customers and be their friends and love them so they will love us."

And these one-off initiatives often deliver big early uplifts in customer satisfaction—then those gains die off, usually quickly, and before long everything returns to normal. That's because the focus always moves on—no matter how committed a retailer is to raising customer service quality, there is always another issue waiting in the wings to occupy the minds of management and teams.

Permanent improvements in standards of customer care have to be earned from the ground up—you can't change things by layering initiatives onto unstable foundations. Building from the ground up is harder work but ultimately more satisfying because gains become self-sustaining and permanent. Dieting is a good analogy—crash dieting creates instant weight loss but almost always results in a net weight gain once the focus slips. Changing eating behaviors, seeking support, changing attitudes to food, and learning about nutrition means slower weight loss but, for the vast majority, permanent and self-sustaining success.

"Self-sustaining" is the key phrase—a successful assault on changing the behaviors and relationships that lead employees to *want* to deliver great customer care becomes a positive viral thing: Changes feel good, staff get more from their employment experience, and customers get more from shopping the store. Even better—these changes reinforce each other in a virtious circle:

Happier staff → better customer experience → happier customers → better interaction with staff → happier staff ... and round and round.

Better still, that loop delivers gains in revenue and profit and draws in improvements in employee retention and reductions in employment costs. It is an absolute win-win.

One team at a time

As a store manager, you might now be thinking that there's nothing you can do to influence levels of service quality in your store, that it's all down to centrally dictated policies. Well, you can influence service standards—your leadership is absolutely vital in creating a good place to work and in filling it with a motivated team. Doing that, following the advice in the "Team" section of the book will make a massive impact on how it feels to come and shop your store—with all the benefits that generates. You might have some weird service rules in the business, but you as a leader are making customer experiences into great ones.

Where things get tricky is in navigating your way through the negative stuff that sometimes you're asked to implement. A great example of this was seen at electrical retailer Powerhouse before that business, funnily enough, got into serious financial trouble and went bust: at one point staff were forced to ask every customer if Powerhouse could please sell them their gas and electric. It was really pushy—staff felt uncomfortable and customers absolutely loathed being asked.

And then they went to Comet or Currys instead.

Faced with something like that, as a manager, what do you do? To be honest, the right thing when it gets that extreme is to read the writing on the wall and jump ship. For most of you though, any negatives impacting on the employment experience, and therefore the customer experience, will stem from good old-fashioned well-meaning but poorly informed policies—unforeseen results of otherwise sensible decisions. Your role as a manager is to try to make these work, at the same time as feeding back your experiences and explaining why such-and-such isn't perhaps the world's greatest idea. Get customer and team comments, show you have tried to make a policy work, and create a compelling case, with alternative solutions in it. Then talk to your bosses.

We need answers on this customer service thing

I know, I know, you're still thinking I'm on a cop-out here. Right, here's a bunch of stuff you can do to make sure that you and your team are delivering great customer experiences and that you send your customers away delighted.

Employee satisfaction

I've probably gone on a bit about this but it's worth saying again: Put into practice the stuff in the "Team" section of this book—the most effective way to ensure your team is delivering more great experiences is to improve the satisfaction of your staff. Having a reward and bonus program based around customer satisfaction scores can be really effective too. It helps your team to make a direct link between how they look after customers and what goes into their own pockets.

Simplify

Be simple and straightforward for customers—make promotions easy to understand and simple to redeem. Use plain language in your advertising and communications: Be clear about what you can and can't do.

Deliver on the promise of your Big Idea

Whatever that Big Idea is, it is also a promise to your customers that you will be what you say you are! If a customer is coming to your store expecting you to be this Big Idea, then make sure that you really are and keep looking out for all those things you could be doing that serve to support and emphasise that.

Meet the fundamental discovery need

All shopping is about discovery (see "Store" section): Help your customers to make those great discoveries. Surprise, delight, inspire, and wow them. Be proud of your stock, make heroes out of the amazing and brilliant, and, above all, make sure your people are knowledgable, that they have access themselves to your product and that they are open-minded enough to listen to customers" real needs and then to find great ways to meet those.

Be consistent

Make sure your team are on top every day—make sure you exceed company standards, stay on top of your game. And across the company ensure that the experience is great, in every store, every time.

Fix problems directly

See, the thing is—any one of us could end up on *Watchdog* one day with Anne Robinson's curiously wonky face looming as she tells us that we are the devil incarnate. That's just the way the world is, but we can reduce our chances of this happening by accepting that we will make mistakes sometimes and then by getting on and fixing those problems quickly, fairly, and with a smile.

Feedback

Making it easy for customers to give feedback to you is critical in improving service quality. If you haven't got a customer complaint process, one that's easy for customers to use, create one. Give customers quality surveys that they can fill in and send back to you. Give them prepaid envelopes to make it even easier for them to do that. Give out your email address and watch for Twitter mentions. Encourage complaints and think of them as free market research. Some customers will rant and rage but at the heart of almost every complaint is a truth that, once learned, will help you to make your business better. Oh, and it's far better that customers complain to you, and that you resolve their complaints, than it is for them to complain about you to their friends instead.

> **Encourage complaints and think of them as free market research.**

Be honest and open

If you don't know the answer to something—say so and then find out. Be ready to admit your mistakes and involve your team and your customers in fixing things and in improving the store. Have an open mind in all situations.

Don't pay sales commission

Put your people on individual sales commissions and some of them will shark your customers. That's simple, straightforward human nature. The best service organizations pay people bonuses based on customer satisfaction combined with something reflecting overall store-profit performance. Or just be a great employer and give your front-line people salaries. Some of the happiest, most satisfied customers in the U.S. are customers of The Container Store: "Our salespeople do not work on commission; instead, they're either salaried or paid by the hour with wages far above the retail industry norm. Therefore, they often work together in teams to find that complete solution for the customer, which allows them to spend as much time as necessary to help customers find what they need." That's simple retail right there.

Smile and be nice, dammit!

Okay, I'm not talking the pained smile of the retail damned—but do try to put your troubles to one side when dealing with your team and your customers. Use the great opportunity you have as a retailer to talk to people, to enjoy their company, and appreciate the fact that you're not stuck in an office staring at the same ten faces all day every day and fearing your turn on the coffee run. Retail is ace like that—for every mean-spirited or rude customer, you'll work with a hundred who are good fun, who are loving being out and spending money. Shopping is fun—have fun yourself, you old misery.

Respect your people and they'll respect your customers

Treat people how you yourself would like to be treated. Be nice, be respectful, give the benefit of the doubt, and remember that your people are grown-ups. Treat your team that way and they'll do the same with your customers.

Living and breathing it

Every decision you make must be in the context of "will this be good for our customers?." Every person you hire must be someone you think customers will enjoy being served by and every process, promotion, and event you choose must be for the benefit and delight of customers. Delivering great customer experiences is not a bolt-on activity—it is the only activity. Every word in this book is written in the context of great customer service.

If experiences are poor, business will suffer. Customers have less patience for poor service than ever before and have even learned how to complain. If there *is* one secret to delivering great customer experiences, it is the knowledge that great customer service begins with your people.

If experiences are poor, business will suffer.

Great moments

What are those great customer experiences? What do they look like? I tend to feel that it's mostly about empathy, common sense, turning on and off the cheek and the banter at the right time, delivering on your Big Idea, and making sure people leave your store with smiles on their faces. Here's a bunch of examples of great customer experiences culled from our customer panel. Almost all of them are pretty ordinary but in each case the effect on the customer is huge: big enough for them to (a) remember it and (b) to bother to write about it on a forum. In each case, these are customers who will favor the stores involved again.

Lush—Sheffield (UK)

Nathan Ditum's experience

I went in to buy a birthday present for my sister-in-law, loaded down with a stroller (Maddy) and a hyperactive four-year-old (Jay). One girl in there was really friendly and polite—it didn't feel like she was being pushy, just helpful. She helped me choose a gift pack for the gift (as a regular customer, I know Lush's stock, but she knew all about which was best for sensitive skin, hairtype, etc.) and to choose a bath bomb as an extra for Sarah. Jay's been in before and he loves taking the bath bomb samples and watching them fizz up—this ace girl not only got some water out to occupy him so he wasn't buzzing around the shop while I was looking around, but added a sample of his favorite one into the bag for free, and then even dug out a baby one for Maddy.

Jay and I were chatting about how nice she was all the way home. It's the sort of customer service encounter that—small though it is in the big scheme of things—puts a big smile on your face and can make your day.

Myer—Adelaide (Australia)

Pete Muller's experience

I got a tip-off from my brother that Myer had 20% off TVs. Seeing as the retail price for the Sony I had my eye on was $5k, I was pretty keen on saving substantial coin. Unfortunately, I couldn't make it in on that Saturday, and wandered in on Sunday instead.

Oh, said the sales guy, it's only 15% off today, not the 20% we were running yesterday ... but since you knew the deal was yesterday, I'll give you the 20% off anyway. Unnecessary, I thought—after all, it's my fault I didn't get in yesterday—but nice, and definitely appreciated. I take the sales guy's card, and arrange delivery—unfortunately, 5 weeks away.

A couple of weeks later, Sony announce a deal where a purchase of one of their TVs garnered you a free PlayStation 3 if you sent the receipt off. Damn, I thought, bad timing on my part ... but I thought I'd chance my arm and see if I could get a receipt re-issued with the appropriate date on it. Went back into the store, saw the same salesperson; he remembered me. I asked whether he could re-issue the receipt: "No problem," he said, "we'll just refund and re-purchase your TV, you won't even lose your place in the line." (There was a massive backlog of this model, hence the 5-week wait.)

Refund, then. "We'll issue a refund onto your credit card, but that'll take a couple of days to go through; if you can deal with double-dipping on the credit card for a couple of days, that'll be great." Unfortunately, my card was damn near maxed, and couldn't accommodate another $4k hit. "That's okay," he said, "we'll issue the refund in gift cards, then scan those cards back in for the purchase."

That's when I discovered that Myer only issued a maximum of $500 on one of their gift cards, meaning he had to initialize and re-scan 9 cards. The whole process took nearly 45 minutes (due to the laborious nature of the gift certificates), but he remained cheery throughout—which I thought was fantastic, especially since he'd already got his money off of me.

Specsavers—Cheltenham (UK)

Melanie Taylor's experience

... sat on my metal-framed glasses a while ago. Annoyed that I'd have to wear my spare pair for a few days, I went with the broken ones in hand to Specsavers in Cheltenham, from where they were purchased. It was a Sunday morning and the store was pretty busy.

“I’ve sat on my glasses,” I said. “Do you think they look fixable?”

The lady at the front desk examines the severely bent glasses. I fully expect her to say, “They might be too bent to straighten out again,” but instead she says, “Yes, no problem at all.”

“How long will it take?” I ask, thinking I’ll have to come back after work the next day, or even later in the week.

“Oh, we’re a bit busy—could you come back in 20 minutes or so?”

“Oh! Sure!”

When I return to pick them up, the store is still very busy. The same lady immediately turns to pick up my glasses as I approach the counter. “Here you are!” she says brightly, passing my glasses back. They have been so well repaired they look like a brand-new pair. I am amazed. “How much will that be?” I ask, digging in my pocket for a tenner. “No charge!” she says. “We don’t charge for minor repairs if you bought your glasses from us. Would you like a slip case for your spare pair?” and she hands me a soft case so that I can take my crappy old pair home without scratching them.

Now THAT’S what I call good service! And that’s why I have gone back to them to try contact lenses.

The Warehouse—Christchurch (NZ)

Sty Smith’s experience

A few weeks ago, I was trawling through the CDs and DVDs on special offer at this no-frills giant store. I came across a *Riverdance* DVD—knowing that my wife likes *Riverdance*, I decided to buy it for her, especially as it was on at a bargain NZ$15. The DVD wasn’t the original one released when *Riverdance* was first launched but was a more recent show filmed in Geneva with different dancers.

While I was paying I mentioned to the girl at the counter that I had really been looking for the original version but this was a good deal anyway. She then said that she was sure they had the original in somewhere for the same price. She checked the computer and confirmed that it was indeed in stock and then spent ten minutes with me searching through all the places it could have been out on the shelves and in the bargain displays, all to no avail.

She then very kindly offered to keep an eye open for it and give me a call if she came across it: She wrote down my phone number and that was that for a couple of weeks. I then, one day, got a very clear message with her name, the store, the fact that she had located the DVD and had put it aside for me for a week, and I could come in and collect the film when it suited me.

That felt like proper service and I've felt good vibes about that store ever since.

Center Parcs—Longleat Forest (UK)

Nick Taylor and family's experience

It's a very big operation so I was very much expecting it to be rather impersonal, or the staff to have the noticeably false "smile and say nice things to the customer" manner that had been drummed in at training sessions. But from the very first person we met on arrival the feeling I got from the staff was genuinely warm, helpful, and enthusiastic.

Then through the stay, it was obvious that really careful planning had gone into making things run smoothly and hassle-free; for example, I was expecting to have to stand in line on the day we had to return hired bikes, but there was extra staff on hand to speed things along at the time when there would be highest demand. All of whom seemed to be enjoying what they were doing and were very helpful and friendly. We might have just been lucky, but to me it felt like it was the culture of the place, and we're going back this Christmas.

Anthropologie—New York (U.S.)

Chris Ahchay and Sarah Treacy's experience

We'd bought some jeans and that from Gap, wandered out of the shop and off on our merry little way without really thinking anything more about it. As you do. Unfortunately Gap had forgotten to take the security tags out of our clothes so in the next shop we went into we set off their alarms.

Now, maybe it's just indicative of what I've come to expect in a big town (a shrug of the shoulders and a cursory bag-search if you're lucky) but the security guy in the shop took one look at the Gap bag, said "Oh, that'll be the security tags then, they're always doing that." He then sent one of the shop girls to find a pair of scissors and then spent five minutes carefully unfolding our Gap stuff, finding the tags, and cutting them out, before folding them all up again and sending us off on our way. All while having a perfectly pleasant conversation with us about our stay in New York and what not.

We bought some candles.

Ship & Pilot—Ilfracombe (UK)

Neil Meddick's experience

Wandering around trying to find a pub with proper ales, I was glad to see six options available and the pleasant man behind the bar offered tasters of the two I had my eye on. Went for a splendid pint of Exmoor Beast, in a handled glass to boot. On returning my glass to the bar and thanking him, I continued on my way.

I didn't then go back for nearly two weeks, but on entering I was greeted with a knowing "hello" and asked if I would like to try the new barrel which was similar to the one I had tried on my previous visit. He then told me what ales he was having on in the next three months and the exact dates they would be available. He then continued, explaining how he kept his ales exactly as per CAMRA. It's one of those places that makes you want to go back because its obvious they care about what they sell and they create a friendly atmosphere. Brilliant, really brilliant.

Two local banks—Pennsylvania (U.S.)

Steve Trimble's experience

I spun a yarn some years ago about Mellon Bank not wanting to give me a plush lion stuffed animal, because I was an "existing" customer and that the plush toys were for "new" customers—it was a nice stuffed animal that I thought my then young kids would enjoy. I closed my account and took all my money out, then opened up a new account with a dollar, got the stuffed animal, and then closed this account. I then walked over to Wells Fargo and opened up an account there out of spite.

Well, yesterday I found myself in Wells Fargo standing in line waiting to do some banking, when I noticed they were giving out ceramic piggy banks. I thought my youngest boy would just love to have one. Not only do I have a personal account, but we have four business accounts with this branch. After my banking needs had been dealt with, I inquired about the gift and was told it was for new customers opening up new accounts. I then asked what about their old customers—and then it happened! She smiled, asked if I wanted one and actually gave me one! Then a wink and a whisper, "just don't tell my boss" ... completely excellent! I'll bank there forever ...

Elliott loved it and spent a good part of last night racing around the house gathering spare change for his bank ... good customer service rocks!

The Natural Grocery Company—El Cerrito (U.S.)

Thomas Moyles's experience

Was picking up some ingredients for sweet potato casserole and wasn't having any luck finding chives. One of the ladies working there smiled and said something nice about my baby son and made it obvious that she was available to help without pressing it on me. When after a few more minutes of poking around I did ask her, she showed me where the packaged chives were as well as the fresh green onions if I preferred to go in that direction.

At the check-out line, both the lady working the register and the bagger fawned over my son and were very friendly and when I was about to put the cart back while carrying my son, an employee jumped in and said “Let me get that for you, sir.” Nothing big, just a pleasant experience to go in to a store and have lots of friendly people creating a comfortable feeling—I really did just have a bit of a happy glow going out to the car.

People make the difference to great customer experiences

> *Of course, what rapidly becomes apparent in a service business like ours is that you can only look after the customer by looking after your staff. So, the route to creating value for the customers is through management of your people. Good retailers always understand this instinctively and we, at Tesco, regard it as a major priority.*
>
> *Sir Terry Leahy—CEO, Tesco.*

Quote taken from the fantastic *Uncommon Practice* by Andy Milligan and Shaun Smith (Financial Times Prentice Hall, 2002).

This year, I pledge my loyalty

Customer loyalty is a myth, a consultant’s pipe dream. A nonsense. Trying to gain it, trying to buy it, trying to bribe customers is ridiculous, costly, and pointless. A customer is no more loyal to Top Shop than she is to New Look. She’ll happily shop both of a Saturday afternoon. Incidentally, Tesco Clubcard and Sainsbury’s Nectar are called “loyalty schemes” but they aren’t really, they’re customer data v. rewards programs. You let us understand how you shop and we’ll give you a few tokens as a thank you. Tesco, in particular, have been able to do great things with that data. It’s a worthwhile exchange.

So, some of us might be loyal to our brand of breakfast cereal or toothpaste but we are not loyal to the names above the door of the various places we can buy them from. But even that brand loyalty is moot in an age when choice is ubiquitous and consumption predicated on disposable living. Sure, personally, I've never forgiven Colgate for discontinuing my favorite sub-brand of toothpaste and actively seek out remainder stock of the green nectar from discount stores (I have 20 packs in reserve right now —thank you, Home Bargains in Liverpool) but if Macleans come up with a toothpaste that tastes and performs as well as the green one—it's so long, Colgate, and not a second's pang of regret will be felt.

This is the reality, my friends. Time to find a new reality—and here it is.

First-visit advantage

First-visit advantage is a move on from the blunt definition of customer loyalty. Traditional customer loyalty holds that customers will always come to you to satisfy their needs in your product areas. To the exclusion of all other stores. Nonsense. The world doesn't spin like that.

But what if we can build formats so great and customer experiences so compelling that people are prepared to give us the first opportunity to sell to them on any given shopping trip? So compelling that they will come to you first before moving on to your competitor's stores. There is loads of evidence, including really strong stuff from Paco Underhill's Envirosell team that shows a massive percentage of customers will buy, or return to buy, the first item they really like on a shopping trip. And common sense says getting the first crack at satisfying customers" needs is a good thing.

The idea of first-visit advantage is that customers enjoy the experience in your store so much that whenever they plan a DIY project, or want to buy some clothes, or want to make something nice for lunch, that yours is the store they visit first. They may park their car nearest to your store rather than a rival's, or visit your retail park before moving on. Being given first crack of the whip leads to a much greater probability that the customer will buy from you in preference to a competitor.

It is a very powerful concept.

First-visit advantage can be won in three ways: through promotion, through preference for your format, and through the human experience in your store. Remember especially that the human parts of that equation are always the most powerful.

Human interaction is bricks-and-mortar retail's secret weapon.

As retail trainer Kate Phillips pointed out (I promised I'd credit Kate with this bit, so I have), there is one area of loyalty that does still mean something to customers: loyalty to people. And she is of course right—wherever you have the opportunity to build something personal, there's a chance that people will respond very positively to that. It's not about forced smiles and pretending—it's about developing a store culture in which staff feel comfortable to chat with customers, to share honest opinions on product, and to banter and be themselves. Much of what the "Team" part of this book tries to do is to support exactly that type of culture—it's very valuable if you can do it. It's also one thing a traditional bricks-and-mortar store can do better than one online—never underestimate the power of eye contact and a genuine smile.

Case study 9.1. Smart Retail: Becoming first

One of Europe's leading DIY businesses discovered in 2006 that customers were only putting 20% of their total project spend with that retailer. Customers were actively driving to these stores, parking the car, walking down the aisles, and still only actually spending a fifth of their cash for that project at that store.

Big chunks of their project budget was found to be going to specialists in tiles, flooring, kitchens, bathrooms and gardens. Customers only came to these huge DIY sheds for the extras, cheap offers on base materials, and for tools.

A legitimate interpretation of that situation would be that customers were almost begrudging having to give this retailer even that share of the project spend.

The response has been to make big investments in improving the in-store format of those specialist areas, bathrooms, flooring, etc., and in significantly raising standards of customer service. To an extent these changes are now paying off; however, I believe this particular retailer needs to do much,

much more on service standards before it can undo its losses to the specialists (and that's why I've not named the retailer in this case study).

The four rules of performance improvement

There is no secret to performance improvement. The techniques can all be learned. But just as some racing drivers can make an identical piece of metal move consistently faster than that of a teammate, so it is that some retailers are able to improve performance better than anyone else. I've known a few racing drivers over the years and the best of them have one thing in common: consistency of line. They take the right line through more corners more times than anyone else. That's it—nothing magic or secret or unknowable. The same thing holds true when it comes to performance improvement. There is no secret; it's about getting the details right and paying attention to the fundamentals—checking you're consistently hitting the right line.

The rules of performance improvement are so beautifully simple and there are only four of them.

To improve performance you can:

1. Sell to new customers.
2. Sell more in each transaction.
3. Persuade existing customers to return to your store more often.
4. Improve margin by cutting overheads and improving sales quality.

This is another of those "it's not rocket science" moments. The challenge is of course in understanding how best to apply each rule. The chapters in this section of *Smart Retail* deal with those things you can do to produce direct results from applying these rules to your customers. People and store issues also have a part to play in the successful application of these rules, of course, but it is what you can do directly for the customer that has the most significant impact.

Priorities

If I was forced to choose just one of the four rules of performance improvement over all others, the one I would pick is number two, “Sell more in each transaction.” Driving up average transaction values is all about maximizing every opportunity. That in itself is a powerful business improvement philosophy. “Make the very best of every customer who walks in” is your first consideration.

Driving up average transaction values is all about maximizing every opportunity.

Added value

Everyone wants a bit of something extra, something free, or on top—a bit of added value. Where we retailers sometimes misunderstand that is to think that added value needs to be made out of actual “stuff.” Customers place value on the less obviously, umm, valuable too—the convenience of a local corner shop is added value, for example, and in certain circumstances a customer will happily pay a little extra for that added-value convenience.

In black and white here the list below feels very ordinary—it *is* pretty ordinary as it goes. Where the magic happens is in the way in which you and your teams put this stuff into practice. A “tip sheet” sounds a bit dull—but written with passion, fun, energy, and a bit of wit, it can be a really welcome part of the customer experience. Do these things consistently and have them support your Big Idea and they carry significant power.

Where the magic happens is in the way in which you and your teams put this stuff into practice.

Here’s that list:

- Recommendations
- Product demonstrations
- Masterclass technique demonstrations
- Product training for customers

- Tip sheets
- After-sales service
- Trade-in
- Expert staff
- Credit facilities
- Loan product availability
- Pre-order facilities
- Services such as tailoring
- Specialist product ordering
- Delivery services
- Free samples
- Try-before-you-buy
- Convenience
- Design services

Case study 9.2. Smart Retail: Value equations

Staff cost money and sometimes it's easy for retailers to see the wages line on a profit and loss account only in terms of the hard figures. At a store committed to everyday low prices at all costs, the percentage of revenue budgeted to cover staff costs might be as low as 4 or 5%. One such retailer is The Home Depot, whose big idea is so entrenched in the idea of everyday low prices that it might not be able to afford to trade at all if it had a wage percentage much beyond that. Now that's fine when you're incredibly far ahead in an exponentially growing market (as Home Depot were in the 90s U.S. DIY sector)—frankly you could force customers to wear T-shirts printed with "I Smell" and they would still come to you for low prices and wide ranges. What Home Depot has been experiencing for some while now is the effect of a flattening market—all of a sudden, customers start to subconsciously add things like service, advice, inspiration, and shopping environment to their personal value equations and that's why Lowe's, who appears to invest more in training and service, picked up customers so rapidly.

What I need—what I want

We've talked a lot about understanding customers and that's because it's fundamentally important—they have needs and we have to understand those needs and steer our businesses and the customer experiences within them toward those needs. So here's a neat thought exercise that will help you to get a clearer picture of what those needs are.

It's a tough exercise, this one—I always ask my clients to brainstorm those needs and to write down as many of the possible needs they believe their customers might possibly have. Instinctively most retailers kind of know what these are—but articulating them is a struggle.

So why bother? At its most basic, understanding the most likely of your customers' needs makes it easier for you to sell stuff to those people through the addressing of those needs.

The first bit of this exercise seems a bit silly at first but try it before reading the "answers." Try to do this in a group if possible—better ideas tend to emerge that way.

Needs Exercise Part 1: Glass

Fetch a drinking glass and put it on the table in front of you. Set a timer for five minutes and then write down all the things you think that glass could possibly be used for. Pick it up, handle it, think about what you could do if you broke it.

Done live, and in groups, the longest list of different uses I've had is 54.

Reveal:

Okay, time's up: Take a look at your list, look at the progression of uses on it—you'll have uses like "drink out of it" and "pen holder" up near the top and then, closer to the bottom, the mad stuff will appear, such as "anti-burglar device (smashed in a doorway)" and "wasp prison."

Okay, more analysis on that in a moment, but first you need to do part two.

Needs Exercise Part 2: Shirt

Do the same thing as with the glass but this time use a shirt instead.

Reveal:

Again you'll have a nice mixture of obvious "wear it" and lateral "to create an instant disguise." Now, what I'd like you to do is to look at both lists and next to each use write down a need that use could satisfy. So with the glass and "drink out of it," the need might be "to quench a thirst." Then do the same again but this time add a second "need" to each line. So you might then have "drink out of it"—"quench a thirst" plus "to wash down some aspirin."

Those second ones are much harder to do but still represent a legitimate need. Take a look at the lists—the "uses" there can be thought of as your customers" actions "Bought a TV" or "Inquired about contact lenses," and the needs are, well, needs. So you might have "Bought a TV"—"Because I was impressed by 3D" plus "I'd like to watch football in 3D."

These first two are all about getting your brain unlocked, so now move quickly on to the really important stuff ...

Needs Exercise Part 3: My Store

Now, with unlimited time, write down all the possible things customers could use your store for, including listing all the different broad categories of products you sell and services you provide.

Then take five of those "uses" and for each of them list at least ten "needs" that your customers could possibly be satisfying by using your store for.

Needs Exercise Final Part: Action

By now you should be buzzing with real customer needs—let's have a crack at using that to learn something useful about our store.

Choose a section of your store or a particular range of items.

Consider:

- What are the needs of customers shopping this section?
- How are we satisfying those needs?
- How does this fit with the Big Idea?
- What needs are going unsatisfied?
- How clear is our added value in this area (if this applies)?
- What can we change to meet a wider range of needs, to better meet existing needs, and to improve the performance of that part of the store?

Chapter Ten. Price and value

I’ve not gone into theoretical strategy much in this edition; I have in the past but I reckon now that it’s not useful to generalize. There is one area of strategy that *is* worth talking about though and it’s pricing. It’s worth talking about for a handful of reasons—one primary one is the value of bargains. Bargains are brilliant in almost every store—upmarket boutique or down-and-dirty pound store (I love pound stores, incidentally—Poundland, especially, is a fantastic example of focused and thoughtful retailing).

Everyday low prices (ELP)

Everyday low pricing is an interesting modern pricing technique. It’s also the best example of the failure of slavish dedication to a rigid price proposition. The theory of ELP is that every price in store is as low as possible every day. Furthermore prices will not be slashed during sale periods—indeed there will be no more sales at all, just the lowest prices every day.

U.S.-based Wal-Mart is often credited as the pioneer of ELP. Founder Sam Walton would almost certainly have suggested that all Wal-Mart did was to take discounting and direct-from-manufacturer purchasing further than his competitors.

I worked for Comet when the company first introduced ELP in the late 1980s. A Kingfisher finance team attempted to codify ELP into a philosophy and then to interpret it as a mission applicable to the whole business. Pricing became the absolute focus of what we, as a retailer, did. To make pricing the absolute mission was wrong, and I’ll explain why as we go on.

I am always mistrustful of attempts to shoehorn simple common sense into complex strategy. At Comet we interpreted ELP as meaning all prices would be monitored against those of major competitors, then adjusted to match or beat these price points. In addition, each key product category would feature at least one product priced lower than any entry price-point offered by our competitors. The product would then remain at that category-killing low price everyday. So, for example, we offered a 14″ portable color TV (remember those!) at $99 when the previous entry price-point for this product was $109. All our competitors were at the $109 price, so we were a good chunk cheaper. For how long do you suppose that competitive advantage lasted? A year? A season? Well, Dixons, Currys, and Argos cut their price point to match ours within days. All that happened was the whole sector now made $10 less profit for every one of those 14″ televisions sold. That's $10 lost out of gross margin, don't forget.

Because we at Comet were committed to our misinterpretation of ELP it made it very hard to respond in-turn to our competitors" actions. If we dropped our own price further, it would have damaged the credibility of our ELP proposition, suggesting that our previous price was not the lowest everyday price after all. If we remained at $99, just like everyone else, we had no competitive advantage since pricing had become our only competitive lever. Building the mission around ELP provided no competitive advantage at all. Comet's current CEO, Hugh Harvey, has spent the last handful of years trying to move Comet off price-focus and on to a proposition based around service—I hope he manages it but with Best Buy breathing down Comet's neck in the UK ...

When rivals" store environments, prices and product ranges are so similar there is a terrible fear that a customer will simply walk from store to store and buy on price alone. Comet, as do many others, believe that convincing the customer that their prices are always reliably low will ensure the customer only comes to them. I'm not sure that's very realistic given the amounts being spent on a single electrical product. Would you only check one store when spending $800 on a TV? No, nor would I. ELP, as practiced by many, is fatally flawed.

Would you only check one store when spending $800 on a TV?

Merchant dealing

I put the challenge of the $99/$109 14″ TV to a number of Britain's best retailers. They decided quickly that it would have been much more effective to have taken that TV and to have slashed a genuine deep cut off the price, say to $89, and then to have run that as a limited stock promotion. We would have negotiated a larger order with our original equipment manufacturer (OEM) and taken a bigger discount. That stock would make up the limited promotion. The promotion would then have been presented honestly to customers: “Here’s a fantastic deal we’ve negotiated specially for you—once it’s gone, it’s gone.” Indeed, in the second half of the last decade, this is exactly how Asda and Tesco have been beating the electrical retailers at their own game.

Yes, the competition would still match our price but by then we would have enjoyed at least two weekends of price leadership in this category. Also, competitors would be forced to cut their margins from existing stock bought at their usual cost price, so their profit per unit would actually be less than ours.

This bargain $89 TV would feature heavily in local press and radio adising. Customers flicking through the local paper would see a bold, bright, honest ad. Many customers would bring forward an intended purchase as a result: “Let’s get one now and put it away for Tommy’s Christmas gift” and “You’ve been on about a TV for the kitchen, shall we get one while this cheap deal is on?” And a significant number of customers would switch to Comet for this purchase because:

1. We made it easy for them.
2. We gave them a good reason to act now instead of tomorrow.

I strongly believe that real competitive advantage comes from maintaining honest everyday prices mixed with bargains. Quite simply: not ripping off the customer, and retaining the ability to offer great, customer-delighting, promotions. It is this approach, call it a philosophy if you want, that will enable your store to convince customers that you are honest people to do business with and that you are capable of exceeding their expectations on price.

Making bargains the star

Back in 2007, I got this nice note from Irish book retailer Lyn Denny: “I’m the owner of a small independent bookshop in Ireland. We’ve been open a year and things are going great. I bought your book in September and haven’t looked back. We immediately introduced a bargains table and it has been the fastest-selling area of my store ever since. We are delighted with it and so are our customers.” Apart from me showing off a bit, why this is worth talking about is that Lyn’s store isn’t some downmarket discount shop: Bookstór (www.bookstor.ie) is a quality independent in a country that values literature highly. People love bargains and they work in almost any store. Oh, and Lyn’s store is still with us—look at their website and you’ll get clues why: The store is buzzing with energy, it’s not just books on shelves. There are story events, loads of communication with customers, passionate and inspirational recommendation, and loads of character on show.

Even in a chain-store branch where you don’t get to dictate prices you can still make bargains the star. There are always awesome offers in the price lists—these might be end-of-line items or even regular stock. Try pulling lots of the end-of-line product into your store from other stores around the company and then putting them out there in front of customers. Don’t forget clearance and manager’s specials too as bargains.

Make up some simple flyers featuring these star bargains. Hand these out on the car park and around town. If you have budget, get them delivered with the local free papers too. Have your team point out the specials to every customer who comes through the door: “Just in case you’re in the market for X later, I wanted to tell you we have got them priced at Y for a week or until the stock runs out.” That’s not pushy; it is friendly no-pressure selling.

Enthuse the whole team at your daily team meetings. Tell them about the day’s top three bargains. Consider running a little incentive on those lines: A bottle of champagne goes to the person who sells the most over the weekend. A bottle of bubbly is just enough to help the team to take notice; it’s a welcome treat for most, but it’s not so much that salespeople will mis-sell just to get it. Put flyers on doors and on the counter top. Set up an A-frame outside if you can. Sometimes the council take offense at the presence of these A-frames, but you won’t know until they send you a nice letter and ask you to take it down, so go ahead and see what happens!

Pulling together the bargains is hard work. You must be inventive, on top of your inventory, and ready to act fast. The work is worth it: You will drive customers into your store and the combination of honest pricing and real bargains will boost your reputation and your sales. Bargains give you competitive advantage.

Bargains give you competitive advantage.

Case study 10.1. Smart Retail: The democracy of bargains

In 2007, Primark, a proper no-nonsense bargain high-street fashion retailer, opened a 70,000 sq ft flagship store on London's Oxford Street. Hilary Alexander, writing in the *Telegraph*, described the scenes on its first day: "I have never seen anything like it. Even the first day of Harrods" sale is a vicarage tea party compared to the Primark pandemonium. By 11:15 a.m., there were still crowds three and four deep winding around the block on both sides and spilling onto the roadway as a mounted policewoman appealed for people to 'please stay on the pavement.' Security guards estimated tens of thousands had arrived by midday."

That mention of high-class department store Harrods is interesting—I've visited the Primark store a number of times since it opened and the customers in there are broadly the same people also shopping Selfridges, Debenhams, John Lewis, Next, and Gap on the same street. The only customer group missing in Primark from those stores are the wealthy over-50s. Thing is, a Harrods customer is as keen on a bargain as anyone else. The millionaire enjoys being able to boast that he got an extra diamond set into the face of his new Rolex Oyster for free, just as much as we do when we manage to snag a second bag of mini-peanuts on a flight. That's what Wal-Mart, Primark, and even Bookstór are tapping into: the buzz customers get from beating the system, from getting a real bargain. All customers love bargains—we are living in a bargain-driven culture.

Cost and value aren't the same thing

Lots of retailers are able to create a premium positioning and charge a bit more for the things they sell. That's obvious, but I wanted to take a closer look at some specific examples and get to grips with how those retailers are able to make customers feel comfortable paying a premium.

Selfridges (London), Bloomingdale's (New York), Galeries Lafayette (Paris, Berlin)

Every last thing in the beauty departments in these four stores can be had for less by searching for thirty seconds on the Internet. Yet those departments, even in trying economic times, generate huge sales and profit. Why do customers spend in this way? For the theatre, the fun, the demonstrations, the quality of the advice, the convenience of being able to try things and ask for samples. Oh, and if you stand in these four (and I'm sure other department stores too) you see that the vast majority of shoppers are not super-rich posers, they are the ordinary boys and girls working in the offices locally and enjoying their bit of retail therapy.

The Container Store (U.S.)

Sell shelves to put things on and stuff to put things into, and other storage-related paraphernalia. Similar, cheaper products can be found easily—often right next door from Wal-Mart, Target etc.—yet this runaway success story was part-sold in 2007 for what was rumored to be near a billion dollars. This is an exceptionally successful store and that's because customers prefer to buy these products from the Container Store because they value the expert advice and the specialist nature of the store.

Lush (UK)

They sell soap. Soap is soap is soap—but Lush sells relatively expensive soap to people who will happily walk past the cheap soap in Tesco just so they get to make a second trip to a store that makes them feel good about themselves. We will look at Lush a couple of times in this edition to understand why that is—see the case studies under Big Idea and Format-led discovery.

Diesel Store (Global)

Again, Diesel jeans can be had from the Internet cheaply but the Diesel Store is not about price: Customers flock to these stores for the experience, for the feel of the store, to be able to touch and feel real product, and for the interaction with people excited by the product. Staff are passionate and knowledgeable: They will tell you about the denim and will chat enthusiastically about cut and fit and colors. Customers value that kind of experience in-store and are willing to pay the proper price for it.

Oi! That’s my planet too—the costs of consumption

While we’re on the subject of pricing, this is a good place to talk about the flip-side of the price-driven consumption frenzy. I’m one of those people who grew up in the 1970s and 80s in a world that believed consumption at any rate could be sustained forever—too young to be bothered by the early 70s oil shocks and too old to really “get it” when, late in the 90s, environmental concerns began to break mainstream ground. Ten years later and even people like me have been forced to confront the reality that the blue and green ball upon which we stand isn’t going to last if we keep kicking the crap out of it. Parallel to that we’ve begun to better understand the long-life health benefits of eating better and walking about a bit more.

As retailers we are in the vanguard of consumption and we have some serious thinking to do. Here and now I need to say that I am an unashamed liberal-capitalist and I believe strongly that the creation of wealth is a force for common good in the world. I’m also very supportive of the idea of globalization: one planet, one nation—and why not.

So how does that square with the need for sustainability? Being one of the world’s biggest sources of employment is a pretty good start—everyone is entitled to opportunity, dignity, and the chance to earn a decent wage. Retail provides that, and here’s where we start to get to important stuff—time and time again it is proved that those retailers who treat their staff with respect and who provide support and opportunities for self-fulfilment are the ones that customers prefer to shop with. On the customer side, growing awareness of the need for sustainable living is leading a quiet revolution, with our customers taking more and more of their money to those retailers whose practices have the least negative impact on the planet.

We're really good, as an industry, at moving minds and influencing consumer behavior—I believe the most forward-thinking retailers have an opportunity here to move customers even faster toward truly sustainable consumption. Why wait for consumer trends and government regulation to push us? Let's drive that change ourselves—not just because doing so, on a human level, is a feelgood thing, but also because we can drive our business's success by doing so.

Broadly, there are two routes open to retailers driving toward a sustainable position:

1. Commit the entire format to a sustainable position (Whole Foods Market, Lush, Abel & Cole).
2. Operate a traditional business but introduce a significant commitment to sustainable practices (Marks & Spencer, Waitrose, American Apparel).

Making these moves is a good community choice and a great human one too. Of course, the usual caveats apply: Choose your position carefully, communicate it well, and above all be authentic—if you say you have a commitment to X then you must genuinely believe that commitment to be right or you run the risk of being "found out."

Case study 10.2. Smart Retail: Live it, breathe it, sell it

A key event in the early days of Whole Foods Market set the tone for the way in which this innovative food retailer sees itself as an integral part of the communities it serves. In 1981, a flood devastated Austin, Texas; among the businesses ruined was the company's then one and only store. The damage ran to $400,000 and without insurance they looked doomed. Incredibly, customers and neighbors volunteered to join staff in clearing up the mess and in repairing the store—creditors and suppliers too provided breathing space for the business to get back on its feet and, less than a month after the disaster, the store was up and trading again. Many people not employed by the company or financially dependent on it nevertheless felt they had a stake in the success of the business. If your local Tesco, ASDA, or Sainsbury's suffered a flood, would you be there bailing out and mopping up?

Right from the start, Whole Foods Market has had a clear vision that the food they sell should be grown responsibly, that local supply and the variety that produces, was preferable to the established mass-production model, and that employees and the community should be closely involved in the decision-making driving the business. They have a snappy line to sum up the way the business feels about its offer: Whole Foods—Whole People—Whole Planet.

What makes Whole Foods Market special is that they have made direct positive connections between "doing the right thing" and making money. Just one small example of that: They offer financial support to employees who choose to do voluntary community service—and they know that doing so makes both the employee and the community feel good. They also know that a happy, motivated employee helps the business to make more money and that an involvement with the community increases customer awareness. There is no cynicism in this: The top team wants to be proud of the way in which they do business; they want to go to bed at night knowing that their working day has resulted in gain for everyone and in the right way.

I'm sure too that Whole Foods Market would be happy to carry on at their own rate, expanding when sensible to do so, and to a large extent minding their own business—the world though has come into line with the principles driving Whole Foods Market and that should spark an interesting period for the business.

Chapter Eleven. Promote or die

Carefully considered promotions are important because they create interest and surprise, and in conjunction with honest pricing and added value, are essential performance improvement tools. There are of course those other factors we've talked about to consider—promotions in isolation from great customer experiences or attention to employee needs are near worthless. Poor, aggressive, or sneaky promotions may bolster sales short-term but unhappy customers will rarely come back (breaking Rule 3 of the four rules of performance improvement in Chapter 9—Persuade existing customers to return to your store more often) and will tell friends how awful you are (breaks Rule 1—Sell to new customers). Unhappy employees will leave (that has a cost to you, so breaks Rule 4—Improve margin by cutting overheads and improving sales quality) or will not make any active selling efforts (breaking Rule 2—Sell more in each transaction).

28 promotions

Here I have listed most of the popular promotion options. I've included a table that makes it easy to see which promotions are good for achieving better performance under each of the four improvement rules. Finally, the promotions planner that follows after will help you to see what promotions are right for you and when to run them.

1—Joint activity

Look for promotions you can share with either manufacturers or other retailers in your street. The obvious benefit is that you can pool costs and then afford to promote the activity more aggressively. An example of retailers engaging in joint activity might be a "fun day" held within your shopping center. A manufacturer and retailer joint activity could include manufacturer-supplied demonstrators, linked to a customer promotion and a manufacturer-funded staff incentive.

So long as they walk out with a bag!

Source: Koworld

2—Displays in empty stores

I need to credit brilliant retail speaker Rick Segel with this great idea: Find the landlords of an empty local retail unit and offer to put a display in the window. It makes the unit look more appealing for the landlord to rent and provides you with an excellent adising space. I first mentioned this in 2003 when it was super-rare—you see it a lot now and it seems to work well for everyone involved.

3—Sponsorship and community events

Don’t dismiss requests for sponsorship right out of hand. Sometimes a sensible sponsorship can do more for you than, say, your Yellow Pages ad. Businesses located at the center of smaller communities gain most benefit from this form of promotion. Sponsoring events such as the town fun run or village fete makes a very strong statement about your commitment to the community. Many retailers have reported that the goodwill this creates does translate into sales.

4—Ads in changing rooms

Cheap, easy, and brilliant: put ads in your changing rooms. Your customer is absolutely captive when they are in there and they have plenty of time to read. Think about featuring deals on accessories especially—customers who bite will be helping to push up your average transaction values.

5—Children's competitions

Maybe we are just a nation of soppy souls but children's competitions always work well. These can be very simple coloring competitions or letter writing. Perhaps themed "draw or write a letter about your Mom for Mother's Day." Local papers love this sort of thing. You have a good chance of getting a photo printed in the paper of the winner in your store.

6—Tip sheets

No matter what your product you can easily produce useful tip sheets. A sheet of tips might seem a little uninspiring perhaps, but time and again retailers tell me that customers go nuts for these, often citing the tip sheets as the reason why customers come back. You can write tip sheets yourself or have a well-known expert do them for you at a cost. Formats can be anything from a full-color booklet to a small card fixed to a shelf edge. My favorite format is loose A5 so that customers can take the tip sheets away with them. Here are some forms of tip sheets:

- Recipes in a grocery store
- Recommendations and explanations in a wine merchant's
- Hi-fi reviews in an electrical retailer
- Home projects in a DIY store
- Album reviews in a music shop

7—Loyalty programs

I don't believe that customers are ever loyal to the over-hyped special offers, magazines, or bits of tinsel that most loyalty programs consist of. In my wallet is a Nectar Card, a Tesco Club Card, and an HMV Card. However, I'll happily spend money in Asda, buy songs from iTunes, or get a quart of milk from Mehmet's round the corner. I'm not loyal even though I am in the loyalty program. Neither am I alone in that response, but then, I think most of us understand that those schemes are really about data for benefits and we use them accordingly.

The kind of loyalty programs that work in more immediate ways are usually much simpler. Maybe a coffee shop gives you a little card that they stamp each time you visit, and that entitles you to your sixth coffee free. Or a pizza company offers a loyalty bonus that allows you to get any pizza you want for free if you have saved up four receipts from previous orders. Those kind of loyalty programs are unobtrusive and relatively low-cost and customers really like them.

8—Customer-get-customer

You could offer existing customers a gift, store coupons perhaps, if they recommend your store to a friend who then makes a purchase. All you need is a printed coupon, which you give to every customer with their receipt. The customer can fill in this coupon and give it to their friend. The friend brings in the coupon and it has the original customer's details still written on it so you can send them their reward.

If you are confident that people like you enough to recommend your store to friends, this is an effective way in which to make it easy for them to do exactly that.

9—Buy one, get one free (or two-for-one, three-for-two, etc.)

In the early 2000s, this was the UK's most popular promotional mechanic. If you can afford to run them, run them. Promote such offers heavily. Talk to your suppliers about funding either the offer, the advertising or both! If you can run a steady stream of good offers over a long period then this becomes even more effective because customers begin to pop in just to see what you've got on "special."

10—Sampler clubs

In some ways, this is an extension of the tip sheet idea but with a chance for customers to actually try the product out. You take a group of your customers and sign them up to a hands-on sampling club. In that hi-fi store example, you could hold regular demonstration evenings just for members, hold set-up lessons with an expert, make pre-ordering on limited edition products available to the members first, and run exclusive offers.

11—Percentage off

Exactly what it says: You run either a day where everything is, say 10% off, or you reduce a selection of lines for a limited period of time. It has become very hard to make such events really work though. The DIY stores especially have trained customers to think that anything less than a 25% discount isn't worth their while. Percentage-off promotions also make a negative statement about your usual prices.

12—Special nights

Inviting selected customers to join you in the store for an exclusive evening of demonstrations and offers can be very effective. Provide refreshments and snacks and if appropriate bring in a relevant speaker, and entertainment too. Try to pick a theme or a special reason for doing it because that can help you to more effectively promote the night. A sports shop, for example, could invite customers in to celebrate the England Football Manager's birthday. It's frivolous, sure, but gives you a hook too. This is another one that can get you coverage in the local paper.

13—Surveys

You should be asking customers for their views anyway but surveys can also be used as promotional tools. Create a survey and then mail it to members of your database. Include a "thank you" voucher for a discount in store. It reminds customers you are there, it tells them customer satisfaction is important to you, and it gives them a reason to come and shop with you.

14—Celebrity visit

Getting a celebrity into your store for a PA (public appearance) can be fantastic for generating traffic. They are not always as expensive as you might think either; TV actors, especially if they live locally, can be a bargain! You can find the contact details of almost all British-based actors in a book called *Spotlight*. Your town library will have a copy. Make sure you tell customers and the local paper that this is happening.

15 Book signings

You don't have to be a bookshop to hold book signings. A fishing tackle shop can get just as much benefit from having the captain of the British

Course Fishing Team in to sign his new book. In fact, it's sometimes a good way for a non-bookseller to get a celebrity in without having to pay them. Heavily promoting the event is key to making a book signing really work for you.

16—Lunch at the store

People are so busy today that lunchtime often becomes a trade-off between eating and shopping. One idea is to help your customers to do both. Think about putting on a simple open-packaged lunch for every customer who visits you on one day or one week of lunchtimes. Obviously it's worth avoiding greasy or staining food. Leafleting local offices is the best way to promote these events. Word is that they are really very effective at getting new people into your store.

17—Seminars, "how-tos," and in-store events

Absolutely essential, whatever your business. Get local traders, designers and even manufacturers" reps in to show off your products and show what to do with them. Construct a series of seminars, "how-tos," and in-store events and then give every customer a calendar with these marked on it. Seminars attract customers and they help customers to decide to spend more money. "How-to" demonstrations and events such as fashion shows bring theater and drama into your store. That excites customers and helps to make their experience of your store a much more enjoyable and interesting one.

> **Seminars attract customers and they help customers to decide to spend more money.**

18—Meeting place

If you have a training room or large office that is not fully utilized consider offering it to local businesses as an outside meeting space. This creates massive goodwill and hardly anyone currently does it, which will mean you will stand out. Maybe invest in a coffee maker and a lick of paint to make the place attractive. Check your insurance terms just in case.

19—Charity giving

An honest charity promotion is a winner in many sectors. Usual format would be to partner with a particular charity and then agree to donate a stated percentage of profits earned during a specific special charity day.

20—Local radio outside broadcasts

If you have got the space offer to let the local radio station come and do an OB (outside broadcast) from your parking lot or store. Make it coincide with a strong event and you'll find the stations quite interested in becoming involved.

21—Banded product

This is a cousin of the buy-one-get-one-free offers. Banding is usually applied to fast-moving lines and means either attaching a different product to another for free, or putting two products together as a package deal. It's a good way to move a slower line out with a more popular one and to please the customer at the same time.

22—Discount off future purchase

I am a big fan of this technique, also sometimes called "delayed discount." Every customer buying on the promotional day gets a money-off voucher that they can use in the store on another day. Usually the value of the voucher depends on the value of the original cost, so a typical offer might look like this:

- Spend $20, get a $5 voucher off next purchase.
- Spend $50, get a $12 voucher.
- Spend $100, get a $30 voucher.

You can afford to be quite generous because a high proportion of the vouchers you give out will never be redeemed. Incidentally make sure that whatever you use is secure and that it has an expiration date and a thousandth of one cent cash equivalent mark on it.

Promote it on the day with lots of bold signs and make sure you have told all your database contacts to come visit. This promotion type makes a great story for adising too.

23—Gift certificate promotions

Very similar to the discount-off-future-purchase offer except redeemed using normal store gift certificates, which can be used at any time. Customers treat gift certificates more like money, so redemption rates, and cost, will be much higher.

24—Buy now, pay later

A credit-based promotion. Very popular among big-ticket retailers because it enables customers to fulfill tomorrow's desires today! Actually they are a good deal for both shopper and retailer. These promotions don't carry perhaps the same excitement and call to action that they once did, though. Customers are used to seeing them now. Like the store card I'll mention in a bit, be careful to make this a good, honest offer rather than something that ties people in debt they can't cope with.

25—Interest-free credit

A very powerful promotion that enables customers to buy your product and pay for it in installments without them incurring any credit interest. Various deals are available to suit independent retailers and are worth serious consideration if you are aiming to move big-ticket items. Same considerations as in number 24 apply.

26—Store card

Store cards earn us retailers a lot of money, and they can be very convenient for some customers. I struggle with store cards though from an ethical standpoint. This is a very expensive form of credit with interest rates that are way above those for ordinary credit cards or for personal loans. Lots of good ordinary people, our customers, get caught up with by store cards and they run up huge debts with awful consequences. Retail is a people business—I don't believe we should be responsible for making anyone's life more difficult. So for that reason I cannot recommend running a store card.

27—Time-limited

At 4:00 p.m. all bread rolls free with soup for half an hour. Every Monday shoes are 20% off. On the hour, every hour, this Saturday we will offer a different item in limited stock at a crazy price. Great for creating instant interest and PR. In the last example, if the stock is too limited then you do risk annoying customers. Amazon.co.uk's 2010 "Black Friday" promotion of this type generated masses of bad press as offers sold out fast, often in under a second.

28—Bargains (price promotions)

And finally, the most powerful promotion of all: the humble bargain. Customers love bargains—so much so that I have filled this book with thoughts on how to get hold of, promote, and sell bargains in your store. Scour your price lists, badger your suppliers, pester the marketing team, gather up end of lines or last season's stock, and go mental for your customers. Bargains bring people in: They make them spend more and they bring them back again.

Bargains bring people in: They make them spend more and they bring them back again.

Table 11.1. Promotions and the rules of performance improvement at a glance

The scale runs 0 to 10 0 = No effect 5 = Neutral effect 10 = Very powerful effect	1 Sell to new customers	2 Sell more in each transaction	3 Persuade existing customers to return to your store more often	4 Improve margin by cutting overheads and improving sales quality
1 Joint activity	7	3	1	8
2 Displays in empty stores	5	0	5	8
3 Sponsorship and community events	4	0	10	4
4 Ads in changing rooms	0	10	6	6
5 Children's competitions	0	5	7	5

6 Tip sheets	8	6	8	9
7 Loyalty programs	0	5	10	3
8 Customer-get-customer	8	5	6	5
9 Buy one, get one free	8	7	10	2
10 Sampler clubs	1	5	10	7
11 Percentage off	6	7	6	3
12 Special nights	6	7	7	5
13 Surveys	6	0	8	6
14 Celebrity visit	10	0 or 10*	8	2
15 Book signings	8	0 or 10*	8	8
16 Lunch at the store	7	0	8	5
17 Seminars and "how-to" events	8	10	10	6
18 Meeting place	7	0	8	6
19 Charity giving	6	0	6	3
20 Local radio outside broadcasts	6	0	6	8
21 Banded product	8	5	8	7
22 Discount off future purchase	7	7	10	5
23 Gift certificate promotions	8	5	10	5
24 Buy now, pay later	7	5	7	4
25 Interest-free credit	8	6	8	5
26 Store card	2	8	7	10
27 Time-limited	10	4	4	1
28 Bargains	10	10	10	5

* *A celebrity or author who is expert in the same field as the store can lead customers into buying all sorts of extras to go with a base purchase. However, a non-related one can't!*

Promotions planner

Putting together a promotions planner is simple but essential—you need to know when you're doing things and more importantly why you're doing them.

1. Start with 12 sheets of A4, one for each month of the year.

2. Write in all the things you can predict will be happening, for example a January Sale.

3. Then write down all the predictable quiet times for your business—summer vacations might be one.

4. Then write in all the predictable mad times such as Christmas.

5. Add any product launches that you know of.

6. Write in any major events that could offer some good promotion links, the Olympics or a blockbuster movie perhaps.

7. Now you will have a good idea where you have either dead zones to fill or crazy times to either avoid or strengthen, and you can see where some themed promotions might work well.

Choosing the right promotions is an art, but this information can really help you. For example, if your business is quiet during August because of summer vacations and most people being away, it might be sensible then to run promotions that maximize transaction values—pull more cash in from the few customers you do have at that time.

You can easily use a form of these planners to impress your potential new bosses at interviews too.

Chapter Twelve. Marketing for real people

> *Tell me what it is, why I'd want one, and how to get it. That's all I give a damn about. If you can do that in a humorous, dramatic, or otherwise attention-grabbing way then, fine, knock yourself out. Please don't talk to me in Latin, use obtuse images, or hit me with stuff that goes way over my head because I just don't care enough about you or your product to bother trying to understand your clever rubbish.*

In that one paragraph, you have all the rules of advertising you will ever need. Be clear, tell people what the benefit to them is, and then make it very easy for them to buy from you. Ad agencies argue that advertising is about building brands too. There is truth in this but, frankly, brand is built more powerfully by your shop, your people in it, and your store culture. Slick eye-candy advertising is simply not important.

Basic brands such as easyJet and Poundland tell you what they are for, why you would want to use them, and how to do business with them. Both those brands are sales heroes. Both are never going to win awards for the glossiness of their advertising. On the other hand, IKEA and Sainsbury's do the same thing but with a bigger budget, and arguably greater creative finesse, but to the same effect.

Advertising made simple

Media commentator Charlie Brooker wrote in his *Guardian* blog:

> *Marketing is the art of associating products with ideas to bamboozle consumers. People in marketing often talk about the "personality" of a given product. A biscuit might be "reassuring and sensual"; a brand of shoe may exhibit "anarchic yet inquisitive" tendencies. Marketers have built their worldview on such thinking, despite it being precisely the sort of babble a madman might come up with following years alone in an isolated cottage, during which time he falls in love with a fork and decides the lightbulbs are conspiring against him.*

And, of course, he's right.

Beauty has its place

There is space for the beautiful—those breathtaking ads that force their way into your awareness. But these are very much the exception that rather proves the rule: You remember these because they are exceptional. Orange, the mobile phone network, has built a hugely successful brand without ever showing a picture of a telephone in its advertising (there was one, once, but Motorola was paying and forced the issue, but even then the phone featured was only shown as an x-ray image). You might think this goes against the simple doctrine I've outlined here. It doesn't. Orange's ads always tell you what they are for (mobile communications), they always focus on one clearly defined benefit at a time (say the joy of swapping pictures on a mobile), and then they put a great big phone number up on screen and suggest interested shoppers might like to call that to become an Orange customer.

Marketing things to make and do

Marketing is not a mythical black art; it is nothing more, or less, than a common sense framework: A framework into which ads and promotions can be fitted. Marketing theory is actually very simple. The skill, especially in the case of retail, is not in cleverly executing the practice of marketing but rather it is in trusting your gut feel to keep things simple. Marketing is about understanding who your customers are, where they can be found, what they want, and how much they will pay to satisfy those wants. That's really kind of it.

This sets up a series of questions. Who are we selling to? How do we tell them about our product? What will they pay for it? Notice how these questions form a chain? The answer to the first informs the second which in turn sets up the third. Answering these questions can help you to make better decisions on promotions and on advertising.

Questions chain

1. Who wants to shop at a store like mine?
2. What is it they like about us?
3. Which products excite them?
4. What promotions do they like?

5. Where can I find these people?
6. What should I tell them?

You might want to go through these questions in a team meeting. Try to cover four or five main customer types separately. Each customer type looked at will create a slightly different thread. Use what you learn to select target audiences and to select the promotions you would like to put before them. The following pages list some of your options for reaching those audiences.

Reaching customers—using recent technology

So you've worked out what you want to say and to whom; the next step is to choose your medium, or mix of media to reach them. The web has become an incredibly cost-effective option—sometimes costing you little more than time. You need to exploit these online communication options fully. So let's start with those:

Facebook

Get a company page set-up, use it to talk about the store, great products, promotions, and anything else that you think your customers will be interested in but that is also relevant to what you sell. Make the page look good, research it by looking at pages of retail businesses you know and respect—look at your own Facebook friends and take note of the company pages they've "liked."

Be prepared to take feedback directly on the page; it might hurt when that feedback is negative but it's important. The great thing about gathering feedback through Facebook and Twitter is that you tend to hear about problems early and so you have an early opportunity to solve them—and to show publicly that you have listened and dealt with an issue.

Twitter

Twitter can be daunting to the uninitiated—it looks like an absolute word-storm, but if thousands of other people can work it out, so can you. The best way to learn Twitter is to set up a personal account for yourself and, well, use it for a bit. Get to know the foibles and etiquette that way, without risking the store's reputation.

Once you're comfortable, set up an account for the store. Look at other popular retail brands on Twitter and see if you can work out what links them. You'll find the great ones tend to have a character to them: They transcend bland corporatism and feature an interesting mix of celebration of great product, news, comments, and tips.

Foursquare

This is one of the leaders in what are called "location-aware social games." It's similar in some ways to the "places" feature on Facebook but is much more flexible. In short: Members use their smartphones to tag whatever location they are in at the actual time they are in it. So a customer can be standing in your store and use Foursquare to tell all their friends they're there. Why would anyone bother to do that? It's a good question—tools such as Foursquare might fail to persist but, so far, investors and users are backing them heavily. What it enables is for individual stores to add their details and reward members for visiting the store: You can link promotions and all sorts to your site. It's free to do and Wetherspoons and Domino's have been among the first in the UK to realize the commercial potential.

Amazon and eBay

For most store types, even if you have your own transactional website, it's well worth also selling through Amazon Marketplace and eBay Stores. Both sites have astonishing reach and it doesn't require a great deal of effort to list your kit on their sites.

Smartphone and Tablet apps

Bit more involved this one, in terms of both cost and commitment; but for many stores, a smartphone app is a winner—it offers the opportunity to become integrated into customers" regular routines, which is so valuable. If you think it's worth doing then find yourself an expert—there are a number of app-developer matchmaking sites on the web.

YouTube/Vimeo

Make videos of staff celebrating product. Honest reviews, useful close-ups, relevant trivia—link to them from your website and Facebook page. Easy to do, customers love them, and they help build your character. Works best if the customer is then able to buy the featured product from you online but still worth doing if they can't.

Your own website

Now, if you're an Internet store then of course you've got this covered. But as I said at the start of the book, the disciplines of retail extend to whatever channel you sell through, and if you're a bricks-and-mortar store then you almost certainly need a transactional website too—one that represents you well and that gives customers another way in which to do business with you. Don't take this lightly—it's not good enough to post a half-assed webpage written by your weird cousin Tim. You must consider how the site reflects on your business: You need to think about how to get stock and POS systems working with the site and you need to think about how you are going to fulfill orders. None of these are trivial concerns. The same care and investment you made on your physical shop needs to be clear in your website too.

Case study 12.1. Smart Retail: ASOS takes it on the chin

ASOS.com is a brilliant retailer using the best of technology to stay crested right on top of the fashion waves. They also use great online tools to communicate with and learn from their customers; www.asosreviews.com is astonishingly clever: It aggregates ASOS mentions on Twitter and YouTube and allocates a "happy" or "sad" to the Tweets (yeah, that's what individual messages on Twitter are called, I know, I know)—those happies and sads are then used to generate a dynamic meter at the top of the page showing how happy, or otherwise, ASOS customers are. The feedback isn't costing ASOS much more than the cost of maintaining the website and it gives them immediate insight into how customers feel about them.

Reaching customers—traditional methods

Radio

Radio is a great medium. It's very cost-effective and you can paint any image you want with words. Often big and bold words work best. Plenty of stations will help you to create your ad. Each station will also be able to give you profiles of their listeners for each of their shows. This means you can choose to advertise only on those stations, and only during those shows, listened to by people who might actually want to shop with you.

There are also lots of resources available for do-it-yourself radio advertisers, and that helps makes the medium very attractive.

The Radio Advertising Bureau exists "to guide national advertisers and their agencies toward effective advertising on Commercial Radio." They won't be able to advise you directly but their website is a fantastic mine of resources. Click on the truly heroic radio advert archive; all the inspiration you could ever want is there. The RAB's web address is www.rab.co.uk.

TV

TV is undoubtedly a powerful advertising channel, but it's expensive and it suffers a tendency to be somewhat scattergun in effect. Unless you can afford to advertise on TV lots then it's unlikely that you will reach enough of your potential customers to make this medium pay. The Advertising Association, www.adassoc.org.uk, has some useful research on its site that you might want to take a look at if you're considering TV. The channels themselves do offer advice and assistance to smaller advertisers, so it is worth asking about those services. Ask too about related discounted advertising packages.

Print

Clear bold messages work best, and buy the largest portrait spot you can afford. Don't do national if you are local. Don't be seduced by glamorous graphics. A bold typographical treatment highlighting a great promotion accompanied by a shot of your product is more effective. And the old maxim of "less is more" absolutely applies.

Posters

Traditional large-format posters can act like a second storefront, but they are expensive. These days the sites available for placing an ad are almost without limit: everything from posters in bar bathrooms to the handles of gas pumps. JCDecaux is the largest independent outdoor media owner in the UK and worth talking to if you are interested in exploring posters. Their web address is www.jcdecaux.co.uk.

Catalogs

A catalog can be a single flyer or a 32-page color extravaganza. Never underestimate the power of catalogs. They provide you with huge scope to tell people about your fantastic deals and at the same time talk about why your store is a nice place to visit and to do business with. George Whalin, one of America's most effective retail consultants, suggests that "if you have one item and just one page, that's a catalog, start from there and build it over time."

Never underestimate the power of catalogs.

Catalogs are exciting because there is so much you can do with them. You can hand them out as flyers, you can put them into the local free papers, you can mail them to your customer database, and you can give them out to visitors to your store.

Consider how you might distribute your catalog. Piles in the store are fine; a stand outside is better. Having a colleague hand them out in the parking lot or up and down the street is always worth doing. Paying a delivery person to distribute catalogs door-to-door is useful too. Of course, this is also dependent on the type of catalog you have gone for. If yours is thick, heavy, and expensive then distribution will have to be more limited. Similarly, if you know that your customer falls into a very narrow interest group then you should consider distributing your catalog directly to them —a baby goods store might want to have its catalog in the waiting area of the local maternity ward for example.

Easy ABC database marketing

Every store can, and must, build a customer database. Used sensibly they drive customers into your store like no other advertising tool can. You don't need complex software to run them: Any database program such as Microsoft's Access will do. You can even get by fine using just the contacts bit of the free program Outlook Express (again available from Microsoft) or on Google Mail. A card index will suffice in high-ticket selling situations where you are servicing a small number of prospect customers.

The best email marketing

How to do email database marketing really well

1. Always get permission; customers hate email spam and junk mail—it irritates them. They respond much better to expected messages, so

long as these are relevant.

2. Make sure you actually have something to say, for example:

- Exclusive offer
- Hard-to-get item here in stock now
- End-of-line special bargain
- One-off event
- Exciting new line due in on date x

3. Start the email with all your headings—just titles with no additional body text, for example:

- Buy-one-get-one-free on all paperback fiction this weekend only
- New Dan Brown arrives in-store here on June 11—reserve your copy now
- David Beckham here signing his new autobiography on July 1

4. Remember: Time limits on offers always help to drive customers into action.

5. Then in the body of the email, below these headlines, you can expand on each subject. Try to keep words to a minimum: Just tell the story and then get out.

- Buy one-get-one-free on all paperback fiction this weekend only.
- Choose any two from our huge range of great titles and you get the cheapest free; that includes all of our current best-sellers as well as the full selection of classic fiction. Saturday and Sunday only—we're looking forward to seeing you!

6. Remember: Close with details of your store including telephone numbers and opening times.

7. Sign it! Customers appreciate a personal touch.

8. Remember the rules: "Tell me what it is, tell me why I might want one, tell me how to get it."

The Data Protection Act

If you are going to hold customers" data in a database, you must comply with the Data Protection Act 1998. Most retailers have notified that they wish to be registered under the Act. If you have done so, you are likely to be entitled to also use the data you hold for database marketing purposes. You must check though before moving on. If you are in a chain-store branch, the company may well have notified too but it can be tricky to find out. If you are lucky, the marketing team will find out for you and will help you with the small number of compliance issues involved. If you are less lucky and the marketing team gets all sloppy, then it may be worth considering notifying in the name of your individual store instead. Lots of clear advice on the whole process can be found at www.dataprotection.gov.uk/dpr/dpdoc.nsf.

One of the key aspects of the Data Protection Act is permission. When you ask for someone's details, you must tell them that you will be holding these details in a database. You must also get their permission to send them things. Check on the www.dataprotection.gov.uk site for the latest advice on what to say and how to say it. Getting permission is good practice anyway—there is little point in taking someone's address only to send them things they don't want to see.

Postcards

Email is the nice, easy, and cheap way to begin database marketing. There is an excellent print alternative, though, that is still cost-effective, especially as a tool for announcing big promotions or sales or as invites to store events. Stores in the U.S. use postcard marketing campaigns very effectively.

Email is the nice, easy, and cheap way to begin database marketing.

The usual format is a large postcard where one side is given over to a full-color image and the other side is split into two halves. One of those halves is a space to put an address label and a stamp. The other half will then usually carry a coupon of some sort.

Local printers are plentiful, so get three price quotes and ask to see samples. Get a fixed-cost quote and some examples. Make sure you and the printer both understand exactly what it is that you want. Short print runs are ideal as this lets you over time send lots of different messages to individual targeted groups of customers.

Selecting prospects to send your cards to needs a bit of thought. You want to avoid wastage and to maximize your chances of success. All current and recent customers who could conceivably need to visit you again should be targeted. Think carefully, though: Writing to someone who bought a sofa from you last week to tell them you are offering 10% off sofas this week is always going to be a bad idea.

Think about your customers; do groups of them have particular things in common? Do you find yourself selling to people who all live in certain areas of town? Are your products related to their hobbies, or to their work? Are there any age groups that you seem to attract disproportionately? Looking at these factors will help you to identify other groups of people who are not your customers yet who are very much like your existing ones. These prospect groups are almost certainly worth talking to, and a postcard offer might just do the trick.

Case study 12.2. Smart Retail: Postcards and the 20%

"Whenever we run a campaign and promote it using postcards, our sales increase by 20%." Andrea Cohen runs young retail business number 35, based in London (see p. 146). She's been successfully trading two stores for some time now and is all set for expanding the brand as a chain. Like a lot of new retailers, number 35 began life located slightly off-pitch, in this case a secondary street off Highgate's main shopping area. That meant the store had to work harder to gain a foothold in customers" minds. Number 35 sells a unique product, its own collection of women's clothes tailored to modern shapes—apparently women are that bit more curved in today than they were when most clothes brands cut their patterns. The clothes are great and customer feedback is stunning—for some, number 35's clothes are the answer to a heart-felt prayer. See for yourself at www.no35.co.uk.

The other challenge Andrea has is that these are clothes made to fit the real shape of modern women—some customers confuse that with "outsize" when actually the range focuses on sizes 8 to 16. So, normal sizes but cut to fit really well. It's a message that needs that tiny bit of explanation and postcard promotions fit the bill nicely. So Andrea's technique has been to create a year's worth of promotions and events and then to drop postcards, via a local newspaper, to support them. The effect is interesting—although often the promotional items themselves only sell in low numbers, reminding customers that the store exists and telling them what the big idea is has the effect of raising overall revenue significantly after each campaign.

Andrea and the first number 35 store.

Source: Andrea Cohen

Keeping track—measurement

Any direct activity needs to be made measurable. You can do this easily by adding coded coupons to printed materials, and by asking email customers to quote a reference code when they come in. It doesn't matter if the customer cannot remember the code, just that they tell you they want to take advantage of an offer you emailed to them.

Set up a basic Microsoft Excel spreadsheet to make tracking easy. Literally, just a few columns for the dates and then a few rows for the various promotions you are running. Then record the number of people responding, the total value of their purchases, and the margin earned on each transaction. At the end of each week, work out the total profit accounted for by your promotions. Then deduct from that the cost of the activity you ran. So long as you capture every relevant sale, then this is a crude but perfectly acceptable way to track how well each promotion is working for you.

You also need to take account of the discounts you gave to normal customers: People who would have bought from you regardless of the promotion. That is quite tricky and will often be down to your instinctive judgement. All the same, it is important because this number helps you to realistically appraise returns from your efforts.

Part Four—Store: *Make it brilliant and they will spend.*

That's a supermarket! Austria's MPREIS chain uses hot architects to design every store—each is then unique. They use the very fabric of the store to differentiate their business.

Source: MPREIS/Thomas Jantscher

The Fundamentals

When customers wander around your store, or look into its windows, they are subconsciously demanding "INSPIRE ME! MAKE ME WANT TO LOOK AT SOMETHING!" If there is a trick to retailing, it's in understanding how to manage that demand to your advantage. The principal tools you have to do that with are:

- Your external communications
- Windows
- Use of retail theater
- Discovery

Those tools will be wielded passively by the store and actively by you and the team. I’m going to talk about discovery first because it both informs everything else but also because it’s the one of those four that was most likely to have made you say “you what?” Let’s turn a bit of jargon into some practical good stuff then ...

Chapter Thirteen. Discovery!

All shopping is about discovery. Even the customer who is certain they just want Heinz tomato ketchup week-in and week-out is disruptable by a good promotion or interesting new alternative—and they delight in it, even if that new discovery turns out to be disappointing. The point at which discovery is made may shift, but no shopping trip is ever made without it. Our role as retailers is to work out how to make discovery work for us to generate a sale.

Point of discovery

Sometimes the discovery will be made before leaving the house: Research having been done online, in magazines, and among friends. That certainly applies to a more significant degree on big-ticket items but even then, having spent years watching actual customer behavior in-store, I suspect not as often as we might assume. Indeed, McKinsey & Company conducted research in 2010 that suggests 40% of customers who leave home knowing what they want, having extensively researched it and used all the tools online to help with that, are still "open to persuasion" once they arrive at the store.

Discovery makes people touch things. Make a customer say "wow" in your store and you've got a sale. Discovery is not just about showing customers surprising things; it is the complete process of helping to guide them to the highlights of your range, to the great promotions, to using great service to lead customers to the right choices and to structuring whole formats to provide moments of discovery throughout the customer journey.

Make a customer say "wow" in your store and you've got a sale.

If you're managing a store within a chain, it's well worth picking up the principles of discovery and making them squeeze your store's merchandising to the limits. Try stuff and communicate back everything that works—use this as an opportunity to influence the direction of the business and to raise your personal profile. If, dear reader, you're one of those lucky people in a position to create, adapt, or relaunch a format then I urge you to put discovery at the center of your thinking. Doing so will increase footfall, increase conversion, and help your team to maximize average transaction values.

Benefits of building formats around discovery

Footfall

A reputation as a store that can meet customers" subconscious desire for discovery will drive your footfall. Customers tend to visit stores that meet their needs—a need for inspiration, surprise, and ideas is satisfied in a store that has built discovery into its format and merchandising. At its simplest, it's about making yours a store that people out on a shopping trip feel like they want to drop into "just because."

Conversion rate

This is a no-brainer: If you can actively get more of the best parts of your range into the minds and hands of customers as they browse your store then the more often you will convert those browsers into buyers.

Average transaction value

Discovery is also about the total sale—everything a customer might need to get the best out of their purchase. So, that might be accessories with clothes, insurance with a phone, sauces with the pasta. It's also about creating such a credible service-position that your people are better able to give customers the right advice on a total package—especially important in big-ticket situations.

Linking it all together

This is all good simple stuff still—the only hard part of all this is in ensuring that there is consistency along through your Big Idea, mission, values, and into the way in which you tackle discovery. It's a little bit chicken-and-egg, but faced with a blank sheet of paper, I would be making sure that my Big Idea was something that can be delivered with the techniques of discovery. Mission and values, what the business exists to do, and the spirit in which it does it should then nicely slot into that.

The different types of discovery

There are broadly four approaches to tackling discovery: promotion-led, service-led, product-led, and format-led. A small handful of retailers—Lush, Pret A Manger, and Stew Leonard's (see later) included—take advantage of discovery across all four approaches and others combine two, sometimes three. Where I've listed a retailer as a great exponent of a particular approach, it's because that's the one that's at the heart of what they do best.

Traditional promotion-led discovery

This is the most common approach, and if you're able to offer great deals, it's very powerful. The availability of those deals is only half the story though—really high-quality merchandising is the critical component: getting your deals, and the benefits of them, into customers" faces.

Be a kid again—get enthused by discovery.

Source: Koworld

Toolkit

- Creative promotions
- Variety of promotions
- A near-guarantee that there will be a deal for every customer, every time
- Consistent low prices on core products
- A retail type that encourages regular revisit
- Celebration of the offers by putting them in good locations and regular inclusion of the "good stuff"
- Store layout that includes plenty of hot spots
- Planned customer journey that leads visitors between those hot spots

Tesco (UK)

The international blueprint for promotion-led discovery: Go walk their floor as an observer and learn how to select, place, and promote offers brilliantly.

Aldi (Germany)

While I'm not entirely keen on the management structures within Aldi stores (managers have very little say in the basic running of their stores), it is understandable and contributes to an interesting twist on the discount supermarket. Aldi aren't just about being cheap—an important component in the store's reputation is the quality of product it sells, even if that product is a special buy and discounted down to the ground. By restricting the variety of options per line (fewer suppliers, far fewer lines overall, and so much larger product orders and potential for significant discounts as a result), standardizing everything to within an inch of its life, spending less on fixtures, and requiring less space than a traditional supermarket they carve themselves a price-led position relative to those supermarkets. But by maintaining product quality, they also then differentiate themselves from the Lidls and Nettos and are able to attract more middle-class spend.

B&Q (UK)

Always good at promotional deals but what puts them into this premier division of promotion-led discovery is their approach to pricing core project items. Let's take decking—the deck planks themselves are almost priced to give way, a few pounds only for each 3m length: A wandering customer will do their initial value calculation—the one done in your head when you've actually come in for something else—based on the cost of the decking planks alone. That makes the cost of the project appear to be very low. It is only then when adding the cost of frame timbers, posts, screws, joints, and finishes that the true project cost emerges. By this point, it's a bit academic because you've already pictured yourself out on the deck enjoying a summer barbecue.

Boots (UK)

Poor old Boots comes in for a lot of stick but I believe it's a fantastic retailer. Boots is really a dreary old drug store, yet customers like to drop in for treats, bargains, and gifts—that's a stunning leap out from their core purpose. One of the things Boots does really well, and that's helped them to make that profitable leap, is promotions—they practically own the concept of three-for-two offers and are very good at communicating these offers, displaying them and refreshing them.

Service-led discovery

This is all about using your people to provide customers with a fantastic discovery experience. We're talking motivated, well-trained, professional teams encouraged to dedicate themselves to providing the best honest advice, suggestions, and after-sales service. Keys to achieving this are all written up in the "Team" section of this book—go do that stuff. Your customers will love you for it—love you with their wallets.

Toolkit

- Make it clear that you trust your team with your customers, that your number one priority is the satisfaction of both.
- Treat your people with respect.
- Offer them great training and lots of it.
- Allow and enable your people to experience the products you sell: Give them big staff discounts and operate loan programs for new products.
- Get your people involved in the supply chain: Allow them to see how things are sourced and made—doing so will help them to enthuse about your products and, more importantly, to identify what makes your stuff great.
- Structure your reward program such that it is biased toward customer satisfaction and away from sales volumes.
- Put in place a recognition program and use it to say "thank you" each and every time you see your people go the extra mile for customers.
- Value knowledge highly but also encourage your team to always be open-minded and make sure they understand that every customer has their own set of needs.
- Stress the value of listening to what customers tell us they need and show how this is more important than telling customers what we assume they should have.

The Container Store (U.S.)

They are brilliant at this. The Container Store provides phenomenal levels of training and wonderful employment experiences and works incredibly hard to build stable customer-focused teams. The result is a business that punches well above its weight and that enjoys a near fanatical level of customer support. One of my favorite retailers anywhere in the world. They provide an average of 210 hours/year staff training, great staff discounts, and have featured in *Fortune*'s 100 Best Places to Work in America list for 11 years straight.

Carphone Warehouse (UK)

I get a bit of stick for holding up CPW as an example of great retailing so often, but I'm not going to apologize for that. When a retailer is this good, and for all the right reasons, then they need to be singled out. CPW is all about service-led discovery: Customers walk into these stores often with nothing more than the notion that they want a new mobile phone. They do so, overwhelmingly, with the prior knowledge that the CPW assistant will honestly, and accurately, discover the right answers to that vague need.

John Lewis Partnership (UK)

A byword for honesty, quality, and great customer care in the UK. Customers are drawn to John Lewis because they feel sure that the team there will help them to discover the right stuff for them. JLP has been especially good at doing this in high-ticket electronics and computing—areas perhaps not traditionally associated with the store but that, nonetheless, customers feel good about letting John Lewis guide them through.

Product-led discovery

Where the product is the star: Innovation, fashion, trends, great iconic design are the critical factors in stores where the product leads discovery. So, we're talking about the kinds of stores that are great at buying and merchandising and at refreshing the ranges. But it's more than that—it's critical that the top team in this sort of store have an innate understanding of the principles and power of design and that they have a sense for the zeitgeist among their target customer groups. A lot of expensive single-store businesses start up as retail businesses in this category and an awful lot of them fail—they fail because the owners mistake "knowing what I like" with "knowing what customers want." When done right, though, the approach can be incredibly successful—the very best fashion and furnishings stores are great examples of product-led discovery shops.

Toolkit

- It’s all about your buying: Spotting exceptional products at the right price points.
- Hang on, maybe it’s all about your merchandising: Showing off those products in inspirational settings?
- Study all the sources of information on trends you can find: Subscribe to trade-specific designers” magazines such as *Frame* and *Creative Design*.
- Watch what goes on in competitors” stores very closely for clues on trends.
- Talk to customers, get feedback all the time.
- Ask customers what’s hot, encourage them to make recommendations on new finds and new directions.
- Investigate design leads.
- Ensure key products are given room to breathe and are displayed to their absolute best.
- Be prepared to drop poor-performing lines early (or at least to change emphasis if you can).
- Refresh ranges often but show respect for important classic lines too.
- Do not presume to dictate taste but do try hard to influence it.

ASOS (UK)

The store launched in 2000 with the name “As Seen On Screen”—the Big Idea was to sell clothes seen on celebs and actors on TV and in the movies. A great niche proposition. The management team there quickly outgrew that space as they discovered that they were good at tracking screen-seen stuff but even better at understanding and stocking up-to-date fashions in general. That awesome instinct for fashion, and a focused concentration on the 16–34 age range, has driven product-led discovery and created a store that customers love to regularly check out.

Habitat (UK)

It's in a right old state at the moment, but there are lessons from Habitat's history that are worth looking at here. From Sir Terence Conran's early days creating the business, Habitat was at the forefront of shaping British living. Habitat sold the duvet to a country raised under scratchy sheets and they did it by explaining to us that the duvet represented freedom from domestic chores. They made every 1980s kitchen complete by selling each and every last man, woman, and child on the planet a bright red, yellow, blue or green teapot; they helped my Mom and Dad feel comfortable enough to throw dinner parties by suggesting that a chicken brick, or a pressure cooker, was the secret to successful entertaining. Mom and Dad divorced in 1988, so I'm blaming Habitat for that too.

Zara (Spain)

Zara is built on an incredibly efficient supply chain that enables it to bring new items into stores twice a week, every week. That's an astonishing commitment to product-led discovery—they lead the fashion retail industry on logistics and are able to take an idea from initial design to retail rail faster than anybody else. It's obvious to see why customers might react positively to such fast change and ever-shifting variety.

Top Shop (UK)

No other fashion store anywhere in the world is as good as Top Shop currently is at product-led discovery. No young British woman, and no hip visitor to the UK, leaves Top Shop out of their shopping trip. The sheer weight of fantastic, right-on-the-money fashion that blitzes through the store and into customers' wardrobes is truly mind-boggling. As my earlier case study on them suggests, this is almost entirely down to Top Shop's commitment to stocking only stuff they love. Everything they sell works or it's dropped fast, ranges are refreshed at speed, one-offs come in and go out (and onto eBay) at the blink of an eye, and even the celebs like to say they've been in and raided Top Shop. The business is all about making customers feel the urge to come in as often as possible in a bid to discover the best new stuff before anyone else does.

Format-led discovery

There are a number of retailers who have based their entire Big Idea and format around discovery and paths to discovery. These are the stores you find full of handwritten notices recommending products. They are the ones in which you see little notes to you, the customer, all over the place that connect you with the products. Everything in the store is about making sure that you are made aware of how brilliant product X will be for you, how you will feel, what a difference this thing will make to your health, well-being, or lifestyle. That sounds a bit "ad-man" written down. It's worth saying that in order to properly convince the format must be honest, credible, and authentic too. Oh, and this is important: Format-led discovery only works if there is service-led discovery in place too.

Toolkit

- Create an authentic voice for the brand.
- Use your values to ensure that voice properly represents your Big Idea and mission.
- Create a compelling conversation throughout the customer journey: Make use of space on product, bags, shelf-edge, in changing rooms, on product cartons, walls, bags, editorial, at the cash register, and so on.
- Provide honest advice, from written communications through to staff advice.
- Celebrate the great products: Be enthusiastic, explain to customers why you think item X is so great.
- Constantly refresh displays.
- Get customers involved with recommendations.

- Make good use of customer advocacy: Make it easy for customers to tell others about your store and range.
- Remember that it's the conversation that's important.
- Make good use of seasonal and "occasion" events.

Apple Store (U.S.)

These iconic retail bases for Apple's products are entirely about discovery. They are built, from the ground up, around the notion of non-Apple people discovering that Apple meets their needs better and of dedicated Apple users discovering more that they can do with their Apple products. So you have every single part of the Apple range, in quantity, out on the shop-floor set up so customers can touch them, play with them, have fun with them, and discover new things with them. Then the Apple Genius team, extremely well-trained customer advisors, make themselves easily available to give advice, recommendations and solutions. In the early days, I wondered if the Apple Stores would turn out to be heavily subsidized brand promotion rather than profitable stores; the opposite is true—the stores are very profitable as well as being stunningly successful discovery zones for loyal and new Apple customers alike.

Target (U.S.)

The team here recognized that in order to beat Kmart and to avoid a Wal-Mart smothering, they would need to offer something different within the variety-store format—and they chose discovery. They did that by building the entire store around innovative displays, by bringing in young and hot designers, through a perfect collaboration with Martha Stewart, and by creating a much friendlier and more open atmosphere than is usual in this type of store. Indeed, Wal-Mart has even been forced into creating a sub-format to tackle Target on Target's ground: These slightly more-upmarket Wal-Marts drop the McDonald's narrow aisles and guns and replace them with better-quality fixtures, more space, and independent café concessions.

Pret A Manger (UK)

These sandwich shops do authentic conversation better than any other retailer in the world. Should you find yourself reading this book while sitting at one of Pret's stainless-steel counters, you would find that the coffee cup you're drinking from has a note on it that explains how Pret's coffee has come to taste as good as it does. That cup would explain too how Pret supports the grower of the beans your coffee was made from. You might then dab the corners of your mouth with a Pret napkin that tells you it's made from unbleached, recycled fibers and that explains why that's a good thing. This conversation Pret A Manger has with its customers is powerful and is about helping customers to discover a lunchtime option that meets a perceived deeper set of needs. There's a lot of research evidence which proves that human beings' sense of taste is affected by contextual information—telling somebody that they should expect to enjoy their sandwich more because it is fresh increases the likelihood that they will enjoy it more. You can use that in lots of ways in retail—we're generally really bad at communicating emotional or sensual information so directly to our customers.

Lush (UK)

The store you smell before you see it has format-led discovery pretty much sewn up. Everywhere you look there are "handwritten" (actually printed but made to look handwritten) signs full of humor and passion telling you why they love the stuff they love. Lush's discovery positioning was born out of a Big Idea that was genuinely new: to create cosmetics from pure fruit and vegetable ingredients with no link, at any stage, to animal testing. Instead of being terribly po-faced about that positioning, the team behind Lush chose instead to have fun. Stores are merchandised in a unique way that sits somewhere between authentic French market-stall, English jumble sale, and display stand at an expo—I like it a lot, it's all really easy for customers and staff to interact with the product and with each other.

Urban Outfitters (U.S.)

You'll notice that I categorize most fashion stores in the product-led discovery category. Urban Outfitters make the jump because of the innovative way they have constructed their display systems, the credible addition of non-clothes ranges and the considered inclusion of branded ranges. All displays at Urban Outfitters are mix-and-match—tables, shelves, and rails can be easily combined, moved and re-merchandised. This makes it easy for the team to constantly refresh the store and to use a form of convection to bring different items to the surface before allowing these to settle back into main stock as new items get pulled to the surface.

Case study 13.1. Exceptionally Smart Retail: Stew's not mad ...

Stew Leonard's is barking. Often literally. Oh, and it's baa'ing, moo'ing, and clucking too, much of the time. Stew's is a chain of just four stores in north-east USA that together take \$300,000,000 a year. They turn nearly four thousand dollars per square foot and that achieves revenue-per-employee above \$150,000. Staggering, stunning, mind-blowing numbers.

And what is Stew Leonard's?

A dairy store.

Yep. They sell a limited selection of 1,000 dairy and dairy-related products—albeit within massive mega-sites. Up to 125,000 customers each week. Those numbers are just unreal.

And although I suspect current boss Stew Leonard Jr. wouldn't call it by this name, discovery is what sits at the heart of the amazing performance of this business. The entire format is built around discovery: loads to see and do and a massive single aisle that snakes customers past every last part of the massive store. Promotion-led discovery is there in spades, and in massive volume. Product-led discovery too is important with, in particular, what they claim to be the freshest milk in North America—which they bottle on-site in a glassed-in lab visible to all customers. Service-led promotion is incredibly important too: the employment experience at Stew Leonard's is of a very high standard (and regularly recognized as such in *Fortune Magazine*'s "100 Best Companies to Work For" annual list).

The customer is king here but only because the staff are allowed to make it so. "You can't have a great place to shop, without first making it a great place to work"—that's a slogan you'll see written up in the store, but it's more than words—the management team deliver on that too.

Stew Leonard's give every employee a real say in how to best service customer needs. If an employee thinks that doing X is good for the one customer in front of them, they will get on and do it. If they think Y is good for all customers then they will suggest the business gets on and does that too. There is a great story Stew Jr. tells that illustrates this in action. He calls it the tuna fish story: "I unwrap one of our tuna fish sandwiches, and this package of mayonnaise rolls out. I figure the sandwich has enough mayo already. So I call Bill Hollis, my deli manager, and tell him 'get rid of the extra mayo, it's expensive.' So next week, I open a sandwich, the mayo rolls out again. I call Bill, and he says 'you gotta talk to Mary Ekstrand, she makes the sandwiches.' I call Mary, who says "Sorry, Stew, the customers want the extra mayo, so I'm packing it again.' You know my reaction? Bravo, Mary!"

Stew Jr. has a cheesy but perfect acronym that illustrates his management style nicely—STEW: Satisfy the customer; work together as a Team; strive for Excellence at everything you do; and get the customer to say WOW.

That "wow" thing is a foundation principle of all forms of discovery: It means customers have found stuff that meets that discovery need. The team have created what the *New York Times* calls “The Disneyland of Dairy Stores,” and it is—banjo-playing robot dogs sing “Dixie,” and animatronic milk cartons (The Farm Fresh Five) dance near a model cow that tells jokes when kids pull its bell. Staff dress as cows, ducks, chickens, and bananas while patroling the aisles, giving out free ice cream and helium balloons. Free food samples are everywhere and staff offer them accompanied by warm, genuine smiles. There are petting zoos, outdoor BBQs, beach grills, cafes, and singing broccoli and carrots. Shoppers don’t just come here to buy a quart of milk—they come for the experience. An experience built on discovery.

Thing is—this store might feel like it’s lots of things all just thrown together but that’s not really true. This is a place built by its people—those 125,000 customers come along each week because they like the products; sure, they come for the atmosphere, definitely, but mostly I suspect they come because the human experience at Stew Leonard’s makes them feel good. That it does so is down to the dedication, imagination, and vision not of just one man but of a whole motivated, passionate team.

Chapter Fourteen. The great big theater of shop

The Stew Leonard's case study featured some great big dripping chunks of retail theater—an idea that's so critical to creating great customer experiences. Theater. Hmm, we love a bit of Shakespeare and all that ... I'm not talking about that sort of theater. Well, I am actually, but not in the same way: retail theater is about animating the store, making it live and breathe. Telling stories with color, sound, movement, and even smells and tastes.

"What for?" is the reasonable question. The answer is: Bringing the store to life brings your customers to life too. Your biggest challenge is to get customers to pick up stuff and interact with it and with staff—get that happening and you sell more things. If that interaction is done inside a great, animated, and exciting store, then you get the Stew Leonard effect: A humble dairy becomes a sales machine and customers love it.

When I talked about customer experiences in the customer service quality bit earlier, this is the part I was building up to—the part where everything you are and do comes to life.

Us, the moles, and the bats

We have a challenge in-store: Human sight is really, really poor when compared to most other mammals'—in particular, our low-resolution eyes coupled to our face-pattern-recognizing and motion-obsessed brains make seeing static things difficult. It is physiologically hard for people to pick out one thing from another if those things are static: like, say, cans of food on a fixture or a row of TVs on display or books packed in on shelves.

Let me put on the lab coat and explain: What we think we see is actually the image after it's been messed around with by our brain. Our brain applies two visual processes in particular that are great for survival of the species but pointless for retailing. The first relates to faces: Our big juicy brains are constantly looking to recognize faces so we can either defend ourselves from a competitive human or mate with a willing one. So aggressively does our brain look for faces that it'll make them out of almost anything: patterns in wallpaper, shapes made by shadows, a gravy stain on a shirt. This process is exactly why people report seeing the face of Michael Jackson in slices of toast or dead relatives in the shape of clouds. The more challenging process is the one that refuses to concentrate on static things and instead scans peripheral vision for movement, because in the past, bigger things were often trying to eat us and they tended to do so successfully by sneaking up without being noticed until it was too late.

Let's talk about that in a retail situation: You'll have experienced what I'm about to describe—we all have. You're standing in the soup aisle in a supermarket facing the hundreds of cans of soup. You want chicken noodle and you're staring and staring but you just can't see the one you want. And then, suddenly, "BANG!" you finally spot the can and it's been right in front of you all the time. You didn't see it at first because your brain was paying attention to somebody on your left moving something down off the shelf, to a shopping cart being pushed along to your right, and to a sign moving in the air-conditioning breeze above you. You found the chicken noodle in the end because your brain kicked in a different process called "reading," forcing you to read labels, which is slower than looking for pictures and patterns.

Movement

Applying one part of retail theater can solve these issues at a stroke—picking stuff up, moving it around attracts customers" attention. You pick up a can of soup and wave it about and suddenly it's the easiest thing in the world to see—everyone in that aisle can pick it out. Now, maybe that's not practical in Tesco, but it is most everywhere else. Let me give you an example and a case study.

Impulse cakes

The example is one you can observe for yourself and it involves the express line in a typical urban supermarket. If you're there and you see a member of staff re-stocking the racks of small cakes and treats that are usually stationed at the point where the line-guide turns ... watch what happens ... of the next ten people in the line, eight of them will at least pick up a cake and of those most will buy it. Then contrast that with the rest of the time when the fixture isn't being re-stocked: You'll see maybe one in ten customers picking up a cake. I'm not exaggerating these numbers—observe it for yourself and think about an area of your store that might be boosted by movement, by taking something out of stasis and giving it energy.

Case study 14.1. Smart Retail: Kinetically charged books

A client of ours, a chain of bookstores, made one small change that boosted sales by up to 20% per store. And it was such a tiny change too. They had asked us to find a way to schedule shelf-stocking so that it could be done away from customers—the logic being "get the book cart off the shop floor before we get busy." I asked them why this was a problem and they reckoned that it looked scruffy stocking shelves and that "as soon as you put something on the shelf, a customer will take it off again."

Now then, I hope you're ahead of me right now—that client was seeing it as an unprofessional irritation, but you're already seeing an opportunity, aren't you? What was happening is that the books, which when static are nothing more than shapes with colors on them, had been given a boost of kinetic energy and customers were drawn to them. So, instead, we created a routine in which books would be shelved at the busiest periods, and we told staff that they were welcome to take all day to do it, provided the delay was because they were having conversations about books with customers who were drawn to the movement. And they did exactly this.

We even did things like taking all the books off one table, putting them on the floor near a different table, then taking the books off the second table and putting them on the first, finishing the job by picking up the original books off the floor and putting them on the now-clear second table. Of course, we let the staff in on the gag—explaining that what looked like a nonsense job was actually generating movement and attracting customers. They loved it because it seemed to break a small barrier between them and customers—it seemed easier to start conversations as this process went on.

All of the above is retail theater: movement, visual interest. Go to a good hair salon and you'll find instinctive performers delivering theatrical experiences there: the smell of product, the noise of the music and the dryers, the performance of stylists cutting, the colors, the action. You'll find great theater at AllSaints (UK), Les Néréides (France), Lush (UK), McDonald's (U.S.), Bloomingdale's (U.S.), Printemps (France), Kiehl's (U.S.), and Bic Camera (Japan). You'll see it at great independents such as Rough Trade East (London, UK), Powell's City of Books (Portland, Oregon) and Robert Moy's Tuscan Pots (Oxford, UK—tiny store but the best indi-retailer I know, anywhere. Awesome place, go visit).

Case study 14.2. Smart Retail: Ceremonies

A neat way to introduce theater into your store is to break down everything you do into small "ceremonies"—little routines that create a bit of difference, done with a flourish. At brilliant hotel chain Malmaison, they pack these theatrical ceremonies into eveything. An example is seen in the way they deal with a dinner order for a glass of port: Instead of bringing you a glass of port, they bring a clean empty glass and their port decanter. Your glass is placed down and the port in poured there in front of you. It's a process that adds very little to the time it takes to serve a glass of port but it looks fantastic to the customer—the lovely liquid appetizingly pouring out, the gently pleasing glass-filling sound, and the rich color of a generously filled decanter.

Boutique French jewelry brand Les Néréides is hot right now and their London showcase store is always buzzing. It's a store in which lots of ceremonies add up to a deliciously satisfying customer experience. It starts with a visually reinforcing store layout: Everything is fresh, collections are given room to breathe, and staff are dressed in sweet summery clothes that match well with the design ethos of the jewelry. That's theater too—it's the equivalent of great set and costumes. As soon as customers interact with the habitually happy and approachable staff, the ceremonies kick in: Lots of drawers of product are removed and placed upon the counter, but in a set way so that only the items that are currently “in play” are visible. Ideas and suggestions are freely offered and they will ask customers for whom the purchase is to be made.

You’ll see women buying for themselves given mirrors and encouraging comment, and you’ll see assistants trying on necklaces to help men buying gifts for partners. It’s incredibly human and involving. Then purchases are wrapped in paper and the paper sprayed with the house-scent, they are dropped into nicely designed gift bags that seem modern and classic all at the same time (much like the jewelry) and finally the bag is tied ostentatiously with a pretty bow. The whole process is full of ceremonies and it makes the experience feel very special indeed.

Fundamentals of retail theater

For our next journey into retail theater, we’re going happily out onto the street—we’ll maybe even learn about other parts of the puzzle too. That’s because the best lesson on the fundamentals of retail you could ever have is to be found at traditional street markets. In particular, the fruit and vegetablee-table stalls on those markets. Right there is where you will see the most efficient, simple, and effective principles all in action—not because somebody has an MBA but instead because those principles have been passed down over the generations. From father to son, from mother to daughter—because they work.

Seriously, I can’t recommend strongly enough that you go and quietly observe the dynamics of a busy street market. While you’re there, take a look at these two.

A—Vocal promotion

B—Merchandising

A—Vocal promotion

Traders calling out to shoppers can be exhilarating to watch, especially when it’s done well. What you can learn from listening to these calls (it’s called “barking” apparently) is a sense of what really turns customers on. The lines shouted out have been passed down from trader to trader over generations. Traders still use them because they make customers react. Go beyond the old-time vocal theatricals and you can see some incredible promotional instinct at work. In particular, fruit and vegetable sellers do two things when they bark:

- They bark the promotions "two for one"
- But listen closely to the words they use when describing the produce —it's not just "cherry, strawberry, apples, oranges, pineapples." You'll hear "Sweet cherry!," "Lovely ripe strawberry!," "Get your crunchy fresh apples!," "Juicy golden pineapple!"

The adjectives—fresh, delicious, ripe, sweet, rosy-red, juicy—are part of the performance and they materially affect the way passing customers feel about what's being sold. If you're even vaguely thinking about a snack and you hear "Sweet and delicious red cherry!" you'll start picturing them in your subconscious, and you'll be imagining what they might taste like. There's a chance that your mouth may even be watering. Incredible stuff!

You need to encourage your team to use adjectives like these whenever they're talking about the products they rate highly.

- Awesome colors
- Fantastic fit
- Stunning design
- Superb taste

This does two things: It engages customers, but even better it also gives them the words they will use later to describe how pleased they are with whatever it is they've bought.

B—Merchandising

There are lessons to be learned on merchandising too—some subtle but very revealing. Fruit and vegetables on a stall tends to be laid out at an angle to the table, with orders being fulfilled from produce behind the angled crates. This arrangement makes it look like there is more food there than perhaps there really is—this is important because we animals are reassured when we see what we perceive to be "plenty." You didn't think we were influenced by that stuff, maybe? We are—all of us.

The colors of adjacent items are carefully selected too: Rather than blending harmoniously from red, to orange, to yellow, and so on, contrasting colors are put next to each other. This is to help our poor eyes pick one thing out from another and also because when you walk past this arrangement, it flickers in your peripheral vision. That flickering attracts and makes passers-by almost involuntarily glance over.

Managing perceptions is also an aspect of great retail theater—here again the fruit and vegetable sellers can do interesting things; when I wrote *Smart Retail*, I would often need to walk down Whitechapel Road and past the permanent street-market there. The market contains six greengrocers' stalls, each offering similar products. One morning I noticed lychees had arrived; these are a big draw for the greengrocers there. On five of the stalls, lychees were all presented at the front in a sort of hot spot visible to all customers.

But on the sixth stall, they weren't even on the table—this greengrocer hadn't even had time to get his lychee stock onto a shelf because it was still all on his delivery cart and customers were clamoring over it. Next day the lychees were again right out front on their delivery cart ... something didn't make sense.

I asked the stall-holder, Dinesh, why he did this. Dinesh said that customers who saw the lychees tended to believe the fruits were really fresh because they hadn't been around long enough to be taken off the delivery cart. "How fresh are they?" I asked.

"Three days, these ones."

"Do your customers really believe your lychees are fresher than everyone else's because you've not even been able to get them onto the stall?"

"Yeah, they do."

Suspending disbelief, helping customers to feel a positive thing—these are theatrical tools and you'll find ways to apply them to your business too.

Case study 14.3. Smart Retail: Theater of lardy dreams

At the height of their success, Krispy Kreme stores were taking three times more money than similarly sized Dunkin" Donut's stores. Broadly the same product (although KK reckon their recipe delivers a better texture), same sort of locations, maybe

Krispy Kreme had a little bit more of an authentic brand heritage, that's marginal though.

So how come they sell so many lovely, lovely doughnuts?

Scott Livengood is the man who took the business from \$200m to \$1.2bn revenues in just three years. His big innovation? The introduction of a little bit of retail theater. Just like fashion—doughnuts are best when hot and fresh in-store. Livengood's moment of genius was to connect the childhood delight of hanging around the kitchen when Mom or Dad was baking with the process of buying a doughnut.

Up until Livengood's time, fresh Krispy Kreme doughnuts arrived to customers through an anonymous hatch in the wall; the machinery of cooking that doughnut was kept well out of view. Livengood recognized that watching your doughnut be cooked fresh in front of you, taking in the wonderful cooking aroma, would heighten anticipation and spike desire for the product. Stores were then redesigned to make the most of what became "doughnut theaters" and cooking times were changed from early morning to times that matched the optimum desire times—lunchtime and late afternoon—with the aromas then pumped out into the street.

A moment of truth: During a store visit, Scott witnessed a staff-member wave to a child from inside the "doughnut theater." It made the kid's day and it appeared the staff member felt good about the interaction too. Scott says that was the moment he realized that he'd done something special.

Dunkin' fight back

There is a sting in this particular tale which goes back to Big Idea. Perhaps a little slower than in the rest of the world, America is waking up to the need to eat less fat and sugar. Potentially the distant death knell for the doughnut. Krispy Kreme have failed to adapt to this change in their market and are suffering as a result.

Dunkin' Donuts, on the other hand, have moved themselves toward a coffee positioning. They have significantly improved

> the coffee itself, installed proper Italian coffee machines, and are now using the advertising slogan “Something fresh is always brewin’ here!.” It’s clever: Dunkin’ are now telling their customers “Hey, we’re a great coffee shop but one with the most awesomely tasty snacks you’ll find.” It’s working.

The theater of demonstration—why shopping channel presenters are unheralded geniuses

One easy way to get a bit of performance and movement into the store is to do lots of demonstrations. Again, watch market stallholders: They handle the product constantly, rotating stock, shifting clothes, rearranging sizes or colors, juggling sweets, playing music, sparking up toys, cooking spices on their hotplates. Almost every trader you see will hold a bag of product in his hand as he barks out the deal on that item—a tiny detail, but again it’s done because it’s useful in attracting customers.

Another great training ground for learning demonstration skills, and I am serious, is the shopping channels on TV. Watch the guest presenters especially. These are the people from the product manufacturers who get to come on and plug their wares. These men and women are brilliant instinctive performers who talk and demonstrate benefit after benefit. Now, I’m like everyone else who gets a bit annoyed when these presenters are talking up something obviously shoddy, but the techniques are still valid—imagine applying it to your best stuff, to product you genuinely believe to be great.

> **Helping customers to more easily imagine your product actually working for them is very powerful.**

What I’m suggesting you do here is to tap into the power of everyday performance. The demonstrating and playing with stock. Customers really are drawn to products when they see life and action around them. Helping customers to more easily imagine your product actually working for them is very powerful.

> **Mast Brothers (Brooklyn, NY)**

The brothers Mast do chocolate as performance, setting themselves and the store as a kind of crazy chocolate-twisted Norman Rockwell painting but, good God, they are authentic too. From first walking in, you see this is somewhere different: The smells are rich and powerful, your senses being triggered from the off; as well as the traditional store fittings you can see the mechanics of chocolate making going on—bars being turned out and foiled and wrapped by hand, or cocoa beans being sorted and graded by eye.

The store is only the front of a remarkable chocolate-making factory; these pioneers are one of only a handful of bean-to-bar chocolate makers in the U.S., and they will let you tour the factory at weekends (you need to pre-book and pay a tiny $9.99 for a ticket—it gets super busy). There's also a special taster room too. The store links production and product in a way that makes the end result somehow more special; Mast Brothers chocolate is exceptional without all this, but the store puts a special seal on that quality.

Apple Store (U.S.)

The entire store is built around demonstration—customers surfing the web, speakers being tried, programs shown off, videos played, music being made. The Genius Bar takes that a step further—this is where customers solve their technical problems. Now, you'd expect most retailers to want to hide their problems away but here Apple use problem-solving to add an additional layer of certainty to the purchase process—customers see that there is going to be somebody there to actually talk to if things go wrong. That's hugely valuable. And finally, a third layer of demonstration is provided through free one-hour workshops on a range of creative and productivity tasks. Show the product, show you'll solve problems, show how to get the best out of that product—that's a story, delivered theatrically, that shifts computers.

B&Q (UK)

The “You Can Do It” classes now running in a handful of B&Q stores are so popular that getting a place on forthcoming classes is a matter of luck and timing. The brilliant, brilliant aspect to these courses is that they happen on the shop floor in full view of other customers. It makes a direct link between the things B&Q sell and what those things can do for people. I’m so glad a mainstream British retailer is finally doing demonstration so well—and they’re reaping the rewards: Customers who train in-store tend to fulfill more of their project needs with the store too (and, cleverly, B&Q have also introduced a free project advisor service, where a member of staff will discuss customers” needs and help them to identify everything required to get the job done). Oh, and there’s a kids version of the program—the little ones get to make mug-trees, bird-feeders, and the like and they absolutely love doing it (get ’em hooked young, I getcha!).

Making it stick

Over and over we have talked about how the best of retailing is down to common sense, and to passion and gut feel. Out on the streets, on the market stalls, these components of success are in plentiful supply. They can be seen in the way stallholders price, merchandise, promote, and demonstrate. All of the lessons on display can be learned and applied to your store, whether that is a hole-in-the-wall grocer’s or a 25,000 sqare foot Currys.

Chapter Fifteen. Detail, detail, detail—the store environment

So, we've talked about discovery and theater—now you're going to need a space to put those things in and you're going to need to think about how to lay out that space to maximum effect. There are some useful general principles in this but the detail is something you are going to have to work out for yourself, based on those principles. It's not as tricky as that might suggest, however—if you know what you are (your Big Idea), if you've worked out how you are going to deliver discovery, and if you've identified your opportunities to create some theater, then you are a good distance toward understanding how to make the physical aspect of the store work properly.

At its simplest, the store fixtures and fittings, signage, colors and windows are there to do a very simple set of things:

1. Tell customers about what you are.
2. Tempt them to come in.
3. Display products nicely.
4. Show off focus and promotional displays.
5. Lead customers through the different ranges.
6. Make it easy to select and pay for stuff.

If you can put a checkmark next to each one of those things and say "Yep, what we've got does all of those" then you're on the money already. Go at each with a lot of honest vigor though—walk through each as if you were a customer. Retail guru Martin Butler has a great expression: "Spend an hour in your customer's moccasins each day"—he's right too, you'll see things differently.

Look and feel

It's relatively easy these days to create knock-out gorgeous stores at a sensible cost. Especially as manufacturers are often keen to supply retailers with great-looking free, or part-sponsored, display systems. But even if you’re spending your own money, you must match that spend to your Big Idea. A dollar store doesn’t need the same level of quality or design as perhaps a boutique jeweler’s. Equally, stores such as Hotel Chocolat prove that you can achieve classy results on relatively modest budgets (go have a closer look at their fixtures and fittings: They’ve managed to adapt some pretty standard kit and make it look amazing—that’s clever retailing).

It’s relatively easy these days to create knock-out gorgeous stores at a sensible cost.

Windows

Your windows are your outside communicators and they must be made to work hard for you. So many retailers seem to think this either means filling them with meaningless piles of stock or filling them with a billion confusing messages.

A good window display is critical. It must be welcoming: It must give passers-by new reasons to come in, and it has to be readable in five seconds. New products are great as window features. When I asked the owner of a successful hardware store how he promoted his hot new items, he said “I put them in the window with a great sign on them that says ‘bargain’ and ‘brand-new’ on it. Customers notice the sign. I know they do because they ask me about these new products and then they buy them.” And, of course, seasonal or special-occasion activity must be celebrated in your windows too.

Broadly, your windows can do three things, either individually or in combination. They can do the following.

Intrigue

Abstract but sharply focused images that pique customers” interest. A great example of this can be seen in many AllSaints stores where the main window features rows and rows of old sewing machines. It is a theatrical intrigue, makes people want to know what’s going on, and has the psychological bonus that in customers” subconscious, it suggests tailoring, hand-making, and quality—all of which helps support AllSaints” premium positioning.

Inform

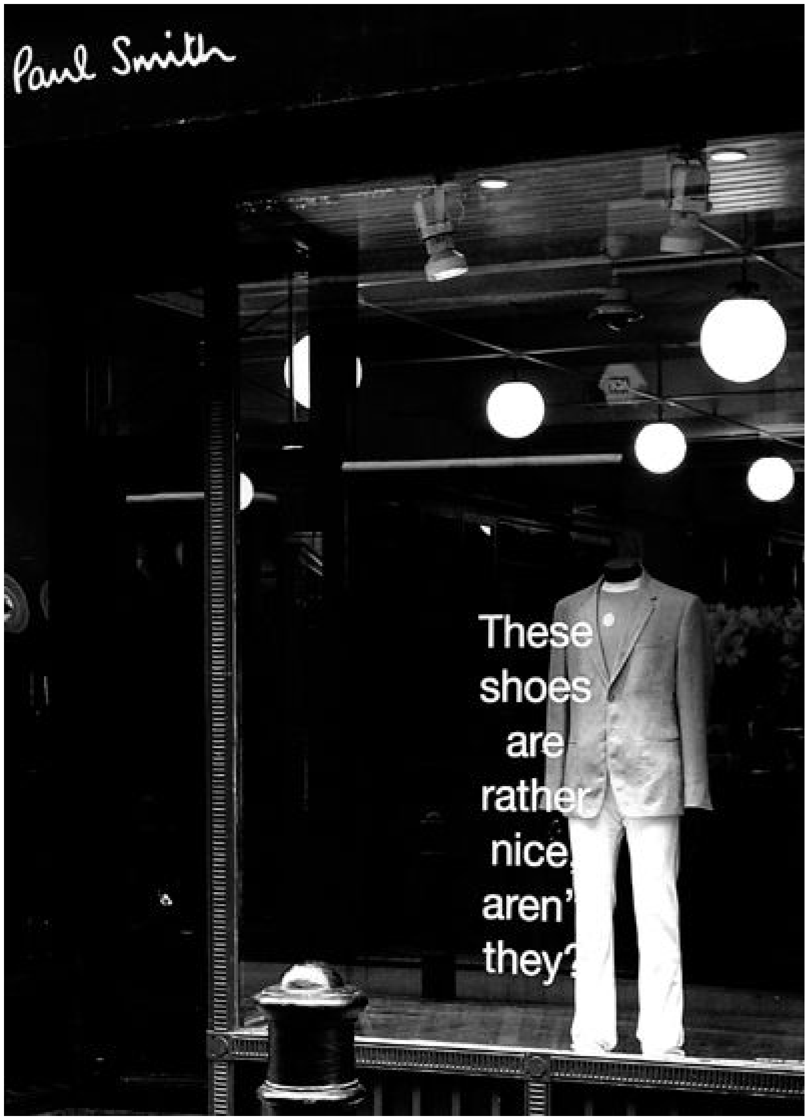
Simple and sharp messages often accompanied by a single product: Sale Now On, Our Best Ever Jacket $99, New Stock Preview. Orange does these very well and change theirs every week. You can do the same using cheap but professional vinyl lettering.

Inspire

A window that gets customers thinking about the store and its contents. Gap had a terrific one recently: three fun spring dresses in the window with a great typographical treatment that just said “Flirty Dresses Are The Key To Spring.” That’s inspiring—it instantly has the customer thinking about ditching the winter blues and jumping into a fun spring wardrobe.

Case study 15.1. Smart Retail: PetSmart performance

Walk up to PetSmart’s Broadway store and you’ll usually see a little crowd of people peering into the window. You might even stop to stare too—for one part of that window looks directly in on their pet-grooming room. You’ll see pampered pooches having their coats trimmed, their claws nipped, and all manner of other crazy pet nonsense. New Yorkers love it, and it’s a brilliant example of a window that both intrigues and inspires—it makes you look and it tells you that PetSmart love your pets.



My all-time favorite window is also one of the simplest I've ever seen: It's this understated and fun masterpiece from Paul Smith—you can't see the shoes. Almost everyone walks over to take a look.

Source: Koworld

Transition zone

This is the area near the door that transfers customers from the outside and then into the store. You have an opportunity here to make or break the customer experience. If the zone is too empty, customers can feel exposed and then reluctant to move further into the store. If it's too cluttered, that's off-putting too—instead it should be clear and easy but with things of interest in it to draw people in gently.

You also need to be aware throughout the store, but here especially, of what retail anthropologist Paco Underhill calls the “butt-brush factor.” He noticed that customers hate standing anywhere that puts them at risk of other customers constantly brushing past them. In the transition zone, this effect can be useful because it keeps people moving forward on into the store. In front of displays, though, it can be a problem because you want customers to linger in those areas. When they do linger, they tend to buy more often. Take a look at all the customer flows in your store, from the entrance and back out again, to see where you can make improvements.

Baskets

If yours is a store where customers ever need to pick up more than one item, then you must offer baskets. Customers who pick up a basket nearly always buy something and very often buy more than customers who don’t have a basket. Stores always benefit from having baskets available invitingly on the side edges of the transition zone.

Put the baskets higher up, not on the floor. Perching baskets on a table makes it very easy for your customers to just dangle an arm down and almost absent-mindedly pick up a basket. Doing so will increase sales and average transaction values.

Promotional hot spots

Creative use of promotions is essential. Fill the store with them, show people excellent value, and then make it easy for them to take you up on your brilliant offers. Never allow a promotion spot to go empty: If you have run out of a line, even for just a few hours, get the promotion POS off the floor right now. If you don’t, you will annoy customers who will feel you have let them down.

The ideal promotional hot spots are:

- Visible from the door
- Well lit
- Bristling with stock

- Easy to linger in front of
- Honestly presented
- Clearly merchandised
- Well signed
- Surprising

Promotional product can mean a lot of different things, remember, such as:

- Price offers
- Products we want to showcase because we love them
- New acquisitions
- Seasonal favorites
- Things that go together (preferable with a package price)
- New ideas
- Products in the news
- Hot trend items.

A good tip in a small store is to reserve a space that's in customers" immediate eye-line when they come in through the front door, and use that to showcase a changing selection. Mark it as such, make it clear, and both regulars and new customers alike will make it their first stop on each visit.

Back wall

Do you remember how record shops always used to feature the top twenty singles up on the back wall? That was so they could draw every customer the right way through the store. The really savvy stores would make it very easy for customers to walk through the middle of the shop to the back wall, so customers would all be flowing down that central aisle. Then when a customer had found their chosen single, they would turn and look for the cash register. This would be placed back up toward the doors. The customer couldn't easily walk back along the central aisle because it was full of people heading toward them, so they would zigzag through the displays to either side. This zigzagging was brilliant because it meant the customer was exposed to a whole succession of promotional hot spots as they navigated their indirect course.

Cash register

There are lots of arguments over where best to put cash registers. To be honest all have their pros and cons. My preferred position is halfway down one side wall. You can see most of the store from there, queuing can be dealt with neatly and it doesn't eat into the best selling areas.

Here are the most popular options:

- Halfway down one side—my favorite.
- At the front to one side—makes it easy to greet customers walking in but puts the desk right in the middle of important promotional space.
- In a center island—although islands can break up sight-lines, this can work really well, especially if you are able to have two people working the desk most of the time because the pair can then watch half the store each, giving you full visual cover.
- On the back wall—popular really only because it usually puts staff near back-of-house areas; makes it hard to greet customers and is the shoplifters" favorite option because staff are so far from the door.

Impulse buys

Whatever you sell there will be products in your range that will make great register impulse purchases. In a newsstand, chocolate is an obvious example. Hip clothing stores will put cheap toys and iconic trinkets on the counter. Anything that is attractive, low-cost, and that is physically small will make a great impulse purchase. Vary your selections a little and don't crowd the area. A few well-chosen items can have a direct impact on increasing your average transaction values. Avoid at all costs the hideously uncomfortable joke of forcing your staff to actively sell these items—staff at WHSmith are made to ask customers if they would like "Any half-price chocolate today, sir?" They hate having to do it and customers are made to feel uncomfortable. It's pushy and weird.

Anything that is attractive, low-cost, and that is physically small will make a great impulse purchase.

Sight-lines

Two considerations here are foremost:

1. Can customers see their way around the store?
2. Can you see them?

Customers like to be drawn through your space by the exciting and attractive products and promotions you put in their middle-distance forward vision even as their brains fight to pay greater attention to the peripheral and to movement. They will often miss things that are right next to them unless you lead them right to the spot.

Being able to see customers is important because it makes it easy for you and the team to acknowledge them. It is also vital in reducing shoplifting. If you can see the thief better, they are less able to steal—simple as that.

Signage

Always go for crisp and readable over complex, over-designed, or wordy. Customers just do not have the time or inclination to decipher clever complicated messages. Promotional signage especially should convey a strong bold message in just a few seconds. Ratty signage does nothing for your store—if POS gets damaged, throw it away or replace it immediately.

So, the fundamental principles are covered, but the rest is up to you—exciting times!

Chapter Sixteen. And finally ... how we got here

I want to finish the store section of the book with a look at the history of retail. It doesn't properly fit here but I didn't want to relegate it to an appendix either. This stuff is important and it will help you to be a better retailer. The lessons are all there for us.

Righty ho—I'm going to take us through the early years, up to somewhere around the 1950s. There are a few reasons for doing that—the first is to prove a really important point: Retailing is not about inventing new stuff.

Eh? "But you've gone on and on about ideas being the lifeblood of retailing and that ..."

That's true, I have—here's the thing: Ideas are of course vital, ideas are about change, improvement, and development, but they are rarely about coming up with things that no human has ever thought about before. You can be an innovative retailer by improving on existing ideas, by combining existing practices in radical new ways. But you don't have to magically pluck brand-new "things" out of nowhere to be innovative and successful.

And this is a good thing. I'm going to show you over the course of this section that there have only really been four important inventions in retailing over the last 2200 years. This should be liberating for you—what I'm, in effect, saying is that you don't have to reinvent the wheel to be innovative.

Rather than make you guess—I'll give them to you for free. The four great inventions in retail are:

- c.200 BC—the creation of the first chain of stores (China)
- 17th century—catalog-based mail-order (Europe)
- 1852—the first true "department" store (France)
- 1915/16—self-service (U.S.)

That's it. Yeah, maybe we're overdue something else earth-shattering and new sometime soon; maybe it'll be you that invents it, but if it's not—that's okay! It's not vital to your success as a retailer. Oh, and if anyone is shouting "Idiot! Hammond's missed out the Internet," calm yourselves down: The Internet is just a development of catalog-based mail order and don't kid yourself that it isn't—it's all distance selling.

On that point, right here in St. Albans where I'm happily typing away, there's an excellent 19th-century analog to the current thinking among leading Internet players around becoming bricks-and-mortar retailers: On our original main street, there's a beautiful white glass, brick, and iron-frame building. It looks like a cross between a massive greenhouse and a Victorian bath. Actually, it was built more than a hundred years ago as a showroom for the leading mail-order seed catalog of the time—it was a place where the seeds could be shown off as plants, where arrangements of flowers, trees, and shrubs could be suggested to customers and in which expert growers could pass on their tips. Isn't that wonderful? You see—our retail past informs our retail present. The seed showroom is a Café Rouge now. Not sure what that says about the future of amazon.com!

Our retail past informs our retail present.

I reckon there are two good reasons for giving you a bit of retail history: The first is to give you the reassurance that you're not trying to invent something nobody has thought of before; the second is to show you that the challenges you face have all been solved before and that you can learn from those earlier experiences.

Actually, there's a third and perhaps more personal reason for pulling together this brief history—and it's that I believe retail is important and that the heroes of retail should be celebrated and their accomplishments enjoyed as we carve out our own retail successes.

The really early days

So, to the history. Our retail trade predates money—money comes later, having grown out of the need to mark retail debt in a consistent manner. What you do really is one of the oldest professions.

Markets

The first formal gatherings of retail outlets were barter-based markets. Within a community, specialist skills developed—one producer who had a skill, say, in stone implements would deliberately over-produce these so that he could swap his spares for food or clothing with specialists in those areas.

Retail chains

That brings us to the concept of the chain-store. It's an interesting evolution—as the markets became more permanent and currency arrived, it made sense to construct a logistical infrastructure around those fixed points, the markets. Successful fixed-location shopkeepers recognized that growing their square footage (or square cubits, or whatever) and growing their potential customer-base represented excellent opportunities to make a little more profit. The answer was to open up another shop and have it operated by a family member. And would you believe, even back then there are records of these fledgling chain-store businesses using their improved volumes to leverage better terms from suppliers.

The earliest reasonable claim to "first retail chain" can be found in China over 2200 years ago and belongs to a retailer called Lo Kass. There is also a strong possibility that Roman shopkeepers may have a prior claim but only Lo Kass's is actually documented. Roman excavations, across the empire, have shown that shops there were extraordinarily like small shops are today and given the excellent formal government, commercial, and transport infrastructures present even early-on in the Roman period, it's pretty likely that chains emerged there. Lo Kass's innovation, the thing that allowed him to extend his business, is that he was the first recorded retailer to employ shop managers from outside of his family.

Family to formal

Two things held back the small chains from making the leap to vast multiple retailers—the lack of non-familial trustworthy workers and audit systems to keep them so, and the lack of long-distance mechanised travel. It wasn't until the Industrial Revolution had really hit, in the 19th century, that chains became much bigger and more widespread. A few of those pioneer chains still exist today.

Places of retail

Generally, retailing has always taken place at the heart of communities. Markets were central points in villages and inside the largest cities markets would spring up, centered on shared-interest locations—animal markets in one quarter, grain in another, cloth elsewhere, and so on.

Main streets, U.S.-style suburban strip-malls, and indoor town-center shopping malls (or centers) are the direct descendants of those community markets. The one major, late 20th century change to retail location history is the out-of-town shopping mall and the edge-of-town retail parks—we'll talk about those a little more in a moment.

But the structure of malls themselves have been with us since the Romans. Dr. John Dawson (Professor of Retailing at Stirling University and a great retail brain) points out that the ruins of Trajan's Market in Rome are remarkably similar to a modern urban mall. He goes on to mention that this particular market continued to operate in the same way throughout the Middle Ages and into modernity.

Later, much later, we get recognizably modern, though still very similar to Trajan's Market, mall-style arcades including the Burlington Arcade in London, opened in 1819. The Arcade in Providence, Rhode Island introduced the concept to the United States in 1828. The larger Galleria Vittorio Emanuele II in Milan, Italy followed in the 1860s.

The move away from high streets

Suburban living, commuting, and the rise of the road and car has given rise to a move away from shopping on high streets. Throughout the 1990s and especially in the U.S., the center of retail has moved from the old high streets and into giant regional shopping malls and to massive stores located in retail parks on the edge of towns.

Lack of space has, to an extent, halted this move in Western Europe but even in spacious North America, something interesting is happening—main streets are thriving once more. Indeed main-street rents in the U.S. are increasing at an astonishing rate—rents tend to mirror commercial success and so are a useful barometer of location health.

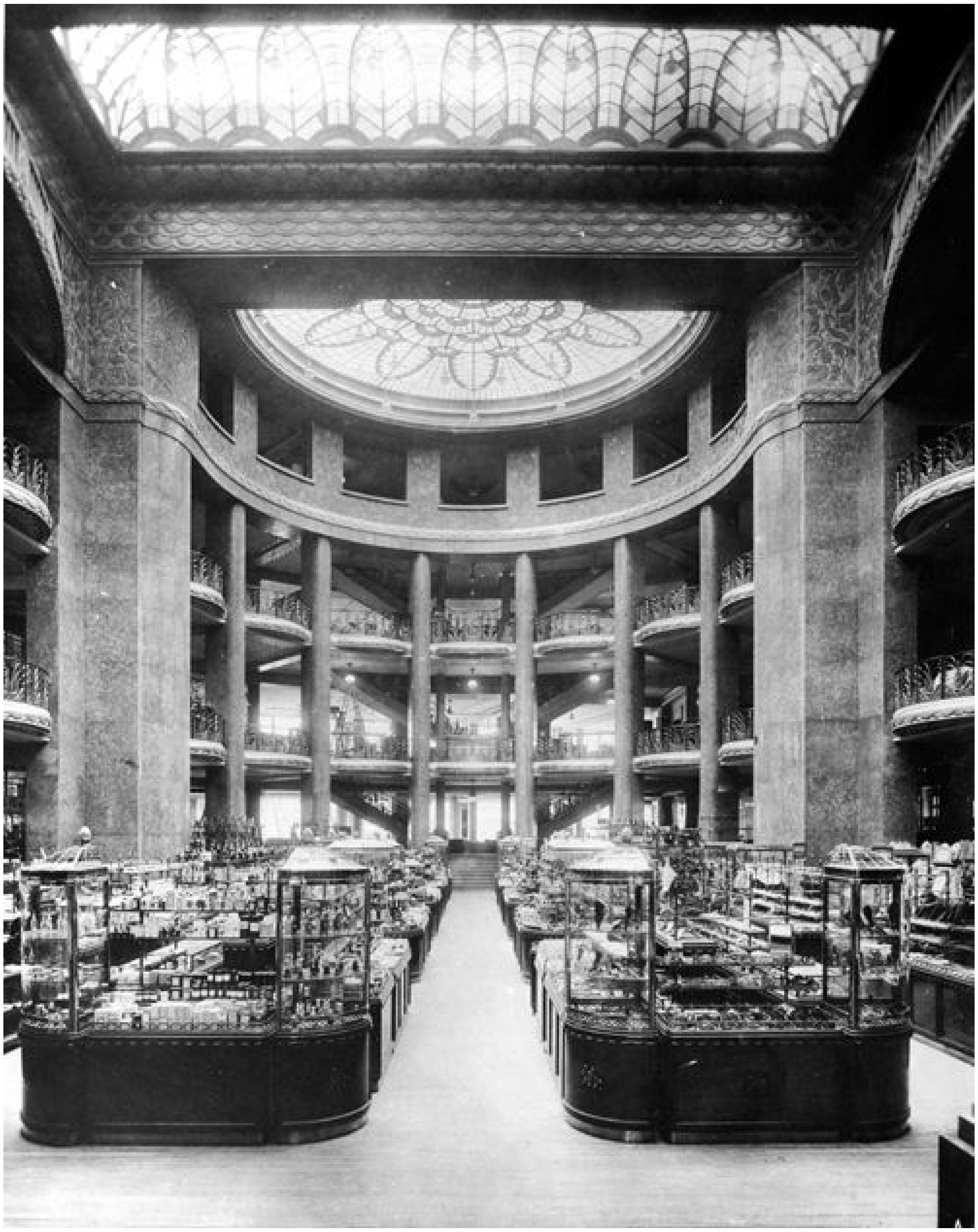
It would appear that there is something fundamental about humans and shopping and doing so inside our communities (however superficial those communities may be). Fashion, food, entertainment, small-specialist, personal technology, personal services, and gift retailers will thrive again at the center of our communities and on our main streets—the added value of convenience, immediacy, and shopping in mixed, varied, and stimulating locations is rising.

Department stores

The development of department stores is important because it marks the first real, systematic, use of retail theater—and it's that theater that has driven almost every single customer-facing innovation since. It is the absolute key component of modern format-planning and concept development. It is what sorts the mediocre from the fantastic.

Until 1852, shops were all small and specialist. That changed forever when Aristide Boucicaut and his wife Marguerite expanded their Parisian drapery store and began to also sell housewares and bed linen. They called their store Le Bon Marché and its inception marked the birth of the world's first department store. The store launched on the back of innovations such as the promise to deliver "to homes as far as a horse can travel in Paris" and for the first time anywhere the store featured prices clearly written on all labels. The Boucicauts are even credited with the invention of modern stock management, where rotating merchandise and the staging of summer sales, winter sales, and blue-cross sales created constant change and excitement in the store.

Then in 1869, Bon Marché moved into stunning new purpose-built premises, designed in part by Gustave Eiffel, in the rue de Sèvres. Imagine how you might have felt the charge strike through you the first time you walked through the huge iron and glass doors and into its fabulous interior. Just imagine that thrill; stunning clothes, awe-inspiring furniture, drapery from all corners of the earth, sweets like you have never seen before, foodstuffs to make the mind boggle, and baffling new gadgets you cannot begin to fathom the workings of. You see assistants bustling here and there, catwalk displays of clothes, and dressed mannequins among showmen demonstrating the latest wonder. Every turn holds something new, a surprise, a wondrous assault on the senses. Imagine too how amazing it felt as you discovered that every department, as well as showing you awesome delights you'd never known existed, had lots of nice things in them that you could afford. Bon Marché changed its ranges constantly; new surprises were guaranteed all the time. It's a product mix and stock management philosophy that worked then and still holds true today.



The Grands Magasins du Bon Marché was the world's first department store. This photograph was taken in 1928.

Source: Royal Institute of British Architects Picture Archives

The concept of browsing a store was alien to the masses before 1852. It just was not a part of the contemporary ritual of shopping. Today browsers are essential to everyone from Wal-Mart to Harrods. That’s why we pack our stores with hot spots and why we change things so often. It’s all down to Bon Marché and their astonishing 19th-century Parisian innovations.

The concept of browsing a store was alien to the masses before 1852.

Well, that’s not entirely true. One other major, seismic, earthquake of change needed to happen and that was the development of self-service shopping. The established retail model, even within multi-department stores such as Bon Marché, was to keep products in cases, behind counters, or under glass—customers would be served by an assistant who would fetch customers” products for them.

Self-service

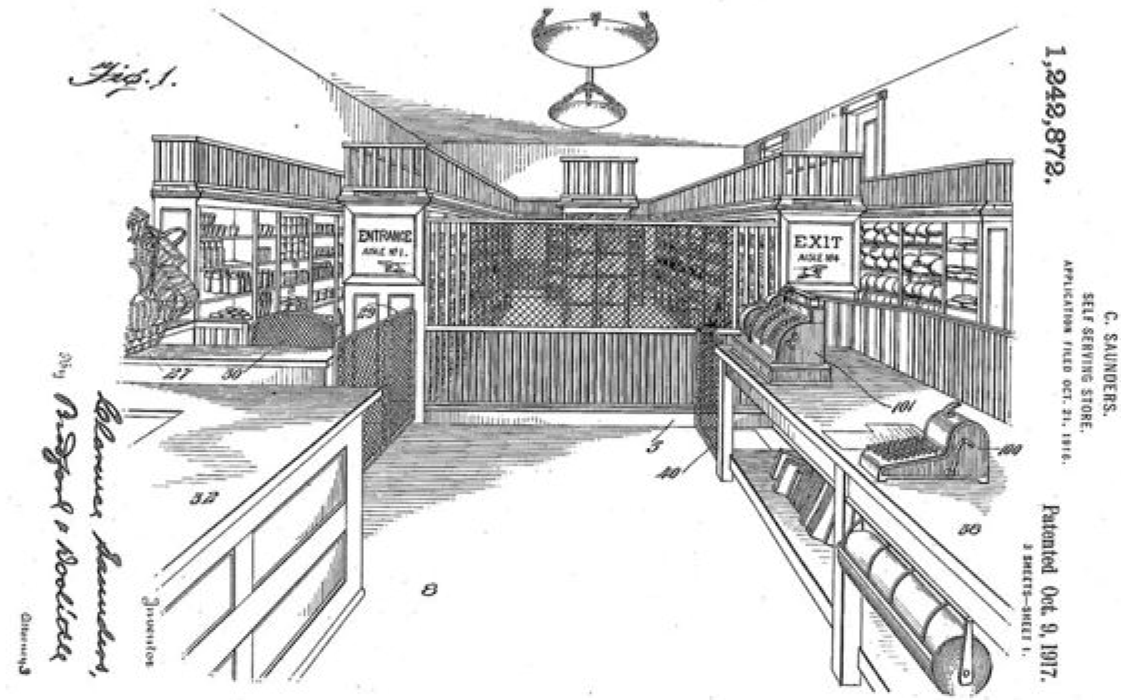
This all changed in 1915 when Albert Gerrard opened the Groceteria in Los Angeles, the first documented self-service store. The early part of the twentieth century was an extraordinarily competitive time in general-store retail in the U.S., but even in that white-heat environment, it took almost a year for another operator to copy the idea. And what a copy it was! Clarence Saunders, the founder of Tennessee-based Piggly Wiggly, built an entire business around self-service and then, the sly fellow, went and secured a patent on the concept (I’ve not been able to discover if that patent was ever enforced—I quite enjoy the thought of one of his long-lost relatives appearing out of the woodwork and suing all the grocers).

Saunders was something of a legendary loon and had begun construction of a pink marble mansion in Memphis, Tennessee when in 1932 the “bears” of Wall Street allegedly took him for a million dollars and rendered him personally bankrupt. The “Pink Palace” is now a museum, and it includes a walk-through model of the first Piggly Wiggly store, complete with 2¢ packets of Kellogg’s cornflakes and 8¢ cans of Campbell’s soup. It’s well worth a visit—the place shows you what a real retail innovation actually looks like.

And that’s where I’m going to leave the history for now and move on instead to the stories of some of the most important pioneers of our trade.

The retail kings

Say hello to the retail kings—these men are the true pioneers of your trade. They had no maps, instead forging their own routes through opportunity and adversity alike. There are a couple of sad endings, mind you—so be prepared for that.



Self-service as shown in Saunders” patent grant no. 1,242,872.

Source: US Patent Office

George Hartford and George Gilman—A&P (U.S.)

The Great Atlantic & Pacific Tea Company, better known as A&P, is the original American supermarket chain. The company was founded by George Hartford and George Gilman. By 1876, A&P had 67 stores, increasing to 1,000 by 1915. In the 1920s and 1930s, the company utterly dominated the American retail market, and by the end of that period, A&P was operating approximately 16,000 stores with combined revenue of $1 billion. That power led to the U.S. Congress passing several anti-predatory pricing laws—it’s interesting to see pressure on governments today to act in a similar manner in order to curb the practices of some of our most powerful supermarket chains.

That 1930s high has now, to a large extent, evaporated—A&P still trades today but from far fewer locations and it is far from the biggest retailer in the U.S. now.

A typical small A&P—this one is at L'Anse, Michigan—1950s.

Source: A&P Historical Society

In 1859, Gilman opened The Great American Tea Company, a corner shop, on Vesey Street in Lower Manhattan (the site today of Ground Zero). The store sold teas, coffees, spices, baking powder, condensed milk—all products that often came to America as ballast in the holds of clipper ships. The name change came in the 1870s when the company began to ship goods via the transcontinental railroad—with their broadened horizons, connecting "Atlantic" and "Pacific" must have seemed like an extraordinary achievement.

What marks out Hartford and Gilman from other retailers of the time is their voracious expansion ambition and achievement, and the way they overlaid that on a consistent format. They knew what customers wanted and delivered a store that met those needs—again and again, in location after location. Even today, the vast bulk of American retailers remain regionalized but the two Georges blitzed out those 16,000 nationwide, coast-to-coast, stores by 1937.

F.W. Woolworth—Woolworths (U.S.)

Franklin Winfield Woolworth (born on April 13, 1852, died on April 8, 1919) was *the* American merchant. Born in Rodman, New York, he was the founder of F.W. Woolworth Company, an operator of discount stores that eventually settled into the Big Idea of pricing merchandise at five and ten cents (making it a "five-and-dime" store). He pioneered the now-common practice of buying merchandise direct from manufacturers and was among the first retailers to fix prices on all items rather than haggle as was the prevailing tradition. Woolworth was also among the first retailers to recognize the potential in selling mass-produced products. Clever man, this Mr. Woolworth! F.W. was one of the first retailers to truly understand his customers—he recognized that this business is about consistency, choice, and democracy (good stuff, at the right price, for all).

Woolworth grew up on a farm but something sparked the retail bug in him pretty early on, and it was while working at a dry-goods store that he had his first great idea. He noticed that leftover items were often priced at five cents and placed on a table to get rid of them; he noted how much customers seemed to appreciate the five-cent table and a light went on in his brain ... Woolworth then borrowed $300 to open his own store in which all items were priced at five cents.

That first store, in Utica, New York, opened on February 22, 1879, and failed before the end of March. At his second store, in Lancaster, Pennsylvania (opened in April 1879), he adjusted the format by expanding the concept to include another range of merchandise priced at ten cents. This second range balanced the offer better and the Lancaster store became a big success. Woolworth and his brother, Charles Sumner Woolworth, solidified the template and then went on to open a large number of their five-and-dime stores.

The concept was widely copied, and five-and-dime stores were a fixture in the average American downtown for the first half of the 20th century, and they then later anchored suburban strip malls.

Always loving the grand gesture, in 1913 Woolworth built the Woolworth Building in New York City at a cost of $13.5 million (which he paid in cash). At the time, it was the tallest building in the world, at a height of 792 feet, or 241.4 meters. The Chrysler Building, with its craftily constructed spire, robbed Woolworth of that record the same year. Can you imagine the sheer balls of a man prepared to make a statement on the scale of the Woolworth Building? I love that—it's madness, but it's wonderful too.

The Woolworth Building in New York.

Source: AP/Press Association

As well as its American success, Woolworths extended across into lots of other countries—in the UK, "Woolies" became a fixture of everyday life.

It provided ordinary families, like mine, with nice things at a very low price. The quality was reliable and the range mind-blowing: some 70,000 different lines by the start of the 1980s.

Woolworth died in April 1919 at the age of 66. At the time, his company owned more than 1,000 stores and was a $65 million corporation. Ten years earlier, he had opened his first British Woolworths, in Liverpool. He went on to personally open 50 UK stores before his death. Opening these stores himself, especially accounting for the time it took to travel between the U.S. and the UK back then, showed F.W.'s extraordinary commitment to consistency.

Stunningly, all that's left of the original company, following a mass store-closure in 1997, is the Foot Locker chain (originally a Woolworths' sub-brand). The South African, German, NZ, and large Australian Woolworths' are very, very distant cousins, having all been independent of F.W. Woolworth and of each other for decades.

Ingvar Kamprad—IKEA (Sweden)

Ingvar Kamprad was born in Sweden on March 30, 1926 and is the founder of IKEA, having opened the first store in 1943. Not entirely sure why, but the earliness of that date surprises me every time I see it. Modern as it feels, IKEA has a long history, and it is thoroughly imbued with the benefits of evolution over a nice long timeline.

Ingvar developed his first business as a boy, selling matches to neighbors from his bicycle. He found that he could buy matches in bulk very cheaply from Stockholm, sell them individually at a low price, and still make a good profit. From matches, he expanded to selling fish, Christmas tree decorations, seeds, and later ballpoint pens and pencils. When Ingvar was 17, his father gave him a little cash for doing well at school. He used this cash to establish what has grown into IKEA.

Early IKEA was very much about opportunist retail, selling whatever it could, but the big growth came after Kamprad started to think systematically about selling furniture. His guiding philosophy came to be "A better life everyday for the majority of people." I think he meant it too: IKEA is much more than the generation of profits. It offers good things to lots of people at a low cost and without class distinctions. It is accessible, exciting, and honest.

The story of why IKEA customers go into a warehouse area to pick up their furniture is a great illustration of why this company is a great one. In the early days of IKEA, you didn't do that: A helper went and found your stuff for you. Then in 1965, they opened a big new store in Stockholm and on the first day, sales went crazy. There were more customers than the store could handle. Things were awful at the collection area. So the store manager made a judgement call: He opened up the warehouse and allowed customers to come in and find their own items. It worked so well that they tried it again another day, and the rest is history. In IKEA, that manager was recognized for having improved the way the store worked. Anywhere else and he'd have been reprimanded for breaking the rules.

A typical IKEA store.

Source: AP/Press Association/Herbert Proepper

In 1978, Kamprad wrote his seminal retail manifesto "Testament of a Furniture Dealer." In it you read statements such as "to make mistakes is the privilege of the active person. Only while asleep does one make no mistakes" and "an idea without a price tag is unacceptable." That character is strong in IKEA all over the world. It is so strong that it can be made to cross cultural borders. IKEA in Croydon is as recognisable in its IKEA-ness as IKEA in Gothenburg. I truly believe IKEA to be the best retail company to have ever opened its doors to a customer—it has become almost the sole source for furnishings for many households across the world, though there is some evidence now that competitors are emerging who can challenge IKEA.

There's a word of caution here, and that's the risk of ubiquity. There is a backlash beginning to rise against "IKEA style" in which a home furnished exclusively by IKEA is considered to be a bit cheap. My single criticism of IKEA is that the company hasn't moved its design forward fast enough. We've had nearly a decade of the IKEA revolution in the UK and the products seem to be broadly similar now to the early days.

> **My single criticism of IKEA is that the company hasn't moved its design forward fast enough.**

Sam Walton—Wal-Mart (U.S.)

Sam Walton, the founder of Wal-Mart, was a customer genius. More than that, in creating the world's biggest company (not just the biggest retailer), he also showed how to create a consistency of culture that is truly gobsmacking. Every single member of the worldwide Wal-Mart team knows exactly what the company does, how it should do that, and why. The stores are packed with bargains, dependable value, and lots of things to make customers smile.

Wal-Mart is, however, facing pressures from home-grown challengers such as Target as well as encountering strong competitors in critical overseas markets (Aldi, for one, drove Wal-Mart out of Germany in 2006). Some of the Sam magic appears to be slipping away from the company (Walton died in 1992). U.S. employee unrest in particular is fast becoming a serious issue—it needs addressing before it's too late, and before the goodwill that broadly does still exist within the workforce is further eroded.

Those are the clouds on the horizon—largely issues after Sam's time—dealt with. Let's get back to the good stuff: Sam Walton's great legacy is everyday low pricing. As an early operator of franchised Ben Franklin five-and-dime stores, Walton made the unilateral decision to cut margins to the bone in a drive for volume. He chose everyday products on which to focus his most aggressive price discounting: toothpaste and ladies" pants were among his favorite and most successful choices. The simple observation that it was better to sell a ton of product at low margin than to sell a small volume at a high margin drove the almost unchallenged sixty years of Wal-Mart growth.

Sam Walton's original store: now the Wal-Mart Visitor Center, Bentonville, Arkansas.

Source: Bobak Ha'Eri

Some of Walton's most innovative ideas aren't around promotion or price but relate to his work on cutting costs (savings that he then always passed on to customers). He was the first to offer his store managers a profit-share—essentially he said, "It's your business; manage it as such and you will receive a share in the success." Walton recognized that this would make his managers focus more on controllable costs, on taking advantage of product opportunities, and on reducing shrinkage. Another Walton innovation is the "greeter"—a member of staff standing in the entranceway to stores welcoming customers in. This system (which was actually introduced first by one of Walton's managers as a temporary thing but recognized by Walton as a valuable permanent practice) dramatically cut customer theft at the same time as making arriving customers feel a little bit more important.

Though price became an absolute obsession for Walton, I don't believe it was ever a greed thing. I'm convinced that driving the focus on price was Sam's heartfelt belief that ordinary people should always get the best possible deal. It was an honest proposition that made him and his family an awful lot of money but that also reduced the cost of everyday items for hard-working honest citizens.

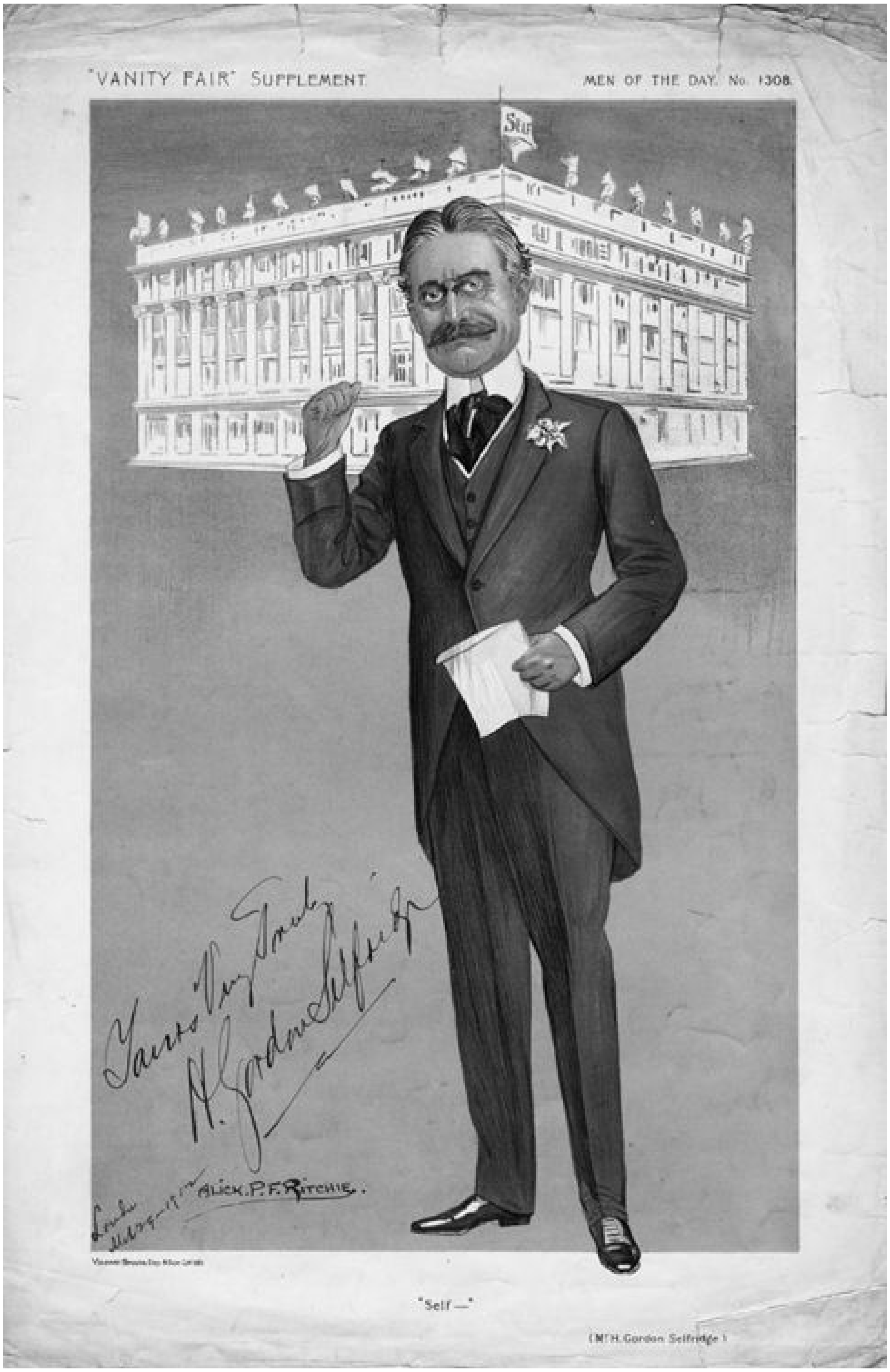
Wal-Mart has always attracted criticism from smaller retailers who accuse the company of exploiting their buying power to drive high-street and local retailers out of business. To an extent that's true, and it's why I believe that some measure of government control on monopoly and single-center retail power is sensible, but that's only half the story. Many, not all but many, of those retailers who go bust in the wake of a Wal-Mart opening are doing so because they fail to offer their customers anything particularly special—there's no added value there. Walton himself challenged small retailers to quit the bellyaching and "Work out what you can do that we can't and then get really good at that thing and get really good at telling your customers about it."

Quite right. That's good advice—get busy living!

The Gordon Selfridge method—Selfridges & Co. (UK)

American Harry Gordon Selfridge opened a large store in London's Oxford Street on March 15, 1909 and named it Selfridges (the current store, frontage included, is larger still, having been extended some time later). A clean-living dedicated man, Selfridge came alive when on the shop floor—he went from accountant to showman and is the true father of great retail theater. Indeed the resurgence of the once-moribund 1970s Selfridges is entirely down to another great retail entertainer—Vittorio Raddice. The key to Selfridges" early success was Gordon's decision to move products out from behind the counters and to make them accessible to customers.

He wanted shoppers to be able to touch, explore, and be excited by products (before an assistant then helped the customer to actually make the final selection—true self-service still being six years, and a continent, away).



The man and his store, Vanity Fair—1911.

Source: National Portrait Gallery, London

A key component in the Selfridges format was staff behavior: He wanted them to be accessible but never aggressive, knowledgeable but never smug. He is the man most often credited with originating the phrase "The customer is always right"—an edict that permeated throughout the customer experience in-store. To be fair, I'm not sure we really know who first actually said that, but Gordo will do for now. Selfridge also recognized that he could make as much money delighting the less well off as from selling crazy curios to the rich. In this way, Selfridges was a democratizer—it was a store that welcomed and treated all customers equally. That simply had not happened before and is an important lesson in how to spread your appeal without diluting your brand.

Selfridge recognized the power of wonder to drive customer traffic and was always on the hunt for grand opportunities to demonstrate the world's cutting edge. In 1909, after the first cross-Channel flight, Louis Blériot's monoplane was exhibited in the store, where it was seen by 12,000 people. The first public demonstration of television was by John Logie Baird from the first floor of Selfridges in 1925. Just two examples in a long history—Raddice brought this sense of occasion back to the store with a series of powerful events and themes. Of late, these themed events haven't quite felt as creative, passionate, or authentic as they did under Raddice. Selfridges in the period up to 2005 was the best store in the world, but it isn't right now. I hope that changes.

Back to Gordon: He was born in Wisconsin on January 11, 1858. In 1879, he joined the retail firm of Field, Leiter and Company (which later became the legendary Marshall Field and Company). Over the next twenty-five years, Selfridge worked his way up the commercial ladder. He was appointed a junior partner and made a significant pot of capital for himself as well as successfully helping to manage the business.

His move to the UK was a huge gamble, really dramatic stuff, and came after he'd taken a holiday in London in 1906. He and Mrs. Selfridge had been utterly underwhelmed by the retail offerings in London and over the next few years, Selfridge plotted a return: this time as a retailer rather than a customer. In 1909, he came back to London with $400,000 capital and chose to invest it by building his own department store in what was then the unfashionable western end of Oxford Street.

I'm as much fascinated by the man as by his store—he was a great retail entertainer, understood inside and out the importance of surprise, discovery, delight, and "wow" but in his formal business dealings and in his private life, he was hugely restrained and at all times absolutely professional.

And then, in 1918, Mrs. Selfridge died.

Gordon went wild in the most splendid fashion. First off, he began to spend extravagantly, abandoned his teetotal tradition, and maintained a busy social life with lavish parties at his home in Lansdowne House in Berkeley Square. He bought Highcliffe Castle in Hampshire and promptly moved in a set of music-hall lovelies, triplet sisters as the story goes, and appears to have kept them as handy mistresses. It was almost as if Selfridge had finally given in to his own heady retail dream and decided to let it rule him.

But what goes up and all that: During the years of the Great Depression, Gordon watched his fortune evaporate—not helped by his gambling habit. In 1941, he was forced out of the Selfridges business, moved from his mansion, and in 1947 he died in absolute poverty at Putney in south-west London. The old man was regularly sighted, in tramp's clothing, outside the Selfridges store toward the end—a sad end to a stunning life.

Epilogue—And we're done?

Again! Thanks for that—I hope you enjoyed reading *Smart Retail* as much as I did writing it. This is a practical book and I would like to think that you are out there putting this stuff into practice as we speak. Please let me have your feedback: on the stuff you didn't like as well as on the bits you've got something out of. Tips on other great retailers for me to go and take a look at are always welcome too—especially ones outside the UK and U.S.

Further Smart Retail

Smart Retail speaking

Nothing brings this stuff to life like me turning up and passionately talking about it—I've got a set of insight-filled, idea-packed, and practical talks that send delegates away buzzing and motivated.

The Smart Retail Seminars

Practical, proven, and effective—my team and I deliver a set of superb training seminars. Our induction day is legendary and our Street Time Live day in which we take your people structured-shopping is one of the most powerful things I've ever been involved in. Always tailored to your business, market, and objectives, these seminars are spot on.

Consultancy

Our bread and butter comes from solving specific problems—if something's keeping you up at night, or you've spotted an opportunity, or you want to bring in a wider perspective, then get in touch and we will build you a great solution.

The Wednesday Clinic

Most Wednesday mornings, I give away my time free to any retailer who wants a little bit of it. I'm happy to talk about anything you want: store problems, ideas, opportunities, confusions—anything. I see it as my chance to give back a tiny bit to the industry that's given me so much. If you want a bit of this time one Wednesday morning, send me an email and I'll give you the phone number to call.

My email: richard@smart-circle.com
Web: www.Smart-Circle.com
Twitter: TheseRetailDays
Foursquare: TheseRetailDays
Facebook: Smart Retail

Thank you for buying and reading *Smart Retail*.

All the best,

Richard

Richard Hammond—Spires Shopping Center, Barnet.

Source: Stillwater Rock

Appendix I. Your job and *Smart Retail*

The book is written from the point of view of an enterprising store manager in a chain. That's for the sake of clarity and expediency, but I know that retailers of all levels use the book, which is great. Here are a few thoughts on how to get the best from *Smart Retail* whatever your role in the business.

Store manager

Most of you who manage stores will be working for a chain. If that's a small chain, you will have lots of opportunity to influence important aspects of the store. You may be able to persuade an owner to introduce new lines or to run certain promotions. If that's the case, you can read this book as an owner.

You may instead be one manager out of a hundred, or out of six hundred for that matter. It can feel really hard sometimes to get your voice heard. Don't let that hold you back—eventually people do notice—keep pushing yourself forward, build a strong team, and make sure key people understand why your store works as well as it does.

In particular, trust me on this: If you follow the "Team" section of the book closely, you will improve your store's performance significantly. It's the most powerful stuff in retail.

Store owner

You're in a fantastic position; you're able to vary any aspect of your business that you want to. You have free rein in this book. Sometimes you will need to spend money on your business, but I am a strong believer in the notion that many things you might need to do can be done at low cost—so it's not all bad.

As is the case for the chain-store manager, all of the advice and ideas on people management can be applied directly for free, and are presented in a practical and obvious way. This means that either you or your managers can make a significant positive impact on the business right away without spending a penny, which is nice.

Team member

There are lots of different reasons why we go into retail: Let's be honest, those reasons might include necessity and convenience. I reckon there's a chance, though, that you might just be in it for something more: After all, you've bought a book on retail; you're getting hooked by it. That makes you very important to me. This book is the tool that will help you to accelerate your retail career. Use it to make suggestions in team meetings; use it to develop your leadership skills and your retail instincts.

Many of the sections and chapters in *Smart Retail* deal with the fundamentals of retail: A good knowledge of these will make you very attractive to employers as you progress your career. To help you get the complete picture, it really is worth going through the whole book in order, front to back at least once. Sorry to sound a bit like your Dad.

As you read, try to consider things from a store manager's point of view; by doing that, you will find it much easier to pitch your ideas to your actual manager. I've also built some of the action plans in a way that means you can easily adapt them to make great interview presentations. This is especially useful when you are chasing a promotion or applying for a job with a new team.

Assistant store manager (ASM)

You are the backbone of retail management: Without good ASMs many stores just do not work. I hope you are alongside a good manager. If you are, that person will value your input and it will be easy for you to make *Smart Retail* work your way. Luckily most of you will be working in good teams and for good people, so use this opportunity to make some positive noise. Make good use of the planning tools provided here and you will gain lots from *Smart Retail*.

Area/regional manager

As one of the few people in the company who spends time both in stores and with the senior management team, you are in a unique position. You have the opportunity to make a big impact on the overall success of the business.

It is a pressure role, and *Smart Retail* can help you to deliver ideas and strategies that keep your boss happy and that can help you to feel that you are actually moving the business forward. You are one of the audiences that I put most thought into when constructing the book—have a long think hard about introducing the ideas in the "Team" section especially. You've also got a good opportunity to use *Smart Retail* to benchmark the way your business operates.

Central functions (marketing, sales operations, administration, and so on)

If you started your retail career in a shop, at the worksite, then you'll enjoy reading *Smart Retail*. Many of the stories and ideas will bring back some, hopefully, good memories. Other sections could well act as useful updates to your experience.

If you have never worked in a shop, then this is the best look into in-store reality you could ever hope for. No matter how good your marketing consultancy, there is no substitute for a proper understanding of what life in-store is really like. *Smart Retail* will give you that.

If you're the type who feels a study visit to the local street-market is beneath you, then this book is not for you. On the other hand, if you are desperate to find effective ways to gain new competitive advantage, to improve customer experiences, or to build better teams, then this may just prove to be the best money you'll ever invest.

Notes for all readers

Above all, *Smart Retail* is a practical proposition. You don't have to read the whole thing or slavishly follow directions like they were the ingredients and instructions for making a cake or something. Just pick out that one thing today that you can make a difference to, then another tomorrow, and another the day after. Before very long, you will find that these baby steps have begun to add up to a significant journey of change and improvement.

Appendix II. Take-action time

Smart Retail is all about the practical. I urge you, please, have a crack at this little personal exercise which is designed to get you started on the route to change. I like selling lots of books, but that process is only really rewarding when I hear that readers have actually used them to make positive moves forward. This exercise is an effective way to kick-start that.

Quickly write down the answers to these four questions. Do it automatically, without over-thinking it. Try to keep writing continuously without pausing. Once you've done that, then you can go back over them and do some trimming and tidying. Tackling this exercise this way helps you to be more honest and more practical in your choices.

- What five things have jumped out at you from the pages of this book?
- What is the first thing you plan to do tomorrow morning?
- What objectives will you set for yourself over the rest of the month?
- What are the changes you want to see in your own management style this year? How will you make these changes?

Time plan

And now, more formally, spend a little time filling out this timed plan. Please be honest, stretching, and practical.

One month after I finish reading *Smart Retail*, I will have achieved these goals:

1.

2.

3.

4.

5.

When we get to six months, these changes will have taken place:

1.
2.
3.

After a year, these important long-term changes will be evident:

1.
2.

Appendix III. Street time

This is a day we run as part of our training programs—normally we obviously try to dress it up a bit with all sorts of important words such as “structured,” “energizing,” and “experiential.” Clients like that sort of guff for some reason. Between you and me: This exercise is about going shopping. It’s good fun when done with a group, and it always uncovers loads of ideas and gets people thinking creatively. It can be quite shocking—I’ve had a number of top retailers give the feedback that they hadn’t really seen shops as customers see them in years.

What do we do?

Ideally run it with six people and do it near a main street or a shopping center. Give each of the delegates twenty dollars and a list of five stores they must visit and allow them to choose one other as a “wild card.”

Take them through the stuff in *Smart Retail* on:

- Reading stores
- Big Idea
- Mission and values
- Discovery

Then send them off, in teams of two, for two hours with the explicit brief that they must observe, talk to customers, and talk to staff. How they get those conversations going is up to them. They can play-act a bit if they want, whatever. But they must get those conversations going. They can spend their twenty dollars however they want to—a bit in each store, all at once, whatever.

The hard part

As well as making some specific observations (listed next), they will need to be taking note of everything with the idea to later apply this stuff to the creation of a sector-raiding Big Idea of their own.

Exercise

Part 1

On returning to the training room, we will be analyzing some of the retailers we've looked at against the following criteria:

- What is the Big Idea at each store?
- How does that translate into values (name five customer emotions per store)?
- How are they hanging these things together as part of the overall offer?
- What are they doing to create theater and discovery?
- What evidence can you cite supporting your views on Big Idea, values, and differentiation of each store?

Part 2

- How might you adapt each store to better suit the Big Idea?
- What might be a better Big Idea for each store?

Part 3

- As a group: Choose one market sector in which you think there might be room to try something new. Then find a Big Idea that would offer an opportunity for a new retail business in that sector.

  Who would want to shop there?

  Why?

  What will the store look like?

  How does discovery work in it?

  What's the perfect customer experience going to feel like?

  How will it compete?

  What will it be called?

Run one of these sessions with your team and you will be stunned by what shakes out. Or get in touch with me and we can set one up and run it for you.

Appendix IV. Books for retailers

Decent books on retailing are few and far between, which is one of the reasons why I wrote this one. Of those rarities, the ones listed here are the best. Two of the titles are pretty hard to get hold of in the UK but are available at www.amazon.co.uk. Good bookshops may be able to order them for you too. I've marked the two in question with asterisks.

***Visual Merchandising*—Tony Morgan (Laurence King, 2008)**

Absolutely essential retail reading—it's the one book on visual merchandising (windows, signage, fixtures, and fittings—if you're wondering) that manages to be both incredibly strong on the loveliness of design and on the practical things that design is there to support. A really good companion to *Smart Retail*. If you can afford it, get Tony's more recent book as well, concentrating on awesome window design: *Window Display: New Visual Merchandising* (Laurence King, 2010).

***The Richer Way*—Julian Richer (Richer Publishing, 5th edition, 2009)**

Richer manages people better than anyone I have ever come across. This is the story of how he does that—essential reading.

***Why We Buy*—Paco Underhill (Simon & Schuster, updated and revised edition, 2009)**

Retail anthropologist Underhill has an understanding of the habits of shopping that is just breathtaking. You have to read this if you're interested at all in customers—which you are.

***People Don't Buy What You Sell: They Buy What You Stand For*—Martin Butler with Simon Gravatt (Management Books 2000, 2005)**

A brilliant combination of personal insight, powerful case studies, and loads of revealing interviews with star retailers. This one is another essential for all retailers.

Retail Success*—George Whalin (Willoughby Press, 2001)

George worked in a famous guitar store in 1960s California and has been a leading retail mind ever since. He told me that the moment he realized that he wanted to be a retailer was the first time he sold a customer a guitar package that made both him and the customer smile. I love that.

***See, Feel, Think, Do*—Andy Milligan and Shaun Smith (Marshall Cavendish, new edition, 2008)**

A brilliant book about learning to trust your instincts and to become more proactive in your decision-making. Loads of retail case studies; brilliant instinctive retailer Jane Shepherdson says it best in her endorsement for this book: “The sooner we start acting on our instincts, and listening less to business school theories, the more the customer will benefit.” This book will help you to do that better, more often.

Made in America: My Story*—Sam Walton with John Huey (Doubleday, 1992)

The story of how Sam Walton and his team built the world’s biggest company: Wal-Mart. This is a lot of fun, full of breathtaking daring, down-home philosophy, and some great retail stories. An absolute must-read, even now so long after it was first published. I love this book.

Index

Footnotes

Chapter 6

[1] The Jane Shepherdson quotes in this case study are based on an interview contained within Martin Butler's essential book on retailing, *People Don't Buy What You Sell (They Buy What You Stand For)*.

[2] Although Jane moved on from Top Shop in 2006, there is absolutely no doubt that the incredible continued success there is directly attributable to her revolution, attitude, and love of fashion-risk.

Chapter 8

[1] Stats and background information taken from *Blink* by Malcolm Gladwell (Penguin, 2006).

Inside the Mind of the Shopper

The Science of Retailing

Herb Sorensen, Ph.D

Publishing as Wharton School Publishing
Upper Saddle River, New Jersey 07458

Wharton School Publishing offers excellent discounts on this book when ordered in quantity for bulk purchases or special sales. For more information, please contact U.S. Corporate and Government Sales, 1-800-382-3419, corpsales@pearsontechgroup.com. For sales outside the U.S., please contact International Sales at international@pearson.com.

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Dedication

This book is dedicated to Bob Stevens of Procter & Gamble (P&G), the man who set me on the path of "active retailing" and who is also widely viewed as a pioneer in the field of shopper research.

He was a man of many talents: A consummate researcher, he was also an avid sports fan. Indeed, at 15, he began a short career as a professional wrestler, assuming the name "Rocky Stevens." Later in life, his love of basketball took him to Israel, Italy, and Alaska to cheer on his teams.

Bob was a devout Christian, a loving husband, father, and grandfather, and a philanthropist, too. He raised money for education and, post-retirement, taught and lectured often on market research and management, donating his honoraria to charity. For a time, he served on the board of Hope Cottage, a temporary shelter for abused, abandoned, or neglected children.

The greatest portion of his life, however, was spent at P&G where, beginning in 1951, he spent nearly 40 years as a consumer research manager. Bob was known as an inveterate people-watcher, fascinated by consumers' behavior both in-store and out, and especially their interaction with products.

His retirement did not put a stop to his professional involvement. He continued to write about marketing and research in a periodic newsletter called "Views from the Hills of Kentucky," which he emailed or faxed *gratis* to subscribers.

So, what made this man special? He was an advocate for the shopper, for understanding their needs and for doing the right thing as a researcher—often acting as a role model for his peers. He was always curious about what people *did* as opposed to what they *said*. And in many ways, his work has stood the test of time, as brands began to focus more on ethnography.

Bob would always dig a little deeper when it came to research. Bob Goodpaster, who is currently Vice President of Global Insights for The Hershey Company, recalls that when he worked with him at P&G, Bob would focus on research at one or two stores, giving people coupons to go in and buy products, while collecting their names and phone numbers for follow-up research.

What he was trying to do was to predict potential repeat purchasing, but working it out over a weekend—without having to wait months and months to read the normal statistical print-outs. He was *way* ahead of his time.

It couldn't have been easy because, as with any pioneer, there were those who were enthusiastic about change and those who were afraid of it. But Bob persevered, and rarely turned down the chance to innovate. For P&G, this resulted in insights that the company might never have achieved otherwise. Indeed, P&G is one of the most innovative research organizations around today—and Bob played a part in laying the foundations of continuing innovation.

He was an expert in understanding the relation between P&G products on the shelf and the shoppers walking by. He followed those shoppers home with their products to see how they actually used them. Harking back to the early days of his career, he pioneered the use of hall tests in the 1950s, seeing it as yet another way to get closer to consumers.

Bob's philosophy lies at the heart of this book, too. His enthusiasm for researching shoppers—for knowing what goes on when they enter a store—is translated in these pages into a modus operandi for retailers (and brand owners) who want to make the most of their businesses.

Earlier, I mentioned his newsletters, which inspired new ways of thinking and working. I include samples from two of his favorite topics in the Appendix, distinguishing between "testers" and "users" and the need for "assessment in context," and the full set is available online. Bob's views on these issues matched my own major concerns as a scientist transplanted to market research. We believe that customers should be studied in their native environment: This means researching supermarket shoppers in supermarkets; food service patrons in restaurants, schools, and other commercial and non-commercial locations; food service operators in their kitchens; schoolchildren in their schools; and so on. Also, we prefer direct observation of "users," and asking questions, converting them into "testers" as follow-ups, rather than as the foundation of the research.

Our learnings about the messy process of testing in context were inspired by Bob, and became integral to my business following discussions with him. It was Bob who turned my narrow focus from the shoppers and the products to the stores, their natural habitat. I hope that, from whatever lofty peak he's now operating, he feels that I'm still taking his work forward in the ongoing search for truth about shoppers.

Praise for *Inside the Mind of the Shopper*

"Read it, do it, and you will sell more!"

—Hermann W. Braun, Director of Category Management and Shopper Marketing, Ferrero Germany

"This is a unique book that examines and explains the need for the measurement of actual shopper behavior in retail environments. Based on real shopper studies, this takes analysis beyond POS data. Herb Sorensen pays particular attention to precise measurement of nonintuitive aspects of shopper interaction with the shelf."

—Franz A. Dill, Former Manager and Founder of Procter & Gamble's Retail Innovation Center

"Herb Sorensen's ideas and observations about in-store shopper behavior have been instrumental in shaping my recent research. He has an uncanny ability to see beyond surface details and detect meaningful patterns of genuine interest to front-line managers and senior executives. It's great that so much of his wisdom—and that of other researchers he has influenced—is collected together here."

—Peter Fader, Professor of Marketing, The Wharton School of the University of Pennsylvania

"Every year retailers disrupt their customers by spending time, money, and resources remodeling stores. Before remodeling one more store, read what Herb Sorensen has learned about how customers shop and how you can use it to improve your customer's shopping performance and your earnings.

One hundred years ago retailers ran their stores by watching their customers closely. Somewhere during the last hundred years, spread sheets, slotting allowances, and quarterly performance replaced the basic principles of the business. Sorensen's book puts you back on the floor of the store and allows you to see how the customer sees your store. What Sorensen shows you will make your stores better and more efficient for the customer and will maximize the money you are investing in design and remodels."

—Norm Myhr, Group Vice President Sales Promotion and Marketing, Fred Meyer

"This book is priceless for anyone in retailing. It is based on 40 years of retail experience, and Herb Sorensen opens the doors to a new world. He serves us with masses of empirical data and examples, but also with new metrics and a new theory of shopper behavior. I am certain that he will challenge most retailers as well as researchers and force them to check if what he states can really be so. He challenged me, I had to check, and he was right!"

—Jens Nordfaült, Assistant Professor, Stockholm School of Economics; Dean, Nordic School of Retail Management; CEO, Hakon Swenson Research Foundation

"*Inside the Mind of the Shopper* is the preeminent handbook for any marketer or retailer seeking to understand why people do what they do when they shop. Armed with the knowledge in this book, marketers and retailers can work together to predict how shoppers will respond (or not!) to package and label design, selling messages, shelf plans, and the entire retail space."

—Matt Ohligschlager, Senior Manager, Consumer and Market Knowledge, Procter & Gamble

"A must read for anyone who is passionate about understanding shopping."

—Joe Radabaugh, Director, Shopper Marketing, Nestlé USA

“From his 40 years of observing shoppers, Herb Sorensen has given us the gift of understanding shoppers. Now, we clearly see that the store layouts merchants want are not what shoppers want. On the ground, managers THINK they know their shoppers, but anyone who follows Herb’s handbook on shopper insights will know them a lot better.”

—Joel Rubinson, Chief Research Officer, The Advertising Research Foundation

“Herb Sorensen is the dean of behaviorally responsive shopper marketing. Crammed with stats and crisp insights, his book guides retail professionals through the maze of motivations that lead shoppers to locate, stop, and buy.”

—James Tenser, Principal, VSN Strategies

Author’s Notes and Acknowledgments

I was born at an early age….

What might have been seen as precocity in the first half of my life has evolved into a certain independence in this half. Here I want to give tribute to some of the key players in bringing this book to fruition.

From my mother, I inherited a drive for improvement, and from my father, hard work as the proper and justifying role of man. I met my wife when I was fourteen, and was blown away by her wise and serious essay on the stages of life, read by her to our English III class in high school. Approaching our fiftieth wedding anniversary, she has been the tether that kept me connected to those most important things in life. Five years after our first meeting, we had our first daughter Kris, while I was finishing my senior year in college.

All of my five children grew up inside the business that evolved to deliver this book. Kris, now a stay-at-home-mom, managed the operations side of the business during some of the most explosive growth we ever experienced. Beth, even as a pre-teen, was helping with keeping those rows and columns straight, in the days when we did manual tabulation of survey data. Later, she and I set a personal record of 130 respondents recruited and interviewed in one hectic day in Santa Monica.

Jon is the philosopher-musician-writer who helped me begin contributing reports and articles to the marketing research press. This work laid the foundations of this book, helping me to think through some of the issues covered here. James is the right hand that built Sorensen Associates, “The in-store research company®,” which the world has come to know. He is the one who transmuted my scientific curiosity into something of practical value for our clientele, which has swelled under his ministrations.

Paul is an award-winning nuclear physicist who wrote the software for our TURF analysis (Total Unduplicated Reach and Frequency). We continue to

use the procedures he developed for shopper flow analysis in our PathTracker® Tool Suite.

Beyond the core of my family, the towering influence from my early professional years was Lloyd Ingraham, my major professor at the University of California at Davis. His was an open and searching mind that encouraged the same for me. What an incredible experience, to be given free range and funding to follow my nose into nuclear quadrupole resonance, chick embryo metabolism, the quantum chemistry of small ring heterocycles, the role of thiamine in muscular dystrophy, and radiocarbon and dendrochronology—all resulting in peer-reviewed scientific papers in one three-year period.

Leaping forward nearly 30 years found me with an eclectic history encompassing university faculty positions, board-certified clinical chemistry, which evolved through a food laboratory and sensory science to market research. The logical connection through all this is curiosity.

In 2000, three things converged—my long-standing curiosity about the overall movement of shoppers through stores, my acquaintance with Peter Fader at Wharton, and client support by Sandy Swan at Dr. Pepper/7UP for an initiative to conduct the study. Although a few others followed, it was Sandy's immediate financial encouragement that launched PathTracker®, the most extensive study of shopper paths (and much more) ever conducted. Sandy was with me on the early work when the insights were accumulating, but the knowledge of how to use the insights profitably was slow to coalesce.

And then, Peter Fader's immediate and enthusiastic support for the project rendered the objective, academic *imprimatur* that I valued more than the money. His practical views on the relation of online and offline retailing are covered in our interview in Chapter 7, "Integrating Online and Offline Retailing: An Interview with Professors Peter Fader (The Wharton School) and Wendy Moe (University of Maryland)."

Mike Twitty of Unilever was another major influence. Mike and I both participated in the first IIR Shopper Insights Conference (2001), and I recognized early on that Mike was a *serious* student of the shopper. Mike Twitty has had the "quick trip" as a focus for several years, and my own overwhelming data forced me to recognize the unclaimed potential in this area. Mike is making a tremendous contribution to the entire industry through the insights he shares from this work in Chapter 6, “The Quick-Trip Paradox: An Interview with Unilever’s Mike Twitty.”

I’ve mentioned the role of curiosity in my career and this book. Science is, of course, another prominent motif. But *independence* is perhaps as important. Not caring what anyone else thinks is a strength and flaw encouraged by a decade or more of living, like Thoreau, in my own mountain-forest semi-isolation. My independence, however, is tempered by a healthy dose of personal insecurity, which always secretly seeks confirmation and approval. But I am very picky about whose approval and confirmation I care about.

This is the significance of Fader, Twitty; and later of Bill Bean, then at Pepsi but now at Colgate; then Mark Heckman, now (and again) at Marsh; and even later of Cliff McGregor of Nestlé; and, finally, Siemon Scammell-Katz of ID Magasin, now a colleague at TNS/Kantar. In any budding and exciting field like “shopper,” there are always plenty of thin poseurs. But these folks are genuine gold, having their own independent and advanced expertise in the shopper that I know and care about.

Bill Bean, while at Pepsi, sponsored a study of four supermarkets using the RFID tracking technology, while it was still cutting/bleeding edge. Bill took the raw data from those four stores and did his own independent study, using intelligent agent modeling with Icosystem, which confirmed and went beyond many of the things I was learning myself. (The Wharton group under Fader has also operated independently, following its own curiosity and analytical strengths.)

Mark Heckman worked with me closely as an associate for a couple years before returning to Marsh Supermarkets. He brought a real-world retailer perspective to our research. This allowed PathTracker® to become not just a tool looking from the outside in on the business, but from the inside looking out. In Chapter 9, “Insights into Action: A Retailer Responds: An Interview with Mark Heckman of Marsh Supermarkets,” he discusses how a retailer has specifically benefited from implementing the principles in this book.

Siemon Scammell-Katz is the first person I ever met who knew many of the principles and truths that were emerging from PathTracker® but had no prior exposure to the intricacies of our work. His knowledge was a result of having spent more than a decade studying shoppers' behavior on a tenth of a second by tenth of a second basis (fixation by fixation) from point-of-focus eye tracking studies, primarily in Europe. Siemon's independent work not only served as confirmation, but also stimulated me to a renewed interest in eye tracking, particularly linking the footpath to the eye path.

Finally, Cliff McGregor at Nestlé and I have had many illuminating (to me) discussions. These interested me greatly, initially, because of Cliff's former participation in the Envirosell organization in Australia before he joined Nestlé. I've mentioned in the book my great respect for Paco Underhill's work, although we have never been connected professionally, other than my reading his books and sitting in his audiences.

Cliff has done me the kindness of reading the entire first draft and commenting, to my profit, on various features. I spent a very pleasant day in 2007 chatting with Cliff about our mutual views on shoppers. This was very helpful because of my own newness to the global scene and his wide experience of global retailing, as well as a more detailed view into the cultural anthropological approach to studying shoppers. The anthropological view has been further enhanced by Emil Morales' contribution on multicultural retailing, which he discusses in Chapter 8, "Multicultural Retailing: An Interview with Emil Morales, Senior Vice President of TNS Multicultural."

In this sense, Siemon, Cliff, and Emil have all enhanced my own study and focus by broadening my scope to a bigger picture, as well as a more detailed focus on the individual shopper.

In my mind, I have something of an artificial boundary between myself and "my" company, which in reality has been run for quite a few years by my son, James. But at the same time, there is an obvious connection, beyond family. Frankly, I could never have learned what I have about shoppers if I had stayed tethered to our clients' questions and interests. On the other hand, had the company not focused on those, we wouldn't exist. It is James and his staff that have mediated the learnings from PathTracker® to the world of our clients. But James has been the stern "client" that always disciplines me with, "So what?" And it has not been an indifferent "So what." This is why Chapter 5, "Brands, Retailers, and

Shoppers: Why the Long Tail Is Wagging the Dog," is in reality a collaboration between myself, James, Siemon, and Ginger Sack, our senior researcher on the client side. So, as I have learned from all the others, James and Ginger have taught me most how to introduce science to our marketer clients.

Of course, many at TNS Sorensen have played crucial roles in supporting my studies, and I thank them all—but two have been the heavy-lifters in research and development. Dave Albers is the concept and numbers genius that always improves every idea I bring him, and Marcus Geroux is the creative talent who does the same with devices, electronics, and anything requiring "making." I told Marcus once that he must have apprenticed with James Bond's "Q." Both have played key roles in one or more of the suite of patents underlying the PathTracker® Tool Suite.

My sincere thanks to the giants mentioned here, upon whose shoulders I have stood.

Finally, I must thank my colleagues at TNS, particularly Sean Hosey, who introduced me to Laura Mazur and Louella Miles, who spent the better part of a year coaxing and encouraging me in the writing of the book, drafting content from my interviews, rewriting and stitching together a vast quilt from the multifarious pieces I had assembled willy-nilly over the years. It really was a surprise to me to learn how different writing a book is than assembling a series of articles. However, the result of all this was a very fine *scientific* document, organized in my own inimitable style.

It was then that the publisher, Pearson and Wharton School Publishing, stepped in, along with Robert Gunther, to reorganize the content and create a book of wider interest to a broader readership. All the while, the steady support of Jerry (Yoram) Wind and Steve Kobrin, Editors at Wharton School Publishing, encouraged perseverance. Jennifer Simon and her supporting team at Pearson have played the final role in creating what I think of as a very fine book. Of course, I retain all responsibility for the content of the final document, so send any brickbats my way. Kudos to the rest!

About the Author

Herb Sorensen is a preeminent authority on observing and measuring shopping behavior and attitudes within the four walls of the store. He has worked with Fortune 100 retailers and consumer packaged-goods manufacturers for more than 35 years, studying shopper behavior, motivations, and perceptions at the point of purchase. Sorensen's patented shopper-tracking technology PathTracker® is helping to revolutionize retail marketing strategies from a traditional "product-centric" perspective to a new "shopper-centric" focus. As *Baseline* magazine commented, "Herb Sorensen and Paco Underhill are the yin and yang of observational research."

Herb has conducted studies in North America, Europe, Asia, Australia, and South America. His research has been published in *AMA's Marketing Research*, *The Journal of Advertising Research*, *FMI Advantage Magazine*, *Progressive Grocer*, and *Chain Drug Review*, and he has been utilized as an expert source for *The Wall Street Journal*, *Supermarket News*, and *BusinessWeek*. Additionally, he is currently a panelist of Retail Wire's "Brain Trust."

Herb was named one of the top 50 innovators of 2004 by *Fast Company Magazine*, and shared the American Marketing Association's 2007 EXPLOR Award for technological applications that advance research, with Peter Fader and his group at the Wharton School of Business of the University of Pennsylvania. Herb has a Ph.D. in Biochemistry.

Preface: Rethinking Retail

> *"When you cannot express it in numbers, your knowledge is of a meager and unsatisfactory kind."*
>
> —Lord Kelvin

The supermarket is my laboratory. After earning my Ph.D. in biochemistry and working for a brief period in the food industry, I traded a lab bench for the aisles of the supermarket. At that time, the supermarket was a black box. Manufacturers and retailers were concerned about how to get shoppers into the door and make them aware of products before their trips, but they assumed that they understood what happened when the shopper was inside. Our research, discussed in this book, shows that in many cases they were wrong.

In the early 1970s, I left my practice as a board-certified clinical chemist and started a small laboratory providing a range of services, primarily to the agricultural and consumer packaged goods industries. One of the services that we provided was sensory evaluation—consumer taste test surveys. Following the example of universities, our "tasters" were college and university students. I initially started doing in-store research because a client said that he didn't think the opinions of college students, with their well-known penchant for pizza and ramen noodles, were very representative of typical supermarket shoppers.

Being a scientist, rather than a market researcher, it never occurred to me *not* to interview supermarket shoppers. I approached the manager of a local supermarket, and he readily gave me permission to interview his shoppers. Remember, this was more than 30 years ago, and the local Albertsons manager had an amazing degree of autonomy. When we were in the store, we found that there were many other interesting questions to study.

I pursued the in-store research niche—first as a solo consultant and then as the founder and president of Sorensen Associates, “The In-store Research Company®,” and more recently, as Global Scientific Director, Retail and Shopper Insights at TNS, a global research and information services firm. We are now a part of the even larger conglomerate WPP, with a focus on advertising and communications. Although most of our experience is with supermarkets and brand manufacturers of fast-moving consumer packaged goods, we have found our core insights hold for work with supercenters, drugstores, convenience stores, auto parts retailers, building centers, consumer electronics, phone stores, and many other retailers or products. We have completed studies in a variety of channels on every continent except Africa and Antarctica, and the paradigm, metrics, and insights are as relevant elsewhere as in the U.S. (with some differences, as we will examine later). Over the years, we came to appreciate the value of conducting research in the store environment, rather than just doing research about the store, products, and shoppers.

We decided to study what shoppers actually did in the store, what they looked at, how they moved through the store, and what they bought. We examined strategies that could be used to increase sales, testing these approaches in the laboratory of real stores with actual shoppers. We traveled with customers down thousands of miles of supermarket aisles and analyzed millions of hours of shopping to help retailers create more effective stores and approaches. We found that simple interventions could have dramatic effects, but only if you understood how shoppers think. And some widely used strategies have little impact on the behavior of most shoppers, so we also helped retailers stop throwing money away.

As a pioneer in the field of in-store research, I have had the opportunity to see retailing go through many changes—including the emergence of new technologies and online retailing. As the industry continues to change, however, the basic insights from our research continue to hold true. And in a more complex and dynamic environment, understanding shopper behavior may be even more important.

I have spent millions of dollars of my own money doing some of this research, and the world’s top brands and forward-thinking retailers have spent millions more on specific projects and PathTracker® studies. We have looked at every square-inch of these stores and analyzed millions of shopping trips on a second-by-second basis, using the best technology at our disposal. The results, to the extent that the information is not proprietary, are contained within the covers of this book.

I am grateful to the many managers who embraced and supported this work, even when it was unproven. I am particularly fortunate to have worked with Bob Stevens, to whom this book is dedicated. He had recently retired after 40 years in market research for Procter & Gamble, and taught me to go far beyond the product-shopper dimension mentioned previously. This, in turn, led to the development of my current holistic view of the shopper experience, including the invention of the PathTracker® suite of tools, metrics, and a scientific paradigm for the subject of shopping. Finally, I am grateful for the fine work by other pioneers, such as Paco Underhill and Siemon Scammel-Katz.

Along the way, we have faced resistance to this approach. As researchers at one of the largest supermarket chains in the world told us: "We do not interview our shoppers in-store, but conduct phone or Internet surveys of them." Interviewing shoppers outside of the store is like trying to understand the movements of a flock of birds by observing a specimen in a natural history museum. It is shocking to me, but not at all exceptional.

This book offers managers in retail firms, or companies that sell products through retail, valuable insights into what happens to their customers when they walk through the front door of the store. Companies that spend countless dollars getting the customer to this point often look away just at this critical moment, giving scant attention to the "last mile" of retailing. Retailers and brand owners know all about who the people are going into the store, and what they are carrying home from the store, and a lot about what they are doing at home. But I stake my career to a large degree on the fact that they know very little about the *process* that occurs in the store. (As I will consider later, this lack of knowledge might be due in part to the structure of the industry, which means retailers and manufacturers get more out of interacting with one another than with customers in the aisles.) This book also offers anyone who has shopped or wants to understand the shopping experience, research-based insights into the habits of the shopper.

On the following pages, we explore some of the key insights from this work—the quick trip, three moments of truth for the shopper, in-store "migration" patterns, and how to put products in the path of customers through anticipatory retailing. We also look at how manufacturers and retailers can collaborate better in shaping flow and adjacency to sell more products in stores. In the second part of the book, we offer insights from a series of interviews with executives and experts on specific topics related to in-store retailing: deeper insights on the quick trip, the integration of online and offline retailing, multicultural retailing, and a retailer's perspective on the issues presented in this book. Whether you are running or designing stores, building brands, or merely want a deeper understanding of shopping behavior, this book will challenge the way you look at shopping.

In a certain sense, the shoppers' eyes offer a window into our entire society. As I realized in four decades of this work, retailing is at the cutting edge of social evolution because it brings people and the things they *must have* together. This is where the dreams and aspirations of consumers and the messages of brand owners intersect in a concrete action to make a purchase. If you want to understand our society, taking a trip with a shopper down a supermarket aisle is a very good start. I invite you to join me on this journey through the modern supermarket. I think you will be surprised at what we find.

–**Herb Sorensen, Ph.D.**

Introduction
Twenty Million Opportunities to Buy

> *The great obstacle to discovering the shape of the Earth, the continents, and the oceans was not ignorance but the illusion of knowledge. Imagination drew in bold strokes, instantly serving hopes and fears, while knowledge advanced by slow increments and contradictory witnesses.*
>
> —Daniel Boorstin, *The Discoverers*, 1993

A woman in her 30s moves through the aisles of a Stop & Shop outside of Boston. She was selected for our study because she planned to purchase dish detergent, one of the types of products of interest to our client. We fitted her with specially designed glasses connected to a device that records her field of vision every 3/25ths of a second and relays it to a computer (see Figure I.1). The glasses also reflect the corneal image of her eyes so we can track exactly what she is looking at in her field of vision as she moves through the supermarket aisles. Instead of *watching* shoppers, we actually *see what they see* and focus on.

Figure I.1 Specially designed glasses record the eye movements of the shopper as she walks through the store.

After the images are overlaid with crosshairs indicating where her gaze is focused, they are analyzed by technicians in India (see Figure I.2). We know where she went, what she looked at, and what she did as a result. We are not asking her what she did after the fact. We are not just observing her. We are seeing through her eyes. Short of crawling inside her head (and we are actually beginning to do this), this is as close as anyone has ever gotten to understanding the complexity of the shopping experience and what shoppers actually do in their natural habitat. Given that 90 percent of all sensory input comes through vision, understanding what shoppers see offers a pretty good view of their thinking.

Figure I.2 The images from the glasses show the field of vision, and crosshairs indicate the shopper's point of focus at each step, second by second, along the route through the store.

In this one-minute journey (images from the first 30 seconds are shown in Figure I.3), our subject moves quickly past shelves of paper towels, tissues, and napkins, scanning left and right without stopping. She is on a mission. At mid-aisle, she looks at the end cap display on the left. Then, she looks all the way to the end of the aisle, perhaps to get her bearings, scanning the very bottom shelf of the left side of the aisle. She swings her gaze across the aisle to the bottom shelf of the right side, and then moves up along the second shelf. Her gaze zigzags to the top and then to the bottom. She hits a display of brushes and other cleaning products and that breaks her path, so she goes to the left side again. She reaches rows of detergents and stops her cart, scanning rapidly up and down the shelves. Just before she grabs the detergent, she looks down at her cart where a store circular sits on the seat. Could she be checking on the brand in the circular before grabbing the product? She leans a bottle of green detergent forward just before taking it off the shelf. Then, she puts back the green bottle, looks up to the top shelf, and pulls down a pink bottle to put into her cart.

Figure I.3 Images from a 30-second segment of a shopping trip show the shopper checking the end cap, entering the aisle, scanning right and left, and making a purchase. The diagrams below each figure indicate the way the shopper is facing between the two aisles.

This video clip of her passage down one aisle of paper goods and detergents lasts just half a minute. In thirty seconds, her gaze has passed over hundreds of products; she has considered a few and selected one. She has evolved from a visitor to a shopper to a buyer.

I often tell clients that there is a whole book in this one-minute clip. In a real sense, the volume you are holding now is that book.

Twenty Million Seconds: Shopper Time Is Mostly Wasted

Twenty million seconds. That is the time all customers collectively spend in a typical supermarket every week based on our measures across many stores. Each of those seconds is an opportunity to sell. That is 20 million opportunities a week to sell something. But the tragedy of modern retail is that most of those moments are wasted because retailers and manufacturers by and large do not know what the shopper is doing during these moments. Retailers focus on traffic but traffic in itself never buys anything; it is traffic investing time that becomes shopping. We have found that about 80 percent of shoppers' time is spent simply in moving from place to place in the store, not looking at and purchasing items, which means that most of the shopper's precious time and attention in the store is spent *not shopping*.

If we shift our perspective from the shopper to the shelf, the picture is just as bleak. We find that a single item in a store might attract only 300 seconds from all shoppers in an entire week, about five minutes. All those products in a typical store, and they get very little attention. Of course, as we will discuss later, some products get much more attention—not necessarily because of the product itself but often due to its location in the store.

In comparison to that huge number—20 million seconds—the number of purchases on most shopping trips is remarkably small. In fact, the most common number of purchases by a single shopper on most trips is just one. All those seconds, all those products, and the shopper walks out of the supermarket with just one item. Think about it. The average supermarket might stock 30,000 to 50,000 SKUs, and yet this shopper walks past them all to emerge with a single item. In a year, the average household buys just 300 different items. Shoppers are forced to wade into this thick jungle of offerings to find the handful of precious items that they truly want. We all know the jungle can be a lonely and dangerous place. Many shoppers are lost there.

This is the tragedy of modern retail. The shopper comes to the store to buy things. The retailer creates stores to sell things. Manufacturers create products to sell. Yet most of the shopper's time in the store is spent *not* buying. Shoppers and products long for each other, like Romeo and Juliet, but are held apart by forces greater than themselves. As we will discuss, some of these forces that keep shoppers from shopping are a result of the relationship between retailers and manufacturers, which means that more of the retailer's profits come from brand promotions than from shoppers themselves. This has led to a great emphasis on promotional dollars at the sacrifice of an attention to shoppers. This, in the long run, hurts both retailers and manufacturers, as well as, obviously, shoppers themselves. This relationship is why both retailers and manufacturers have paid far too little attention to shopping behavior. But it also means that there are tremendous opportunities to improve sales and profits by understanding shoppers better.

Table I.1 Lost Opportunities

The Facts	
1 quadrillion	The number of seconds all shoppers spend in all stores, globally, every year (not including automotive)
20 million	The number of those seconds shoppers spend in a single typical supermarket or supercenter in a single week
70 percent	The share of the shoppers' field of vision that is filled with commercial messages, including packages, on average
3 hundred	The number of seconds all shoppers spend in a give store, on average, on any single item, in a single week
80 percent	The share of the shoppers' time that is spent navigating the store instead of actually considering items for purchase
3 hundred	The number of different items a typical household buys in an entire year, only about half of those month after month

Brand owners have invested a great deal in understanding consumers outside the store, but how people behave in stores is quite different from what these studies outside show. There is no substitute for watching shoppers in the aisles of actual stores. People do not become real shoppers until they enter the store and cease to be shoppers when they leave the store. Forget what you know about consumers before they walk in the door of a store. Just as examining a military leader's strategy will tell you very little about what actually happens on the battlefield, no amount of shopper knowledge derived from outside-the-store measures will tell you about what will happen in the store. *Shopper insights are specifically about behaviors within the store's four walls*.[1]

The tragedy of modern retail is that most of the shopper's time in the store is spent not buying or selling. Of all the products on the shelves, only a small number account for most sales.

Time Is Money: Shopper Seconds per Dollar

The millions of lost buying opportunities are very important. If we look at the whole shopping trip, the critical issue is not merely sales per visit but *seconds per dollar*. How long does it take shoppers in the store to spend a dollar? Across many studies, I have found a basic principle: The faster you close sales—the less time wasted for the shopper—the more sales you will make. In fact, when we charted this effect across a series of typical stores, we found that the efficiency of the shopping trip was directly related to overall store sales, as shown in Figure I.4. Given this data, does it make sense to force the shopper to walk through the entire store to find a quart of milk, thinking you might sell something else along the way? Or should you get them buying as quickly as possible and build momentum?

Figure I.4 The faster shoppers spend, the higher total store sales.

As this figure illustrates, time really is money. The more quickly shoppers can make purchases, the greater the total store sales. In this sample, by shaving off 30 seconds per dollar, stores have doubled sales. This means that what goes on inside the store—including how the store is designed and what selection is offered and where—has a tremendous impact on sales. Following shoppers around on the trips through stores can reveal a great deal about how to make stores more profitable.

Leaving Money in the Aisles: The $80 Million Question

Retailers and manufacturers who understand what goes on inside the store can use this knowledge to increase their sales by fivefold. Because the typical supermarket does $10 million to $30 million in annual sales, wouldn't one doing $100 million in sales suggest something beyond extraordinary? In fact, a great deal of my thinking about supermarket design is influenced by the roughly $80 million of extra sales the typical supermarket leaves on the table. A great example of the potential can be seen in Stew Leonard's stores, with their $100 million in annual sales. Although Stew Leonard touts his world-class customer service as the secret of his success, there are two factors that amount to Stew Leonard dealing himself four aces hand after hand, and then thinking his winning is strictly due to his skill at playing the game. These four aces are founded on bedrock principles of shopping behavior. Stew Leonard's first two aces are the use of a serpentine path, which involves a single wide aisle that snakes its way past the merchandise through most of the store. The serpentine path eliminates the question: Where do I need to go next? You are going exactly where everyone else is going—right down this very wide aisle. This reduces navigational angst for shoppers. The second two aces are the reduction of shopper choice by pruning down his products to less than 2,000 individual items (SKUs) in the store, compared to 30,000 to 50,000 items in "competitive" stores. Stuffing the store with massive choices is unwelcome and unhelpful to shoppers, whereas it may be attractive to brand partners, particularly when what shoppers really want and need is buried in this indiscriminate mass. Although variety may help attract customers to the store, it often creates a barrier to shoppers. Through his store design, Stew Leonard makes sure that the right products show up in your field of vision by the time you get to the checkout. This reduces a second kind of shopper angst: choice angst.

Removing all this angst (choice angst and navigational angst) means that the shopper moves along at a steady pace—I'm told the shopping trip is actually *faster* than in a full supermarket—thinking about nothing except whether to put this or that into the basket. The result of this brilliant plan is an *extra* $80 million of sales each year, all put in the basket one item at a time by shoppers engrossed with nothing but putting items in the basket. No need to look over *huge* quantities of merchandise of no interest to you or your fellow shoppers. No need to "hunt" for anything. This means fewer shopper seconds per dollar and a resulting leap in annual store sales.

This serpentine path is not the only solution, as we will discuss later, but it does illustrate the potential of working with, rather than against, shopper behavior. This recognition of superior shopper strategy, of course, is not to underrate the truly world-class service that Stew Leonard regularly provides to shoppers, to which he credits his success. I believe this is a chicken-and-egg situation. If you are cranking $100 million in sales (admittedly running hard to do it), it's no wonder that you can go more than the extra mile with *all* your shoppers. Trust me, if you delivered Stew Leonard's service in your typical supermarket, you *would* get a significant bump in sales, *but it wouldn't be an extra $80 million!* To get that kind of performance, you have to rethink the total shopping experience.

I'm not surprised that retailers haven't leapt on the Stew Leonard's model. After all, they didn't leap on the Wal-Mart model or the convenience store model. Tesco's Fresh & Easy in the U.S., and the European discounters Lidl and Aldi, are pursuing the limited selection strategy. Echoes of Stew Leonard's model can be seen in HEB's Central Market designs, built on a serpentine model with a side warehouse area to accommodate the missing SKUs of a big store. Stew Leonard's now also has a "warehouse" area on the side, at the end of the trip, where shoppers can browse for those less-needed items. It makes the store more attractive without hectoring the shopper with massive amounts of merchandise in which they have no interest.

Planning Our Trip

On the following pages, we will take a journey through the store—and the mind of the shopper. As shown in Figure I.5, which highlights some key insights from Part I, “Active Retailing,” we will consider diverse aspects of this journey, including the rise of the quick trip, moments of truth in the aisle that lead to purchases, migration patterns through the store, principles of active retailing, and the challenge of managing the big head (the few products shoppers buy frequently) and the long tail (the many products retailers stock). Before rolling down the aisle, let us briefly survey the path ahead.

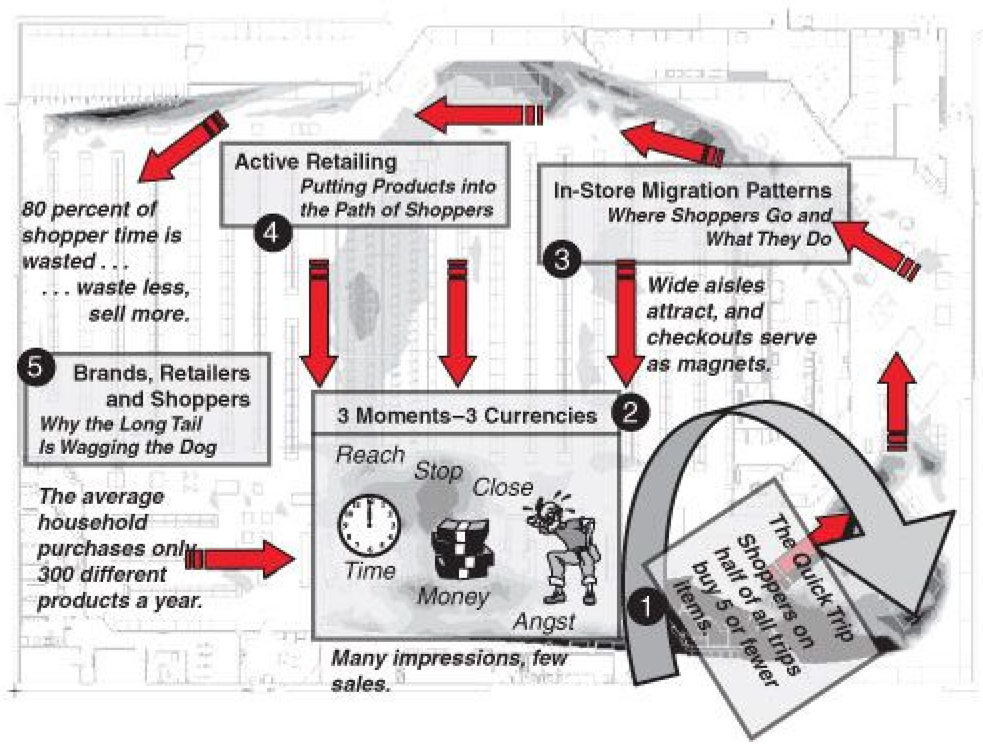

Figure I.5 Planning our trip through the book

Shoppers Make Small Trips to Large Stores

In observing the behavior of thousands of shoppers, letting shoppers group themselves according to behavior, we have identified three primary types of shoppers, as follows:[2]

- **Quick:** As noted previously, the number of products purchased most commonly on a shopping trip is one. These shoppers spend a short time in a small area, with a relatively slow walking speed but high spending speed. A third of all trips to the supermarket result in only one or two items being purchased, with fully half of all trips consisting of five or fewer items purchased.

- **Fill-in:** These shoppers visit about a fifth of the store, have a slightly faster—but still slow—walking speed and an average spending speed.
- **Stock-up:** These shoppers cover a larger area, walk more quickly, but have a lower spending speed.

Although most retail stores are designed for large stock-up shopping trips, most shopping trips are "quick trips," when shoppers buy only one or two items. In fact, shopping trips for 1 to 5 items typically generate a third of dollar sales. This is a mismatch between shoppers and stores that convenience stores have exploited, but other retailers have been slow to recognize. As retailers make bigger and bigger stores, they make it harder for quick trippers. As discussed previously, the average household purchases only 300 different products a year. Shoppers are purchasing these "big head" products—the small group of products that account for most of sales—while stores are stocked to the brim with "long tail" products. Retailers need to limit or manage these long tail products effectively, so they do not confuse or overwhelm the shopper.

One of the most important findings from this work is that quick trippers are *not* price sensitive. This has enormous implications for promotional strategies—many of which are a waste of money. Retailers are throwing away their discounts and coupons: Quick-trip shoppers who account for a large share of purchases are *price insensitive*, so price cuts do not change their behavior. In Chapter 1, "The Quick Trip: Eighty Percent of Shopper Time Is Wasted," we consider these three types of shoppers in more detail, particularly the quick-trip shopper. If half of all trips are quick trips, yet most stores are designed for stock-up purchasers, it is no wonder that stores underperform.

Three Moments of Truth and Three Currencies

Retailers and manufacturers typically focus on purchases and products, but the shopping experience is much richer and more complex. If shoppers, as we have found, spend only 20 percent of their time in-store actually selecting merchandise for purchase, what are they doing with the other 80 percent of their time? In our opening example, we saw how the woman in the Stop & Shop moved through three critical stages of shopping: reach, stop, and close. Her attention was caught by the product (reach), she stopped her shopping cart to look at it but also scanned other products around it on the shelf (stop), and she chose a particular bottle of detergent (closing the sale). These correspond to three in-store “moments of truth:” exposures, impressions, and sales. This is the process by which all in-store sales are made. Although retailers pay the most attention to the purchase itself, they need to understand this entire process.

Shoppers are spending more than money in the store. They are also spending their time and racking up angst. These are the three currencies of shopping. In addition to looking at what shoppers take out of their wallets, we also need to consider what they invest in time and angst in the experience. As we discussed, this angst can come from navigation (making products hard to find in the store) and from choice (overwhelming shoppers with too many choices). To understand shoppers, retailers and brand owners need to understand the entire shopping experience and the three currencies shoppers are spending in the store, as we consider in Chapter 2, “Three Moments of Truth and Three Currencies.”

> *Shoppers are spending more than money in the store. They are also spending their time and racking up angst.*

Migration Patterns: Where Shoppers Go and What They Do

In addition to studying shopper segments, we also study the broader “migration patterns” of shoppers throughout the store, as illustrated in Figure I.6. Anchored by the entrance and exit, we observe predictable flows of traffic throughout the store. These flows are very hard to alter—although this can be done, particularly with store design. But you can also understand these flows and use a retail strategy that is designed to meet the shoppers where they naturally travel. This is what retailers do in deciding where to build their stores—looking for high-traffic areas or intersections of major interstates—but they rarely pay the same attention to actual traffic flows within the store, as we will consider in Chapter 3, “In-Store Migration Patterns: Where Shoppers Go and What They Do.”

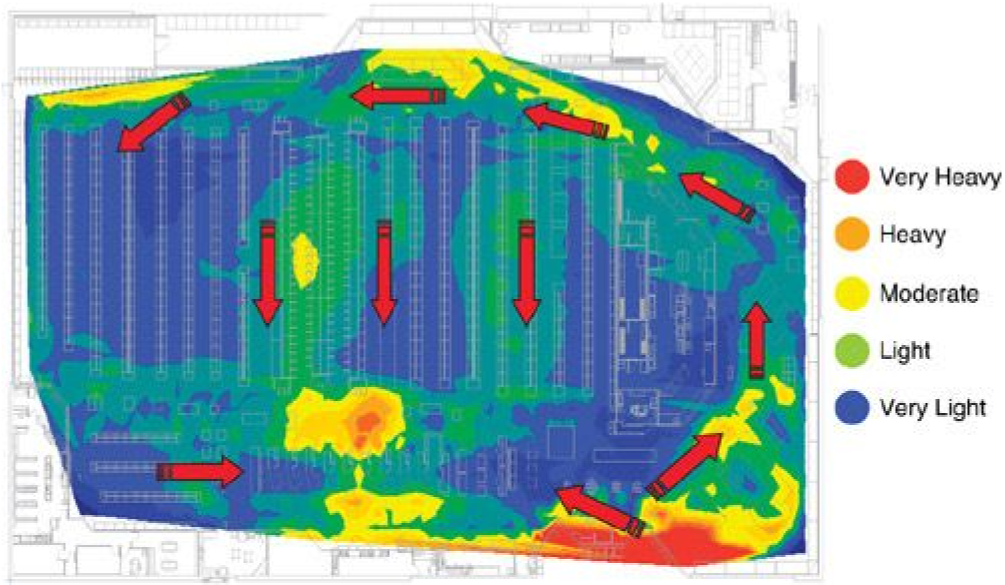

Figure I.6 Shoppers follow predictable paths through the store and some areas (darker shading) receive much heavier traffic than others.

The location of the entrance and the exit, as well as the location of wider aisles, largely defines this flow. Shoppers are used to coming in through a right entrance and making a counterclockwise sweep through the store—and they are somewhat resistant to changing these features as well. On the other hand, once managers understand these patterns, they can use this knowledge to put products in the path of shoppers.

The Holy Grail of Retailing: Taking Products to the Shoppers

We have found that it is hard to get shoppers to go to a specific point in the store, even if you throw money at them to do so. Time-pressured shoppers are less and less willing to invest *time* in the store to go that extra mile to connect with the products. As a result, those retailers who succeed in the future will be those who take control of that final mile in the store, by getting the right merchandise to the right shoppers at the right time. Retailers have to understand *where* the shoppers are spending their time in the store to make relevant offers where they actually are, rather than frustrate them by making them hunt for products.

Taking products to shoppers in the store represents a fundamental shift from the way most retailers and manufacturers think about retailing. In the early days of retail, shopkeepers actively waited on customers, assisting them with their selections and purchases. Then came self-service retailing.

With the advent of the modern supermarket, interaction was no longer necessary, and turning the process over to the shopper reaped tremendous productivity gains. The supermarket became a mini-warehouse for the community. If the shoppers were taking care of themselves, retailers assumed they could take a passive role. Put the right products on the shelves, organize them by category, and turn the shoppers loose to find their way. This passive approach opened the way for smaller convenience stores, pioneered by gasoline service stations, which offered a limited selection of grocery items to customers.

Today, there is no shopkeeper to help customers make a purchase, but there is a different kind of active role for the retailer. It is actively understanding where shoppers are headed and actively making sure that they run into the product(s) they need and you want to sell. This is "post-modern active retailing." Getting products to people when and where they want them in the store is a strategy that requires detailed knowledge and insight of shoppers based on tracking what and where they buy on a trip-by-trip basis. For example, shoppers who buy candy on impulse in convenience stores usually come for a beverage. A candy maker seeking to increase its sales placed its product on the path to beverages and reduced the variety of offerings to simplify the choices. As a result, sales in the category increased by 3.3 percent and brand sales rose by 6.6 percent.

Through my own studies and other research on shopping behavior, I formulated "The Holy Grail of Retailing," as follows:

- To know exactly what each shopper wants, or may buy, as they come through the front door.
- To deliver that to them right away, accepting their cash quickly and speeding them on their way.

This goal reflects a different kind of active role for the retailer. Instead of a physical clerk taking products from shelves and presenting them to customers, the modern retailer takes an active role by superior understanding of shopper behavior and by creating the right store design, navigation, and selection so shoppers are presented with what they want when they want it. To the extent that retailers can achieve this goal, they will be rewarded in higher sales and profits. We will consider these strategies of “active retailing” in Chapter 4, “Active Retailing: Putting Products into the Path of Shoppers.”

Online retailers face similar challenges, such as the problem of the abandoned Internet shopping cart, with a successful sale often requiring the vendor to identify early in the online browsing experience exactly what shoppers are looking for, and then serve it up to them quickly. But just as the online merchant monitors the click-click-click of the online browser/shopper, so too can the bricks-and-mortar merchant monitor the click-click-click of shoppers in the store, assess what they need or might want, and make appropriate offers. Active retailing is as much a state of mind as a set of specific methods or measures. Online is leading the way, conceptually, for what offline bricks-and-mortar retailers must do to gain or keep the leading edge.

Without at least a rudimentary knowledge of these issues—which this book provides—retailers and brand owners have no option but to continue to operate passively within the store. No amount of shopper knowledge derived from outside-the-store measures will do. The modern battle for retail ascendancy will be won *inside* the store. Outside-the-store factors will continue to influence what goes on inside, but they’ll contribute less and less to the winners’ positions.

> *Active retailing is actively understanding where shoppers are headed and actively making sure that they run into the product(s) they need and you want to sell.*

Retailers and Manufacturers: Why the Long Tail Is Wagging the Dog

The fact that in-store behavior has been largely ignored is not an accident. The structure of the industry means that there is more incentive for retailers and brand owners to look elsewhere. A large share of retailer profit comes from the manufacturers in the form of rebates, slotting fees, and other promotional allowances. U.S. supermarkets derive their profits from four principal sources, listed here from the largest and most important to the smallest and least important:

1. Trade and promotional allowances from the brand suppliers. (Money manufacturers pay to get their products into the store.)

2. Float on cash (accruing interest on cash from sales).

3. Real estate (the appreciating value of property).

4. Margin on sales (often on high-margin departments around the perimeter).

Shoppers only play a role in the fourth source. When these sources of profit, and the inherent nature of self-service, or passive retailing, are made clear, it is not surprising that retailers don’t know a lot about the actual behavior of the shoppers in their stores. Why should they? The shoppers have been assigned responsibility for their own shopping and aren’t really complaining. This business model may be inefficient, but it is not irrational. (Las Vegas also is inefficient, except in relieving gamblers of their money, but nobody is predicting that Vegas will disappear any time soon.) The retailers are paid by manufacturers to stock many SKUs (the long tail) on their shelves. But if these products are not selling, it is not helping the retailers or manufacturers. The long tail is wagging the dog. Although the long tail can attract customers to the store—because they know they can find whatever they need—it can impede shopping in the store if not carefully managed, reducing sales.

The relationship between retailers and brand suppliers is changing. In the age of mass media, major brand manufacturers dominated retailing. The brands “had their way” with the market. Now, the power has shifted more to retailers, thanks in part to Sam Walton, who made Wal-Mart the largest corporation in the world. Today, the adage: “The brands have all the money, but the retailers have all the power” is at least partly true. The nonautomotive retailing business is a $14 trillion business, globally. Of this, the brands get $8 trillion, while the retailers get $6 trillion. But there are no absolutes. Although retailers *can* forgo major brands, few take that approach. Ol’ Roy may be the top-selling dog food brand, but Wal-Mart still sells a lot of other-branded dog food. And remember, even Wal-Mart has highly successful competitors, using other business models.

In Chapter 5, “Brands, Retailers, and Shoppers: Why the Long Tail Is Wagging the Dog,” we consider how retailers and brand owners can work together more effectively to manage “flow and adjacency.” If shoppers do not buy products in stores, no one wins. This is a compelling reason for the two sides of retailing to work more closely together.

Rapid Change: Online, Multicultural, and Industry Insights

The world of retailing is changing so rapidly that even researchers with cameras and RFID tags on millions of shopper trips cannot gain the full picture. In the second part of the book, we interview a set of experts who offer additional insights on the forces changing retailing. In Chapter 6, “The Quick-Trip Paradox,” Mike Twitty of Unilever looks at the quick trip in more detail. In particular, he points out what he calls the “Quick-Trip Paradox”: Although most shoppers come to the store on quick trips, the types of products they buy are all over the map, so it is hard to create a “quick trip” selection of products.

While many observers feel that online and offline retailing have little in common, Professors Peter Fader of The Wharton School and Wendy Moe of the University of Maryland note that there are many things that bricks-and-clicks retailers can learn from one another. They explore the insights and opportunities from their research on shopping online and in stores in Chapter 7, “Integrating Online and Offline Retailing.” With new in-store technologies, the lines between these two worlds are increasingly beginning to blur. In Chapter 8, “Multicultural Retailing,” Emil Morales of TNS Multicultural explores the rise of the U.S. Hispanic market and the implications for multicultural retailing around the globe. In particular, immigrants from developing countries are used to small stores with traditional active retailing, so retailers need to address both the ethnic culture and the shopping culture of these segments. Finally, Mark Heckman of Marsh Supermarkets offers closing perspectives in Chapter 9, “Insights into Action: A Retailer Responds,” on the ideas in this book, from the perspective of applying these concepts where cart meets the aisle. The conclusion of the book then examines some of the emerging technologies that are continuing to transform the retailing experience.

Shopping Serengeti

The food industry is the world’s largest industry—the African Serengeti of our modern consumer society, an ecosystem teeming with life and activity. You can look at shoppers in a more constrained environment—which makes research much easier. For example, television and online interactions are passive and uni-directional. The viewer looks in one direction and you know what they are seeing (although you also can track where they look on a web page). Shopping, in contrast, is complex and multidirectional. Shoppers are moving through the environment, changing their gaze, and taking an active role in directing the experience.

The shopping environment is much more challenging to study but offers much more meaningful insights into shopper behavior. Unlike television and the computer, the in-store experience is 360-degrees, 3D, and in living color. It also passes by at blazing speeds. Although researchers may study brand impressions in the laboratory of 30 seconds, if you use eye-tracking technology to see what shoppers see at the point of purchase, it may actually take them only three seconds to decide on a purchase. This fast-paced, sensory-rich interaction also might be what makes the shopping experience so attractive to customers, leading to the surprising endurance of in-store shopping when there are much more efficient virtual alternatives. (Remember when WebVan was going to replace bricks-and-mortar stores?) To understand what shoppers truly care about, you have to spend some time with them walking through the store. It is very hard to understand how to influence behavior in this environment, but we have proven that you can use an understanding of shoppers to increase sales and profits.

In the past decade, there has been tremendous growth in recognition of the value of transaction data associated with specific shoppers through shopper loyalty cards. In fact, what was at the time a very small consultancy, Dunnhumby, assisted Tesco’s move up to the position of third-largest retailer globally, by looking at the purchases of individual shoppers, linked to demographics and other characteristics. But these, and other measures such as customer satisfaction, are output measures. They still don’t tell us about the process that customers use to shop in the store.

As with the shopper in the Stop & Shop, we know exactly where and how shoppers walked, how fast and how far, where they stopped, where they lingered, and when and where they actually selected an item for purchase, including whether that was in the main category aisle or at a secondary display. We also know how that behavior related to other shoppers, both at the same time and spread over weeks and months.

Understanding how shoppers shop can lead to better designs and strategies that can significantly boost sales and profits. Although we live in a world of Smart Carts and new high-tech approaches, many of which are quite valuable, the insights in this book don't require fancy technology to implement. It took sophisticated technology to generate this knowledge, but implementing it requires primarily a shift from a passive to an active mindset. The greatest obstacle to this shift in thinking, in the words of Daniel Boorstin, is the "illusion of knowledge." We think we understand what shoppers do in the store. But there are many misconceptions, even by relatively sophisticated retailers and manufacturers. This book offers research-driven insights that can challenge these illusions and shift our thinking, so we can better understand the brave new world of active retailing. This shift in mindset is the true revolution and greatest opportunity in retailing.

Endnotes

1. Of course, some may disagree with this more narrow definition of shoppers as strictly in store, extending their focus to the preshopping experience, as we will see in the interview with Unilever's Mike Twitty in Chapter 6. While this is not to discount the influence of factors outside the store, I believe the dynamics of in-store behavior are so compelling that they shape the shopping experience.
2. Jeffrey S. Larson, Eric T. Bradlaw, and Peter S. Fader, "An Exploratory Look at Supermarket Shopping Paths," *International Journal of Research in Marketing*, 22 (2005), 395-414.

PART I
Active Retailing

1
The Quick Trip: Eighty Percent of Shopper Time Is Wasted

"I am the world's worst salesman; therefore I must make it easy for people to buy."

—Frank W. Woolworth

In the fall of 2008, Wal-Mart launched a set of small stores in Phoenix, Arizona.[1] With the arrival of these "Marketside" stores, it was clear that even the king of the mega-store was beginning to think small. The move was apparently in response to the arrival of UK retailer Tesco, which had come to the United States with its "Fresh & Easy" small-format stores. Tesco opened dozens of the stores in Nevada, Arizona, and Southern California. Safeway, Jewel-Osco, and many others are downsizing stores in an attempt to upsize profits. Retailers such as Trader Joe's and other specialty stores have also successfully pursued the smaller store model in the age of mega-stores. When Wal-Mart is building smaller stores, it is clear that there is a shift in the winds. At the heart of this change, and the success of these smaller formats, is the quick-trip shopper.

Across the pond, German discounters Lidl and Aldi are growing rapidly in the British market with stores that are a tenth the size of Tesco or Asda stores. The smaller stores offer a faster trip with a more limited selection at lower prices. Although large UK superstores typically stock 32,000 different items, so shoppers are likely to find any obscure product they need to stock their pantries, Lidl carries 1,600 SKUs and an Aldi store sells just 900 items.[2] Aldi, which arrived in the United States in 1976, has more than 1,000 stores. It is rapidly expanding its U.S. presence and competing aggressively against Wal-Mart and Kroger's, using a limited selection and lower prices, as well as very different store designs.[3]

The rapid growth of Lidl and Aldi was aided by a tough economy in 2008, which sent more shoppers looking for discounts. But their success also depends upon an understanding of the power of the quick trip. Most supermarkets are designed for shoppers who are stocking up their pantries, but most shoppers walk out of the store with only a few items. In fact, the most common number of items purchased in a supermarket is *one!*

Three Shoppers: Quick Trip, Fill-In, and Stock-Up

Building on the work of Wharton Professor Peter Fader, we studied data collected on 75,000 shoppers across a series of three stores to develop behavioral segmentation of shoppers. By mathematically clustering a large number of shoppers by factors such as how fast they walk, how fast they spend money, how much of the store they visit, and how long their trips are, we found that shoppers group themselves into three basic segments or clusters, as shown in Table 1.1.

Table 1.1 Quick-trip shoppers spend more quickly than other segments.[4]

	Clusters - Market Segments		
Description	Quick	Fill-in	Stock-up
Share of store visited	11.2%	21.1%	41.0%
Trip duration (in minutes)	13.4	18.5	25.3
Walking speed (feet per second)	0.52	0.66	0.98
Buy time (seconds to buy a single unit)	38.7	30.2	21
Spending speed (dollars per minute)	$1.88	$1.32	$1.23
Efficiency (seconds per dollar)	31.9	45.5	48.8

Each of the segments exhibits fairly distinctive shopping behavior, as follows:

- **Quick:** Short time, small area, slow walk, high-spending speed, very efficient.
- **Fill-in:** Medium time, medium area, slow walk, average-spending speed, modest efficiency.
- **Stock-up:** Long time, large area, fast walk, low-spending speed, lowest efficiency.

Very few supermarket retailers are aware that half of all shopping trips result in the purchase of five or fewer items (these numbers come from actual transaction logs from every continent except Africa and Antarctica). This ignorance is a consequence of the justified focus on the economics of the stock-up shopper, and a lack of attention to the behavior of the mass of individual shoppers in the store. This huge cohort of quick trippers is not a different breed of shoppers. They are simply stock-up shoppers on a different mission.

Anyway you slice it, these quick trips are an important part of retailing. *Single item* purchases account for more than 16 percent of all shopping trips. Further, as noted, half of all shoppers walk out with five items or less, and the average purchase size is about 12 items. As shown in the figure, in addition to looking at the average, we also need to consider the "median," half of the distribution, and the "mode," the most common result (see the box for discussion).

The Danger of Using "The Average"

It is important to have a good understanding of the problems of using "average" data in many shopping scenarios. When we looked at the distribution of the number of items shoppers purchase on typical trips, we saw that the "average" could be grossly misleading, because *one* is the single most common number of items purchased, while half of all supermarket trips result in purchases of *five* or fewer items—the other half, more, of course—but the arithmetic mean number of items is *twelve*. This is because half of the shoppers buying five or fewer items only constitute about a third of store sales, so the much larger baskets, though fewer in number, skew the share of total store sales. The bottom line is that simply using the arithmetic mean to try to understand shoppers is certain to give an erroneous view. The median (half of the shoppers) and the mode (most) are also important.

Another example that illustrates the problem of averages as applied to shoppers became apparent when we sought to define trip lengths by number of items purchased, rather than by the amount of time spent on the trip. It seemed perfectly logical that shoppers buying fewer items in the store spend less time, and those buying many items would be spending lots of time. This reasoning seemed especially useful based on our earlier efforts to understand how long shoppers spend standing in line at the checkout and elsewhere. For example, it takes a relatively constant 8–10 seconds per item for a shopper to unload her items onto the belt, the checker to scan

> them, and to get them bagged, *plus* about a constant 90 seconds that is involved in meeting/greeting the checker, handling the payment process, and so on. Of course, this time is all in addition to wait time in the queue, in terms of total checkout time. But the point is, there *is* a relatively constant per item time. So, it would seem likely that a similar relation might exist between total time spent on the sales floor and the number of items purchased.
>
> First, the good news: There is a relation between the number of items purchased and the length of the trip. The bad news is that these are *modes*, not means. That is, they are the most common trip durations for items purchased—but are not the average. For single-item purchasers, rather than the 2 to 5 minutes that might be reasonable, some single-item purchasers stretch this out to 10 or 20 minutes (perhaps waiting for a co-shopper). With each increase in number of items purchased, the distribution begins to broaden. At the dozen "average" number of items purchased, the distribution of trip durations is so broad as to hardly be useful in trying to relate the number of items to the length of the trip. As these examples illustrate, it is important to understand the average, but not get caught in the average quicksand. To understand shopping behavior, we also need to look at the mode and the mean.

But it is not sufficient simply to begin catering to quick trippers. Rather, the store must be distinctly managed for all three types of shoppers, particularly the quick trippers *and* stock-up shoppers. Supermarketers are obsessed with stock-up trips, because even though there are so few of them, each one is worth a lot of money. But this has led to ignoring the importance of the one- to five-item trip. Even though these are smaller baskets, there are so many of them that they still constitute fully one-third of all the store's sales. What is more, they represent a tremendous opportunity. Although it might be hard to convince a stock-up shopper to put another half-dozen items into a bulging cart, the quick tripper may have a hand free or room in a basket if the right product comes into view.

Because the one- to five-item basket is presently generating one-third of dollar sales, simply doubling the size of those small baskets would increase total store sales by more than 30 percent.

But this is not simply about figuring out how to coax customers into picking up a few extra items on trips that continue to look just like the ones they are taking now. Instead, there is a need to understand *distinctly* the three primary types of shopping trips: quick trips, fill-in trips, and stock-up shopping. Those retailers and brands that make a conscious and focused distinction between the quick trip and the stock-up trip will steadily pull ahead in sales and profits.

Rise of the Small Store

When supermarkets failed to respond to the needs of half their shopping trips, others stepped into the vacuum. This led to the creation of the entire convenience store industry and encouraged the growth of competitors with small-store formats. In 2007, for the first time in two decades of expanding superstores, the average size of a grocery store fell slightly. It appears that large retailers are finally waking up to the power of the quick trip.

Many of these smaller stores such as Lidl and Aldi attribute their success to their low pricing. But in addition to offering discounts, they have created streamlined stores that reduce navigational and choice angst. Many consumer studies show that pricing is not the primary factor that drives retail. Giving people money to buy things has to be the least creative way of selling something. As with Stew Leonard attributing his success to superior customer service, the success of retailers might not be for the reason they think. In the case of Lidl, Aldi, and others, our studies indicate that the reduction in SKUs and simpler navigation may play as great a role as pricing in their success.

At the same time that supermarkets were being attacked by the small stores from below, the big box outlets were taking a large slice of the stock-up shoppers. Winning retailers of the future will earn their top-tier status through clearly distinguishing shoppers into quick/fill-in versus stock-up, and serving the two groups distinctly, rather than dumping the whole store together and expecting the shoppers to sort it out. This does not mean, however, that it cannot all be done in the same building.

A Slow Walk on a Quick Trip

It seems counter-intuitive that a quick-trip shopper would walk more slowly than a stock-up shopper. But bear in mind that this "walking speed" is an average based on their total shopping trip—total distance walked divided by total time. The trip itself is composed of time shoppers spend actually selecting merchandise for purchase *and* time they spend cruising from one purchase location to another. The greater the share of their time spent purchasing, the slower the average walking speed.

So, quick trippers have very slow average walking speeds due to their high focus on purchasing, whereas stock-up shoppers have very fast average walking speeds due to the high percentage of their time spent navigating around the store, with an occasional purchase. This is the kind of reality of shopping that is totally missed by researchers studying about shopping but not studying the phenomenon itself.

Perils of Promotion

Given the predominance of the quick-trip shopper, how important are traditional promotions? Promotions are designed for stock-up shoppers, not for quick trippers. If shoppers are only buying a handful of items, promotions probably don't have their desired effect in either attracting them to the store or generating sales inside. In fact, in a 1997 study of 300 randomly chosen shoppers in four retail chains, Glen Terbeek found that consumers were unaware that 51 percent of the promoted items they had purchased were on sale; the discount had no impact on their buying behavior.

Of those 49 percent who were aware of the promotion, 40 percent would have bought the item anyway; 37 percent switched from another brand,

and only 23 percent purchased product “incremental” to their regular buying behavior. Terbeek’s conclusion: “Trade promotion is unproductive, disruptive, and complex, with a dubious return on investment for anyone. Specifically, hidden costs are higher, and benefits much lower, than participants imagine.”[5]

The hidden cost of price promotions is also emphasized by Rui Susan Huang and John Dawes in their paper for the Ehrenberg Bass Institute for Marketing Science. Analyzing 3,000 price promotions, they found that the promotions had a hidden cost: the profit margin forsaken on sales that would have been made at the normal price, which they call the “baseline” volume. In many cases, the baseline volume that is sold cheaply is twice as much as the extra sales arising from the price promotion. As they write, “Plainly, many price promotions result in a price reduction on significant amounts of inventory that would have been sold anyway…. This means that marketers are paying a heavy price for making some extra sales from price promotions—for every extra sale, they are often giving away margin on another two times as much volume (or more). So while many marketing people and trade sales teams say ‘price promotions work,’ these promotions have massive costs in foregone margin on sales that would have been made anyway, at a normal price.”[6]

Of course, as we will consider later, the promotions may have more to do with the relationship between the retailer and manufacturer than the retailer and shopper. Even so, they are ostensibly designed to increase sales and seem to be less effective than expected in this task.

The Big Head and Long Tail

Once the behavioral groups are identified, it is important to match the groups to their distinctive purchases. For the segments identified in this study, the share of shoppers who purchase something from each of the listed categories is shown in Table 1.2. In other words, once shoppers “group themselves” by the behavioral measures, we can look at the resulting market segments to see what they bought, as clues to what we should offer to each group.

Table 1.2 Matching Groups to Distinctive Purchases

Market Segments – Purchases				
Category	Quick	Fill-in	Stock-up	Where to Locate
Beverages – Non-alcoholic	30%	30%	33%	Common to All Segments
Breads/Pastries/ Snack Cakes	13%	19%	35%	
Salty Snacks	14%	18%	21%	
Health and Beauty Aids	14%	11%	14%	
General Merchandise	15%	13%	13%	
Candy/Gum/Mints	18%	14%	11%	
Tobacco	11%	8%	4%	
Frozen Foods	4%	23%	47%	Fill-in and Stock-up
Dairy – Refrigerated	1%	20%	70%	
Produce	6%	11%	68%	
Breakfast Food	5%	9%	21%	
Cookies and Crackers	7%	11%	17%	
Alcoholic Beverages	8%	10%	15%	
Meat, Poultry, Seafood – Fresh	0%	5%	47%	Stock-up Only
Baking/Cooking Supplies	2%	8%	28%	
Paper and Plastic Products	2%	8%	25%	
Dressings/ Condiments/ Pickles/Olives	2%	7%	25%	
Canned Vegetables	1%	4%	16%	Stock-up Only
Soup	0%	4%	15%	
Prepackaged Deli-Meats/Cheese	1%	4%	15%	

Given most stores' focus on stock-up shoppers, it is not surprising that they are poorly designed for the quick trip. Stock-up and fill-in shoppers are looking for the same products—just expanding the set. We want to focus on, at most, a few thousand items that are needed to satisfy perhaps 90 percent of shopper needs. Moreover, because we will deliver this merchandise to all shoppers very quickly—near the entrance of the store—we expect them to pay for the convenience. So pricing will not be promotional, but rather we will focus on premium brands, quality, and freshness.

This is not how most retailers think. Warehouses typically offer in the neighborhood of one million different items that retailers could offer for sale in their stores. The retailers have wisely selected a mere 30,000–50,000 items to offer in your stores. But the typical customer's household buys only a total of 300 to 400 distinct items in an entire year. And they buy only about half of those on a regular basis. Those items purchased over and over, day in, day out, week in, week out, constitute a really short list. In fact, 80 items may contribute 20 percent of a store's total sales, with milk and bananas typically vying for the top slot at supermarkets (see Figure 1.1). A thousand items contribute half the dollar sales. (The same phenomenon holds for other classes of trade.) As noted here, those few items generating the lion's share of sales are referred to as "the big head," while those thousands of other items—and they do generate significant sales—are referred to as "the long tail."

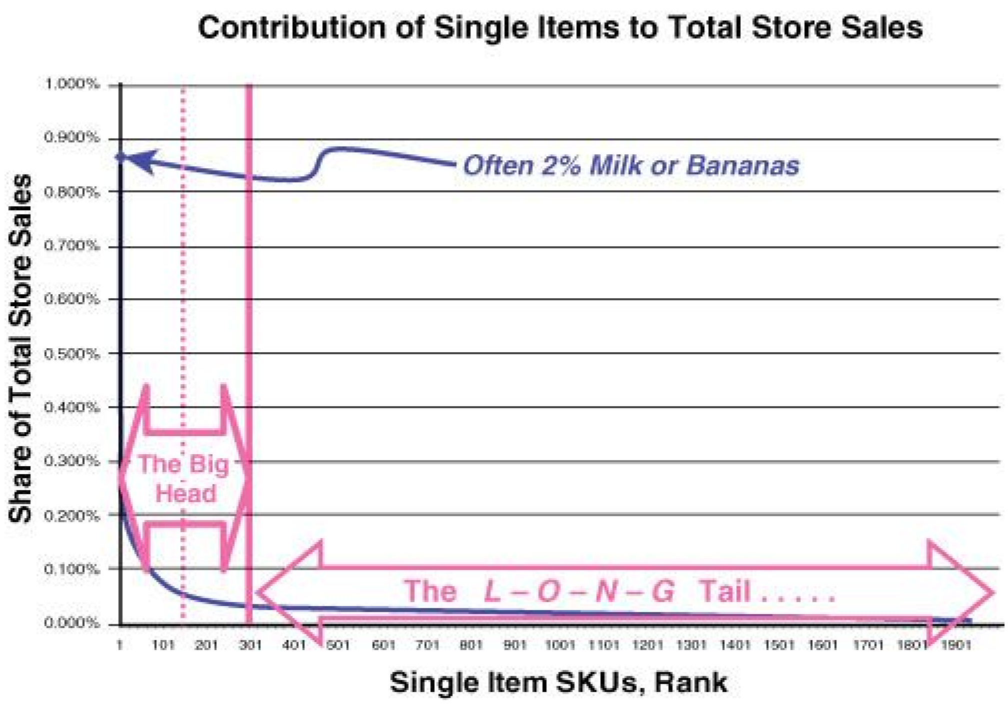

Figure 1.1 Contribution of single items to total store sales

Heads You Win

Winning *always* involves making careful distinctions. There are a few crucial distinctions in retailing that largely define success. This distinction between the big head and the long tail could be the single most important distinction to make in terms of managing the *range* of merchandise that retailers carry. Yet we observe many retailers stirring the two together indiscriminately, in an attempt to sell more of the long tail. Selling more of the long tail is a good idea but not at the expense of penalizing the big head.

Wired magazine editor Chris Anderson has pointed out that online retailing makes the long tail an important business. Online retailers can profitably stock and sell small numbers of niche products rather than only concentrating on the hit products that constitute the largest number of sales. Booksellers such as Amazon can stock an obscure title alongside *The New York Times* bestsellers. The many small sales of these niche titles add up to a large return for the retailer.[7] There is some debate about whether this attractive theory holds true even in the online retail space, as pointed out in a detailed study by Anita Elberse of Harvard Business School.[8] In bricks-and-mortar stores, however, the case is clear for focusing on the big head.

The reality is that it is easier to increase total sales of the big head than it is to increase sales of the long tail. Focusing on the long tail is equivalent to trying to get more people to shop on Thursday, rather than focusing on how to serve the Saturday crowd better and more efficiently. Slight increases in Saturday performance *per shopper* are worth a good deal more than lots of additional weekday shoppers. In the same way, modest increases in per-item big head sales are worth much more than large long tail sales increases, scattered across the massive range of products. Help your winners to win more and bigger. It will give you the resources to selectively focus on the long tail more appropriately.

Many retailers hide the big head, as shown in Figure 1.2. This is a map showing the exact location of those top 80 items from the big head for this particular store. As expected, there is a significant collection in the produce section—upper right—and in the dairy—upper left. Otherwise, the big head is pretty well scattered about, as the retailer attempts to sell more long tail by "hiding" the big head among those many thousands of items of very limited interest to the shopper.

Figure 1.2 Where the big head is hiding

The net result of this is a very large loss in big head sales, coupled with angst, frustration, or ennui on the part of the shopper. Don't worry: There is an important role for the long tail—and there *are* valid justifications for "SKU proliferation," "range growth," and promotional fees to support the long tail—but killing off sales of the big head is not one of them.

In addition to making it harder for shoppers to find "big head" products, a proliferation of SKUs also contributes to the problem of out-of-stock items (stockouts). Increasing from three SKUs to 10 will not necessarily increase sales because it is harder to manage inventory and avoid stock-outs. Roughly 8 percent of store sales are lost due to stockouts, and greater variety increases this risk.

The Communal Pantry

The dominance of quick trips means that retailers are functioning as the communal, neighborhood pantry, offering just what the household needs with emphasis on fresh (quality) products at modest prices.

In the developing world, traditional retailing involves mostly very small neighborhood shops where patrons of limited means purchase only what they need “right now.” These customers cannot afford to stock a pantry at home, so the neighborhood market becomes a communal pantry. In other words, it creates community. Small, family-owned stores, some as small as closets, provide their customers with needs on a daily basis. For example, in India, about 96 percent of the retail marketplace consists of small shopkeepers. Across emerging markets, an estimated 80 percent of people buy their wares from mom-and-pop stores no bigger than a closet. “Crammed with food and a hodgepodge of household items, these retailers serve as the pantries of the world’s consumers for whom both money and space are tight.”[9] In Mexico, despite being one of Wal-Mart’s most successful markets, high-frequency stores are still regularly visited by almost three-quarters of the population. Although the average spent is only \$2.14 a day, the annual sales total reaches a significant \$16 billion.

Small stores catering to the quick tripper in developed markets are also serving as a communal pantry. In this case, the shift is not because of a lack of refrigeration or funds but due instead to a change in lifestyle and a shortage of time. Once the home pantry was the communal focus of the home, but now kitchens have often evolved into a fast-food preparation point to adapt to changing habits, with people grazing, or eating on the run. The household pantry is thus becoming de-emphasized because more customers would rather pick up quality, fresh merchandise in the local “bodega” or neighborhood market rather than stock a home pantry, even though they could easily afford to. So, in this way, the modern consumer is returning to a “communal pantry.” This, of course, has had a consequential effect on buying patterns and subsequently on storage.

So, this is a phenomenon that affects all strata of society, from the rich to the poor: People are visiting stores very regularly, possibly every day, buying what they want when they need it. The retailer takes on the responsibility for warehousing and stocking the essentials that consumers no longer have the space for or desire to stock, and keeps the products fresh and available. This also leads to the homogenization of rich and poor, who visit stores such as Wal-Mart, Costco, and Fresh & Easy. The objective is to have shoppers come in several times a week to pick up dinner, so these stores are essentially acting as a communal pantry.

A 2007 report by Booz Allen Hamilton notes that, after years of hype about “big box” retailing, there is an increasing number of small-format success stories, ranging from convenience stores to discounters to stores that sell basic staples and key grocery items in a cost-effective neighborhood format.[10] The report cites three reasons for the trend. First, consumer experience in massive retail stores is becoming increasingly unattractive. Lower-income shoppers, in particular, are uncomfortable in large stores because of impersonal service and the sheer number of items on offer, which underlines their lack of spending power. Second, smaller stores are no longer necessarily saddled with higher prices or lesser quality. Finally, small formats give retailers the chance to have a more intimate relationship with customers and employees, which provides scope for genuine innovation in store and business model design.

This is a global phenomenon and is leading to the breaking down of the divide between the developed and developing world in regions such as Europe and Latin America—a democratization of retail. As the Booz Hamilton Allen report notes: “In Europe’s affluent economies, consumers are looking for convenience items, including meals, to suit their busy lifestyles of single heads of households. Retailing in Latin America, by contrast, is focused much more on low-income and larger families. Part of the explanation for why smaller formats are working in Latin America is that items such as dry pasta, cooking oils, milk, bath soap, and laundry detergent can be acquired in precisely the right quantities for daily use. The stores are, in effect, the *customers’ pantries*. [italics added]” As these smaller stores have begun to sell high-quality items at low prices, they have come head-to-head with traditional, passive retailers. More important, this shift has tremendous social significance for the countries where implemented, because the product quality has a strong appeal to wealthy customers, whereas the lower pricing appeals to low-income customers. This begins to make retailing a new and valuable community builder. Retail is, once again, at the cutting-edge of social evolution.

Layered Merchandising

Given three emerging features of retailing—the quick trip, big head, and communal pantry—retailers need to rethink how they merchandize their stores. The original idea of the store as a community warehouse needs to be rethought. The importance of quick-trip shoppers argues for a different store design, where the "fill-in" and "stock-up" areas should be considered as extensions of the "quick" convenience area, rather than having the convenience area an afterthought in a store designed for stocking up. Other than representing small selections of the categories specified in the second group (fill-in and stock-up) and the last group (stock-up) in Table 1.2, this convenience area should adhere to the same pricing and selection criteria: high-quality, higher-margin merchandise, delivered more conveniently than that in the long tail. Of course, it is easily possible that the "convenience store" area already is embodied in the promotional store, end-caps, and other promotional displays (see "Managing the Two Stores," in Chapter 3, "In-Store Migration Patterns: Where Shoppers Go and What They Do").

The essential element of this merchandising plan is to offer a common area for all shoppers that serves up the merchandise that all segments include in their baskets; then to provide a secondary area that encompasses the first two segments, a third area for the more extended trips that encompass the third segment, and finally, an "everything else" long tail area where a shopper can find almost anything but may need to spend some time looking. The "quick" area becomes the big head portion of the store, where shoppers can spend more dollars per minute (fewer seconds per dollar) than any other part of the store, while the other areas blend into the long tail.

The fundamental concept here is to address explicitly and distinctly the needs of each group of shoppers as they come through the door. Conceptually, this means that retailers should stand at the door of their stores, call out the first segment, and then ask themselves: How am I delivering *right away* to this group what I know they are going to buy, accepting their cash quickly, and speeding them on their way? The answer to this should be a clear and attractive path that covers all of those items quickly and with clarity—providing just the choices necessary to accomplish the shoppers' purposes.

For each segment that comes through the door, it should seem as if the store was designed just for them. If retailers can stand at the door and know that they are achieving the Holy Grail for the quick-trip segment, they must proceed similarly with the second segment, and then the third. The key is for each segment to sense that the store was designed just for them. And how is this to be done? Through what we call *layered merchandising*.

Layered merchandising simply means that the principal needs of each segment are easily and logically found on as short a path as possible between the entry and the checkout. It creates stores within stores. For instance, say that a five-minute trip, by the nature and number of the items, is required for shoppers to acquire all the items they want or may buy. Remember the treasure hunt on which most retailers send customers in looking for the big head within the store, as shown in Figure 1.3. Treasure hunts might be fun for children's birthday parties, but they are an irritation for a time-pressed shopper.

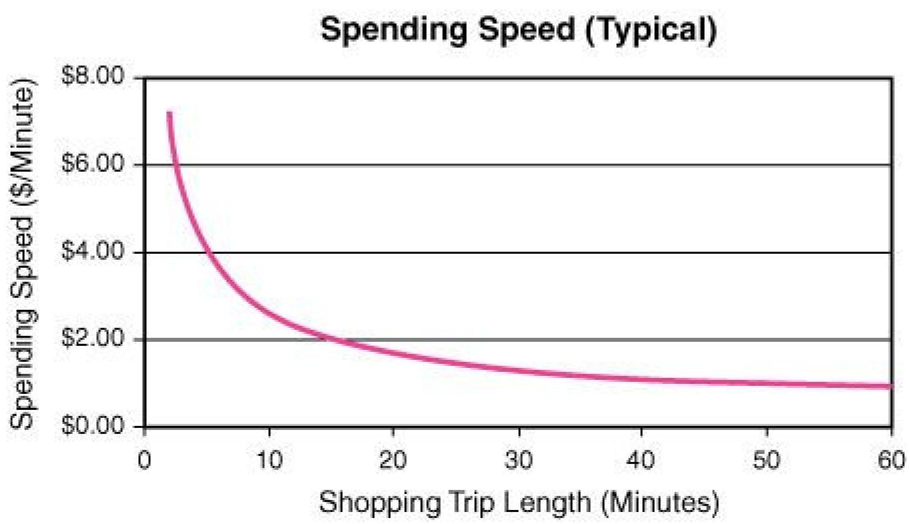

Figure 1.3 Spending speed: Shoppers spend faster the shorter the trip.

Yet retailers think that they are cleverly boosting sales and profits by holding the shopper in the store for ten minutes. They should think again. They force the shopper to spend his or her time walking around the store to find items to buy, instead of spending more time buying. Is this frustration worth it just to get the shopper to walk past a few more items? In reality, the shopper is being told, go somewhere else if you want to shop efficiently—here we intend to frustrate you and hinder you to maybe get a little more of your trade. This leads to fragmentation of the channel as needs are met elsewhere. To reverse this baleful trend requires true customer orientation, beginning with understanding the distinctive types of shoppers (segments) coming in the door, and serving each group efficiently through intelligent product placement.

The Right Paths for the Right Shoppers

Layered merchandising allows the retailer to provide *instinctive-distinctive* paths appropriate to each shopper segment. That is, when *all* shoppers arrive in the store, they intuitively recognize, even if subliminally, that all of their most common needs are right around them so that they can efficiently access the “big head” selections from those categories in their pathways to checkout. Some retailers, for example, put a selection of dairy at the entrance instead of forcing quick-trip shoppers to make their way through the entire store to reach the dairy case. The first segment (quick trip) can proceed to the checkout as soon as its members have shopped the common area, whereas the second, the “medium” group (fill-in), needs to pass through and shop a secondary area that should be welcoming and intuitive to them, and again, conveniently on the path to the checkout. The “long” group (stock-up) needs to pass through a third area before passing through the same secondary area as the medium group did, and then to checkout. In every case, the goal is to provide an intuitive, instinctive path, distinctive to the shopper segment, which delivers just what they need from a preselected, high-margin offering, speeding them to the checkout.

The path outlined here would deliver a high volume of sales to shoppers from the 2,000 to 4,000 items they are most interested in, with no compromise of margins. Selective margin reductions are reserved as motivation to entice shoppers to look at more complete selections of the specified twenty categories, plus all other categories, in the long tail portion of the store. But this approach can only be pursued if the retailer recognizes the different segments, understands what they buy, and designs the store accordingly.

There are other motivations/inducements for shoppers to extend their trips beyond the convenient, higher-margin area. One obvious motivation is to benefit from a much wider selection of merchandise. Both price and selection benefits for the long tail can be advertised in the big head portion of the store, without eroding the convenience of the big head experience. Successful execution of such a communication plan will obviously affect the success of the long tail, without compromising the big head. Retailers need to manage not just the big head versus the long tail, but simultaneously offer the long tail to shoppers engaged in big head purchases.

The problem here is somewhat analogous to managing quick trippers at the same time as stock-up shoppers. As noted before, quick trippers *are* stock-up shoppers, just not on a stock-up trip *at the time.* So the challenge is to *predispose* a “soft drink and personal care only” buyer on this trip to return to purchase their laundry detergent or other staples *at this store.* This problem is one of connecting a single shopper’s quick trip with the same shopper’s later stock-up trip.

Purchase Modes and Selection Paradigm

We also need to recognize that shoppers can be in different purchase modes, and this leads to different selection paradigms. First, the modes can be planned or opportunistic. Some purchases are carefully decided based on shopping lists, research, or careful planning. Others are opportunistic, responding to chance meetings with products in the store.

At the moment of purchase, there are also different types of decision making. Some decisions such as repeat purchases are instinctual, not involving the conscious mind. For these, presenting the shopper with the 100 or so SKUs is the most important factor. Other purchases are decisional, through evaluation and selection, so the use of shopping lists or reminders to buy can help to trigger a decision.

There are also two ways that shoppers view purchases within their trips. The first is that the purchase is mostly not pleasurable or fun, but strictly a chore and should be completed as quickly as possible. The second is a hedonic view, where the purchase is pleasurable, and they might enjoy a leisurely purchasing experience for the item.

Spending Faster

The mismatch between store design and shopper segments, particularly the hiding of big head items in the long tail areas, leads to a great deal of wasted time. How much time is only apparent through careful observation of shoppers. We have found through our research that shoppers spend only 20 percent of their time in-store actually selecting merchandise for purchasing. Because pretty much the sole reason a shopper is in the store is to acquire merchandise, and that pretty well aligns with the retailer's reason-for-being, too, this represents a tremendous failure. This means that 80 percent of the shopper's time is economically nonproductive—largely wasted! This single fact has huge implications, because time is money, and we are obviously wasting a lot of it. (This fact lies at the root of my own focus on seconds per dollar as *the* single most important productivity measure for shopping.) Simply making that nonproductive time productive might give retailers *five times* the sales.

One of the things that gives me confidence in these recommendations is that there are actually multiple streams of evidence coming together that all support the observation that an awful lot of sales are left in the aisles. For example, consider the average walking speed of shoppers on different kinds of trips. Counter-intuitively, quick trippers' average walking speed through the store is much slower than the stock-up shoppers. This is a direct consequence of the fact that all the shopper's time in the store can be divided into two buckets:

1. Now I am standing at the shelf, selecting merchandise for purchase, and *walking* very slowly, if at all (<1 ft/sec.).
2. Then I am looking for the next merchandise that I might be interested in buying, and hurrying along trying to find it, walking quite quickly (1–4 ft/sec.).

So quick trippers have a lot less wasted time than the stock-up shopper, and as a consequence spend their money a lot faster. Remember that *shopper seconds per dollar* is one of the key measures of retailing success, so shoppers spending money more quickly ultimately leads to greater overall store sales. As shown in Figure 1.3, the data show that shoppers spend faster on the shorter trip, as a direct consequence of them doing less walking about and more actual acquiring of merchandise. In contrast, a Wharton School study called "The 'Traveling Salesman' Goes Shopping'" highlights the tremendous inefficiency of the typical long shopping trip.[11]

As noted in the Introduction, in addition to focusing on the large head, the other massive angst reduction at Stew Leonard's comes from having only one, single aisle, that wends its way through the entire store. This is a wide, serpentine aisle that essentially transports every shopper through the store, introducing them in the same order to all of the merchandise there. This virtually eliminates *navigational angst*. Whereas the typical store is worried about how to get the shopper to the right merchandise—with sales flyers, specials, and flashing lights—Leonard already knows where his shoppers are going and can put the right products in their paths.

For a wide variety of good and valid reasons, everyone is not going to run out and build a "Stew Leonard" kind of store. There are many possible models. The point is not for retailers to copy a simple formula—if everyone is doing it, it becomes less competitive—but to understand the principles that drive extraordinary sales, and leverage those principles in their own operations. In addition to the serpentine design used by Leonard, other effective store designs include the enhanced perimeter, the inverted perimeter, the compound store, and the big head store, as we will explore further in Chapter 3.

Conclusion: Dual Chaos

Matching these diverse segments to a broad set of products—in a way that works for shoppers, retailers, and manufacturers—is a "dual chaos" problem. There are a multitude of types and varieties of people (chaos 1), as well as a multitude of types and varieties of products (chaos 2). The question is how to match the people with the products. In the bricks-and-mortar retailing world, it's not possible (yet) to do an exact one-to-one match. The store cannot be reconfigured to personal tastes every time a shopper walks in the door. As much as retailers might like to customize their stores for every single shopper, this is not operationally practical. So, the best thing a retailer can do is create a "variety" of shopping experiences addressing the distinctive needs of groups of shoppers.

Organizing shoppers into groups is what segmentation or clustering is all about. Although we have considered the three broad segments that have emerged across many retailers, each retailer or store will have more specific insights into how people shop in their stores. There are two general problems of most shopper segmentation. The first is that most of these schemes result in far too many groups of clusters for practical in-store use. Retailers can respond to a small number of large groups inside the store far more intelligently and in a more targeted way than they can to a large number of smaller groups. However, in defense of segmentation schemes producing larger numbers of groups, these may be effective outside the store, where various advertising media may be targeted distinctly to more varied groups.

The second problem is that most segmentation schemes are based on a wide variety of psychographic and demographic data, which although collected by surveys and other research, are not obviously related to in-store behaviors. The goal of the store is to organize the chaos of shoppers into groups and to organize the chaos of products into groups, and then to introduce the appropriate groups of people to the appropriate groups of products. So, in reality, we're interested in grouping the shoppers by their *behavior* in the store rather than by their attitudes, opinions, or even need states.

Generally, such characteristics as age, sex, and others inherent to the individual shopper are subsumed. *Attitude*, of course, is less fixed, but has been given a great deal of consideration in many segmentation schemes. This certainly includes such things as need states and other transitory mental conditions. Although individual characteristics and attitude criteria are of great value in planning outside-the-store communication strategies (advertising), they are more difficult for store management to actually respond to effectively.

Behavior is the critical in-store factor. It is widely recognized that it is more reliable to observe what people do than to ask them what they do. In other words, if behavioral data is available, it will generally be more reliable and relevant than the shoppers' attitudes and memories. After all, in the end, the only thing that matters is whether the shopper buys—a strictly behavioral matter. Alexander "Sandy" Swan of Dr. Pepper/Seven Up, an early supporter of PathTracker™ studies, once told me: "I don't care whether the person buying my product is a 60-year-old man who drives up in an $80,000 BMW, or a 17-year-old pierced teen who arrives with her friends in a beat-up VW. All that matters is that they buy."

Endnotes

1. Andrew Martin, "Miles of Aisles for Milk? Not Here," *The New York Times*, September 10, 2008.
2. "The Rise of Lidl Britain During the Credit Crunch," *The Telegraph*, October 9, 2008.
3. Cecelie Rohwedder and David Kesmodel, "Aldi Looks to U.S. for Growth," *The Wall Street Journal,* January 13, 2009

4. For the more technically minded, arriving at the clusters in Table 1.1 is based on a formula that calculates the discriminants, which are complex combinations of the variables chosen. There are mathematical ways to judge which variables will help to discriminate among the members of the group. Using the variables that show the differences among the clusters most clearly suggests that those are relevant differences. Although any number of discriminants can be computed, you are really looking for the lowest number that still gives a reasonably good description of the data. Those variables that have the most impact can then be used to describe the emerging clusters. A word of warning: The results are based on the variables selected, so they will reflect the analyst's judgment in selecting variables, as well as the available data.

5. Glen A. Terbeek, *Agentry Agenda*, The American Book Company, 1999, pp. 32–34.
6. Rui Susan Huang and John Dawes, *Price Promotions*, Ehrenberg Bass Institute for Marketing Science, 2007, Report 43.
7. Chris Anderson, *The Long Tail: Why the Future of Business Is Selling Less of More*, New York: Hyperion, 2006.
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10. Ripsam, Martinez, Navarro, 2007, Booz Allen Hamilton.

11. “The ‘Traveling Salesman’ Goes Shopping: The Efficiency of Purchasing Patterns in the Grocery Store” (http://knowledge.wharton.upenn.edu/article. cfm?articleid=1608).

2
Three Moments of Truth and Three Currencies

"If we will not buy, we cannot sell."

—U.S. President William McKinley

A few years ago, Guinness worked with ID Magasin, one of Britain's leading retail research and design companies, to improve its sales. They created in-store displays designed to stop customers and get them to buy. To analyze behavior, researchers filmed thousands of customers visiting the beer, wine, and spirits aisles, and interviewed a large sample afterward. Selected participants wore point-of-focus/eye-mark recorders, which record the precise point-of-focus of the eyes. This provided quantitative data on penetration and conversion rates and the nature and duration of consumer interaction with the category. It also enabled understanding of the search and selection process and established the draw of the various elements of the displays.

Exhaustive analysis of the findings indicated principles to improve in-store visibility. Based on these, Guinness created a prototype fixture and installed it in test stores, as shown in Figure 2.1. The extruding fins were highly visible, ensuring that the offer would reach shoppers at the end of the aisle. The fins also broke the linear nature of the aisle, helping to stop shoppers by the display. Product layout was clear and authoritative. All these elements were within the cone of vision. Strong brand block and the use of signpost products reduced visual "noise," strengthened impact, and acted as guides around the fixture.

Figure 2.1 This Guinness display, using fins to break the aisle, helped stop shoppers and increase sales dramatically.

Guinness monitored checkout scanner data in the test stores. It then modified the design in response to these findings and installed the display in various retail sites. Guinness then installed the new display in ten sites and identified another ten control sites for a formal test.

The new fixture increased sales dramatically. Why? The new display was able to pull customers through the three moments of truth: reaching, stopping, and closing the sale. The fixture made stout easier to find in this busy category, so the display *reached* out to shoppers. The time until the first customer interaction decreased from an average of 38 seconds to 11 seconds. The majority of stout purchasers went straight to the fixture, so it did a better job *stopping* them in front of the display. The total average visit time reduced from 2.08 minutes to 1.53 minutes, indicating that it is easier to shop from the new fixture. U-turning in the middle of the aisle halved, to only 24 percent. More customers were now shopping the whole aisle. And, finally, these customers *bought* Guinness in much higher numbers. In the test stores, Guinness draught sales increased by 25 percent in value and 24 percent in volume. Total stout sales grew by 10 percent and total beer sales by 4 percent.

Moments of Truth

Each shopper second is a moment of truth—an opportunity to sell something. Unfortunately, many of these seconds are lost. As noted in Chapter 1, "The Quick Trip: Eighty Percent of Shopper Time Is Wasted," in the typical retail store, 80 percent of these seconds are wasted in commuting between shopping points. Shoppers would like to spend more money in retail stores. But as long as retailers approach retailing with the attitude that it is a tussle between the store and the shopper about money, and just how to relieve shoppers of a bit more of it, stores will get only their minimum allowance. Shoppers come into stores with the express purpose of getting stuff they want, and they have no compunction about wanting more. Of course, they would like to spend as little as possible, but that's not because they want to get as little as possible. Focus on delivering what they want, and amazing things can happen. To make a sale, however, retailers need to take shoppers through three moments of truth.

Table 2.1 shows the three moments of truth in the shopping process. As indicated, there are parallels between these three moments of truth and the concept of exposures, impressions, and sales in advertising. The retail experience is similar to an advertising-rich environment. Note that this table includes both shopper "presence" and shopper "vision." This is because the eye has a crucial and parallel role in what happens in the store. Indeed, vision is the immediate motivating force behind shopper behavior, as discussed next.

Table 2.1 The Three Moments of Truth in the Shopping Process

First Moment	Second Moment	Third Moment
Reach	**Stopping/Holding**	**Closing**
Visits (V)	Shops (S)	Purchases (P)
Exposures	Impressions	Sales
Offer	Engagement	Persuasion
Appearance	Attention	Action
Presence	Interaction	Consummation
Place	Time	Money
Navigate	Find	Decide
Location	Scans	Follow Through
Paths and Counts	Observation and Interviewing	Scan Data and Observation

Seeing the Truth: Eyes Are Windows to the Shopper

We shop with our eyes first, so vision is at the center of the three moments of truth, as illustrated in Figure 2.2. There are three general stages of eye activity in shopping. First, the eye serves as the pilot that steers shoppers around the store. Next, it serves as a rapid scanner of a category or section to home in on prime candidates for purchase, and finally it feeds the sales communication to the brain, thereby closing the sale. Just as no sale can occur without the juxtaposition of the merchandise to the shopper, nothing will be bought that does not first fall into the field of vision of the shopper, and it is that field of vision that leads to the shopper coming into juxtaposition with the products.

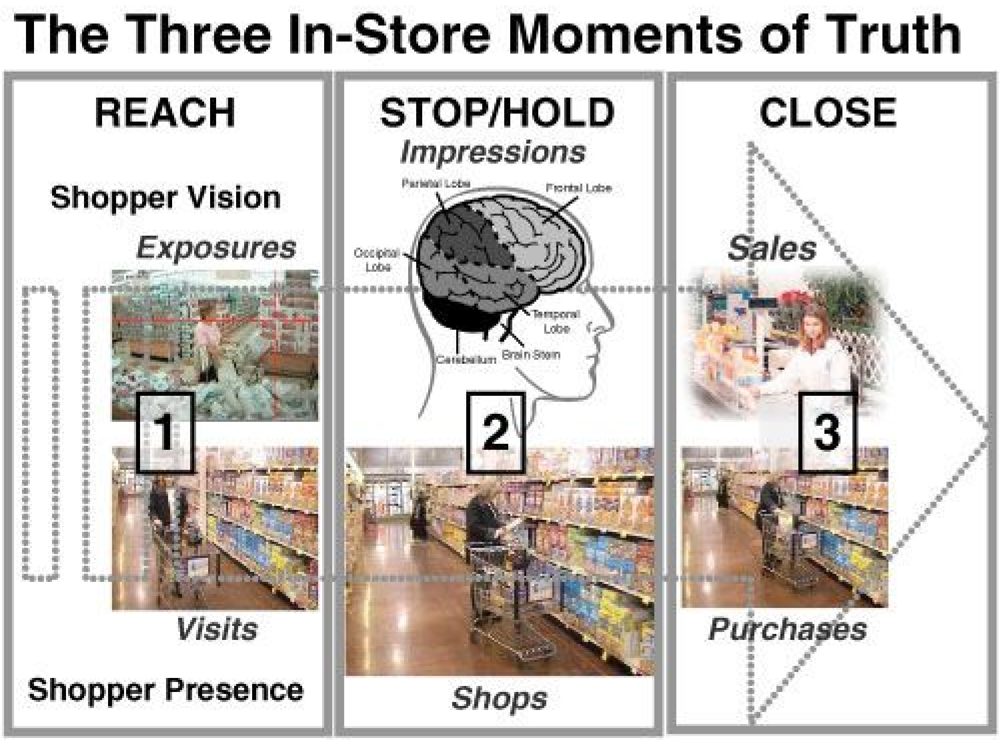


Figure 2.2 The three in-store moments of truth: reach, stop, and close

Vision research offers insights into this process. Distilling what we have learned from two point-of-focus methodologies, mobile and fixed, some general principles emerge that describe the purchase process, as follows:

- It is really fast!
- Category complexity leads to visual blindness.
- If the shopper can’t find or see the products, they are unavailable.
- Poor merchandising and communication make it difficult to find products.
- Shoppers navigate using signpost brands.
- Eye-focus level is three to five feet.
- Shoppers rarely do the math in the store; price does *not* register.
- Shoppers have been trained to shop on deal.
- Gondola ends increase sales but the opportunities are rarely maximized—a strong “call to action” is needed.
- Most in-store communication, both promotional and corporate, is not seen by shoppers.

- Shoppers will read very little while shopping, instead responding to colors, shapes, and images.
- Shelf edge is the most powerful location for communication.

Finally, research has shown that shoppers scan horizontally more than vertically (two-thirds of our eye muscles are designed for horizontal movement) and that when standing at a fixture, we work horizontally within a vision cone of about 5 feet (1.5 meters). However, visual attention is drawn by vertical strips when we are traveling (which is why fins such as those used by Guinness work), as this attracts peripheral attention. Most research tests show that horizontal is stronger than vertical blocking unless the vertical blocks are of a sensible width (that is, 3 feet or about 1 meter).

Not everything the shopper sees in the store is for sale. This is a mixed blessing because although shoppers need a break from solid commercial activity, time spent in these areas is definitely not spent shopping. As noted in the Introduction, a typical supermarket that accrues a total of 20 million exposures from all shoppers, per week, averages out to about 300 exposures per item per week across a total of 10,000 to 20,000 shoppers per week in the store.

There is a bigger waste factor, as we have discussed—the time shoppers spend in traveling through the store. This is where vision becomes critical. Shoppers do not wander around the store with closed eyes, and then open them to see where they have arrived. They do not teleport to their new location. The eye leads the body like a pilot. In fact, to understand shopping, it is helpful to think of the shopper as a pair of eyes mounted in a head, with the rest of the body acting as a servant to work the will of the brain. Because 90 percent of the sensory nerves entering the brain come from the eyes, the eyes not only rule the shopping process but also, in reality, rule life.

This has profound implications when trying to understand shopping by measuring bodies around the store. Whereas the body passing through an aisle may come within "reach" of all the categories in the aisle, at any given point the eyes are exposed to only about one-fourth of what is within reach (an elliptical cone, as shown in the left-hand side of Figure 2.3)—unless our shoppers have eyes in the backs of their heads. That is why we always give consideration not just to counting shoppers, but also to taking note of their orientation and direction in the store, as well as the amount of time being spent. Again, at any give time, shoppers have the *potential* for 360-degree orientation, but at any given instant, they only realize about a quarter of that potential.

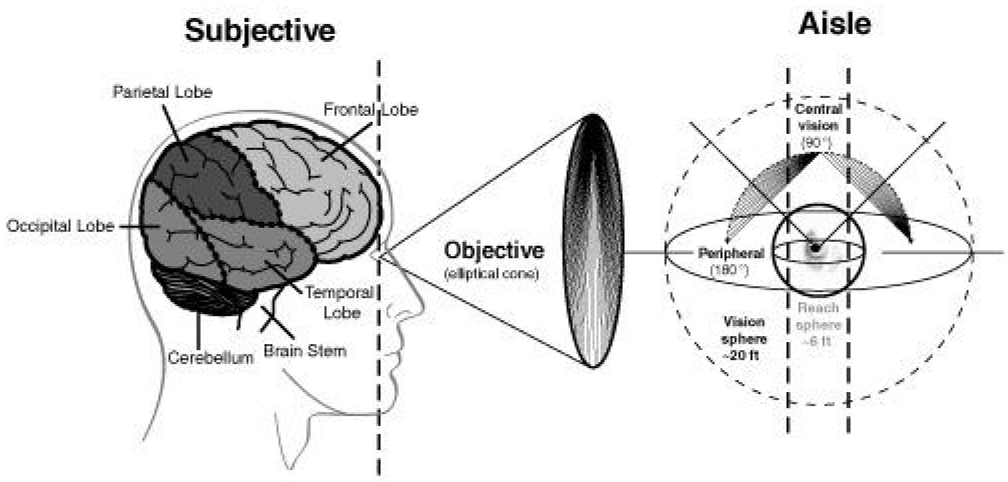


Figure 2.3 Cone of vision: The eyes are exposed to only about one-fourth of the items in the total sphere of vision.

The right side of Figure 2.3 illustrates the relationship between physical reach and exposure to vision. The parallel dashed lines represent a typical seven-foot-wide store aisle. The six-foot radius sphere (labeled "reach sphere") represents the physical reach of the shopper, whose eye is in the center of these spheres, facing up the dashed-line aisle. Most people's peripheral vision extends to about 180 degrees, but the far edges of that peripheral vision best detect things like color and movement, not detail. The resolution of images occurs more accurately in a 90-degree range centering around the line of sight. For comparative purposes, the 20-foot radius sphere (labeled "vision sphere") is a fairly convenient scanning radius for the eyes. To understand the shopper, we use eye tracking to learn more about the shopper's vision (see the following box). We have analyzed these moments of the sales and purchase process in minute detail, ultimately in fractions of seconds, to understand how quadrillions of shopper seconds add up to $14 trillion of annual retail sales.

How Eye Tracking Works

Eye tracking is an unobtrusive method for measuring what the shopper looks at every tenth of a second. Proprietary software analyzes the focal point information, providing valuable insights into how a shopper navigates a category, responds to POS, or reads packaging.

Here's how it works:

- Eye tracking uses specialist technology to track the cornea of the human eye, thus recording exactly what the eye is looking at (fixating on).
- The technology has been adapted to form a pair of glasses.
- Respondents are recruited to shop a store while wearing the glasses.
- The output includes a recording of shopper fixations (what has been looked at).
- A minimal fixation lasts a tenth of a second. This is the amount of time for the brain to register a single piece of information.
- The average respondent will have around 600 fixations per minute.

Reach: Impressions and Exposures

Reach is the first essential step in the shopping process: when the shopper and the merchandise are in the same place at the same time. In other words, the product *reaches* the shopper. This is the same process that media mavens go for when they seek *reach and frequency* for their advertising material. (See the box, "In-Store Media," for further comparison of advertising and in-store media.) It is fair to say that no offer to sell has been made simply because both the product and the potential buyer are in the same building.

Everywhere the shopper turns, there are commercial messages—typically packages—competing for attention. Even in a short trip, the shopper is going to be “offered” thousands of different items. The actual selection of an item for purchase, including the shopping part, often requires just a few seconds per item. So, actual shopping and purchasing happens at blazing speed.

In-Store Media

Thinking of shoppers in a store as an “audience” in the traditional media sense can offer some intriguing possibilities. Gross Rating Points (GRPs) are used in advertising to measure reach and frequency, and this is the appropriate convention in-store as well. GRPs combine exposures and frequency, meaning that as much weight was given to showing one advertisement to 100,000 people one time, as was given to showing the same advert to 50,000 people two times. However, in-store, many purchases occur in less than five seconds. We consider both exposures and seconds. For example, even though only about one of five shoppers in a particular store carried the weekly circular with them, their frequent references to it, though brief, accumulated enough exposures to make it one of the forms of media with the highest GRPs. Sales are preceded by exposures. Any exposure that creates an impression that leads to a sale is a worthwhile exposure. Consider that in the typical supermarket, there are a large number of items that sell one or fewer copies *per week!*

It is relatively easy to establish a common opportunity to see (OTS) measurement for all media of a *single type*, because the relationship of actual exposures to opportunities for exposure is likely to be relatively constant within a single media type. However, any distortion is unlikely to be comparable across disparate media: television, radio, print, outdoor, Internet, in-store, and so on. The drive to achieve common metrics across all media must lead to a more careful assessment of actual exposures in each of the media types, as opposed to simply opportunities for exposure. The use of such in-store metrics does create the opportunity to take a broader view of exposures and impressions across diverse types of media.

The point of focus is the prime mover for engagement of the shopper, but the point of focus is *selected* from the entire field of vision, large parts of which never come into specific focus, but are nevertheless received and processed by the brain. And, of course, the point of focus shifts around quite freely as the observer scans and takes note of this or that. We need to make a clear distinction between exposures and impressions. Exposure is what happens in front of the eyes, and an impression is something that goes on in the brain—or to put it more succinctly, exposure is what you *see* and impression is what you *look at*. In that sense, everything in the field of vision is *exposed* to the shopper, but only the point of focus makes an *impression*. This line of thinking is very important when one begins to make a distinction between the shopper's entire field of vision—what they had an opportunity to focus on or were exposed to—versus what the shopper *looked at*—which items actually made an impression.

Beginning with a purchase, we can back up to what the shopper focused on at the exact point when they selected the item for purchase, and back up further than that, asking what they focused on before that, and before that. Once we are thinking this way, and recognize that all those points of focus were selected from the field of vision, it becomes increasingly valuable to ask what did the shopper *not* look at, which *might* have.

Table 2.2 is a direct tabulation of various media that appeared in shoppers' fields of vision in a specific store—without any consideration of the specific points of focus. For the store represented here, we report not only the share of shoppers being reached by each media point, but also the number of seconds the average exposed shopper sees the media during their full shopping trip. Notice that they are *seeing* the media (because it appears in their field of vision), but that does not mean they are looking at it, which would require tracking their point of focus. So, these are *exposures*, not impressions.

Table 2.2 Shoppers' Exposure to In-Store Visual Media

Stimulus Exposed	Share Exposed	Times/ Trip	Seconds/ Exposure	Seconds/ Shopper	% Reach x Frequency
End aisle displays	100%	15.5	5.8	90.1	90.1
Free-standing product display racks	100%	9.0	4.0	36.3	36.3
Display bins	97%	4.2	3.3	13.9	13.5
Floor ads	91%	2.9	2.4	7.0	6.4
Free-standing ads, cutouts, inflatables	88%	3.8	3.4	13.0	11.5
Pallet of featured product	85%	2.1	4.9	10.6	9.0
Navigational signs (Aisle Directories, Product Markers)	74%	5.7	3.3	19.0	14.0
Shelf ads	62%	4.9	2.5	12.3	7.6
Coupon dispensers/ tear-off pads	50%	3.9	3.0	11.5	5.7
In-store flyers	21%	14.0	5.6	79.0	16.3
Refrigerator/ freezer door ads	21%	4.4	3.8	16.9	3.5
Store staff	6%	1.5	45.0	67.5	4.0
Video or inter-active displays or kiosks	3%	8.0	2.5	20.0	0.6
Shopping cart ads	0%	—	—	—	—

This table reveals exactly which visual media (including store staff) are actually being seen by shoppers as they proceed through the full shopping trip. “Reach” is simply the percentage of shoppers who at any point in their trip “see” the designated media by having it appear in their field of vision. For “frequency,” we have used the total number of seconds that “reached” shoppers see the media. In terms of measuring impact, the total seconds per shopper are almost certainly a better measure than how many times they see it.

Based on these data, you can see that there are nine different media that are seen by at least half of the shoppers, with the lion's share of that exposure going to end-aisle displays and the free-standing product display racks. Possibly surprising is the impact of the in-store flyer and the staff, both of which get a lot of attention in terms of the total seconds/shopper. For the flyers, even though only one in five shoppers carry them around the store, their frequent, short references to the flyer add up to a lot of exposure. For the staff (not including checkers), few shoppers are exposed, but the staff tend to be in view for a long time—presumably during interactions.

There is no point in thinking about media in the store without considering the package. All media competes with all other media in the store, and not only does the package feature in two of the top three areas of greatest impression—end aisle displays and free-standing product display racks—but also in center-of-store aisles, 80 percent of visual impressions are packaging.

In addition to measuring individual exposures, we can *compute* the probable field of vision from the path that shoppers walk. The head usually faces the same way as the body, and the eyes almost invariably face the same way as the head. It would obviously be more desirable to measure the point of focus and field of vision of shoppers, but the practical reality is that we can measure full-trip points of focus for only a few shoppers in any given study, and can measure the fields of vision for a few hundred. By contrast, we can measure the locations and orientations of tens of thousands and have, in fact, measured the full trips of millions. This means that we can use path and shopper position data to compute reliable estimates of actual exposures.

One practical application of this is determining the relative exposures that every end cap (end-of-aisle display), or other types of displays in the store, receives. Often this analysis is confused with simply counting the shoppers who pass by. But it is so much more than this, taking into account as it does the position and orientation of all the thousands of shoppers who come within eyesight of the display, their distance from the display, and the amount of time they are there. Figure 2.4 shows the exposure all the end caps in this store received. The bigger the circle, the higher the exposure. The end caps at the back of the store (top of diagram) receive little exposure, whereas the largest exposure is at the back of the produce section.

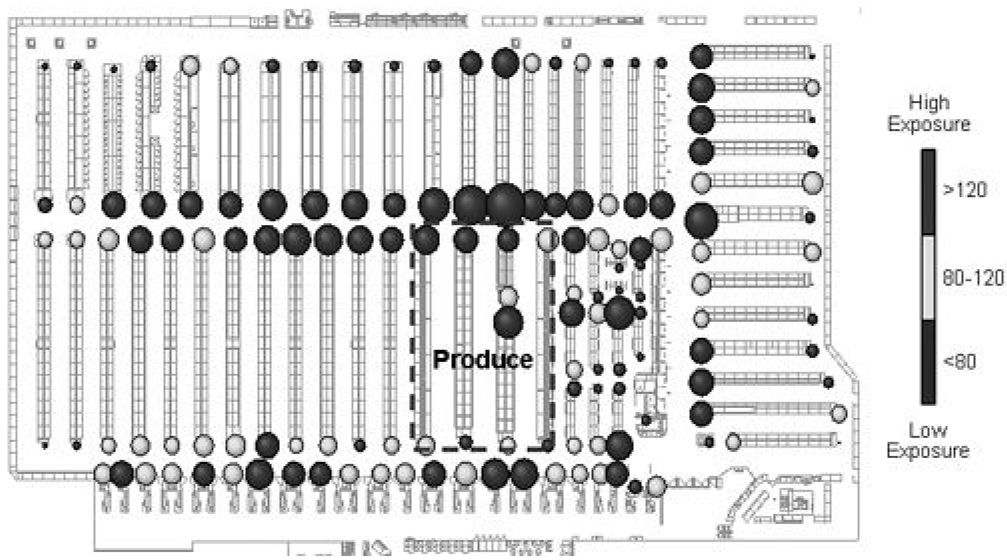


Figure 2.4 Exposures at end caps: End caps at the end of produce receive the most exposure (largest circles).

A study of breakfast cereal purchases illustrates the difference between exposure and impression. The results for nine stores in the study (see Figure 2.5) show that in one store (B), 73 percent of shoppers were exposed to breakfast cereals, the highest exposure rate of any of the nine stores in the sample. Yet only 8 percent of all the shoppers in that store purchased a breakfast cereal, nearly the lowest share across all of the stores. The shoppers in the store saw but did not *look.* They had more exposures but fewer impressions that led to purchases.

Although there is variability from store to store in terms of share of baskets purchasing a given category—cereal, in our example—the reality is that the share of baskets with category purchases is *relatively* constant across stores. In this case, about 9 percent of baskets contain a cereal purchase across this series of stores, across the United States, across chains. To be sure, some sell more and some sell less, *per basket*, but the relative constancy of category sales is a reflection of the constancy of crowds. Although there will be differences, any 100,000 people will behave pretty much as any other 100,000 people will, at least in terms of cereal purchases (and for most other categories, for most of the time).

In Store B, many people were exposed to cereal, but this did not affect the percentage that made purchases. As any magazine advertiser knows, the opportunity to see (OTS), while easier to measure, is quite different from actually seeing. Magazine buyers have the opportunity to see every ad in the issue, but will typically only see a few, and pay attention to ("look at") an even smaller subset. David Polinchock, chairman of Brand Experience Lab, comments about the Wal-MartTV network: While they claim to have 140 million viewers a week in their stores, "What if this study showed that they really only have 2 million *engaged* [italics added] viewers?"[1] There is a big difference between 140 million exposures and 2 million impressions. End-aisle-displays, other free-standing product displays, and the in-store flyers (weekly circulars) receive the most exposure in the store. It is not surprising that 30 percent of all store sales come off end-aisle displays. On the other hand, we have found that even very limited exposures can be highly effective in producing sales.

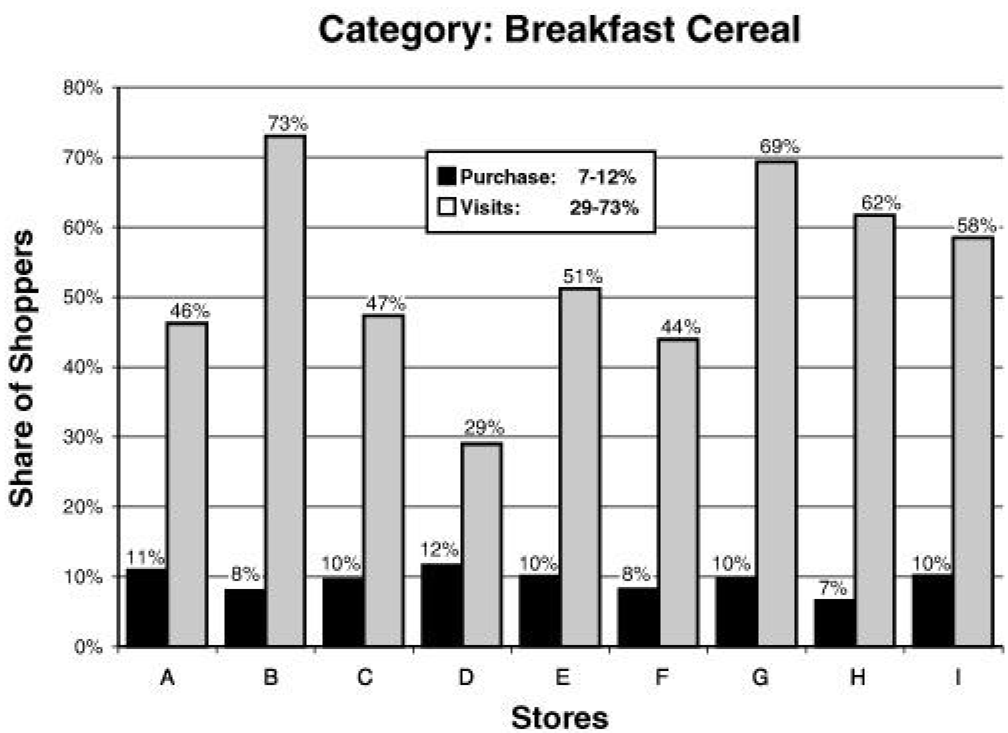


Figure 2.5 Exposures and sales of breakfast cereals for nine stores: Although 73 percent of shoppers were exposed to cereals in Store B, only 8 percent purchased them.

Stopping Power (and Holding Power)

Stopping power is the second crucial element of the process—translating these many exposures into impressions that lead to arresting the shopper's forward movement through the store. It begins with some change in the shopper's behavior. Because shoppers navigate the store by walking around, "shopping" may begin with them starting to walk more slowly, increasing their time within an orbit of products. The initial impact of a category or product causes them to halt their nonshopping behavior (cruising) and switch to shopping mode. It might be a very slight or weak interaction, but it alters the shopper's behavior.

Admittedly, the line between reach and stopping can be hazy. At what point does a person go from being exposed to something, to being engaged with it? If you want to decide this from a scientific, analytic point of view —which we do—then *time* is what distinguishes visiting from shopping, because if you take a visit and add time, you have shopping. Time converts a visit to a shop, whatever other behavior may occur. Looked at from the point of view of the product, stopping power is what converts a "visitor" to a "shopper."

This transition is again a matter of degree. Stopping can mean a "California stop," as when motorists roll through stop signs slowly, or a full stop. A momentary pause may indicate that some element of "shopping" has occurred. But is a momentary pause adequate? Before addressing that question, let us recognize that measuring the amount of the time involved here is measuring "holding power." As in *Goldilocks and the Three Bears*, too much holding power is not good, and likewise for too little. It needs to be "just right." We can also divide holding power into two subcategories: "buy time," which is the holding power, however long that may be, which results in purchase, and "dwell time," which includes the time that both purchasers and nonpurchasers spend on the products, display, or category.

Closing Power

Capturing the shopper's time is only effective inasmuch as it leads to *closing power*. Holding a shopper at a product is a mixed blessing because reach and stopping power, if they don't lead to a sale (or display closing power), become a wasted exercise. Excessive time that does not lead to a sale probably creates angst and burns through shopper time in the store, resulting in lower profitability. The third moment of truth is closing the sale.

In this context, the array of choices presented to shoppers is critical. The typical retailers have no conception of what it costs them in lost opportunity when they jam up their stores with tens of thousands of "choices" that are largely irrelevant to their shoppers. Stew Leonard's chain, as noted in the Introduction, cuts the Gordian knot by eliminating all but *2,000 items* in his supersized store. That may seem radical, but it is eminently reasonable from the shopper's perspective. Remember, the shopper is only going to buy up to 400 different items in an entire year. This means that Stew Leonard is giving the typical shopper, on average, *five options for every item they buy*. This represents a massive reduction in selection angst for the shopper.

For some people, this selection angst may not be too large of an issue. But as Swarthmore College professor Barry Schwartz points out in his book, *The Paradox of Choice*, there are two kinds of people—optimizers and satisficers. *Satisficers* have some level of performance that they require when they make a choice, and as long as the product meets their expectation, they are satisfied, without spending a lot of time worrying about whether something else might be better.

Optimizers, on the other hand, always want to make the best choice. Giving them lots of choices can overwhelm their decision system and lead them to either not make a decision, or fret with dissatisfaction over whatever decision they have made, on the grounds that, with all these choices, there must have been a better option. This is not theoretical: Shoppers have been shown, under parallel test conditions, to buy ten times more from a limited selection than from a large variety. Dr. Schwartz describes an experiment involving product demonstrations at matched stores: "In one condition of the study, 6 varieties of the jam were available for tasting. In another, 24 varieties were available. In either case, the entire set of 24 varieties was available for purchase. The large array of jams attracted more people to the table than the small array, though in both cases, people tasted about the same number of jams on average. When it came to buying, however, a huge difference became evident. Thirty percent of the people exposed to the small array of jams actually bought a jar; only 3 percent of those exposed to the large array of jams did so."[2]

As Dr. Schwartz observes, "A large array of options may discourage consumers because it forces an increase in the effort that goes into making a decision. So consumers decide not to decide, and don't buy the product." In this case, fewer choices led to ten times as much purchase! This surprising result confirms what we have seen in the aisles of store after store: Fewer choices lead to higher sales. A passive retailer simply waits for each of these moments of truth to happen, whereas the active retailer understands all three and works with the shopper to expedite them. While the abundance of the long tail may attract customers to the store, this experiment demonstrates how the presence of the long tail in the aisle may impede sales. The retailer that can identify the right six products to sell, rather than burying them in the entire set of 24, can sell significantly more of the products.

Three Currencies of Shopping: Money, Time, and Angst

So far, we have focused primarily on shopper time in examining these moments of truth. But shoppers are not just expending time; they are also expending money and angst as they move through the retail store. Money, time, and angst are the inputs that shoppers invest in shopping. There are two outputs: purchases and satisfaction. At any point in this journey, the shopper is balancing the inputs and outputs. Effective retailing means minimizing the inputs to generate higher outputs.

Most retailers focus a great deal of attention on the money part of this equation, ignoring the other two currencies. Many observers see the retail transaction as, simply, the shopper gives money and receives a product. Given this view, it is not surprising how retailers used the data from electronic checkout scanners in the 1970s, which opened the way for massive and relatively accurate measurement of the money and items exchanged, the two most obvious of the shopper's inputs/outputs. In fact, two of the largest research organizations in the world, IRI and Nielsen, are founded on the business of compiling the counts of these two variables and metering them out to both retailers and suppliers, for a healthy stream of profits.

For many years, great numbers of retailers used scanner data for little more than totaling up the shopper's payment at the checkout and for inventory control: monitoring the flow of goods through the store. It is especially significant that this data is summed up at the store level and compiled *on a weekly basis*. Weekly totals are hardly the kind of detail that might be required in terms of understanding actual shopper behavior in the store.

To understand the moments of truth, we need to look beyond collective data to the individual experience of a single shopper. Individual data for this purpose does not even exist in the weekly roll-ups that are provided by Nielsen and IRI. It is not just shopper identity that is required, but also the detailed log of those shoppers' every single shopping trip and every single item purchased on those trips, which delivers the value. (Better to have all the detailed data for a few shoppers, than all the *pooled* data for *all* shoppers.)

Although some stores are measuring customer satisfaction through surveys outside the store, this recalled experience does not always equate with the actual experience in the store.

Because we know quite a bit about the money side of this equation, we will focus on insights about time and angst.

Time

Think about it: If you are a supplier who wants to move merchandise through a retail establishment, it is not having shoppers in the store that brings you sales; it is having shoppers in the aisle or location where *your* merchandise is. More than this, it is not the shoppers who are hurrying past your location on their way to somewhere else, but shoppers who are spending at least a modicum of time considering your (and your competitors') offerings. *Traffic in itself never buys anything; it is traffic investing time that becomes shopping.*

Time is an opportunity to sell, but not a sale in and of itself. As we saw in the previous example of breakfast cereals, there is a difference between time spent moving around and looking versus time spent buying. Based on a variety of research studies, it is apparent that it takes about a second for a shopper to actually take note of a stimulus, whether of a package, a product display, or some other media. This means that one second of one shopper's time is a pretty good basis for measuring how much shopping is going on. Hence, as noted earlier, shopper-seconds are the basic unit of shopping. Retailers commonly compute the turnover of cash per square foot or meter. This is certainly a useful and valid measure of the productivity of the real estate. Why wouldn't we want something to tell us the productivity of their use of an asset of far greater value: the shoppers' time? In fact, it is not too great a stretch to say that many retailers know a good deal more about the management of real estate (and inventory) than they do about the management of shoppers. One can succeed in retailing with this situation because it is *self*-service, and shoppers are expected to manage their own shopping experience.

To become actively engaged with the shopper, it is necessary to understand how shoppers are spending their time in the store—or, perhaps more accurately, understand *where* shoppers are spending their time in the store. The reason for this is so that, rather than waiting passively for shoppers to find their way to the merchandise they need, we can actively understand their needs and make relevant offers to them to expedite their purchases.

This is a crucial concept. Instead of frustrating shoppers by trying to "build basket size" by holding them in the store longer and hoping they will buy something more, we will build basket size by getting more merchandise into their baskets more quickly. The simple fact is that, in the long run, holding them in the store longer will mean that they won't be coming here so often. Because, in the long run, whether they put words to it, they will come to realize that *you* are not being as helpful as your competition.

But there is a very important point to add: Most shopper behavior is *not* driven by the location or arrangement of merchandise! In fact, a very large share of shopper behavior in the store is not driven by the merchandise. As we noted before, only a minority of the shopper's time is actually spent in the direct acquisition of merchandise. The role of active retailing is to identify this noneconomically productive time and to do more selling during that time. Simply attempting to increase shopper time in the store has counter-productively led to fewer shopping trips, of shorter duration.

Another way to look at this is that, instead of trying to lure shoppers to where they are not, learn where they are (and where they are going) and merchandise to that, as we will discuss further in Chapter 3, “In-Store Migration Patterns: Where Shoppers Go and What They Do.” But, of course, this active retailing will begin with knowledge of just where the shoppers are spending their time. It is shopper knowledge rather than product knowledge, the latter being the specialty of most retailers and their suppliers.

The Versatility of Time as a Measure

We have noted that time is one of the three currencies of shopping, second only to money in terms of importance. We also say that time is the proper metric of shopping. It does, however, play an even greater role than simply counting the seconds a shopper spends in this or that activity, including the full trip. In fact, a good deal of our in-depth knowledge of shoppers derives from connecting precise *clock time* with just a few other data inputs: the exact geographic location (*xy*) of the shopper, the exact location (*xyz*) of every product in the store, and the list of exactly what the shopper purchased (T-logs.) Some of the distinct uses of time include the following:

- **Elapsed time:** This is used to assess the magnitude of the shoppers’ involvement, whether from the trip length (for the full store), or any portion of the store (department, category, brand, or single items). The elapsed time can be evaluated for all shoppers, for some specific group (such as purchasers versus non-purchasers), or for individual shoppers.
- **Serial time:** In what order did events occur? This should begin with the shoppers’ path, its progression, and the location where any designated event occurs.

Once all shoppers' trips are catalogued, the trip progression—the first 20 percent of the trip, for example—can be examined for individual shoppers or grouped by cohort.

- **Clock-calendar time:** This is the basic time stamp that is placed on every event or series of events. Events can then be related by identity, location, and time. For example, the items purchased on a trip can be identified by the exact time that trip passed through exactly which checkout lane, and exactly which products were scanned at checkout. This time is also the key to analysis by hour, day-part, day of week, week, month, and so on.
- **Time-derived measures:** Dividing the distance between two points in the shopping trip by the elapsed time between those two points gives the *speed* of the shopper. Derived measures like this can give important insight into whether the shopper is dawdling, engaged, or just speeding by displays. Other insightful measures, like seconds per dollar spent, measure the efficiency of the shopping trip, and indeed, of the entire store, chain, channel, country, and so on.

Angst: A Vague and Unpleasant Emotion

Angst is driven by time and money, but it also arises from excess choice or difficulty in navigating the store. The third currency of shopping is easy to understand but difficult to measure. Shopper's angst is a psychic, emotional deficit that can involve anything from a long checkout line to an out-of-stock item. Although it may be difficult to measure, this does not mean that the effects are slight or inconsequential. While angst is clearly affected by time and money, here we want to focus on two other major drivers of angst, both of which are related to the matter of choice. As noted previously, a smaller selection of products sometimes can actually *increase* purchases, primarily because a smaller set reduces the angst involved in the purchase decision.

Retailers are driving sales to new heights by moderating choice angst, offering a more limited selection of items. But there is a related angst issue in most stores: “Where is the …?” We refer to this as *navigational* angst. And there is no question that navigation can create significant frustration, whether it is navigating the shelf visually or finding one’s way around the store. There are at least five ways to reduce navigational angst, as follows:

- Design the store and lay out the merchandise in a logical and intuitive way.
- Provide signage or other navigational aids to assist the shopper.
- Reduce the size of the store to reduce the need for navigation.
- Remove visual barriers so shoppers can see the whole store.
- Eliminate or reduce path options.

The first two of these seem reasonable, but are sometimes violated with a deliberate strategy to cost the shopper time, in hopes of translating that into sales. Making shoppers spend more time looking for merchandise and less time buying is never a good idea. It reduces overall sales for the store and significantly increases navigational angst on the part of the shopper.

A Complex Optimization

In summary, the three currencies that the shopper pays in the store are money, time, and angst. The key to retailer profits—and massive customer satisfaction to go with massive amounts of merchandise bought from the store—is to deliver goods and satisfaction while reducing the expense in time, angst, and money. This is the crux of the matter—what is the optimum? The reality is that money, time, and angst are themselves interrelated, so there is not a single optimum.

This brings us to a criticism of a great deal of shopper and retail research. It is simplistic, depending on data and tools readily at hand; consequently, the focus is on the easy, not the important. Paraphrasing a professor’s criticism of a student paper: “The parts of shopping research that are easy are not important, and the parts that are important are not easy.” Understanding the money part of the shopping experience and the products sold is as easy as tallying up register receipts and tracking inventory. But understanding other currencies, and how the three moments of truth lead to sales, is a more complicated proposition. We need to observe and study shoppers to understand their true behaviors in the store, where they are experiencing angst from choice or navigation, where they are investing their time, and whether that time is leading to sales. This approach can also help in improving sales forecasts. To understand how they spend their time, we need to understand the difference between time spent in the three moments of truth: reach, stopping, and closing. We can then look for opportunities for encouraging shoppers to spend more time buying and less time getting to the sale. This requires hard data on shopper behavior—each of the moments of truth and the three currencies—but gives us a much more accurate assessment of what is going on in the stores and the strategies that lead to profits.

Endnotes

1. *Advertising Age*, June 12, 2006.
2. Barry Schwartz, *The Paradox of Choice: Why More Is Less*, pp. 19, 20, New York: Harper Perennial, 2005.

3
In-Store Migration Patterns: Where Shoppers Go and What They Do

"There is no path. You make the path when you walk."

—Antonio Machado, poet

An award-winning store in the Philadelphia area was designed with a dual entry—one entrance on the left and one on the right. It was arranged by the designer in such a way as to make the right entry inconvenient to reach, creating what was expected to be a dominant left entry. Customers were expected to move from the parking lot into the left entry and then proceed around the store starting from the left. Of course, shoppers did enter from the left, but this is where the plan broke down. The designer knew a lot about design, given that the store won industry awards, but not as much about shoppers. When the store opened, shoppers were so determined to make a right entry that they entered through the left door, and then crossed the entire front of the store to shop in the natural direction, starting at the right and moving counterclockwise.

Managers deemed this unacceptable shopper behavior, so they positioned several pallet displays to impede efforts to execute a counterclockwise shopping trip. Given these obstacles, they thought shoppers would come to their senses and start from the left. Instead of accepting the flow of the shoppers, the managers tried to change shopping behavior. The managers, of course, were wrong. It was with real sympathy that we observed shoppers struggling to maneuver their carts around these pallets, as determined as salmon swimming upstream. Because this store won awards, it not only reveals a weakness in understanding shoppers by the store itself, but also across the industry.

Retailers who understand the natural migration patterns of shoppers can design stores that fit with shopper behavior, rather than trying to change behavior to fit the store. Sociologist William Whyte reflects this understanding when he writes about the virtues of a good entrance: "A good entrance draws people—not just those who mean to go in, but those who do so out of impulse. It draws them not by forcing a decision, but by making a decision unnecessary." To illustrate, he describes the entrance of Paley Park in Manhattan, which has been cited as one of the finest urban spaces in the United States. "Its attractive paving and trees extend out to the curb. There is no clear line between the park and the street, and because that entry space is so broad, there is a full view of the activity within. Passers-by look at it. Some will pause. Some will move a few steps closer, then a few steps more, and they are in, without having decided to be… Store doorways should be similarly inducing."[1] Contrast this view with the image of store managers throwing obstacles in the path of hapless shoppers.

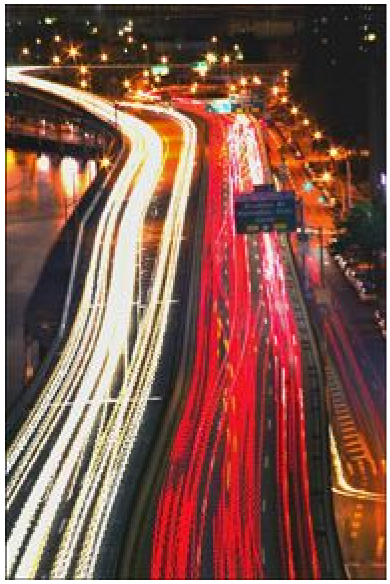
The experience of many shoppers and many stores shows that changing such basic shopping behavior is like trying to convince a dog not to spin around several times before settling in for a rest. Understanding and aligning with this behavior can lead to higher sales and profits. In fact, one retailer we worked with increased sales by 7 percent simply by moving the left entrance to the store to a more natural position. This is a huge increase in sales just from a better understanding of shoppers, perhaps more valuable to a retailer than a design award.

If You Stock It, They Will Come

Retailers are quite expert at where to locate stores. They put stores at major expressway interchanges and other high-traffic areas. (In fact, it was traffic studies that inspired, in a way, our in-store studies of shopper traffic patterns; see the following box.) Retailers study demographics and traffic patterns to place retail in the path of consumers. Except for Wal-Mart's counterintuitive early strategy, retailers don't locate their stores in the hinterlands hoping that customers will make a pilgrimage. This may work for religion, but few retailers have that kind of draw, even among their most passionate zealots. Retailers take the stores to places where they are likely to find customers.

A Time-Lapse Photograph

PathTracker® began conceptually 40 years ago when I was stretched out on the living room carpet with my kids, looking at a *Time-Life* book that showed a time-lapse photo of night-time automobile traffic passing through an intersection. If people could look at the traffic on a road over time, why not do the same thing in a supermarket? That way of looking at, and thinking about, traffic stayed with me for my first 30 years of studying shoppers in stores, although I had done very limited shopper tracking studies to that point, mostly focusing on observing shoppers at-the-shelf, and interviewing them about their experiences and opinions. I was certainly not the first to study shopper paths. Farley had done shopper tracking in the'60s, the Marsh super-study in the'90s did extensive shopper tracking, and Paco Underhill and Siemon Scammell-Katz both included shopper tracking in their practices. However, when I began serious tracking in 2001, it was with the express goal of generating an electronic stream of behavioral data from the sales floor that might provide helpful understanding of the electronic scan data of sales, recording the final delivery from the store.



PathTracker® is designed to produce massive amounts of shopper data (millions of trips) to match the massive amounts of sales data available. PathTracker® has evolved into a sophisticated tool integrating data about shopper paths (often measured with cart tags and antennas in the store, as illustrated), sales data, product locations in the store, and shopper demographics, psychographics, and attitude data.

Antennae

Cart Tag

Yet when shoppers arrive at the entrance to one of these stores, this logic and science tend to disappear. Retailers may have an entire department dedicated to studying what happens before shoppers arrive, understanding the traffic that will bring shoppers into the store. But the locational focus is lost once the shopper is inside.

One reason for this state of affairs is that retailers and brand suppliers alike believe that the location of the products in the store determines where shoppers will go once they are inside. So, if retailers put the products in certain places, the shoppers will "find" them—a *Field of Dreams* logic: If you stock it, they will come. This is the model that retailers have followed for years. In their minds, the relationship between people and products represents the most important aspect of shopping. This is an illusion of knowledge and is a consequence of being intimately involved with stores without actually *measuring* what shoppers do there.

The traditional view is that people come to the store to buy goods, and travel from one product to another, rationally working their way through their supposed shopping list. As discussed in Chapter 1, "The Quick Trip: Eighty Percent of Shopper Time Is Wasted," the quick trippers who dominate retail may not even *have* a list. And, as we saw in Chapter 2, "Three Moments of Truth and Three Currencies," exchanging products for money is not the only concern in the shopping experience. Shoppers are spending time and angst along with their money, and they are receiving experience along with hard goods. The approach of letting shoppers find their way to products focuses on the exchange of products for money but does not place a very high value on shopper time or angst. Whereas money is the proper metric of the outcome of shopping, time is the proper metric of the process of *shopping*. Money measures sales, and time measures shopping. So, if shopping is our subject, time is our focus.

A passive retailer relies upon gross measures—sales, margins, inventory, and square feet or meters—which offer a pretty good picture of the relationship of the store's assets to profit. But between the time the shopper walks through the entrance and reaches the checkout, a great deal has happened. In this period, our passive retailer has left the shopper to do all the work in finding products in the store. How has the shopper spent time during this shopping trip? Did the shopper earn a decent return for this time? What kind of debt of angst has the shopper racked up? Could the retailer have reduced this angst and time, while realizing opportunities along the way to make additional sales? The data on shopper time and angst never appear on the retailer's balance sheet, but you can bet they are top of mind, at least in qualitative form, for the shopper.

A more active retailer plans to pursue the sale by making offers to *where the shopper actually is*, including where they are facing, and for how long. The questions are: Where are shoppers to be found in the store? And what is the most efficient way to make offers to them?

Understanding Shopper Behavior

To understand shopper behavior in stores, we need to look at where and how shoppers are spending their time in stores. These measures are similar to the studies of frequency and reach in advertising (see the following box). As with studies of vehicle traffic used to locate stores, looking at traffic volume, speed, and direction, in the store we need to measure where the shoppers are, how long they stay there (in time or speed), and where they are heading. With these measures, we can create distribution maps that show the high-traffic and low-traffic areas of a given store, as illustrated in Figure 3.1 (which we presented in the Introduction). The checkout stands typically are centrally located across the front of the store. For the most part, the retailer has absolute control over only two points in the shoppers' trip—where they enter the store and where they check out and exit. We consider three insights from these studies: the importance of the entrance, shopper direction, and the role of products in dictating shopper traffic.

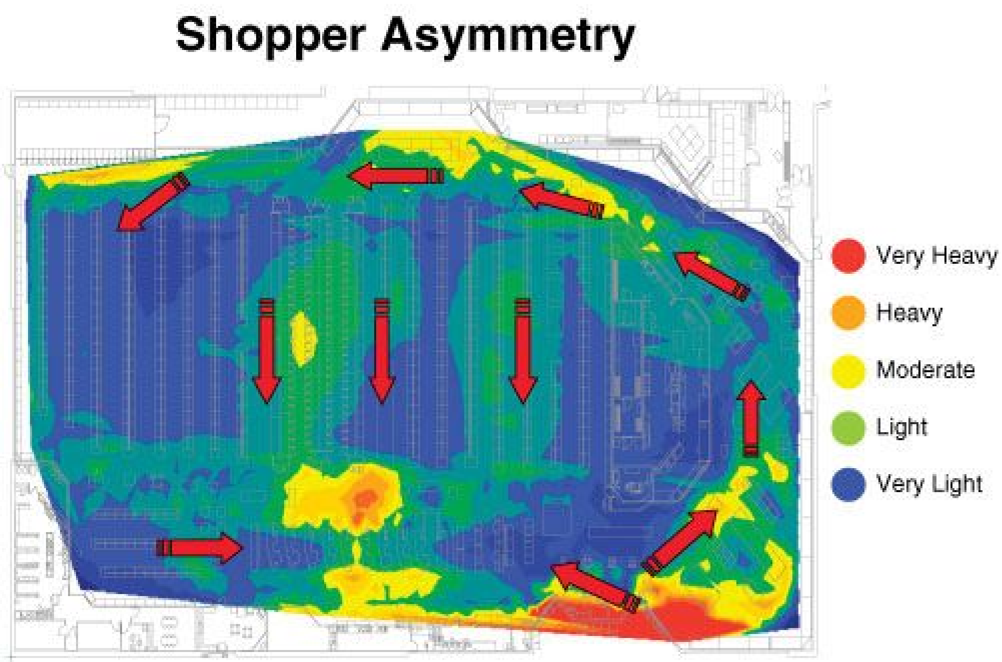


Figure 3.1 Shopper movement through a store

Three Measures: Counting Shoppers, Time, and Direction

Advertisers have long used Reach and Frequency (Gross Rating Points) as a standard metrics for advertising exposure. It was Wharton Professor Peter Fader who first pointed out to us years ago the relationship between the metrics we were developing and advertising metrics. *Frequency* and *time* are closely related. Just as one person viewing a single advertisement five times results in the same five Gross Rating Points (GRPs) that five people seeing the advert once does, so 50 people visiting an aisle for an average of 20 seconds each results in the same 1,000 shopper seconds (Gross Rating Points) that 20 people for 50 seconds would. And just as with advertising's GRPs, it is the total shopper seconds that are the proper accounting of the opportunity of shoppers to buy—or the opportunity to sell, if we take a more active view.

First Impressions: The Entrance

As with stage acting, a strong entrance sets the tone of the entire trip. First, we notice that there are a lot of shopper seconds being invested just inside the entry. This is because nearly 100 percent of shoppers visit this area, and a very large number of them stop at the cart corral to pick up a shopping cart. But this “landing area” plays another role: Here is where shoppers can stop to get their bearings as to where they are going to head and to check their shopping list, if they have one. For the active retailer, *this is an important opportunity to begin the sales process*. For many supermarkets, this opportunity is taken to establish a “fresh, attractive” ambiance by featuring prominently such items as produce, fresh deli, and possibly the in-store bakery.

This, however, definitely doesn’t happen in every case. Our purpose here is not to consider the pros and cons of all the different ways of handling the immediate entry, but just to call attention to its extreme importance. And this is *not* simply for grocery operations, but for any type of store. As William Whyte notes in the previous comment, a good entrance finds visitors “in, without having decided to be.” Whyte suggests minimizing the demarcation between inside and outside and widening the entrance (extending the welcome) to the extent practical. Personally, I prefer air curtains, even in fairly harsh climates, rather than doors of any kind. It takes shoppers three to four times longer to buy a frozen food item than another grocery item, as we will consider next. This is almost certainly—or at least partially—because of the door that you have to go through to retrieve what you want.

Of course, the second area with a great concentration of shopper seconds is the checkout area. Nearly all shoppers must pass through here, as with the entry. Otherwise, one sees a band of high density of shopper seconds most of the way around the perimeter of the store, with two bands of heavy concentration linking the back of the store with the front of the store. In fact, one or the other of those two bands represents the heavy flow of the traffic from the back of the store to its front.

Some retailers have experimented with left-entry and center-entry stores, in addition to the more traditional right entrance. With center-entry stores, most shoppers turn to the left when they get to the back of the store. The entry is the last place you want to have a choke point. McDonald's realized this years ago when they replaced their small windows for taking orders with a storewide counter. It removed a choke point right at the entry. Center-entrance stores have a choke point at entry. This nearly always leaves such stores with under-shopped areas to the right of the entry. Again, the dominant back to front traffic is the first aisle leading to the checkout, and again in this example, the wide frozen food aisles, which have in this case been arrayed at the beginning of the left third of the store. Almost certainly it is the continuation of the wide perimeter aisle, here returning to the front along the left perimeter, that has encouraged a quite wide distribution of shopper seconds in this store.

For the left-entry store, we previously discussed the Philadelphia store that tried to force customers into the left-side pattern. Some shoppers make their way to the right side of the store so they can move in a counterclockwise pattern. What happens to the others? Some shoppers move directly back from the entrance through produce, as hoped. Others walk along the front of the store and then turn up one of the aisles, then resuming their counterclockwise progression from that point. If they turn up the middle aisle, for example, they will miss half the store on their right.

Shopper Direction: Elephant Herds

In addition to finding out where shoppers spend the most time in the store, we can also discover the general direction of their movement, as shown by the arrows in Figure 3.1. (As with vehicle traffic studies, the direction of travel has a significant impact, as discussed in the Walgreens example in the following box.) We see that not only do the shoppers enter at the right of the store, but that the dominant traffic is around its *perimeter*, in a counterclockwise rotational pattern. This rotational pattern dominates shoppers' movement in the store, and echoes many rotational patterns in nature, such as migration of elephant herds. For shoppers, we know that substantial majorities are right-handed, and a right-handed person, pushing a shopping cart, is going to tend to push with their right hand, giving the cart a natural tendency to turn left; that is, in a counterclockwise direction.

The next question is why is there the heavy traffic through the center of the store, several aisles after the shopper begins crossing the rear of the store? In examining store after store, this phenomenon is often repeated, with the first dominant path from the back of the store to the front being the first aisle where the checkout area can be clearly seen. This is a manifestation of the "checkout magnet," which draws the shoppers toward it, like a vortex.

Walgreens Finds Profits in Two Directions

One of the best-performing Walgreens stores was located on Michigan Avenue, north of The Loop in Chicago. It was on the southbound side of the street, convenient to traffic heading into the city. Walgreens then located a second store right across the street on the northbound side, convenient to traffic leaving the city. The result: two high-performing stores at essentially the same location but addressing traffic going in opposite directions. Similarly, in looking at in-store traffic, to maximize sales, we not only have to consider the volume of traffic going by a certain point but also traffic *direction*.

The second back-to-front dominant aisle is near the end of the checkout area, and through, in this store, the frozen food aisles. But we should also note that it is through the *wide* frozen food aisles. The wideness is significant because "open space attracts." Thus, there are at least three forces driving traffic down this aisle: It is the last visual opportunity to return to the checkout; it is wide and accepting; and it contains frozen food. This third factor—the actual products—probably accounts for the least number of shoppers down this aisle, although the perishability of frozen goods means that shoppers tend to like to buy them at the end of their trip (see the following box).

Shoppers Save Frozen Foods for Last, but Not Produce

It is interesting to compare shopper behavior in buying frozen food and fresh produce. Frozen food exerts a strong force on the order of the trip. That is, no matter where the retailer locates frozen food, it will often be visited near the end of the shopping trip. So, the aisle nearest the entrance of the store will ordinarily be shopped first, followed by the second, third, and so on, across the store. But if frozen food is not placed at the end of the trip in terms of layout, shoppers will often skip it and return near the end of the trip —if they remember—or just skip it altogether.

Compare this to fresh produce. We could theorize that shoppers might prefer to have produce at the end of the trip, to avoid having fragile, crushable fresh produce on the bottom of the cart. We do not, however, see large numbers of shoppers skipping fresh produce, which is often the first category offered to them, although this undoubtedly does occur to an extent.

Of course, progression is not the only factor to consider. In this case, *fresh* produce sets the tone for the store's image, not only from the stand-point of being visually attractive, but also by conveying the message of naturalness and freshness about the entire store. (Having cut-price items prominently at the entrance can similarly convey a *value* message for the entire store.)

We can cite a number of principles seen on this shopper second flow diagram, as follows:

- Trips always start at the entrance, and end at the checkout/exit.
- After pausing at the entrance, shoppers tend to move to the back of the store, especially if that pathway is broad and attractive.
- Once at the back of the store, shoppers will tend to turn to the left, counterclockwise, and immediately begin to exhibit exit behavior.
- The appearance of checkout stands on their left, at the front of the store, will attract many to move there.
- Several extra-wide aisles will hasten the growing rush to exit the store.

Clockwise or Counterclockwise: The Coriolis Effect in Shopping

The pattern of movement in the supermarket is counterclockwise in the United States, but PathTracker® studies in the UK, Australia, and Japan show a much greater tendency for shoppers to move in a clockwise pattern there. This could be due to many factors, including more crowded stores, but it could indicate that while there could be biological or instinctual forces that drive this behavior (such as the dominance of right-handedness), traffic patterns in the store may also be affected by *vehicle* traffic patterns outside. In these small studies, we noted that in countries with right-hand driving, where traffic circles move in a clockwise pattern, shoppers in stores may be more comfortable moving the same direction. Like the Coriolis Effect in physics, where winds and currents tend to veer to the right in the northern hemisphere and to the left in the southern hemisphere, the movement of shoppers in a store may depend, in part, on where in the world you are located.

The Checkout Magnet

It takes less and less time for shoppers to make a selection as their trip progresses. Why is this happening? Shoppers come through the front door with a goal in mind. That goal is the checkout and exit (and beyond), and they behave as if drawn by an irresistible force toward it. The speed of their shopping increases as they near the checkout. The shopping trip is not so much an event, such as a movie or sports contest, as it is a road or pathway (or even a detour) on their way to somewhere else. Within the store, we can refer to this shopping behavior as the "checkout magnet."

The checkout and exit is drawing the shopper away. This may seem obvious because all shopping paths lead to the exit. But it is manifested also in the quickening pace of shopping within sight of an open (and short) checkout line (and by steadily decreasing time spent per item purchased as the shopper moves around the perimeter racetrack). The shopper will hasten to complete any shopping to get into the short line before other shoppers can lengthen the line. Retailers should thus plan for more leisure time at the beginning of a shopping trip.

Products Hardly Ever Dictate Shopper Traffic—Open Space Does

There is a great deal more that could be pointed out for this store, but the single most important thing to learn here is that there is nearly nothing about *products* that is required to explain this shopper traffic. This is radically at variance with very close to 100 percent of all thinking about shopping, which assumes that it is all about the shoppers and their relationships with this or that product or category. After all, people come into stores looking for products. Why wouldn't products be the driver of movement through the store?

> ***The location hypothesis:*** *85 percent of shoppers' behavior is controlled by the geographic location of the shopper in the store, and only 15 percent of behavior is controlled by product interactions.*

Observations of millions of shopper trips have led to what I call "the location hypothesis": 85 percent of shoppers' behavior is controlled by the geographic location of the shopper in the store, irrespective of what products may be around them, and only 15 percent of behavior is controlled by product interactions. This hypothesis has been confirmed by two groups of independent researchers working to create models that predict shopper patterns across a single store (Wharton) and across multiple stores (Pepsi).

A recent study with Wharton provided additional confirmation of this hypothesis. The study examined the impact of changing locations of products in the center aisles across six matched stores. The results indicated that the product itself had very little impact on sales, while location had a significant impact.[2]

So far, we have discussed how produce and other fresh goods influence the initial shopper landing zone, forming an attraction for shoppers. We also cited the frozen food aisles in relation to channeling traffic back to the front of the store. But there are plenty of examples of shoppers *not* moving through produce to the back of the store, and even largely ignoring the produce if it is not on their natural path. Also, notice that on the frozen food aisles, we cited the *extra-wide* nature of these aisles. Products have a role to play, but they are not the primary driver of traffic patterns.

Open Space Attracts: The Call of the Open Aisle

This is one of the most powerful motivators to shoppers—*open space attracts*. This means that adding a foot or two to the width of any aisle is likely to generate more traffic. Convenience stores generally do a *much* better job of creating open space than do other types of stores, primarily because their fixtures tend to be not as tall. Retailers in larger supermarkets want to entice shoppers down steel canyons, but shoppers like open space and visual freedom. For a convenience store, this extends right on outside the store. If a driver passing a convenience store, particularly at night, can't see into the store, and preferably the *entire* store, they are unlikely to stop and enter. Hence, these stores are typically heavily glassed and lighted, inside and outside.

Drug stores, potentially very effective competitors to convenience stores (they're convenient, given a multitude of locations), could significantly enhance their traffic by getting rid of those fortress exterior walls (reserve that for around the pharmacy in the back corner, if necessary). But it isn't just glass and lighting. I would *never* build a store with fixtures over five feet high in any area where I expected significant traffic. These six-foot and higher displays are overt throwbacks to the retailer as warehouseman. There is a place for warehouse displays, but not where you want to attract shoppers—you need open space.

Narrow, crowded aisles like packed highways can lead to social pathology, and even "aisle rage." In one incident, two shoppers met in an aisle less than two feet wide. They exchanged words, and as the hapless patron arrived from the aisle to pay for his purchases, the fellow shopper from the narrow-aisle encounter clubbed him. The angry assailant escaped for the moment, but the security camera recorded his criminality. Few shoppers carry matters to such extremes. Rather, they avoid cramped aisles, and probably the stores that have them, in the same way that motorists avoid congested freeways if they can.

Using a few wide aisles as thoroughfares to move the bulk of shoppers around stores is, of course, common everywhere. Beyond those nice “drive aisles,” there is a more nuanced question of the “aisleness” of stores. We define this as the extent a store is divided into aisles. There are several ways to approach computation of this measure, but the simplest is probably the percentage of the store occupied by products, fixtures, and staff compared to the remaining total shopping area (where shoppers can actually walk). The higher the aisleness, the more crowded the store.

We first identified the importance of “aisleness” while trying to unravel a puzzle at a chain of gift and card stores. We found that two stores had much higher sales than two similar stores. All the stores stocked the same merchandise and were matched stores, but the key difference was that the two underperformers had much higher aisleness. They were cluttered and hard to navigate. We started looking more closely at this issue across a number of stores and found it was correlated with the success of the store. (It should always be compared across a set of congruent stores.)

The point here is that space in the store is allocated either to the shoppers or to the overall effort to sell to them—products, fixture, and staff. As the products and fixtures swell, about the only thing the retailer can do is work to highly organize and expand this product space. This results in aisles rather than free space. More open formats—what we typically refer to as a “bazaar” shopping domain, referring to souks and less-structured shopping—are more like typical produce areas in supermarkets.

There are aisles of sorts in these open arrangements, but they do not limit a shopper’s walking path. Center-of-store aisles, for example, are highly constrained for the shopper—no turning this way or that way. It is all usually toward the front or toward the back. Of course, those long aisles are often intersected by a transverse aisle about halfway back in the store. This is a highly recommended feature that decreases aisleness to some small extent but adds an extra rank of end-aisle displays.

The bottom line is that stores with a lot of aisleness necessarily have less freedom for the shopper. This doesn’t mean that all aisleness is all bad, but it is *mostly* bad, so in general the ideal store will have a minimum of aisleness. Aisleness costs the shopper time, so shoppers penalize the retailer by spending more sluggishly. Looking at shopping efficiency across a series of stores tends to confirm this, as shown in Figure 3.2. As aisles become more crowded (higher aisleness), the time it takes for shoppers to spend a dollar increases. As we have noted, the faster customers spend money, the higher the overall store sales. Aisleness is a significant factor to consider in thinking about store navigation.

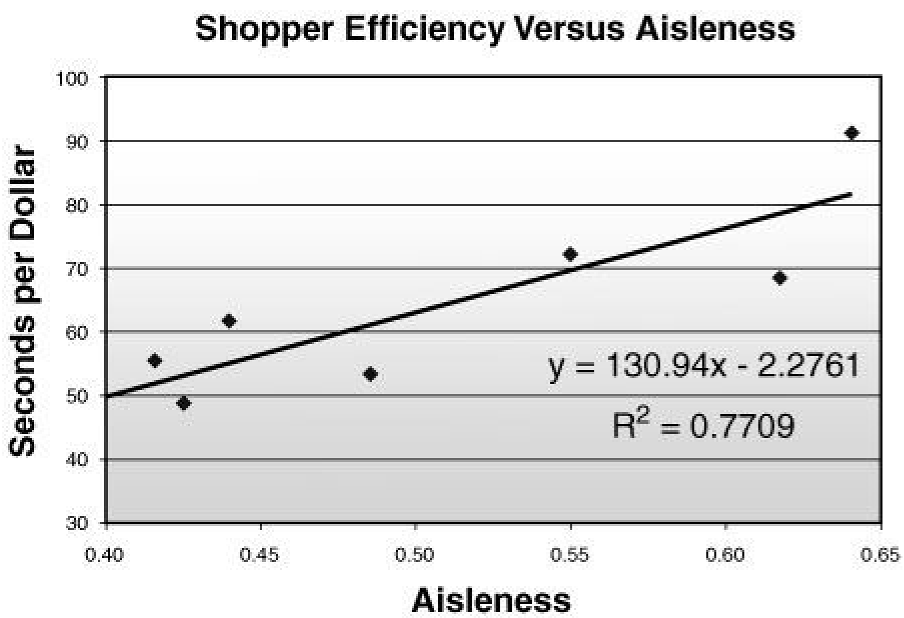


Figure 3.2 The greater the aisleness, the slower shoppers spend their money.

If you are a retailer, perhaps you have never thought of actually measuring your store's capital commitment to shoppers' space, instead of to the merchandise space. In fact, it is widely thought that investing in a massive product offering for the shopper is done to cater to their needs. But it is simply not true. Shoppers do *not* prefer to shop in a warehouse. Hence, the slow death of the center-of-store "warehouse."

So, what kind of fixtures should the ideal store have?

- A maximum of 66 inches (2.6 meters) high.
- Not more than 30 feet (9 meters) long, preferably 15 to 20 feet.
- Always pyramidal—sloping back from the shopper.

This does not mean that if you have a store with tight aisles, you have to tear down the store. If you intelligently manage the store, you might blow away competitors. If you have a store with high aisleness and you recognize it, you can intelligently manage it through use of devices such as sloping displays, as we consider next.

The Great Pyramids

The sloping back is well illustrated by a Pão de Açucar store in São Paulo, Brazil, as shown in Figure 3.3, but we have seen this feature occasionally in Europe, Asia, and North America as well. It creates a sense of greater openness and wider aisles without expanding the actual distance of the aisle at floor level.

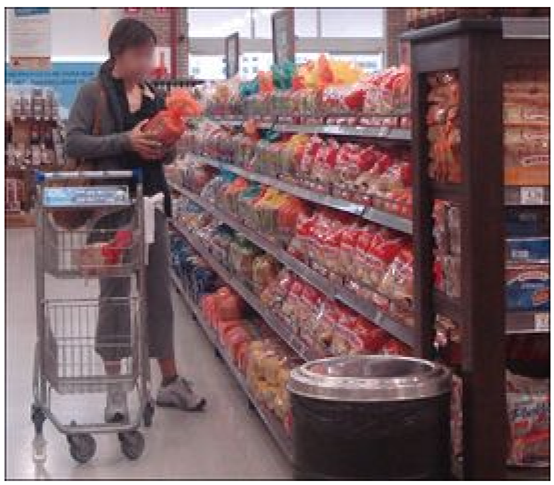


Figure 3.3 Sloping shelves create a sense of greater openness without expanding the aisle width at floor level.

We can see the shopper not only has the benefit of being able to see (more or less) over the top of the fixture, creating a great sense of openness, but the top of the fixture is recessed from the shopper by about 16”, giving nearly three full feet of *apparent* extra aisle width, if this type of fixture is used on both sides of the aisle. This is of tremendous significance: With pyramid fixtures deployed in the typical seven-foot wide aisle, the shopper would react as if the aisle were nine or ten feet wide. Whether this would make possible a shrinking of total aisle width is uncertain, but it is most certain that shoppers are far less concerned about the crowding of their feet than they are about the crowding of their visual space.

> *The old canard that "eye level is buy level" is quite simply untrue. The true shelf sweet spot is from the waist to the shoulder.*

The old canard that "eye level is buy level" is quite simply untrue. The true shelf sweet spot is from the waist to the shoulder. The pyramidal fixture focuses on this sweet spot, sacrificing nothing in terms of facings, other than above "buy level." The shelf, however, serves as more than a vehicle to *display* merchandise (facings). It is also the primary vehicle for maintaining inventory (avoidance of out-of-stocks). So, the most serious loss is of "warehouse" space behind the facings, particularly at the top shelves. This seems a small price to pay for a greatly enhanced shopping experience.

A slightly less radical design is to use an offset. Rather than a smoothly sloping pyramid, the offset design uses a series of steps to move products away from the shopper. It maintains vertical shelf facing, but at about 40 inches, pushes the upper shelves back eight to 12 inches. This gains up to two feet of the precious visual space per aisle (assuming both sides are similarly treated). This design also allows for the addition of a sloped signboard of eight to 12 inches width, the full length of the fixture.

Some early applications of in-store media, for all their hype, were close to worthless, but new approaches are now sometimes highly effective. The offset fixture may be the true future of in-store digital media, with several targeted messages or "kiosk" functions at perhaps five to eight foot intervals for the length of the fixture. Such deployments, automatically or shopper-activated, allow many of the functions to be found on mobile Internet devices, whether cell phones, PDAs, or custom devices such as Modiv Shopper™ and MediaCart.

New Angles

Before moving on from fixtures, we should consider something about their orientation and layout in stores. Another way to change the customer experience of the store is to shift the angles of the aisles. The angle of the aisles does not have to be from front to back. Rectilinear layout is a clear throw-back to warehouse type thinking. The store shown in Figure 3.4 has aisles set at a 45-degree angle. This means that, among other things, shoppers will ordinarily be approaching these from a less acute angle, which may make them more inviting to enter.

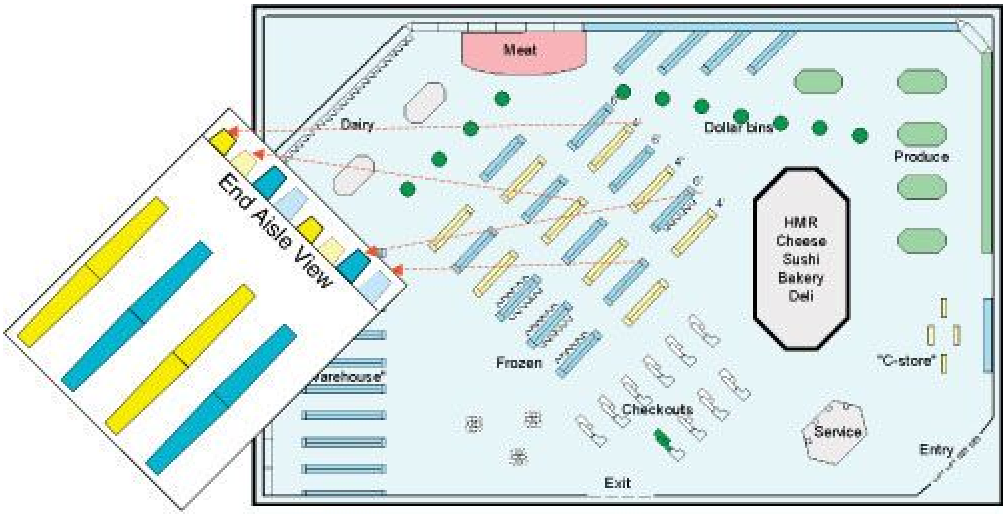


Figure 3.4 Angled displays change the customer experience.

These are shortened gondolas, laid out in a staggered pattern. So, if you are looking down any of those aisles, instead of being treated to a continuous view to the opposite side of the store, you see the end cap of a gondola in the next rank.

Notice also that every other gondola in each rank has been shortened, rather than shortening every gondola. In other words, as a shopper navigates down any of these “aisles,” they will see on one side a gondola of standard height, about six feet, and on the other a lower gondola that they can see across, giving them a lateral visual expanse in the neighborhood of 20 feet—two “aisles” plus one gondola width. Also, because many fewer shoppers get to the center of any gondola/aisle, we suggest that giving the gondola a slight diamond shape, or otherwise providing some interruption of the surface of the gondola—vertical signage, for example, or convex shelving protruding into the aisle (referred to as “bump-outs”)—is entirely acceptable, and likely to be a plus from the shopper’s perspective.

You may notice also the nook nature of some of the perimeter shelving, as well as a designated “warehouse” area on the most remote perimeter. These are ideal locations for long tail displays, and will be discussed further as we look at the five basic ideal store designs.

Many of these ideas are conceived *not* to involve radical departures from existing operations. This is in recognition of the fact that radical changes may be foolish, since what *is*, has considerable merit—including management inertia and shopper familiarity. There is no such thing as an objective “ideal” store, primarily because shoppers themselves have been thoroughly indoctrinated for many years, by the way things are already being done, and thus there is a level of acceptance and expectation by the shopping public. This is an expectation that is not based on strictly scientific, rational grounds but on the grounds of familiarity. (Remember that the persistent QWERTY keyboard that we use on our computers was originally designed to separate mechanical keys that might stick if struck too quickly but has persisted long after the age of mechanical typewriters.)

These facts account for the well nigh worthless results of many surveys asking shoppers how things should be done. For example, in surveys, most shoppers regularly report that they shop “most of the store” on each shopping trip, when in reality less than 2 percent shop as much as three-fourths of the store. There is nothing wrong with asking them, but the results will be a more accurate picture of their current perception than any reasonable plan for evolving the future.

> *Most shoppers regularly report that they shop “most of the store” on each shopping trip, when in reality less than 2 percent shop as much as three-fourths of the store.*

Although we have stressed the wideness of aisles in drawing shoppers to them, products certainly play a role in attracting shoppers and causing them to spend time when they arrive. Frozen foods, as noted, benefit from a broader aisle, but also tend to take longer to purchase—two to three times as many *seconds* as the average item in the store. This is likely due to both the means of display (often behind closed glass doors) and the multiplicity of similar items that make choice difficult. This latter factor evidently also causes longer purchase times for canned soups, yogurt, and baby foods. (And although we generally advocate efficiency in making the best use of shopper time, there are cases such as canned soups where some strategic inefficiency works to the retailer’s advantage, as discussed in the Alphabet Soup example in the following box.)

Alphabet Soup: The Power of Inefficiency

Although we've stressed the importance of making the best use of shoppers' time, there is an exception to any rule. Years ago, Campbell's Soup recognized that its soup, with all those little red and white cans with identical labels in many varieties, represented some real challenges for shoppers attempting to find the specific items they wanted. The manufacturer realized that this variety might create significant angst for shoppers. Managers reasonably expected that they might reduce this angst if they could place the soups in a more rational order, so shoppers could quickly find cream of celery or chicken noodle without scanning through the whole selection.

It seemed like a reasonable assumption, so the company created a carefully controlled matched store test, with one test display of soup alphabetized (just like spices are). Sure enough, shoppers could find their targeted variety more readily—reducing angst. This would seem to be a good thing. As discussed in Chapter 2, money, time, and angst are the three currencies of the shopper, so one might expect that reducing angst would lead to higher sales. But Campbell's found that while customers were more efficient, they also bought less soup, presumably because they missed buying impulse varieties they just happened to come across while looking for their target varieties. In this case, making the experience a bit more inefficient proved to be a wise move. There is no substitute for this direct testing with actual shoppers. It is also clear that shoppers are complex creatures. To understand them better, we cannot use simple recipes. We need to use careful observation to study their true behavior.

Having wide frozen food aisles contributes to an accumulation of shopper seconds from the wideness of the aisles, as well from the nature of the product (and display). This illustrates the interplay of the *location hypothesis* with the *product hypothesis*. There is no point in pretending that the products play no role, simply that it is far less significant than generally thought.

Managing the Two Stores

There are two stores inside nearly every store—the main store (primary) and the promotional (secondary) store. These roughly correspond to the big head (promotional) and long tail (main store) we discussed in Chapter 1. Although retailers can't ignore the main store, the success or failure of the store is driven primarily by the promotional side of the store. This is not because the items there are *promotional.* As we have noted, promotions do not do much to drive traffic and sales. Instead, the importance of the promotional store is due to its location. While the main store is located in the center aisles (with the exception of produce, dairy, and meats), the promotional store is on the perimeter, around the entry and the checkout stands or in special displays such as shippers and pallets.

How shoppers are reached in these two stores is illustrated in Figure 3.5. This is actual reach, by categories, measured on a million shopping trips in supermarkets scattered across the U.S. The actual reach in any single supermarket will vary from these averages, possibly significantly, depending on the store's design and layout.

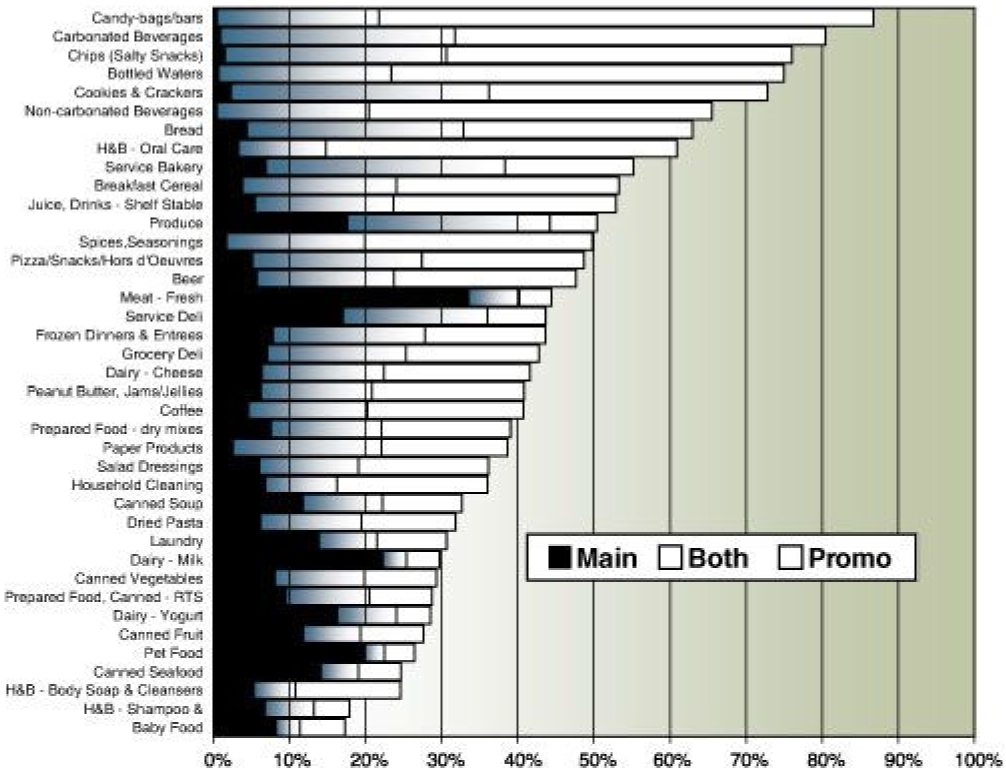


Figure 3.5 How shoppers shop the "two stores"

One of the most striking observations here is the minor role of the main store, except for a few categories such as produce and dairy that predominantly appear at a single location, usually on the heavily traveled perimeter of the store. In other words, except for those few categories with large black bars, you could effectively shut down the main store and still reach nearly all the shoppers with the category! Even though the promotional store contains only a small fraction of the total number of items in the store, it delivers something like 40 percent of *all* store sales.

Take a category such as cookies. Across a wide selection of stores, retailers offer this category to 78 percent of all the shoppers in their stores. They "reach" 30 percent of their shoppers in the main aisle, on the gondola. Virtually all of those main aisle shoppers, however, have been reached by at least one promotional display. This means that the main display adds *nothing* to the reach of cookies. The promotional displays deliver more than twice the total sales of the main aisle—5 percent of store shoppers versus 2 percent for the main aisle.

Scattering displays around the store increases sales. In one store, for example, several of the cookie displays occur in alternate aisles, not in the usual promotional locations. But *any* alternate display, even on an aisle not frequently visited, has more potential to increase incremental sales than another, expanded main aisle gondola location. Of course, the reasonable expectation is that “cookie” shoppers will be found in the cookie aisle. But this is only true in a *very* limited way, since a high percentage of cookie purchases occur outside the main category aisle. Not only that, but we know that a large share of shoppers going down *any* aisle are not particularly interested in the merchandising in that aisle. Instead, they’re simply using it to get from one place to another. In other words, they are navigating the store, which is what the shopper spends the majority of time doing. So placing cookies in an unrelated aisle is not necessarily a bad strategy.

Five Store Designs

Given these insights on shopper behavior and movement within stores, what are the implications for store design? There is clearly no one right answer for all occasions. Retailers need to design the best store for their customers and products. But it is useful to think about where the insights into shoppers would lead. A supermarket executive once challenged me to provide him with ten new ideas to increase sales—with the proviso that they needn’t *all* be immediately workable. In that spirit, we discuss five models for store design that take advantage of our knowledge of shoppers.

As discussed in Chapter 1, there are three distinct groups of shoppers: quick trip, fill-in, and stock-up. For simplicity, the store designs discussed next take a layered merchandising approach to accommodating two types of trip: a combination of quick/fill-in trips, simply designated as *quick*, and the ever-desirable *stock-up*. Any loss in matching the needs of diverse groups is more than made up by the practicality of execution in the store. For the quick trip, there are a few hundred thousand U.S. stores that specialize *only* in the quick trip—the convenience stores—so I would look there for what is working best, in terms of store design, layout, and merchandising selection and display.

However, some things are crystal clear:

- The quick trip store *must* be near the entrance to permit a quick in and out.
- The merchandise is mostly a *selection* of big head items, not entire categories.
- No promotional pricing is needed—premium and high margin should dominate.
- Visual enticement to the rest of the store should saturate the experience, without being intrusive.

The Enhanced Perimeter

The enhanced perimeter design is pretty much the direction that retailers have evolved the modern supermarket. That is, there is a broad perimeter aisle, which we sometimes refer to as the "racetrack," around the entire store. They have retained the classic center-of-store self-service "warehouse" but have gradually built a very attractive high-volume service belt around it (mixed with self-service, for sure).

There is nothing stunningly creative about this approach, but tens of thousands of very sharp minds have created and refined this structure. It doesn't matter that the reasons for its existence have largely to do with the fact that shoppers need "stuff" and will solve almost any retail "problem" adequately for their own purposes. Another advantage of the enhanced perimeter store as ideal is that it can compete effectively with the other designs we will consider, with less draconian changes to traditional store format. These stores are going to be with us for some time to come and can function at a high level without *revolutionary* changes.

In this format, retailers focus mostly on the profitable (for them) perimeter and cede the center-of-store "warehouse" to the brand supplier—with category management and aisle management being a cooperative effort. The brand suppliers who have successfully escaped the center-of-store dungeon have been the direct-store-delivery (DSD) categories like carbonated soft drinks and, to a lesser extent, the salty snacks. Pulling magazines and candy into the checkout lanes blesses those businesses, too. Otherwise, access to the majority of the store's traffic, for brand suppliers, is limited to end-aisle displays and occasional lobby or other promotions, for which the all-important promotional dollars are required.

The Inverted Perimeter

This store is essentially the enhanced perimeter turned inside out. That is, all of that center-of-store merchandise is moved out of the way, and the perimeter departments migrate into the center of the store. Of course, then the former center-of-store merchandise is properly arrayed, probably still in its "warehouse" fashion, around the perimeter of the store.

Within five miles of my office is a store, based on this design, which regularly does a million dollars of sales *in a single day*! Of course, it is not a supermarket, but a big-box Costco, the highest volume store in the chain, that pushes nearly $300 million per year in sales. There are obviously a lot of factors at play here other than store design. But the center-of-store is a very large open area, with low displays—a bazaar design—similar to other high-producing displays.

Surrounding this are true warehouse shelves, all visible from nearly anywhere in the center-of-store, where the majority of shoppers spend the majority of time. But all that warehouse merchandise is there, just a few steps away, without cramping the shopper's visual space. No wonder sales in a store like this, for an individual shopper, are often double what the shopper intended when they came in. But they like it! Think of all the money they are saving!

In fact, Marsh Supermarkets (the people who introduced electronic grocery scanning to the world) built a store like this a few years ago. This was a remodel from an earlier conventional perimeter store (see Figure 3.6).

Figure 3.6 Inverted perimeter store

Initially, shoppers did not care for this "radical" new design. Nothing in their shopping experience prepared them for such a concept. As time passed, however, shoppers adapted, comfort levels grew, and after several months, the desired sales lift was achieved. The nerve-wracking transitional period has, though, dampened the appetite of management for further digression from shopper expectations. None of this deterred HEB from undertaking a similar approach with its now highly successful Central Market concept. We see validation and a growing body of thinking and data favoring the inverted perimeter style of store.

The Serpentine Design

We mentioned the success of Stew Leonard's serpentine design in the Introduction. Although most supermarkets do $10 to 30 million in annual sales, he is doing $100 million in sales. As discussed, he gains an additional $80 million in sales by significantly pruning shopper choice, reducing choice angst and wasted time, and then streamlines navigational angst by creating a single serpentine path through the store—not to mention his superior customer service. But the serpentine design takes advantage of natural shopping behavior and creates an experience for customers moving through the store that is directed by the retailer. As long as the selection of products and their display are right, then the shopper only has to follow this road and put products in the cart.

The Compound Store

The fourth "ideal" store is less a single store than an aggregation of stores. Of course, one can create a compound store by deliberately aggregating distinct stores. In this sense, the typical shopping mall is a compound store. But what we are referring to here is rather the fact that somewhere between 40,000 and 80,000 square feet (4,000 to 10,000 square meters), stores begin to fragment into substores, which then constitutes a compound store. Below this size, the store is shopped more or less as a unitary whole. That is, even though shoppers typically only shop a small portion of the store (less than 25 percent), they cruise and can see enough of the store to at least have all the square footage as a part of their consideration set. This fragmentation does not require distinct walls demarcating the various stores. Instead, we have found "virtual walls" that divide up the store, defined by shopper behavior.

This means that in a standard supermarket, you can think of the entire population of the store, at any given time, as a single population. However, as the store grows in size, eventually there will be distinct populations in the different virtual substores of the compound store. If there are two substores, few shoppers visit both the stores. One crowd visits one, and another crowd visits the other, with little cross-over. When looking at detailed performance measures, the figures will be distorted because we need to separate out the performance of the two stores.

The Big Head Store

This final store focuses exclusively on the "big head," an approach popularized by retailers such as Trader Joe's and Tesco stores in the U.S. southwest. Instead of a promotional store and then a main store, this store is just the promotional store. By introducing a 10,000 to 15,000 square foot store, and offering only 3,500 different items, Tesco aims to replace long stock-up trips with many more short and medium-size trips. I think an even smaller store would be adequate to the purpose, and the aisleness is probably higher than it needs to be, depressing shopping efficiency. This, however, is offset by lower gondola fixtures, resulting in the very attractive, greater openness that is common in the convenience store channel.

We note with approval, also, the 45-degree angle of the aisles in Trader Joe's, rather than the less ideal rectilinear, as discussed earlier in the chapter. The much smaller size offsets the navigational issue to a significant extent. I don't know that I would recommend the serpentine path here, but certainly fewer fixtures with better full-store visibility—think Costco—would be helpful. There is no problem with having tall fixtures as small nooks around the perimeter, if there is a desire to include the first few percents of the long tail.

Where the Rubber Meets the Linoleum

Changing store designs requires understanding the big head and long tail, courage in challenging tradition, and specific insights into shoppers measured in the store. Notice that the first two designs I discussed included both the big head and the long tail in their strategy. I don't know how to put this more plainly: Whether brand or retailer, you *will* learn to manage the big head and the long tail distinctly, or enjoy your retirement in the not-distant future.

If your store design is not a result of direct measurement of the shoppers in your stores, it isn't real, unadulterated shopper insight. To my knowledge, there are only three people, and their organizations, in the world who got their insight from studying shoppers in the store, through observation and measurement of various aspects of the overall shopping experience. That would be Paco Underhill of Envirosell, Siemon Scammell-Katz of TNS Magasin, and, immodestly, myself. Like they used to say of EF Hutton, when Paco and Siemon talk, I listen. That doesn't mean we always agree, but at least we are pretty much the only ones drinking from the pool that should matter to you. This doesn't mean that no one else does good valid research. But they don't live on the sales floor—Paco's rubber-soled shoes, if I might. Given the source of our data, we have collectively lived on the selling room floor for upward of 100 years. So I salute my colleagues Paco and Siemon, and the *millions* of our colleagues in the retail and supplier businesses to whom we have dedicated so much of our lives. It is the indomitable spirit of the retailer that delivers to the masses of the world the things they need and must have. It is our goal to help them do it better.

Endnotes

1. William H. Whyte, *City: Rediscovering the Center*, Doubleday, 1988, p. 100.
2. The study was conducted by Wharton student Jacob Suher.

4
Active Retailing: Putting Products into the Path of Shoppers

"Give the lady what she wants."

—Marshall Fields

Early in our traffic studies, we noted an aisle that we thought was receiving very little traffic, considering the number of shoppers passing either end of the aisle. In an effort to rectify this situation and drive traffic to this aisle, we decided to give shoppers a $1.00 coupon for a store-brand purchase of $3.00 or more, just for visiting the aisle. We installed a special coupon and dispenser about halfway down it. Above the dispenser was a flashing red "police light" to attract attention to the free dollars. We also installed a moving LED sign at the entrance to direct shoppers to the coupon dispenser, and on weekends, a greeter at the door called shoppers' attention to the presence of the coupon. In other words, we did everything in our power to attract attention to this aisle.

The net result was an increase from 28 percent of shoppers visiting the aisle to 30 percent in the month of couponing, a 2 percent increase in overall visitation to the aisle, primarily due to more traffic near the back of the aisle. We gave away a dollar off any $3.00 store-brand purchase (limit one per customer per day). This was as if we had dropped dollar bills in the aisle! And still, we only bumped overall visitation to the aisle by 2 percent.

As this example shows, it is very hard to get the crowd to move, even if you pay them. So you probably can't get many more shoppers down your aisle. Does this mean that you cannot influence shopper behavior? Far from it. Take the product to the shopper. That's the approach of the active retailer.

Organization of the products in a store (segmentation) seems so obvious and simple until you actually try to do it. Take juice as an example of a potential category. It is not uncommon for juice to actually fall into five different departments in a supermarket. There will be shelf-stable juices in the dry grocery area, typically in both canned and bottled versions. And then there will be frozen juices in the frozen food department. Chilled juices are in the dairy section, and freshly-squeezed in produce. The organic juices may be in produce, or in a special natural foods section.[1]

Publix, a Miami retailer, put a thin slice of fruit nectar into the middle of an end display of Ocean Spray juices, as shown in Figure 4.1. The fruit nectar bisects the overall display of juices. And, like nectar to a bee, this slice of nectar is designed to attract the attention of shoppers. Nectar is a major draw for the Caribbean customer, which makes up a high concentration of the shoppers in Miami. Once they are drawn to the nectar, they find themselves looking at the broadly popular juices. A minor item is embedded in a major display in a way that stops shoppers and encourages them to buy.

Figure 4.1 Nectar in the middle of the display, a major draw for shoppers in Miami, helps attract shoppers to this juice display.

Placing nectar in the middle of the Ocean Spray juice display not only offers margin opportunities but also *directional navigation* opportunities.

Displays like this can make helpful suggestions to the shopper. For example, “For a more complete selection of juices and nectars, visit aisle 8.” Technology such as tools to provide map guidance to shoppers for related purchases elsewhere in the store can enhance this ability. (I have, however, never been one to wait for future technological development to do what I can do right now, right here, with existing resources.) For Miami shoppers, with an attraction to nectar, this might be enough to take shoppers to these aisles. The problem in many stores, however, is that product segmentation is often carried out on an operational or other basis that may have little or nothing to do with the purchase process—the ultimate “coin on the counter.”

Active Retailing

In the days of the country store, retailers typically interacted directly with their customers, actively assisting them with their selection and purchases. About 100 years ago, the modern supermarket was born, and self-service became the rule rather than the exception. With the advent of the modern supermarket, interaction was no longer necessary, and turning over the process to the shopper reaped tremendous productivity gains.

Supermarkets were enthusiastically welcomed by shoppers, because of their convenient self-service, low prices, and wide selection. Nonetheless, the net result was a large measure of passivity on the part of the retailer. In fact, the supermarket became a neighborhood mini-warehouse, where the retailer stocked the wares, typically neatly on their warehouse shelves, and waited near the exit to collect their payment as shoppers departed with the merchandise. The first such establishment is often credited to King Kullen in New York, in 1930, but was certainly preceded by Ralph’s in California.

The wholesale movement to passive retailing created some problems while it solved others. A major and continuing problem is how to organize the merchandise in the store. One early effort to solve this problem actually involved organizing the categories in the store alphabetically. The Alpha Beta stores began doing this as early as 1915, with the chain surviving—without the category organizing principle—until 1988.

Put the Right Products in the Path of Customers

But with increasing competition and higher customer expectations, this passive role is no longer enough. The old store clerk and cracker barrel won't be coming back, but retailers can take a more active role in the way they place products in front of shoppers. As we noted, the traditional view of shoppers is that they will travel great distances, walk through the dark valley of imposing shelving, and undergo unspeakable hardships to find their desired products. In reality, as we have seen in Chapter 3, "In-Store Migration Patterns: Where Shoppers Go and What They Do," there are patterns of movement in the supermarket that are not driven by products as much as by open spaces and natural flows. Some shoppers may come down the frozen food aisle for ice cream, but others just happen to be there because it is a wide and inviting aisle that leads them to the checkout. The question is: Given the natural flows of shoppers, how do you put the right products in front of shoppers? In contrast to the more passive approach of warehousing products for customers, this more active approach might be called "anticipatory retailing." The retailers anticipate the needs of shoppers and meet them.

By understanding shopper segments, moments of truth, and migration patterns through stores, retailers and manufacturers can do a better job of converting visitors to shoppers and shoppers to buyers. This chapter explores how.

Double Conversion™: Converting Visitors to Shoppers to Buyers

For a retailer to make a sale, customers have to undergo two conversions. These conversions occur during the process of reaching, stopping, and holding discussed in Chapter 2, "Three Moments of Truth and Three Currencies." First, customers move from being visitors—tourists moving through the retail landscape—to active shoppers. Second, they move from shopping to buying. Good merchandising will yield high Double-Conversion™—stopping power to arrest shoppers and closing power to convert the shoppers to buyers (see Figure 4.2).

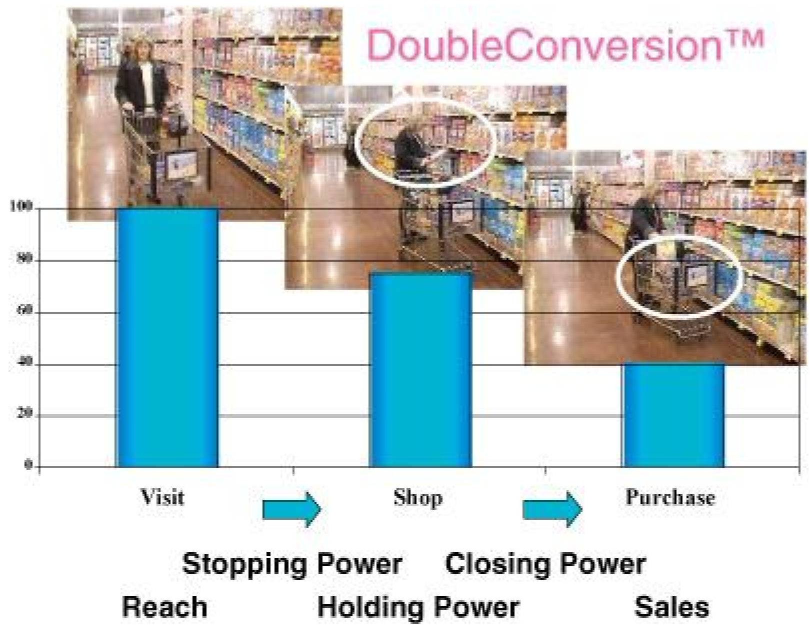


Figure 4.2 Double conversion: Converting visitors to shoppers, then shoppers to buyers

This distinction is important because those two conversions independently measure two different types of issues for the product. In the first instance, it is far more important to know the *share* of total visitors to the store who come within the orbit of the product than the total number of visitors, since the impact of the product occurs only when the visitor is close by and may become a shopper. Once they have been engaged, the next question is whether the product can make the sale, by convincing the shopper to pick it off the shelf and put it into the shopping cart—conversion into a purchaser.

How to Measure Double Conversion™

Double conversion requires three measures: Visits, Shops, and Purchases. Purchases (P) come directly from the retailers' sales logs, or may be visually verified if the shopper is being observed, in person or by video. Visits (V) are measured by all PathTracker™ methods, especially those that track individual shoppers' complete trips, but can also be obtained by directly counting either by observation (personal or video) or through electronic means like aisle counters. Shops (S) are a subset of visits, which we usually

> identify by counting visitors who exhibit a shopping behavior, most commonly by spending some *time*, not just passing through or visiting.
>
> Various researchers may use different thresholds to define shopping, but it's always the same basic idea of some type of interaction with the merchandise, which could be a weak interaction or a strong interaction. The two conversions are then the share of visitors who become shoppers (S/V) and the share of shoppers who end up buying (P/S).

We now have a framework for analyzing the shopping process. The three stages of the shopping process are reach, stopping power, and closing power, where the critical elements are the conversion from visitors to shoppers, and from shoppers to purchasers. How these three elements are managed in practice defines the difference between active and passive retailing.

Packaging Must Play the Starring Role

Only 45 percent of shoppers use a shopping list. Shoppers are not automatons following out the commands of a preordained list. They are making decisions on-the-fly as they walk through supermarket aisles. This means that packages have an opportunity—a very brief opportunity—to grab the shopper's attention and make a sale.

Many consumer goods companies no longer see packages merely as containers for shipping products, according to a report in the *The New York Times*. "The shift is mostly because of the rise of the Internet and hundreds of television channels, which mean marketers can no longer count on people seeing their commercials. So they are using their bottles, cans, boxes, and plastic packs to improve sales by attracting the eyes of consumers, who often make most of their shopping decisions at the last minute while standing in front of the store shelves."[2] For example, Evian created a swanlike neck and silver tray for its "palace" bottled water, conveying a sense of luxury. Coors added thermochromatic ink to its label that changes the color of the mountains when the bottle is cold.

The package has to do two things: First, it has to engage the shopper by standing up and waving its arms and saying: Pay attention to me! I'm over here! Second, the package must be compelling enough so that the shopper feels the urge to complete the sales process.

Although everything that goes on outside the store plays a role in shopper choice, the crucial element in the store is the package. In terms of communication, it has the most impact. Far too many marketers view packaging as a labeled container, necessary to deliver the product to the shopper. Such complacency is dangerous, because this is the one factor over which the manufacturer has nearly total control. With more than 5,000 new SKUs on the grocer's shelf every year, existing brands and new products find it more and more difficult to get on the shelf and gain trial. Today, the package is often the pivotal factor in a product's success or failure.

There are a number of reasons packaging is so critical to shopping, as follows:

- For most new products, the store shelf is the first and only opportunity to sell to the consumer. Because of the decline in effectiveness of traditional advertising methods, many consumers are first made aware of a new product after seeing it on a shelf.
- Strong packaging can drive trial and awareness of a brand.
- The package is the last chance to have an impact on purchasing decisions—100 percent of all these are *ultimately* made at the shelf.
- A typical package generates 570 million impressions each year, just by being on store shelves.
- Packaging generates impulse purchases. Research from point-of-purchase trade association POPAI shows that a consumer may enter a grocery store planning to buy 10 items and leave having purchased 20.
- The package is the best way to break through the clutter/noise at retail.

Creating shelf impact helps maximize a brand's chance of success. But more than being noticed is required. A bottle of salad dressing with a hot pink label may have impact, but will consumers buy it? Generally, to improve shelf impact, a package needs to look different than the other items in the category, but attractiveness remains a requirement for closing the sale. The package has to take the customer through both conversions—not merely attract attention, but also close the sale.

Context matters, of course. Brand owners should study the shelf impact of competitors before trying to improve their own. The brand may already be the market leader, but a close eye needs to be kept on private labels and smaller brands seeking to emulate the leaders' appearances. Also, shelf impact is more important in a fragmented category with low brand loyalty, such as barbecue sauce, than in a category with few major players and loyal customers, such as canned soup. Additionally, although the front panel may make the sale at the store, the side or back panel may be more important in the freezer, refrigerator, or pantry.

What Is a Package?

Ten personalities of a package are as follows:

- **Container/transporter:** This is the box, bottle, bag, or can. Functionality is the key.
- **Protector:** Protects the product, the consumer, and the environment.
- **Facilitator:** Is easy for the consumer to use. Easy to open, use, and seal.
- **Attention-getter (shelf impact):** Communicates through color, graphics, or copy to grab the shopper's attention.
- **Communicator:** Communicates brand identity and the product's reason for being.
- **Image builder:** Claims, statements, or banners, which enhance or strengthen the image of the brand.
- **Instructor:** Communicates usage instructions. Can either be copy and/or graphics.

- **Educator:** Information such as fat content, ingredients, calories, and so on.
- **Reminder:** Reminds consumer that it is time to buy again.
- **Secondary life:** Recycling and other secondary uses of the package.

Taken from: Robert E. Stevens, "Creating a Tiebreaker with Packaging," *BrandPackaging*, Fall 1997.

Packaging is the workhorse of today's marketing mix. Not only does it need to be attractive and stand out, but it also needs to do the following:

- Generate awareness through optimizing brand identity, shelf impact, and "findability" on the shelf.
- Generate trial by communicating the product's most persuasive points or "reason for being."
- Support the brand's image by communicating the desired brand-equity elements (such as gourmet, fun, sophisticated, and so on).
- Ensure repeat purchase by delivering value through package functionality.

Having said all this, we emphasize that the first and most important marketing function is to stop the shopper. Unless this happens, nothing more will happen. So, first the product must reach the shoppers, and then stop them. But then it must "hold" them—the intermediate stage between stopping and closing power.

Holding Power—How Long Is Long Enough?

Holding power is about time: How much time is involved in turning a visitor into a shopper? This is a delicate balancing act for the brand owner when it comes to product placement and packaging. Where the product is—both on the shelf and in a particular aisle—and its packaging can have an enormous impact on closing power. Think of a package's *stopping power* as its capability to initiate a conversation with passing shoppers.

Holding power is its capability to continue the conversation as long as necessary to make the sale. The question then is: What is the right amount of time for this conversation to last? The answer is: Just long enough to complete the sale.

So, the package is the key to stopping, holding, *and* closing power. It is the interaction of these measures for categories and products, along with the reach that is provided at retail, that not only forms the foundation of a systematic approach to product management, but also segues into promotional planning. Location and merchandising in the store are driven by flow and adjacency analysis, linked to the metrics for measuring the conversion of visitors to shoppers, and shoppers to buyers. This is discussed in Chapter 8, "Multicultural Retailing," with promotion planning incorporating elements of the purchase cycle and other consumer behavioral traits.

Before getting into the details of these "final mile" issues, we will look at some intermediate category analysis steps, called VitalQuadrant™ analysis, which will assist in evaluating the inherent properties of various categories, as well as spotlighting potential problems.

Stopping and Closing Power: VitalQuadrant™ Analysis

Because a product's stopping and closing power are the key to making the sale, we can plot both of them in a VitalQuadrant™ analysis, as illustrated in Figure 4.3. It is helpful to group categories in terms of their stopping and closing powers, since entire categories exhibit characteristics that are, more or less, the sum of all the packages in them. So, we look graphically at categories dispersed according to those two measures, stopping and closing power.[3]

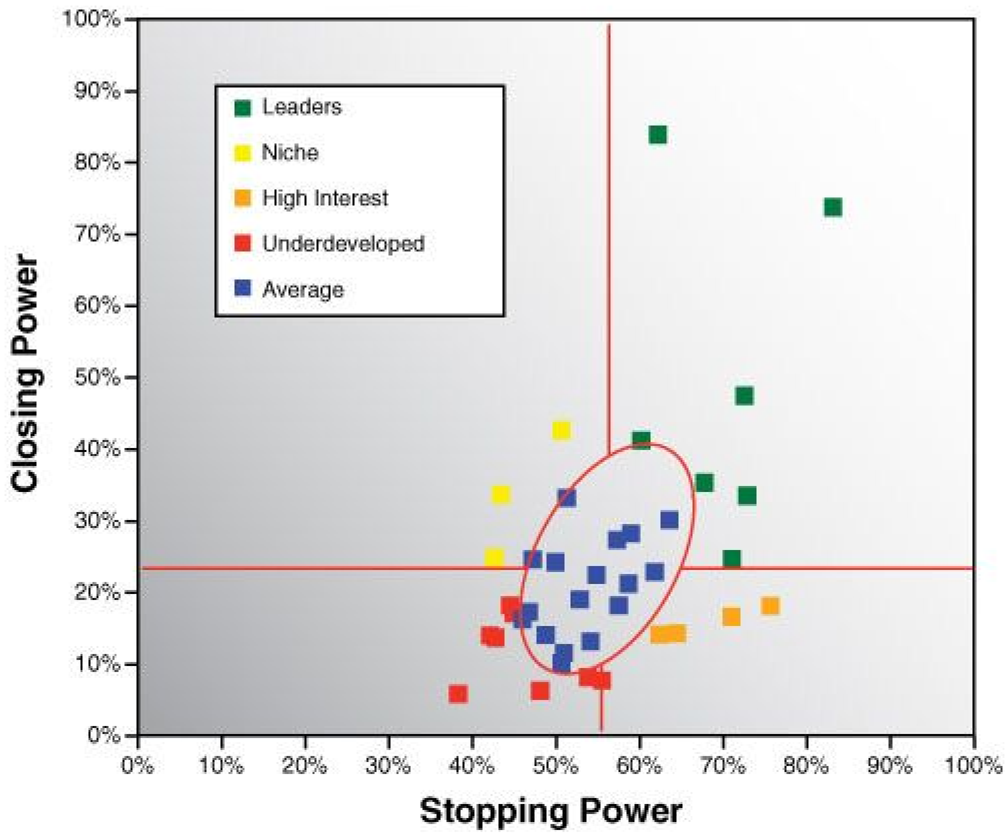


Figure 4.3 VitalQuadrant™ analysis

Beyond the broad average category in the middle, the categories in order of sales performance are as follows:

- **Leaders:** These categories have extraordinary stopping and closing power. If shoppers see these products, they stop and buy them.
- **Niche:** Few stop to shop, but those who do, buy.
- **High interest:** These are window-shopping categories. Shoppers stop to shop, but don't buy.
- **Underdeveloped:** Few stop to shop, and the few who shop don't buy. These categories have little stopping power and even less closing power.

This helps move our focus away from the average group in the middle to what quality guru Joseph Juran called the "vital few." Juran was talking about the 20 percent of defects that lead to 80 percent of quality problems. Focusing on correcting these "vital few" defects leads to tremendous improvements in quality. Similarly, it is clear from our analysis that focusing on the set of "leader" products in the supermarket—as well as the other categories—could have a tremendous impact on overall sales.

Figure 4.4 shows the average reach, stopping power, and closing power numbers for 40 major categories, based on the shopping trips of a million shoppers in stores across the U.S. Note that whereas the closing power overall is 22 percent, the closing power for leader categories such as bread, dairy, soft drinks, and produce is 54 percent. Categories are not always in the same VitalQuadrant™ in each store, but bread, dairy, produce, and soft drinks are often in the leader group. This is a reflection of the fact that they have the highest stopping and closing power of any categories in the store—70% and 45%, respectively.

Category Conversions by VitalQuadrant™ Groups

	Reach	Stopping	Shops	Closing	Purchases
	VitalQuadrant™ Group Averages				
Leaders	63%	70%	44%	45%	20%
Niche	33%	45%	15%	34%	5%
High Interest	80%	69%	55%	16%	9%
Underdeveloped	41%	48%	20%	10%	2%
Average	51%	54%	27%	22%	6%

Leaders:

Bread	Dairy - Milk	Produce	
Carbonated Soft Drinks	Meat - Fresh	Salty Snacks	

Niche:

Dairy - Yogurt	Pet Food		
Canned Fish			

High Interest:

Bottled Water	Cookies		
Candy	Ethnic Foods		

Underdeveloped:

Baby Food & Beverages	Body Soap & Cleansers	Shampoo/Conditioner	Brewed Teas
Frozen Appetizers/Snacks	Oral Care	New Age Fruit Drinks	Peanut Butter, Jam/Jelly

Average:

Beer	Canned Soup	Dairy - Cheese	Paper Products
Sports/Energy Drinks	Canned Vegetables	Frozen Dinners & Meals	Pasta
Boxed Dinners/Side Dishes	Cereal	Household Cleaners	Salad Dressing-Shelf Stable
Canned Fruit	Coffee	Juice - Shelf Stable	
Canned Entrees/Meals	Crackers	Laundry	

Figure 4.4 Leader categories close more sales.

This doesn't mean that every item in the category exhibits this kind of behavior, but the category as a whole does. However, the type of thinking that goes into this category-level analysis can be applied to subcategories, individual brands, and even specific items. Any category, subcategory, brand, or item that exhibits strong stopping *and* closing power is truly a leader.

Studies across a set of stores can show how different positioning of leader categories in the store can dramatically influence sales. Figure 4.5 shows the position of soft drinks and resulting sales for four different stores. Stores that locate these products on the perimeter "racetrack" of the store, whether front or back (as shown in the right-hand side of the figure), achieve significantly higher share of baskets with soft drinks in them, as compared to stores with this category principally located on center-of-store aisles (as shown in the left side). The better placement in the first store led to nearly a third of shoppers picking up soft drinks, as opposed to just 13 percent in the last store. Even attractive "leader" items such as soft drinks will not necessarily lure shoppers into the center aisles, but if they are placed in the path of shoppers, they will lead to sales. This indicates the tremendous opportunities retailers and manufacturers have for increasing sales by better placement of products in the store.

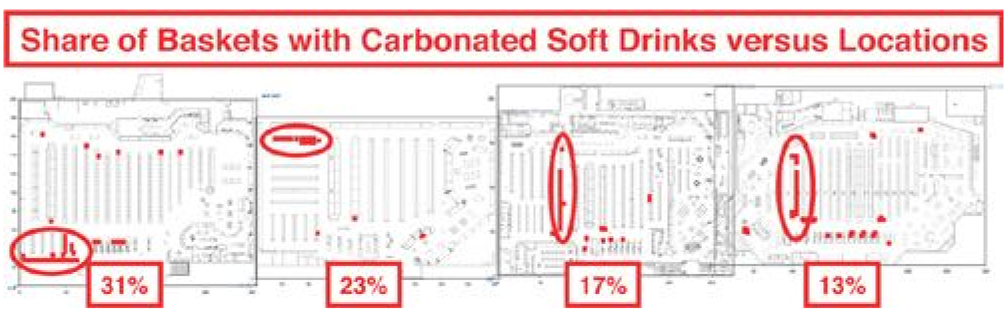


Figure 4.5 Shares of baskets with carbonated soft drinks across four stores

Most categories, however, would not have such a wide swing as carbonated soft drinks, since purchases per category, on a basket share basis, tend to be relatively constant across stores. Carbonated soft drinks, on the other hand, are unusually sensitive to regions, the weather, and so on. For instance, you can expect to sell more soft drinks on a per capita basis in July and August in the Carolinas than in the Dakotas in January and February.

Breaking the Rules

There are no rules in active retailing that somebody isn't breaking very successfully, somewhere. They might be doing so consciously, deliberately, and with a clear understanding of the principles we have discussed—or not. While many passive retailers do well, active retailers who understand what they are doing based on measurable data will spot opportunities that would not otherwise be apparent.

Some examples are as follows:

- Costco CE Jim Senegal happily breaks the rules of active retailing—but he does so based on a clear understanding of what they are. He has, for example, been quoted as saying that he often gets challenged about two main issues in the store. The first is a lack of a directory so customers can find what they want. But, he says, maybe I don't want them to find things straight away. And the second is the lack of an express checkout for those buying only a few items. But why should he reward his poorest customers, he argues?
- Trader Joe's carries 100 percent private-label merchandise. Although the role of private label is increasing across the retail world, 100 percent private-label represents a niche in itself.

Playing the Niche

The niche group of products offers another prime hunting ground for potential sales improvements. These are products that are very good at closing the sale, but poor at stopping the traffic. Notice, though, that they reach the lowest percentage of traffic in the store. On the other hand, high-interest products often are placed in front of more traffic than any other category in the store, *including the leaders*! Why is this, when they are doing such a poor job of closing the sale? Like a lot of "salesmen," they talk a good game, but just don't get the job done. But retailers are fooled by the high interest in these products and fail to see that with the highest level of exposure and reach, they don't deliver sales to match. But the niche products can deliver respectable sales with minimal exposure. The key is to give them visibility from high-traffic areas, but not necessarily locate them within these areas.

What is the potential of niche products? We analyzed this question for a single superstore and found that the store was potentially leaving $2 million on the table because of its strategy for a single category of niche products. We compared the sales in the niche categories (baby food) to an opportunity index (market demand index) based on actual total store traffic, neighborhood demographics, and sales at other stores across the country. For baby food, this store was selling nearly $2 million less per year than could be expected. Simply exposing that category to more in-store traffic—moving it to a higher traffic area—could deliver $2 million of additional sales. (Notice that in this supercenter, baby food falls into the niche group, illustrating how a category's performance varies depending on specific store conditions. Across a national sampling of supermarkets, the average performance of baby food puts it in the underdeveloped group—poor stopping *and* poor closing.)

General guidelines for each of these categories are shown in Table 4.1. By more carefully managing each of these groups, retailers can put products in front of shoppers that they will stop and buy. And that will increase overall sales.

Table 4.1 Category Guidelines for Placing Products

Leaders	Leader categories should be put in very high-traffic locations and be given priority for secondary placement (end caps, placement on perimeter, and so on).
Niche	Niche categories require increased awareness. It is key to have visibility from high-traffic areas, but not necessarily placement in those areas.
High Interest	Conversion issues for high-interest categories are not related to layout/placement within the store. Investigate assortment, pricing, merchandising, and messaging opportunities for improvement.
Underdeveloped	Underdeveloped categories can be placed in lower traffic areas. The alternative is to increase awareness in these categories with unique offerings or positioning (as with new products).

Good Is the Enemy of the Great

Understanding these distinctions can help put the right products in the right place in the store. The right placement can help meet shoppers where they are and close a sale. It can allow the retailer to play a more active role in the process, without standing in the aisles and taking down items from the shelves. This understanding of shoppers and stores can help retailers make the creative leap of putting a line of nectar in the middle of a juice display. There are many other opportunities for rethinking approaches in the store that can boost sales.

This concept of distinctions overcomes the instinctive reaction to settle for what is merely “good.” As Jim Collins wrote in *Good to Great: Why Some Companies Make the Leap…and Others Don’t*,”the good is the enemy of the great.”[4] In other words, if you settle for good performance of products and don’t investigate what makes the leaders great, you won’t outperform your competitors. In this case, we are considering retail strategy as well as the products themselves.

Endnotes

1. This might not matter, except that how categories are defined will alter significantly, not only the statistical performance measures, but also how they are conceived ever after. And the statistics that begin to be a baseline for our understanding tend to be set in concrete, based on what we include or don't include in any category. So, defining "dairy" to include chilled juices and refrigerated dough may make a lot of operational sense, including incentive pay for the dairy manager. But it can result in serious distortions of the "juice" market if juice is not identified separately in the dairy department. In other words, move one product to a different section, and the whole statistical picture changes.

2. "Product Packages Now Shout to Get Your Attention," *The New York Times*, August 10, 2007.

3. A quadrant analysis of this type has the usual advantage of dispersing the individual members (categories) so that their relative performance on two measures can be readily visualized. A disadvantage of the usual approach is always a central tendency, or clumping. We alleviate this problem by statistically identifying the central "clump" as average, and taking our cue from Joseph Juran, focus on those categories at the perimeter, the "vital few" most easily characterized, and most susceptible to specific creative management practices. In naming VitalQuadrants™, we follow the language of Paco Underhill and others, although our definitions differ to an extent.

4. Collins, Jim. *Good to Great: Why Some Companies Make the Leap… and Others Don't*, New York: Collins Business, 2001.

5
Brands, Retailers, and Shoppers: Why the Long Tail Is Wagging the Dog

> *"Whenever an individual or business decides that success has been attained, progress stops."*
>
> —Thomas J. Watson, Founder of IBM

There is a famous story about when Tesco started trials of its loyalty card, Clubcard, in the mid-90s. The retailer called on the services of Dunnhumby, a company specializing in data analysis. The results of these first trials were delivered to the Tesco board in November 1994—which led to a prolonged and awkward silence.

The board chewed over a 30-minute presentation about customer response rates, the impact on like-for-like sales, and a dazzling array of data collected from 14 stores. It was Sir Ian McLaurin, then Tesco chairman, who broke the silence with a now apocryphal remark. "What scares me," he said, "is that you know more about my customers after just three months than I do after 30 years."[1]

It might seem odd that a very successful retailer would know so little about its customers or what they do while shopping. Tesco and other retailers obviously are increasing their understanding of shoppers (although loyalty cards just tell what happens at the checkout, not in the store). In many ways, the massive problems in this industry are caused by everyone assuming that supermarket managements are the repositories of deep insight into the shopping process. By and large, they are not. There are a few exceptions—but they prove the rule.

There is a reason why retailers have historically paid so little attention to their shoppers—they are not rewarded for doing so. The economics of retailing are completely biased against it. We cannot explore the mind of the shopper without expanding our view to look at the broader—and shifting—relationship between retailers and the manufacturers of brands on their shelves. This complex and uneasy relationship helps explain much of what may appear to be counterintuitive about how retailers work. Understanding this relationship also highlights opportunities, which we discuss in this chapter, for brand owners and retailers to collaborate more effectively in selling products. Brand owners can help retailers redesign their stores to maximize sales and can also take advantage of powerful merchandising promotional planning programs to pitch the emotional messaging of each category more precisely.

Where the Money Is in Retail

If shoppers are ignored, it is because they contribute the least to retailers' bottom lines. This may be surprising, because on the surface the entire business model of a retailer seems to be to sell products to shoppers. But a closer look shows that this is only a front for the true business. The main sources of supermarket profits are, in order of importance:

1. **Trade and promotional allowances from the brand suppliers:** The number-one source of profits consists of rebates of one variety or another from those manufacturers who want to "warehouse" their merchandise in the retailer's self-service stores. The sometimes-maligned slotting fees are, in reality, a rational warehouse operator's recovery of storage costs from those who want to take the available space. It has been noted that supermarkets make their money by buying (from the supplier), not by selling (to the shopper).

2. **Float on cash:** Stores necessarily manage very large amounts of cash. In fact, one executive pointed out to the author the large amount of "abuse" the store receives from shoppers, but then pointed out that this is compensated for by the fact that they leave "their cash on the counter." This cash is hurried to the bank to begin immediately accruing interest, or *float*. Float will multiply until the necessities of business require the dispersal of cash to suppliers, employees, and others, days, if not weeks later. In any event, the store wants to begin *instantly* accruing interest on its portion of that $14 trillion annual

turnover of the retail industry. A few seconds of that interest would suffice to maintain most households for decades. This is the second major source of profits.

3. **Real estate:** Every major chain maintains a large real estate department that finds real estate to develop for stores, often in developing communities. In a few years, that developed real estate will likely be worth multiples of the initial investment—not carried on the books as profit, because it will be unrealized until the sale of the property itself—often decades later after the underlying business has paid for it many times over.
4. **Margin on sales:** This fourth source is not to be sneezed at, largely consisting of *service* departments, operated on the retailers' own prime in-store real estate—the wide perimeter zones or other high-traffic areas. This would include things like the meat department, in-store deli, pharmacies, and so on. Another growing area of profit is contract outsourcing, where outside suppliers manage certain aspects of the operation (such as cafes/restaurants or flowers) and the retailers get a share of the margin from the contractor.

When these sources of profit, and the inherent nature of self-service, or passive retailing, are made clear, it is not surprising that retailers don't know a lot about the actual behavior of the shoppers in their stores. Why should they? The shoppers have been assigned responsibility for their own shopping, and aren't really complaining. But this is a dangerous and complacent position for retailers to be in because this passive methodology is increasingly being strained by the diminishing effectiveness of outside-the-store communication.

The reason the long tail is wagging the dog in retail is that brand owners are investing in promoting their many products in the long tail. As long as manufacturers are putting up the money, it makes sense for retailers to keep their large warehouses well stocked. But if shoppers are buying largely from the "big head" store, could retailers and manufacturers work more effectively in meeting this need?

> *The reason the long tail is wagging the dog in retail is that brand owners are investing in promoting their many products in the long tail.*

Massive Amounts of Data

In addition to this economic imperative, there is another major factor driving the lack of interest in what is going on *inside* the store. That is the massive amount of information about what is coming *out of* the store, or the veritable flood of data spewing out of the scanners around the world. This scan data has spawned two major industries in their own right: compilers and resellers of the categorized data—Nielsen and IRI being the preeminent examples—and the advanced analytics relating this data to specific shoppers through the use of loyalty card programs, demonstrated by Dunnhumby and related businesses.

As positive as these derivative businesses are, neither speaks well of the retailers' own understanding of the shopping process. First, for decades, electronic barcode scanners contributed little more than an expedited method for ringing up the shoppers' purchases. Of course, sales data was more reliable for inventory control than the older warehouse velocity measures such as those provided by SAMI, which measured movements of goods based on warehouse withdrawals to the stores. But pricing and inventory control hardly bathe the retailer in glory for its use of shopper insights.

In fact, the salutary effect of Dunnhumby on Tesco only serves to highlight the deficiency of the retail giant's previous approach to the business. And now there is an ever-growing cadre of Dunnhumby-type firms who are surely accelerating business and profits for any number of retailers through advanced analytics of the scan data linked to the loyalty cards of individual, specific shoppers. So, just imagine the impact on profits of going even further and measuring what is going on in the actual *shopping process* in the store.

This is the stark reality that drives a good deal of retailing. It's not that retailers and suppliers don't seek to have a relationship with shoppers, but that their own mutual relationship tends to cause those to the shoppers to pale into insignificance, and, as a result, to remain somewhat distant by comparison. This is the reality of the self-service, warehouse-based view of the store. Sometimes my views may seem too critical, but there are certain absurdities in the industry that are driven by the economic structure. In the U.S. alone, fully one trillion dollars is paid by brand suppliers for the supermarkets to manage their supermarkets in a certain way.

To me, this is the emperor with no clothes. This is why supermarket managers measure inputs and outputs of the store but are largely blind to the process occurring in the store. And this blindness is shared by their brand suppliers. It is essentially the $1 trillion that the brands are paying retailers that justifies their leaving the $80 million per store on the table through not understanding and serving shoppers better. Of course, we have no illusions that there really is, in aggregate, an extra $80 million per store available to every store. But exceptions such as Stew Leonard's, with its $100 million stores, shows that much more is possible.

Shifting Relationships

The relationship between manufacturers and retailers is already shifting with the rise of private-label brands and the increasing marketing sophistication of retailers. In an October 2008 article in *Advertising Age*, Jack Neff reports how retailers are hiring talent away from consumer goods companies, measuring shoppers, and building their own brands —"raising big questions about the balance of power in the industry."[2] Retailers are increasingly focused on building their own brands rather than turning over their stores to manufacturers. This is neither good nor news to the brands. However, the role of brands is often not well understood or represented at retail. It helps to consider that when shoppers purchase branded items, they are acquiring three distinct values:

- **Intrinsic value:** A carbonated beverage will quench your thirst and meet your physiologic need for water.
- **Added value:** Packaging the beverage and delivering it to you in a convenient, and possibly chilled, form adds value to the intrinsic value of the water.
- **Creative value:** This third value is in the mind of the shopper and is the essence of brand value.

Because this third, creative value sometimes seems to be a gossamer wisp, it tends to be misunderstood and abused. It obviously has considerable commercial value, because all profits derive from the difference between costs and prices. The cost of intrinsic value is properly regulated by competition for basic, commodity resources. The cost of added value depends on manufacturing and distribution efficiency, including such things as cleverness of design. So what is the cost of creative value? Unit cost is zero, because once created, the more it is sold.

Once created, creative value is a bountiful source of profits. This is its strength and its vulnerability. The vulnerability is because those who do not own the brand are probably unwilling, at some level, to pay for it. This is the reason brands spend so much time and effort trying to convince the market that their value is really intrinsic or added. There is nothing wrong with a better mousetrap, and part of the value of the brand is the assurance that the brand will provide the "better" product.

But whether designer jeans or bananas, there is that something about the brand that makes a customer feel very good about spending a few pennies—or more than a few dollars—for it. In fact, that additional creative value is an important part of accelerating the upward growth of society. Think of that creative value as aspirational, something in the soul that longs for improvement and betterment.

In times of economic distress, there is always a call for a retreat to only intrinsic and added value. Retailers' first ventures in competing with their brand suppliers historically involved offering intrinsic plus added value private-label products only. The cutting edge today in retailing, however, is heavily dependent on building strong own-label brands, far removed from the old white label generics, as can be seen in retailers such as Trader Joe's. This is shifting the balance of power in retailing and placing more emphasis on understanding how shoppers interact with brands in the store.

While retailers have learned how to create brands (creative value), they have long assaulted the concept of brands by insisting on cutting prices to promote them. This strategy suggests to customers that brands were overpriced at their regular retail prices. Although the relationship between the manufacturer and retailer is often seen as a great struggle over the value created from shopping, this does not have to be the case. In fact, as we consider next, both retailers and brand owners can often do better if they work together to serve the shopper better.

A Refreshing Change: Working Together to Sweeten Sales

Assuming that both retailers and manufacturers want to sell products to consumers, if they understand shoppers better, they can work together more effectively to use in-store marketing in more sophisticated ways. ID Magasin, for example, worked with chewing gum manufacturer Dandy, a business unit of confectionery giant Cadbury-Schweppes, to increase category sales by as much as 40 percent by introducing “refreshment cues” in the pre-checkout area of Swiss retailer Pilatus Markt.

In-store research in 2001 examined how shoppers interacted with chewing gum displays at the checkouts. The company filmed, interviewed, and counted thousands of shoppers at three checkouts, each of which was merchandised differently to enable comparison of different concepts. Representative customers were also fitted with a point-of-focus/eye mark recorder to identify the visual cues used in purchasing decisions. Researchers discovered that customers had stopped actively shopping by the time they reached the checkout. Because the customers were no longer shopping—just visiting—the products didn’t have a chance of stopping, holding, and selling.

The researchers realized they needed a trigger to reignite the shopping mode at the checkout. And, because “freshening” is the overwhelming motive for purchasing chewing gum, researchers recommended that refreshment cues be introduced in the approach to the checkout area. The company then employed a group of experts to establish the visual elements that signal refreshment. The group recommended imagery that strongly communicated refreshment and which shoppers could instantly decode and associate with chewing gum. Dandy next commissioned in-store marketing material based on these signals for use in the key pre-checkout area. There were four graphic directions, each of which could be adapted for individual retail customers to promote the entire chewing gum category.

The next stage of the project was to confirm that refreshment and breath-freshening cues in the pre-checkout area do increase sales in the chewing gum category, and by how much. Dandy undertook research in two stores in Denmark, Kvickly supermarket and OBS hypermarket. Overall, nearly 20,000 customers were filmed at four checkouts in each outlet. Two checkouts per outlet had the trial setup and two provided experimental control. Dandy found that the new point-of-purchase material did indeed stimulate consumers to revert to shopping mode and attracted more of them to that checkout area. The new strategy increased the sales of all the categories represented in the display by an amazing 40 percent and Dandy's sales by up to 44 percent.

This is a major boost in sales just by retailers and manufacturers working together to understand shopper behavior. The retailer had to rethink its checkouts. The manufacturer had to rethink its in-store marketing. This is a different relationship than a passive retailer receiving stocking fees from a brand owner to gain shelf space. This is creating a more compelling sales opportunity for shoppers, reflecting an understanding of the three moments of truth for the shopper. If visitors are not converted to shoppers and shoppers are not converted into buyers, there is no sale. Working together, the retailer and manufacturer increased sales, which benefits both of them.

> *If we assume that both retailers and manufacturers want to sell products to consumers, if they understand shoppers better, they can work together more effectively to use in-store marketing in more sophisticated ways.*

Beyond Category Management

As this example illustrates, collaboration between retailers and manufacturers can help both. This partnership between manufacturers and retailers moves beyond traditional category management to active cooperation in management of parts of the store, or even total store management.

To understand this evolution, we need to consider the evolution of the concept of category management over the last decade or so, as retailers and their brand partners began to realize they needed to take a more shopper-centric approach. Category management began in the early 1990s when Brian Harris of The Partnering Group set out a number of "best practices” for collaboration between suppliers and retailers. Basic category management, still in widespread use, involves retailers and suppliers using sales data to answer questions such as: How should the products on the shelf be segmented? What should the layout be? How can SKUs be optimized? How many items should be on the shelf? Which ones? More brands or fewer brands? What about different pack sizes?

The next level, category reinvention, has come to the forefront over the last few years. This is far more extensive, going beyond segmentation, assortment, and pricing decisions to include such elements as themes, fixtures, signage, size, layout, location, paths, adjacencies, flow, assortment, and planograms. This approach is becoming more prevalent because it is more engaging and encourages higher levels of conversion by offering a more emotional experience. A meat department, for example, might be creatively reinvented to look like a butcher shop. The coffee aisle might be redesigned to give a coffeehouse experience.

A New Era of Active Retailing: Total Store Management

Category management, aisle management, and even store management are blunt instruments. They lump products and categories together. Item management, on the other hand, is a scalpel, targeting the small number of items in the store that are major levers for sales. The typical approach to category management is for every category to have its place in the store. But if the individual products were instead totally randomized through the store, the shopper would be more exposed to more categories. Taking this approach to this extreme might lead to chaos, but secondary placements in the store do move retail in this direction by putting items in unexpected places, and managing individual items that drive store sales. The long tail of the store may be organized by categories, but the big head should be placed where shoppers can find it.

A third and higher level of category and aisle management is emerging, which is a natural progression from category management and the drive to create a real partnership between active brand owners and active retailers. Total store management takes a much broader perspective, with manufacturers working with retailers to design their total store layouts. This goes to the specifics for all the major categories, both in organization and arrangement in the main store, as well as in the promotional store. This progression from category management to aisle management and on to total store management can be seen as part of the accelerating movement from passive to active retailing that is now underway.

There are several reasons why this approach is attractive, particularly to larger brand owners. First, they often have products all over the store. Coca-Cola, for example, has products in the water section, in juices, in teas, and so on. Anything the brand owner can do to maximize the performance of the total store is going to improve its business. Second, when companies have a very large category—confectionery, say—overseeing the store in a holistic way means they can exploit their positions not just in the primary display areas, but also in the secondary, promotional display areas such as end caps and the checkout, where an average 30 percent of purchases are made. Instead of fighting for space in the center aisles where shoppers are reluctant to come, manufacturers can take their brands out to the shoppers more effectively by looking at the total store.

A sophisticated large European confectionery manufacturer, for example, worked with a major retail partner to determine the ideal layout for stores, addressing the following questions:

- **Identifying leaders:** What are the steering categories in the retailer's stores, which genuinely move traffic? Remember, there are typically a small group of categories that do move traffic, the leaders—the rest are just along for the ride.
- **Arrangement:** In which order should different categories within a given arrangement ideally be placed?
- **Interaction:** In what way is the usage of different categories influenced by the location of other categories?
- **Order:** What is the optimal order of planned categories, impulse categories, and the categories "in between" (if they exist)?

All these questions are essentially *behavioral* questions. That is, if we can understand exactly how all the shoppers *behave* in the present store, this will serve as the foundation guide to how it might be altered to enhance that behavior to the mutual benefit of shoppers, the retailer, and their brand suppliers. To study shopper behavior, researchers began by analyzing how shoppers move through the store. In this case, data was collected by “shadowing” shoppers, re-creating their trip with various behavioral annotations on a web tablet, as illustrated in Figure 5.1. The paths of individual shoppers were charted, as shown in the right side of the figure, and then paths of many shoppers were amalgamated. The methodology used here, *Personal* PathTracker®, is one of many methods for creating this data, including radio-frequency idenification (RFID) tracking, video tracking, or shopper vision tracking

Figure 5.1 Shadowing shoppers, researchers follow shoppers and take notes on a web tablet.

Figure 5.2 shows the trip progression of these many shoppers in a stylized form. The numbers indicate how far along in the average shopping trip the shopper is, beginning at the lower left (0.7 = 7% of the trip) to 1.8 and 2.8 to the right, and so on through the store to the 9.2 at the end of the store. The numbers are across many shoppers so the reason it doesn’t go from 0 to 10 is that no matter how many people are heading one direction, there is always someone going the other direction. If nearly everyone ends their shopping trip at the checkout, there will be someone who begins there and moves in the opposite direction, both in terms of traffic flow, on the right, and time point (progression) in the trip. The arrows in the right side of Figure 5.2 represent the dominance of traffic, not volume of shoppers. (A small arrow, for example, means that the number of people flowing both ways is about even. A larger arrow means that traffic is predominantly in that direction.) The researchers used the metrics summarized in Table 5.1 to understand shopping behavior in the store.

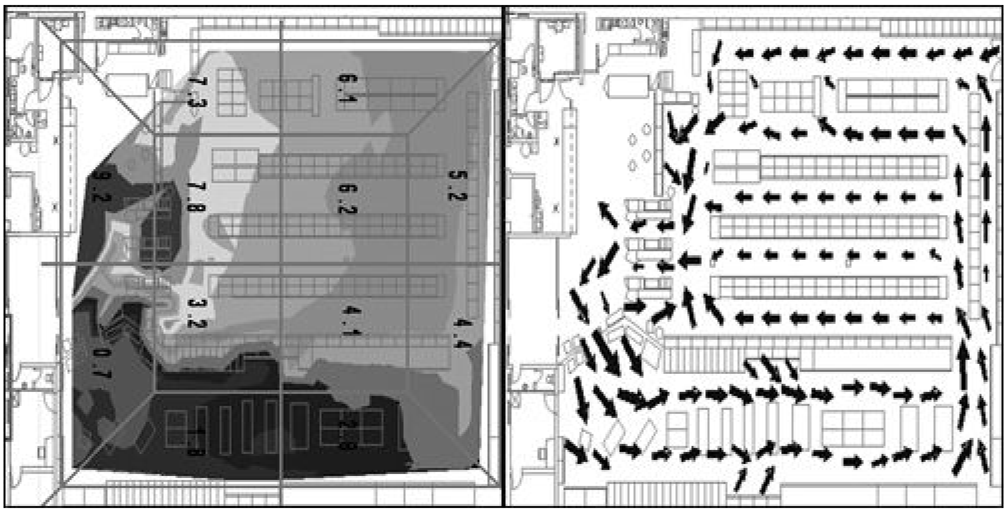


Figure 5.2 The progression of shoppers, showing patterns of movement

Table 5.1 Metrics for Shopper Behavior

For Every Category in Store	For Every Shopper
Reach (visit %)	Duration of shopping trip (seconds)
Stopping (shop % divided by visit %)	Proportion of store visited (%)
Closing (purchase % divided by shop %)	Proportion of categories visited (%)
Holding: of buyers (buy time—seconds)	
Holding: of buyers and nonbuyers (dwell time—seconds)	
Trip progression (% of trip completed at the point in the trip)	
Walking speed (feet per second)	

The complete flow and adjacency analysis produced six key insights, as follows:

1. **Understanding store and aisle traffic flow, hot spots and cold spots, and target shopper segments:** Researchers gained insight into the dynamics of movement of individual shoppers, as well as the overall flow of the crowd. This allowed identification of points of congestion and fixture location issues that might restrict traffic flow to all parts of the store. The goal was to open up and encourage traffic in an orderly way, to maximize the opportunity to offer the shopper the right merchandise at the most receptive point in their shopping trip.

2. **Identifying "leader" categories—high performers for stopping and buying power:** These "leaders" may be identified in the Vital Quadrant™ analysis discussed in Chapter 4, "Active Retailing: Putting Products into the Path of Shoppers." There we saw that there is not an iron-clad identity of these across all stores, but certain categories do appear again and again on the leader list. We also identified a series of categories through statistical clustering of

shoppers by their trip behavior, which are common to the largest groups of shoppers, whether for quick, fill-in, or stock-up trips. Even though the metrics and analytical approach are not identical, there is significant overlap between the groups.

Other independent groups, working with RFID trip data, using intelligent agent modeling, found a similar group of categories whose impact on the shopping trip accounted for the total store traffic, in terms of density and flow. This type of convergence from multiple analytical approaches gives us added confidence, not only in the role of the leader categories, but also that the great majority of categories in the store *do not* drive shopping behavior and that purchases occur largely incidentally to those driven by the leaders.

3. **Determining the ideal placement of "leader" categories to maximize performance and improve flow throughout the store:** Categories with high stopping power (visitor to shopper conversion) are given priority early in the shopper's trip (progression). This gets the shopper started off on the right foot, by beginning to fill the basket early. This also means that they're willing to spend more time on these purchases, making more of them, because they will tend to shop faster and faster, or spend less and less time, the longer they are in the store. It is also helpful to consider category buy time, trip type, and level of planned or impulse purchasing of the category.
4. **Identifying leader category "affinities":** Affinity means that when one product is purchased, then another is often purchased as well. This analysis helps determine the placement of these affinity categories to maximize their performance and improve flow throughout the store. Because we have data on trip progression, we can then place these affinity categories in the right order in the path of the shopper.
5. **Placing remaining categories using similar analysis procedures:** Once the leaders are positioned, the remaining categories can be placed based on margins and relevance to the other categories, as well as the guidelines offered for niche, high interest, average, and underdeveloped categories.

6. **Identifying ideal placement, contents, and messaging for promotional (secondary) displays:** This is done through visual audits of stores—what's seen and what's not seen—as well as a detailed accounting of the exposure to shoppers of various end caps in stores.

The results for this specific store were impressive, with post-redesign surveys showing that shoppers were very satisfied with the results and were likely to recommend the store to others. Specific sales lift improvements cannot be disclosed, due to proprietary concerns, but management consistently reports sales increases from a few percentage points to double digits after active retailing redesigns.

Pitching a Category's Emotional Tone More Precisely

One of the biggest questions retailers and brand owners have to answer is how to promote individual categories in the store. What should the emotional tone of each one be? Siemon Scammell-Katz introduced a set of powerful tools for merchandise promotional planning to address the type of promotions appropriate for various categories.

The foundation of the methodology was the evaluation of in-store shopping metrics from a large number of shoppers in a single UK supermarket linked to data from the same shoppers, as tracked over years in the TNS World Panel. Researchers found that two of the most significant variables in conversion rates are Buy Time (how long the purchase takes in minutes) and Purchase Frequency (on an annual basis). This analysis helped identify the emotional involvement of different categories. The categories are divided up based on these metrics and then restated in terms of the emotional mindset that shoppers are likely experiencing, given their investment of time in the purchase and its frequency, as illustrated in Figure 5.3.

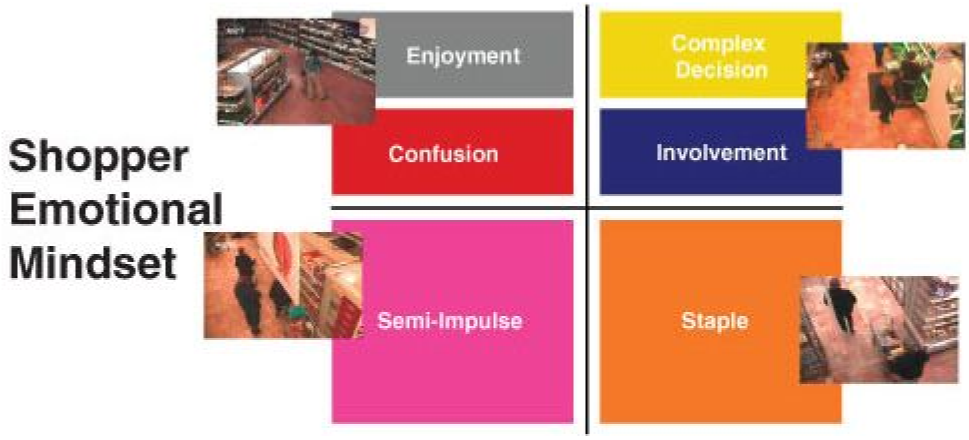


Figure 5.3 Connecting with the shopper's emotional mindset

Those emotional mindsets then provide guidance for appropriate communication strategies, to reach shoppers with the right type of messages, for the right emotional states associated with specified categories. For example, the categories that are high frequency but low involvement are most likely to be staples (in the lower-right quadrant). This, in turn, leads to a rational communication strategy appropriate to the category. For staples, for example, it should be about range reduction and ease of shopping. For "enjoyment" categories, it should be "theater," and for "involvement" products, the focus should be on providing information. Although this is a practical scheme for managing communication strategy in the store, it does not, of course, dictate the creative strategy. As noted earlier, a hot pink package might capture attention but may not make the sale, so there is plenty of room for creativity in communication.

The examples we have used for illustration are largely drawn from supermarkets and consumer-packaged-goods (CPG) or fast-moving-consumer-goods (FMCG) retailing. Our largest experience has been in this arena. But the most valuable asset here is not the massive normative database providing insight to CPG/FMCG, but rather the organized, scientific approach to retailing. We have applied this schema across a broad spectrum of retail trade around the world, including sectors such as autoparts, home electronics, phone stores, gift/card stores, clothing, jewelry, and so on. Moving from country to country (discussed in more detail in Chapter 8, "Multicultural Retailing") and across classes of trade changes the values of the metrics, but it does not change the organizational paradigm. Wherever we have gone in the world, we have found that most people are right-handed (hence the inherent trend to navigate a store in the counterclockwise direction). In similar fashion, across wide swathes of human behavior, there is more that makes us alike than different.

Retailers Control Reach

One challenge in the traditional relationship between retailer and brand owner is that the retailer controls the first stage of the sale: reach. Retailers control the design and layout of the store, so brands usually need to work within this framework. The passive retailer views reach as visiting: It's the shopper's responsibility to visit a product if they want it. Passive retailers also want to keep shoppers in the store as long as possible, so if products are difficult to find, or inconveniently placed, they reckon they are doing their job well. This attitude, which is locked into so many retailers' minds, is unhelpful. Supermarkets, for example, usually put the milk at the far corner of the store because they believe it will make people go there. Well, they very possibly won't. Instead, they may stop at the convenience store or a competitor if it's easier.

This creates great problems for brands because brand suppliers have to work through retailers to accomplish *anything* in terms of reach. First, people tend to shop with the subconscious expectation that they are going to buy just so much "stuff." Once they have the right amount, they are going to leave the store as quickly as they can. They are not going to anguish over whether they have Brand A or Brand B. In fact, even if they usually buy a particular brand, and the retailer moves it elsewhere, the shopper might not realize it and no longer use that brand for some time, if at all. This is the real challenge for the brand owner: The retailer is relatively indifferent about what people buy as long as it is a reasonable amount and they do so with some frequency and efficiency. Brand owners try to address this careless attitude through promotional fees, but it is a crude instrument. Brands make the real difference in stopping power—once the shopper comes into the product's orbit, but the shopper first has to get close enough to see the brand. To address this challenge of reach, brand owners need to work with retailers to more effectively position the brand in the store.

Once the shopper comes into reach of the product, its “visual equity” from branding and packaging makes a huge difference, particularly among the crowded long tail products. Packaging is the number one communication vehicle at retail. It is the most viable method the brand has for communicating with shoppers. The shape and color of the package—visual equity—that consumers associate with the brand (such as Coca-Cola’s color red) allow the consumer to quickly identify products among the clutter at the point of purchase, in the pantry, or on the tabletop.

The Urgent Need for Retailing Evolution

Retailers are harvesting massive cash from the brand manufacturers for representation in the promotional area. Meanwhile, brand manufacturers are spending further billions on researching how to manage the main store. The two parties are both distant from actual shopper behavior—to the financial detriment of both. These economics are the foundation of the supermarket’s profits but are killing the brands, whereas the shoppers tolerate this modus operandi because so far there are not many options.

We reemphasize here that we are not advocating retail revolution but are excited about the continuing evolution and hope to contribute to it and perhaps accelerate it. What we want to eliminate is the thinking that says: “Shoppers are in the store, and it is just too difficult to conduct research there. And it is also much too difficult to master the promotional store. So we, as the brands, will continue to invest in aisle/shelf management. And we, as the retailers, will continue to develop our promotional store for ourselves.” They should both be focusing more attention on the promotional store—the big head. That is where the money and the opportunities are.

We also suggest that the strategy of putting promotional pricing on the items on the end caps is seriously misguided. Instead of trying to train shoppers to think: “If I want to get a deal, I should just grab something right here,” they should think: “If I want a deal, I know I’m going to go down that aisle to get it.” Retailers and brand owners should understand that their pricing and promotional strategy is highly irrational.

Brand suppliers, meanwhile, need to know how to maximize and optimize their secondary display performances: where the displays should be, what kinds of products should be on them, the type of message to attract the shopper and convert them to buy, and so on. It is not that brands do not work in this second store but that, because it is far more complicated and difficult, the focus tends to be on the section of flat wall in the main store over which they have some influence or control, and which is much easier to study and understand.

Promotional spending of big brands distorts the shopping experience in ways that are not good for the shopper, the retailer, and, often, even the brand owner. If I were a retailer, I would fiercely manage the big head strictly for the benefit of the shopper, and insist that the promotional "crack cocaine" not override the behaviorially expressed wishes of my shoppers. If you don't know how to manage the big head part of the store strictly in the shoppers' interest, learn or retire. I would continue to allow the long tail to be a battleground for the brands—and profitable for them, too. But the rational ones of them will want to know what they are getting from their share of that trillion dollars of retail spending.

No problem. It is urgent that you know the value of every inch of real estate, every aisle location, every end-aisle display, every shipper, every lobby display, and all the in-store media. I'm talking about approximately monetizing every inch of the store.

Endnotes

1. www.thecrossbordergroup.com.

2. Jack Neff, "Brand Giants Weakened as Retailers Get Savvier," *Advertising Age*, October 6, 2008.

PART II
Going Deeper into the Shopper's Mind

6
The Quick-Trip Paradox: *An Interview with Unilever's Mike Twitty*

As discussed in Chapter 1, "The Quick Trip: Eighty Percent of Shopper Time Is Wasted," the quick trip has become the most common unit of shopping, yet most retail stores are designed primarily for stock-up shoppers. We interviewed Mike Twitty, Shopper Insights Director of Unilever Americas in the U.S., who has conducted pioneering research on quick-trip shoppers. As he notes, although quick trips account for about two-thirds of shopping trips, shoppers buy many different types of products on these trips. This is the Quick-Trip Paradox. This means catering to the quick tripper is not as simple as defining a small set of "quick trip" products.

How do you define a quick trip?

Twitty: In Unilever's research, the term "Quick Trip" is a relative term that shoppers use to describe the amount of time, effort, and money they invest in a given trip to a retailer.[1] Shoppers spend an average of about $100 on Major Stock-Ups, about twice what they spend on Fill-in Trips (about $50), and four to five times what they spend on Quick Trips (about $20). Because Quick Trips are relative, they vary in size, depending on the retail outlet visited. A Quick Trip to a club store is substantially longer and has a higher spend (about $44) than a Quick Trip taken to a convenience store (about $15). One way to think about the terms "Quick Trip," "Fill-in Trip," and "Major Stock-up Trip" is that they represent three different sizes of trips: the small, medium, and large trips that most shoppers take to their retailers.

The Quick Trip is different in frequency and purpose. In our research, we found that shoppers took an average of about 10 trips per month that resulted in a food purchase. Six of these were Quick Trips, and only one was a Major Stock-up Trip. Fill-in and Major Stock-up Trips both focus on buying items for the longer term or for restocking the household or pantry. Quick Trips, in contrast, are focused on buying items that will be used shortly after purchase, usually the same day or the next.

If you spend enough time watching shoppers in most retail outlets, you will notice, among other things, that few of the shoppers actually shop the whole store. In addition, if you read the research that measures actual shopping behavior, rather than what shoppers *say* they do, you will see mountains of data showing that most consumer packaged goods (CPG)/food shopping trips are composed of a small number of items per basket. Considering these two observations, one obvious question is "why?" This simple question has driven a whole body of research aimed at understanding shopping trips, the shopping decisions that take place outside of the store, and how they affect the behavior that takes place within.

Why do shoppers make so many quick trips?

Twitty: The simple answer is: because they can. Because we have easy, affordable access to so many retail outlets, shoppers often choose to get what they want as they discover they want it. Instead of having to organize their lives around the availability of the retailer, they develop strategies to use the abundance of available retail options, "cherry picking" them to best serve their changing needs. Although shoppers use a variety of strategies, the important thing is this: Most shopping trips to buy CPG and food items are Quick Trips, and Quick-Trip shopping is a unique opportunity for manufacturers and retailers.

Quick Trips are a byproduct of our affluence and its effect on both U.S. households and our retail space. If we flash back in time, to some 78 years ago, the first supermarkets appeared on the U.S. landscape, and shoppers of King Cullen and Ralph's delighted in taking advantage of two key benefits they offered: self-service and one-stop shopping. At that time, there were many fewer retail outlets, and shoppers had fewer opportunities to buy. In those days, shopping trips were infrequent, and planning before each trip was more important because running to a nearby store whenever you needed something was just not an option. Over the years, however, more and more retailers offered the items found in grocery stores and more and more retail space was built. Simultaneously, food and CPG items were also beginning to take smaller percentages of our growing incomes.

Looking over the course of time since the first grocery stores were created, we can see that as our household affluence increased and our retail options multiplied, the value of one-stop shopping declined. Today, we believe that with the great supply of retail alternatives available, when household money supplies expand or are in great supply, there is less of a need for one-stop shopping. When household money supplies contract or are in short supply, the value of one-stop shopping increases.

Although it is true that one-stop shopping and stocking-up are more economical ways to shop because they decrease the number of trips we take, our comparative affluence and easy access to retail has reduced our reliance on this practice. It follows, then, that quick trips are a convenience that has been enabled by easy, affordable access to retailers.

Another appeal of Quick Trips is that they enable shoppers to spend less time and effort planning. Quick trips make our lives more convenient by allowing shoppers to avoid the time and effort of planning before a shopping trip and by minimizing the need to live our lives limited by making sure that we have access to the resources available from our homes. Instead, shoppers can go more places and do more things because they can replenish their resources practically wherever they travel and whenever they choose. Regular stock-up shopping still takes place, usually on a weekly basis, and is vitally important in most households, but shoppers find themselves taking frequent, smaller trips to supplement their Major Stock-up Trips. Although it’s true that increasing costs of shopping trips can change this pattern of shopping, for now it appears that Quick Trips are still the way that the majority of CPG and food items are shopped for.

How do pre-store decisions affect the quick trip?

Twitty: Before they enter a store, buyers of food and packaged goods have a relatively clear idea of what they want, and this knowledge steers them to visit some parts of the store while avoiding others. Unilever research shows that about 70 percent of all category purchase decisions (the decision to buy a product category such as mayonnaise or shower gel) occur *before* shoppers get to the store. Recent research from Ogilvy *Action* found a similarly high percentage of such decisions were made outside of the store.[2] Such pre-store decisions also play a great role in determining how much shoppers will spend on that trip. For manufacturers, understanding and influencing shopping behavior outside the store is at least as important as understanding and influencing what happens within. For retailers, some argue that leveraging shopping behavior outside the store is even more important, because it often determines whether the shopper will visit their store on a given trip.

As soon as a consumer decides to get something they need or want, they become a shopper, and shoppers have lots of decisions to make. Two of the more important decisions they will make are which store or stores they will choose to visit to get the items they seek and what type of trip they will make. In this context, the words "type of trip" are a kind of shorthand that describes the shopper's objectives for a given trip and the personal resources they choose to invest in that excursion.

What factors do consumers consider in deciding where and how to shop?

Twitty: For any given shopping trip we might choose to take, there are three primary considerations that shape the trip: 1) What do we need or want?; 2) How much money do we want to spend for what we need or want?; and 3) How much time and energy are we willing to devote to acquiring what we need or want?

Shoppers pit these considerations against their knowledge of the retail landscape to determine where their investment will take place. There are a host of other important considerations that follow these three, especially when focusing on shopping behavior within the store, but these three seem to be the most important considerations that determine the type of shopping trip they take and which store(s) will be visited.

How do consumers think about shopping trips?

Twitty: Using our "Trip Management" research method, Unilever has studied over 20 million trips and years of household tracking with the general population and key subgroups, such as Hispanics and baby boomers. We pioneered the method in 2004, which enabled shoppers themselves to classify the types of trips they took, based on trip definitions determined from prior ethnography. Shoppers also indicated where the trips were taken and what was purchased. In addition, shoppers provided the researchers with their register receipts to validate the shoppers' claimed behavior. This research was the first time CPG shopping trips across all major retail channels in the U.S. were measured attitudinally and validated with actual purchase behavior. The result was a powerful look across the major retail channels and retailers, as well as most CPG categories. It provided new insight into how people shop for CPG/food categories and how they use retailers to achieve their shopping goals.

One important distinction from other shopper studies is that the trip classification in this research was done by the shoppers themselves, rather than inferring or guessing at the shopper's motive based on the items purchased. The way it was done was very simple. After each shopping trip that included a food item, shoppers were asked to answer two basic questions about the trip:

1. How would you best describe this trip?
   - Major Stock-up Trip
   - Fill-in Trip
   - Quick Trip—to get a few items for a meal to be eaten within the next day or two
   - Quick Trip—to get a few items
2. What was the MAIN reason for the trip?
   - To re-stock the pantry or kitchen
   - A routine grocery shopping trip to buy items for today
   - A routine grocery shopping trip to buy items for the next day or two
   - To get an urgently needed item or two, quickly

- To take advantage of a special offer
- Just to get out, to look around, or have fun
- To shop for a special occasion (for example, for guests, a party, or the holidays)
- To get "ready-to-eat" items to eat/drink right away or before I return home
- To purchase a nonfood item (but I eventually purchased a food item)

All household shopping trips that resulted in a food purchase were tracked over a two-week period, resulting in over 4,400 trips from about 900 households, across all major retail channels and most CPG/food categories. Since this first study, we have removed the limitation of looking only at trips that resulted in food purchases and now track households over the course of a year or more rather than just two weeks. Looking at all of these results has enabled insight into the basic patterns of CPG/food shopping.

What did you learn from this research?

Twitty: Quick Trips are the most common trip for consumer packaged goods or food shopping. Shoppers classify the majority of their trips to buy CPG or food items as Quick Trips. In Unilever's original research published in 2004, "Trip Management: The Next Big Thing," 62 percent of all trips were classified by shoppers as Quick Trips, as shown in Figure 6.1.

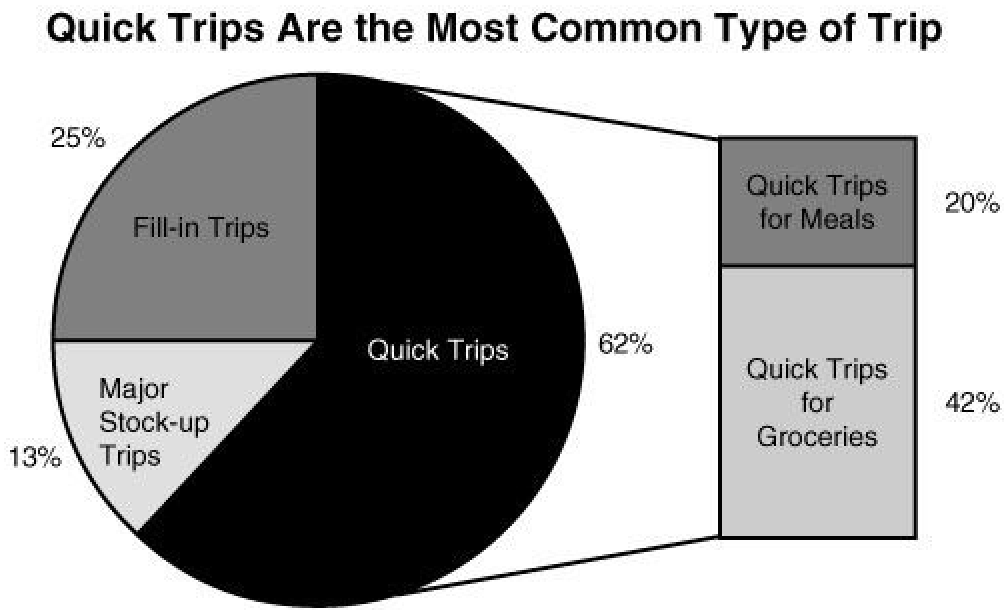


Figure 6.1 When shoppers define their shopping trips as either Quick Trips, Fill-in Trips, or Major Stock-up Trips, Quick Trips are the most common trip they report when buying groceries.

In recent Trip Management research where 11 million Nielsen-measured trips to all retail channels were monitored over the course of 2007, and all CPG trips were included, we found that 64 percent of the trips to purchase CPG categories were Quick Trips.

That such a high percentage of trips were Quick Trips was eye-opening, but what was absolutely shocking was that Quick Trips were the most common type of trip to *every* major retail channel—warehouse clubs and supercenters included! This finding has been confirmed every time the study has been replicated.

How could it be that even warehouse clubs and supercenters—whose design so strongly encourages stock-up shopping—receive more quick trips than stock-up or fill-in trips?

Twitty: The answer is that on most trips, shoppers are using these stores in ways that make the most sense for their busy lives and in ways that are possible simply because they have the financial resources to do so.

Figure 6.2 provides a great deal of information about the way shoppers use retail channels. You can easily see how shoppers use the different retail channels and the relationship between the size of the retailer's box and the types of trips that shoppers take there.

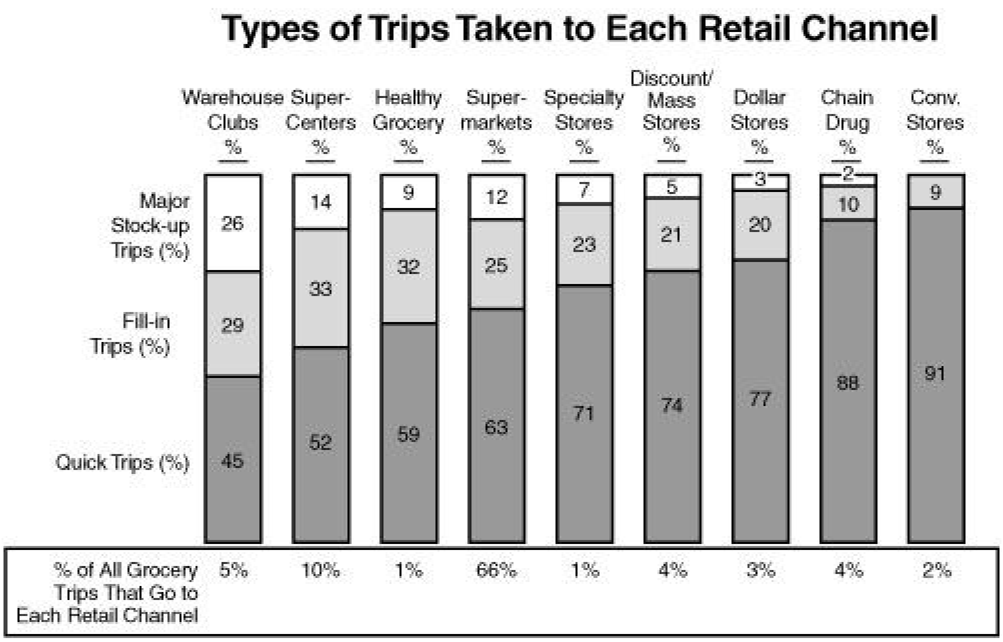


Figure 6.2 Quick Trips were the most common type of trip for every retail channel, even warehouse clubs and supercenters.

Given that quick trips account for two-thirds of shopping trips, how can retailers and manufacturers cater to these shoppers?

Twitty: It would seem that all we have to do is understand what shoppers buy on Quick Trips and we would have the basis for serving them better. Unfortunately, this is where things begin to get difficult. Looking at the 2007 data (featuring Nielsen's Syndicated Category definitions and purchases from all outlets), we can see the troubling observation we call the "Quick-Trip Paradox."

What is the Quick-Trip Paradox?

Twitty: The paradox is that although most shopping trips are Quick Trips, these shoppers are not coming to the store for the same products each time. In fact, we found that the average CPG category is purchased on a Quick Trip just 38 percent of the time. Quick Trip shopping must be composed of a very broad and changing variety of CPG categories. In a single week, a household might make a Quick Trip for milk, chips, and beer on one day, whereas a day or two later they might take another Quick Trip seeking light bulbs and paper towels. The following week might see a Quick Trip for antiperspirant, shampoo, and mouthwash. There just isn't a concise set of related categories that would satisfy the range of shoppers' needs on Quick Trips.

There are a wide variety of products that draw Quick-Trip shoppers to the store. This is a substantial impediment for anyone hoping to capitalize on the Quick Trip by dedicating retail space to serve these trips efficiently.

> *The Quick Trip Paradox: Although more than 60 percent of shopping trips are Quick Trips, the average consumer packaged good category is purchased on a Quick Trip only 38 percent of the time.*

Given this paradox, how can retailers and manufacturers capitalize on the quick trip?

Twitty: Trying to identify the ideal assortment to satisfy the Quick Trip is maddening. There are no simple answers. Some categories are purchased more often on Quick Trips than the other trips. Out of roughly 120 categories, just 27 product categories are purchased mostly on Quick Trips. Table 6.1 is a ranking of categories that are more likely to be purchased on a Quick Trip. The categories that have the highest percentage of their purchases occurring on Quick Trips are at the top of the list. The table below excludes infrequently purchased categories, categories that are purchased on less than 1.5% of all trips.

Table 6.1 Top Categories That Are Purchased Most Often on Quick Trips, After Removing Slow-Moving Categories

Category	% Times Item Purchased on Quick Trip	% of Trips That Include the Category
Computer/Electronic Products	70.9	3.5
Tobacco and Accessories	70.4	4.7
Housewares/Appliances	63.6	2.0
Office/School Supplies	62.9	6.1
Light Bulbs/Telephone	60.6	2.1
Misc. General Merchandise	59.7	3.8
Cosmetics	58.3	1.9
Battery/Flashlight/Charge	56.8	2.9
Cough and Cold Remedies	56.1	3.1
Beer	54.2	3.1
Medications/Remedies	53.3	5.6
Grooming Aids	53.2	1.7
Candy	52.1	14.6
Vitamins	50.4	3.6
Pain Remedies	49.6	2.4
Skin Care Preparations	49.4	2.5
Wine	48.7	2.1
First Aid	48.4	2.4
Kitchen Gadgets	48.2	3.0
Pet Care	48.2	3.9
Gum	47.4	2.8
Sanitary Protection	46.7	1.9
Hair Care	46.4	4.9
Oral Hygiene	42.5	5.3
Pet Food	42.1	9.5
Shaving Needs	42.1	1.8

Can you spot the link between these frequently purchased categories that are most likely to be purchased on Quick Trips? Is it clear what ties these items together? Can one understand what would be the best assortment and layout of a "Quick Trip retail space" by speculating on the underlying motivations of Quick-Trip shopping based on this list of categories? It's very difficult!

Could the shoppers' motives for making the trip offer insights into the best assortment to offer?

Twitty: What is it that shoppers are seeking when on Quick Trips? Shoppers told us that when they were on Quick Trips, they usually wanted to accomplish their shopping quickly, and as we have already said, they were seeking items to be used or consumed in the very near future, meaning that day or the next. Unfortunately, the range of products that can be needed somewhat urgently, for that day or the next, is staggering because literally every product category qualifies. So, it seems that neither the shoppers' known motives for taking Quick Trips nor the list of Quick-Trip categories provides the necessary insight to define a workable retail space tailored to serve the quick trip efficiently.

How can retailers best meet the needs of quick-trip shoppers?

Twitty: If we chose to assemble a collection of the most frequently purchased categories, we would probably have a much greater likelihood of attracting and satisfying those valuable shoppers who are in a hurry to get items they expect to use that day or the next. Stocking the most frequently purchased categories in a convenient way assures that you have the assortment for the broadest array of Quick-Trip shoppers. See Table 6.2 for the most frequently purchased categories across all outlets, as compiled by the Nielsen Company.

Table 6.2 Most Frequently Purchased Items (All Trips)

Category	% Times Item Purchased on Quick Trip	% of Trips That Include the Category
Bread and Baked Goods	33.4	23.4
Milk	34.0	21.0
Fresh Produce	28.0	18.4
Snacks	34.6	18.4
Carbonated Beverages	40.7	17.3
Paper Products	32.1	14.7
Candy	52.1	14.6
Juice/Drinks—Can, Bottle, and so on	29.6	14.5
Cheese	23.2	13.3
Packaged Meat	24.1	13.3
Condiments, Gravy, and Sauces	22.4	11.3
Cereal	26.4	11.1
Prepared Foods—Frozen	23.0	10.0
Pet Food	42.1	9.5
Vegetables—Canned	21.1	8.6
Cookies	33.8	8.4
Eggs—Fresh	26.2	8.2
Prepared Food—Dry Mixes	21.7	7.8
Soup	22.3	7.7
Prepared Foods—Ready Serve	21.9	7.1
Vegetables—Frozen	20.6	6.8
Crackers	24.9	6.6
Dressing/Salad/Deli	24.8	6.5
Detergents	32.0	6.4
Butter and Margarine	19.2	6.2

Butter and Margarine	19.2	6.2

Bread, milk, produce, snacks, soft drinks…these familiar, high-frequency categories may provide a better basis for building a reasonably efficient "Quick-Trip retail space." It would be a good idea to supplement this list with categories identified by a basket analysis against each of the most frequently purchased items. (A basket analysis identifies those items that are most often in the basket when a given item is purchased.) This analysis will identify the items most likely to be purchased, along with these high-frequency winners. Although it is focused on the most frequently purchased items rather than just those purchased on Quick Trips, organizing a retail space around these items seems to be a better basis for serving Quick-Trip shoppers—and all shoppers.

What are the implications for retailers and manufacturers?

Twitty: Retailers seeking to satisfy Quick-Trip shoppers should focus on how they manage their most frequently purchased categories. This is because satisfying shoppers on Quick Trips is not a simple matter of identifying those categories that are purchased most often on Quick Trips and making them conveniently available in a retail space. Quick Trips do not center around a limited number of items that are always purchased on Quick Trips. Quick Trips are composed of an impossibly broad array of items that are purchased on Quick Trips simply because they are needed for use or consumption on that day or the next. Such items range from soft drinks for immediate consumption all the way to items that are usually stocked-up on, such as light bulbs or batteries that, on this occasion, happen to be needed "right away" or for use in the near term.

Similarly, manufacturers should not be aiming to engineer products or "solutions" to be purchased on Quick Trips. Instead, they should focus on creating offerings that have high purchase frequency so that they have a greater likelihood of being purchased on any trip.

Endnotes

1. The terms “Quick Trip,” “Major Stock-Up Trip,” and “Fill-in Trip” have specific meanings in Unilever research so they are capitalized as proper names when used to refer to these definitions.
2. Ogilvy *Action*, Shopper Decisions Made in Store, 2008.

7
Integrating Online and Offline Retailing: *An Interview with Professors Peter Fader (The Wharton School) and Wendy Moe (University of Maryland)*

While I have spent most of my career studying the click-click-click of shopping carts in physical retail stores, the click-click-click of online retailing has emerged as an important new window on shopper behavior. With new technologies moving into retail stores, and increasing integration of online and offline commerce, studying online retailing also provides insights into how shopping might evolve in the future. I had long been aware of Wharton Professor Peter Fader's shopper modeling studies in physical retail stores and have had a chance to collaborate with him in studying the in-store shopping process. In the late 1980s and early 1990s, he and other researchers used a growing avalanche of point-of-sale scanner data to analyze what people buy. Their models could help us understand, for example, why shoppers bought one brand of orange juice over another. While linking sales data to specific customers was a leap forward, it still offered limited insight into the behavior of shoppers in the store. Our work, as discussed in the book, initially helped fill that gap in the physical retail space, carefully observing and analyzing how shoppers shop.

But then came the Internet. In addition to his studies and modeling of physical retailing, Fader and his colleague Wendy Moe, associate professor of marketing at the University of Maryland, have conducted path-breaking studies of online behavior. In studying their work on online shopping, I saw that the core principles bore a striking resemblance to what we see in physical stores. The point-by-point clickstreams of online shoppers are similar to the point-by-point visiting, shopping, and purchasing of in-store shoppers. Although I have focused more on "crowd" statistics in my work, looking for descriptive insights for all shoppers or major groups, Fader and Moe (along with other colleagues) have looked at patterns of individual shopper behavior as a means of assessing the drivers of individual behavior. The picture is richer from both perspectives than from either alone, and each confirms the other. In this interview, they share some of the insights from their research.

How did the Internet change the study of shopping behavior?

Fader: For my first ten years or so here at Wharton, I was looking strictly at point-of-sale scanner data, just analyzing what people buy and completely ignoring the context around it. Not that I wasn't interested in the context, but there was just no data. So, we had all these models trying to help us understand why people buy this brand of orange juice instead of that. The models worked great and people applied them to very different areas such as pharmaceuticals and financial services. Then everything changed with the dot.com revolution. As everyone was jumping into these uncharted waters, I initially wanted no part of it. I figured the process of someone standing at a shelf and deciding what juice to buy is going to be very different than someone sitting at the computer clicking through a bunch of different books or CDs—until I actually looked at the data, and it turned out that the patterns were remarkably similar. The same types of patterns were apparent in both purchasing *processes*. It was really fascinating. I never expected it.

Moe: I focused on online research from the beginning. My early research looked at online shopping behavior, how frequently people come to the store, how much they visit it, and what kind of search activities they use in comparison to other stores. That can give us an idea of how much they purchase. Then we can forecast their purchasing. We looked at patterns across visits and repeat visits to predict what they might buy in the future. I realized, however, that for some categories of products, consumers are not necessarily going to make repeat visits before they buy, so I focused on page-to-page behaviors within a single store visit. I looked at issues involving the focus of search behavior: Does one look at a specific brand or jump around across categories? Within a category? Is the consumer buying or just browsing? What do these patterns mean for purchase behavior?

E-commerce marketers have an abundance of data that most offline retailers don't have access to. They use this for better diagnostics and more accurate forecasting. They also can experiment with product layout and promotional messages. In the physical world, customer data have been focused mainly on when, what, and how much people buy. What researchers in physical stores haven't been able to measure as well are activities such as comparison-shopping and information gathering, which often have a strong influence on the final choice. Insights from online data might help offline retailers better understand shopping behavior.

> *"I figured the process of someone standing at a shelf and deciding what juice to buy is going to be very different than someone sitting at the computer clicking through a bunch of different books or CDs—until I actually looked at the data, and it turned out that the patterns were remarkably similar."—Peter Fader*

In what way are the online and offline patterns similar?

Fader: We found that people's tendencies to do something and decide whether or when to do it again—and how many more times to do it—were similar. The mathematical models describing the behavior could be applied in almost a "cookie cutter" way to a variety of products, from cans of baked beans on the shelf at the Safeway to books online at Amazon.com. I threw myself into e-commerce because there we could see not only what people buy, but also the process leading up to it. We began looking at the interplay between visits and purchases online. There were all these patterns that we could never see before that were consistent with what we had been seeing. Then we came across your PathTracker® studies in bricks-and-mortar stores, using RFID tags on shopping carts, and this allowed us to integrate these two areas of research, measuring shopper behavior with a variety of different tools (see the following box). We could take the rich context that we were able to see in the online world and marry it with our deep understanding of what happens in the grocery world. It allowed us to address questions such as: Which zone will you visit next? Are you just passing through or are you really shopping there? And if you're shopping there, what things, if any, are you going to buy?

Studying the Same Shoppers on Different Paths

The same shoppers move through a path and decision process in finding and buying, whether online or offline. Different research tools are used to track and compare the behaviors of these shoppers in these different environments, including the following:

- **Retail shopping:** Radio Frequency Identification (RFID) tags underneath shopping carts track consumers' in-store movements.
- **Eye tracking:** Researchers ask subjects to view print advertisements and capture their eye movements using infrared corneal reflection technology, or use the same technology in the store.
- **Web browsing clickstreams:** Consumers' web-browsing patterns are tracked by recording the sequence of web pages visited in a session.
- **Information acceleration:** Researchers immerse subjects in a multimedia environment to understand how they collect information and make decisions about a radically new product or service.[1]

How are paths in the supermarket similar to paths online?

Fader: Online and offline marketing both have path-type data associated with them, yet very few people consider the path aspects. They simply look at outcomes. Look at some of the e-commerce work on how people click from page to page and whether they are buying. I tended to think, like most people, that there's nothing else like it in the physical world. The

Internet is brand new, right? But clicking through an online site is a lot like someone pushing a cart up and down the aisles. Turning left or right in the grocery store is a lot like clicking on this link or that link, even though the physical movements are quite different. The decision process, when you get down deep, appears to be pretty similar. A path is a path, whether it's online or offline, people or birds.

Can online retailers learn from offline shopper behavior?

Fader: Take a small example: Herb, your in-store research has found that shoppers tend to look to the left and move to the left, counterclockwise, as they move through the store. Where is the shopping cart located on just about every online site? On the right. You've got people who will experiment with absolutely everything in designing their website—different content, different colors, different everything. But the shopping cart is always on the right. They have no idea why. Should they test the cart on the left?

We should no longer be surprised when we see these online/offline analogies. We should expect them. But a lot of people don't buy it. They say, oh no, come on, looking at a screen is totally different than pushing a cart in a store. There's very little evidence to suggest that it's really different. On the other hand, offline retailers, who have spent all this time laying out the aisles and getting the merchandise at the right height, don't think they could learn something from online. But I believe they can. The ultimate irony is that bricks-and-mortar retailers are outsourcing their online business to online firms. They say: Make our website as efficient as possible and just tell us how much money we are making. These online companies are running thousands of different experiments every day. But they tend to be two completely different species of people, and they are not taking any of these learnings back to the offline store.

Some of the areas that we have studied that have implications for both online and offline retailing are crowding and herding, sequencing or licensing (buying "vice" products such as chocolate after "virtue products" such as vegetables, for example), shoppers speeding up as they move toward their goals, shopping momentum, the impact of variety, and hedonic shopping behavior.[2]

Tell me about what you've found out about crowd behavior?

Fader: Studies online and offline show similarities in crowding and herding. It boils down to this: If I'm in a store and I see a big crowd of people down an aisle, does it attract me or repel me? There are two schools of thought. One says that a crowd attracts people, the other that it repels.

But it's not that straightforward. People tend to go where there is a crowd—but they won't necessarily shop there. I see a crowd in a store, so I am going to push my cart down there to see what is going on; however, it might just be too crowded to engage with products on the shelf, so I'm going to move on. What we found is that it doesn't just depend on the individual but also on the type of behavior. We have some insights, but there is still a question about how these two forces counterbalance each other. This is an excellent example of why we need a statistical model.

It is also worth mentioning the connection here with GRPs (gross rating points) and their constituent components, reach and frequency. The question is: Do we want to get people staring at the shelf often, or do we want to get *a lot* of people to stare at the shelf? You might get a lot of reach but repel people at the same time because of the crowding.

What have you learned about licensing and sequencing—such as the purchase of vice items after virtue items?

Fader: There is a sequence in how people buy things. One important driver of this sequencing may be "licensing" behavior. If shoppers buy a virtue product—something good for them—then it gives them license to buy a vice product—something that they might enjoy but is probably not good for them. If they pick up broccoli or tofu in the produce section, they can buy the ice cream or chocolate cake or cigarettes. It has tremendous implications for the placement of products on the path through the retail store or online. This is one of the reasons why sequence matters. The chocolate cake at the beginning of the shopping trip might be viewed differently than at the end, when the shopper has accumulated some virtue products and now might be more willing to indulge in a vice.

We see this in the laboratory, but it has yet to be validated in the real world. We sit people down and show them a list of things and ask them to indicate which ones they would buy. But for certain people, you prime them by saying you've already bought a certain product (virtue or vice), and then see if they buy the vice product after the virtue. There is some variation across people in how attractive the vice products become after the virtue ones.

> *"If shoppers buy a virtue product—something good for them—then it gives them license to buy a vice product."—Peter Fader*

What have you found out about the pace of the shopping trip?

Fader: Research has shown that the closer you get to your goal, the more you speed toward it. This is called the "goal-gradient hypothesis." We see this in the context of loyalty programs, where people buy ten and get one free. A number of researchers have noticed that as you get closer to the goal, you speed up purchasing. This is consistent with what you've seen in the store, the concept of the "checkout magnet," where shoppers move more quickly as they get closer to the checkout. We could extend the goal gradient hypothesis beyond the checkout, to look at other goals that occur as you shop. They might be items on your shopping list, parts of the store that you go to on every visit—for example, to see if meat is on sale each week. This is difficult to study because, other than the checkout, shoppers have different goals. But we believe we will see evidence that this goal-gradient hypothesis applies to intermediate goals as well as the final checkout.

What have you learned about shopping momentum?

Fader: The idea here is that as more purchases are made, everything in the store becomes more attractive. Once shoppers pick up a number of items, it gives them the momentum to buy more. Once you have two or three items in your cart, you start really rolling and then pick up a lot of stuff. The more you buy, the more you buy. As your studies have shown, the most common number of items purchased in a grocery store is one. That means many shoppers never really get rolling. They may get that one item and, before they can be enticed to buying a second or third, they leave. If they do build momentum, they buy a lot more.

Just as with the other forces in play in the store, the impact of the forces at play such as shopping momentum will vary across individuals. That, again, is why we need a proper statistical model to measure the effect of these forces on individuals.

What have you learned about the role of variety in shopping?

Fader: There are some people who say that people like variety. If there's greater variety, then you're meeting people's needs in a better way and, therefore, the category as a whole becomes more attractive. On the other hand, if you have too many forms and flavors, as Barry Schwartz points out in *The Paradox of Choice*,[3] people are actually put off by too much choice.

We've only tested this so far in an indirect way—across categories, which is not the best way. We looked at categories that have high variety and those with low variety to see how attractiveness varies across them. What we see is that high variety is more attractive.

This doesn't necessarily refute your perspective or Barry Schwartz's that offering more limited selections can increase sales. We're looking across categories within stores, rather than the same category across stores, and there is tremendous opportunity for reverse causality here. It could be that if a category is more attractive, people really like it, and then retailers are going to want to stock more SKUs in it. That could explain why greater variety in a category is associated with greater attractiveness. There is a lot of testing that needs to be done.

What have you learned about efficiency? Is it better to allow shoppers to get quickly in and out of the store, or should retailers try to prolong the trip?

Fader: Traveling salespeople are famously well organized. They have to be: They are always on the move, visiting a certain number of clients every day, so they need to find the most efficient route possible. Our studies of the paths taken by 1,000 grocery shoppers at a store in the western U.S. have found that shoppers, unlike traveling salespeople, are often quite inefficient.[4] They might choose the right order in which to travel to find the products they want, but they take too long and go further off course than they need to. Another interesting finding is that inefficient shoppers tend to have more in their carts than those who shop more efficiently, so this inefficiency within reason is not necessarily a problem for retailers.

This research has major implications for both store owners and brand manufacturers. Retailers want their customers to have as efficient an experience as possible. On the other hand, they want the shopper to stay longer and interact with more products in the hope that it will drive more impulse purchases and incremental revenue and build the relationship that will make shoppers want to return. If, however, they prolong the shopping trip through confusing store design and bad signage, customers will get annoyed and not return. More time spent shopping could be a good thing if it is a sign of increased engagement but might be negative if it reflects confusion and aggravation.

In the online world, measurement has taken a radical turn from looking at how many unique visitors are attracted to a website to measuring time spent per session. Again, there is the divergence between efficiency and engagement: To what extent should retailers, whether online or offline, help shoppers finish shopping as quickly as possible or try to hold them for as long as possible?

Moe: I conducted a study on the impact of pop-up promotions on people's online surfing behavior.[5] People often complain that these advertisements are annoying. They don't like them. But actually they influence their behavior positively from the perspective of the retailer. People who are served pop-ups at the right moment actually stay on the website longer and shop and search a little bit more. If the pop-up itself has good content that matches their needs, visitors are encouraged to stay, search and buy. If the pop-up is on a gateway page—a home page or category page—that visitors use to get to the products they want to see, a pop-up is stopping them from getting to their ultimate destination. These are received poorly.

> *"People often complain that these [pop-up]advertisements are annoying. They don't like them. But actually they influence their behavior positively from the perspective of the retailer."—Wendy Moe*

This raises the question of whether shoppers are in the store for utilitarian reasons alone, or if they are interested in an experience. What is the difference?

Fader: Shopping can be for a utilitarian purpose—something that has to be done—or it can be done for a hedonic purpose—for the sheer enjoyment of it. Online grocery shopping has not caught on in the U.S. to the same extent as the UK. This might be because larger U.S. bricks-and-mortar stores offer the hedonic experience that online shopping lacks. Many Americans live in large houses spaced farther apart than their European counterparts, which makes going to the store more of a social experience. Again, this is an area ripe for investigation in both the online and offline world. In the online world, you can watch the same individuals over a number of shopping trips and start to notice patterns. Offline, what is needed is to marry data from a series of PathTracker® studies over time with data from a shopper loyalty card to find out exactly who is doing the shopping. This would show how often they are shopping hedonically versus in a utilitarian fashion and whether there were patterns involved.

What have you learned so far about what shoppers are looking for when they go online?

Moe: My research has looked at the underlying objectives of online shoppers and the expression of these objectives in purchases. I identified four distinct types of visits associated with different online behaviors, as follows:

- **Directed-purchase visits** are where the shopper enters the store with a clearly defined purpose of walking out with a specific purchase.
- **Search/deliberation visits** are utilitarian visits where a future purchase is being considered, and the store visit is designed to gather relevant information before buying.
- **Hedonic browsing visits** are more about enjoyment, where shoppers browse without looking for anything specific but might make an impulse buy.
- **Knowledge-building visits** are also enjoyable but are more geared toward collecting information for possible future purchases.[6]

It is important for online retailers to understand this to target their marketing activities effectively to the right people. Shoppers come into bricks-and-mortar stores for some of the same reasons.

How do online retailers use these insights about shopper visits?

Moe: The next stage of research looks at differentiating between online shoppers not just according to what pages they are looking at, but by also actually examining the products they are interested in.[7] In other words, what are the characteristics of the products they are searching for and interested in? And what are their ideal products? Building a model based on data from this research enables the retailer to estimate the probability of purchasing. For example, if someone looks only at a series of black shoes, you can infer that she has a clear preference for this color shoe. Someone else might be looking only at shoes in a certain price range. The sequence of pages tells the researcher something about what a person's preferences are. This helps predict not only *whether* they will buy, but also *what*.

By understanding better what shoppers are looking for, retailers can, in theory, create a virtual smart salesperson to help. This assistant might be compared to the salesperson in a physical store who, through observation and experience, can help shoppers find products they prefer while carefully screening out items they feel the shopper is uninterested in buying. A model of purchase expression could help create a virtual assistant that could do the same thing.

This captures the whole point of what we've called "active retailing." Online is leading offline in this area. How does this come into the physical store?

Fader: This has obvious implications for online retailing, but as more interactive technology comes into offline retail stores, through cell phones, PDAs, or other devices, it could also be done in the bricks-and-mortar world. To offer this kind of assistance, you need to understand shopper behavior and how it relates to purchases.

How do some of the complex forces of shopping behavior play out? Why is there a need for better modeling?

Fader: As we've discussed, there are sometimes countervailing forces in shopping. Crowds attract shoppers but might make them less likely to actually shop. (This is similar to the attraction of the "long tail" discussed earlier, which attracts shoppers to the store because they know they can get anything they need—although they may only buy from the "big head.") The checkout serves as a magnet to draw shoppers to the end of their journey, the goal gradient, but at the same time, shopping momentum makes shoppers absorbed in the process of shopping the more they shop, spending more time in the store. Efficiency is another area of balance. On the one hand, you want the trip to be as efficient as possible, so the shopper finds what he or she needs and leaves. On the other hand, you want to create engagement, to make the shopper stay longer and interact to drive more impulse purchases and form some kind of relationship. You also want variety, but not too much.

These forces counterbalance each other, which is why we need a statistical model to understand behavior. There is no way we can just look at the observed data and figure this out. These effects vary across people, and their interactions also vary across people. We need a proper statistical model that lets each person have his own momentum effect and each person have his own checkout attraction and to see if we can pull him out from the data.

What topics are you studying now?

Fader: A big issue we are looking at is edge detection in the "stores within stores" in what you call a "compound store." Since the edges of these stores are not always formally delineated, we are defining the way shoppers see different parts of the store. Where are the invisible walls? For example, if people tend to circulate within one area, it could be a self-enclosed zone. Why is that? How do they move beyond the borders of that area? Is it tied to products, or is there a psychological reason? We can study this through eye tracking and through models drawn from disease mapping, which look for clusters of diseases. There is a lot of scattered literature about how we can do this kind of boundary definition or edge detection, and we're just now starting to apply that to the grocery store.

Moe: I'm trying to refine the model for a virtual salesperson, as we discussed, and also looking at the role of online reviews. There is a lot of research that shows reviews have a significant impact on sales. If you have more positive reviews, or even just a higher volume, you get more sales. But the process of posting is something that we don't understand very well, and lots of managers and marketers and some researchers have speculated that there are biases in those reviews. Posted reviews tend to present more extreme views, so they don't really reflect the true quality of the product. I'm trying to separate the effect of that bias from the effect of true product quality. The purpose of doing that is that some marketers have started to seed some of these chat rooms and product reviews with their own comments to try and get the ball rolling. So the question is: Do these fake marketing posts have the same effect as an organic consumer-posted review?

Endnotes

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8
Multicultural Retailing: *An Interview with Emil Morales, Executive Vice President of TNS Multicultural*

In addition to new technology that is changing retail, shoppers themselves are changing, with shifting demographics and the rise of multicultural retailing. This century is seeing dramatic shifts of population, and retailers are only just beginning to wake up to the changes they need to make to capitalize on these changes. In this interview, Emil Morales, executive vice president of the TNS Multicultural practice and general manager of their Centers of Excellence, explores this changing landscape, with a particular emphasis on the Hispanic population in the U.S. as an example of the global challenges of multicultural retailing. As he points out, many of these shoppers are coming from traditions of shopping at very small local stores, where clerks take a very active approach. Retailers need to take an active approach to meeting this segment, particularly with the added barriers of language and culture. Similar changes are occurring whether the multicultural customer is a Middle Eastern Muslim who has transplanted to Europe, a Hispanic immigrant in the United States, or a rural Chinese moving to one of the great cities of China. Morales examines how retailers need to change their thinking, product offerings, and store designs to reach this growing market.

This book looks at how retailers need to move toward active retailing by anticipating and responding to shoppers' needs. What does active retailing mean in the context of multicultural marketing?

Morales: First and foremost, you must understand the cultural norms, values, and needs of these consumers. Moreover, it is essential to know their geographic concentration and key demographics to provide the right products and services via the proper channels. Most new arrivals from developing countries are moving from a "service" retailing experience in small shops to one of self-service, which can be very impersonal. The developing world is characterized by neighborhood shops, where proprietors are hands-on and active in a very personal way. Rather than being educated about products and services by their local grocer, they are now required to learn in a physical environment, as well as a language and cultural setting, which is unfamiliar and even intimidating. This certainly slows progress for the retailer, manufacturer, and consumer. This means immigrants from developing countries may expect more active approaches, enabled by both new technology, such as smart carts and old tried-and-true methods that respond to their needs.

What are some of the challenges facing the multicultural shopper that retailers need to be aware of?

Morales: For those of you who have experienced foreign travel to a non-English speaking country, there inevitably comes a time when you need to make a purchase. You might be purchasing a power converter in an electric supply store in Paris, searching for a contact lens case in Amsterdam, or buying food items for a picnic lunch in Santorini. Needless to say, the experience creates feelings of both excitement and anxiety. In our daily lives, we rarely think about the shopping process. However, in a foreign country, the process takes on new meaning, as there are a number of steps to be considered. First, there is the language barrier. Even if you know what to call the item, you certainly will not pronounce it like a native, and you also need to express your search with more than a single word. Second, you need to figure out where to find the item, as you have likely discovered that where items are sold conforms to the norms of each country. Of course, figuring this out requires still more linguistic challenges. Once you know where it is sold, if you are lucky, you can simply walk there. If not, you need to deal with the logistics of travel to your destination. And then finally, you have to work through the actual cost in the local currency, especially if you cannot see the numerals on a display at the point of sale.

I count myself fortunate in having had such experiences, but it is also invaluable in helping to place myself in the shoes of the multicultural shopper. Although my struggles were temporary and also provided a sense of adventure and discovery, for those who have to maneuver the “stranger in a strange land” scenario every day with far more limited language and coping skills, it can be an exhausting and stressful experience. In fact, one only has to look at the number of American tourists who flock to a Starbucks in overseas locations to understand the importance of familiarity with the shopping process, as well as a product or brand. There is certainly an expectation that they will have what I want, they will understand me, and I will be in the company of like-minded individuals with whom I have something in common. It should come as no surprise that in the U.S., multicultural segments will behave the same way.

What is the significance of the Hispanic segment in U.S. markets?

Morales: Without question, one of the transformative events of the last several decades has been the explosive growth of the U.S. Hispanic population. Not only due to the sheer numbers, but most important, because it has caused an intense examination within the U.S. of our future national identity. Although Hispanics are often highlighted, the rapid growth of the U.S. Asian population and the emergence of a strong African-American demographic, as was evidenced in the recent presidential election, have a huge impact on U.S. society. The demographic shifts taking place are powerful and inexorable. By 2050, approximately 225 million people in the U.S. will be part of a multicultural segment. We’re talking about almost a quarter of a billion people. It’s a number that many marketers and retailers have yet to grasp. In fact, if you could convince these 225 million people to give you a dollar a day for a year, your total would be over $82 billion. Surely, a number like that will get retailers’ attention. As shown in Table 8.1, according to the 2008 U.S. census, there are currently more than 46 million Hispanics in the U.S., about 15 percent of the population. The population is growing very rapidly. By 2050, Hispanics are expected to account for 30 percent of the U.S. population.

Table 8.1 Characteristics of the U.S. Hispanic Population

Figures	Facts
27.6	Average age versus 36.6 for total U.S. population.
46.7 million	Hispanics in the U.S. = 15.1% of U.S. population.
184%	Rate of growth: U.S. Hispanics estimated to hit 132.8M by 2050.
1.8%	Rate of growth: U.S. non-Hispanic white population to hit 199.8M by 2050.
30%	Overall Hispanic share of U.S. population by 2050.
40%	Current share of U.S. Hispanics who are foreign born.

Source: U.S. Census 2008

What makes this segment attractive to retailers and manufacturers?

Morales: By any measure, the U.S. Hispanic segment would qualify for serious investigation or investment. The Selig Center for Economic Growth in Georgia estimates that U.S. Hispanic buying power will reach $1.2 trillion by 2011. This figure exceeds by far the Gross Domestic Product of Mexico. McKinsey & Company, in their top trends published in 2006, stated that by 2015, the U.S. Hispanic population will have spending power equivalent to 60 percent of all Chinese consumers. These are large numbers and have already drawn the attention of retailers and manufacturers from across the globe, in particular those from Spanish-speaking countries, looking to leverage their brand equities in the U.S. It has also drawn interest in the investment community from companies such as Goldman Sachs, which has set aside $50 million to fund companies focused on marketing to fast-growing multicultural segments.

How can manufacturers and retailers seize this opportunity?

Morales: Serving the needs of U.S. Hispanics is not a simple task. Although all consumers have certain unique features of which retailers need to take note, U.S. Hispanics present their own set of challenges. For example, our research shows that close to two-thirds of U.S. Hispanics are either Spanish-dominant or Spanish-preferred. This translates into varying degrees of comfort not only with the written and spoken word, but also with entering environments where they may feel ill at ease. As we discussed, understanding cultural norms and creating welcoming environments are central to attracting and retaining these consumers. Their cultural norms dictate what they seek not only in terms of products, but also from retail environments. Figure 8.1 shows data from the most recent TNS Shopper 360 syndicated report. As you can see, U.S. Hispanics tend to shop many channels versus their non-Hispanic counterparts.

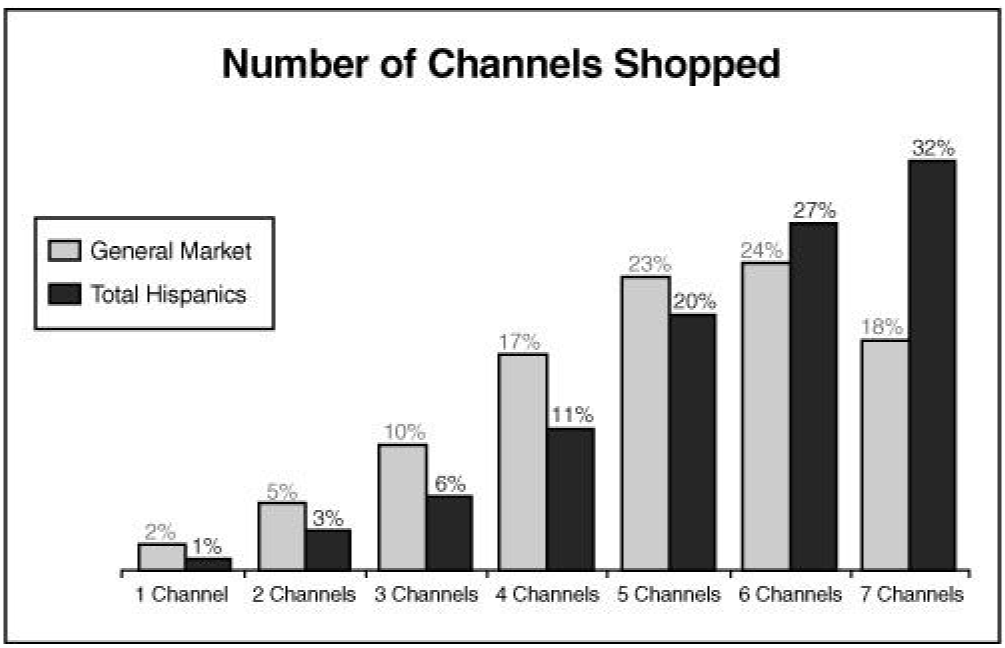

Figure 8.1 Channel use

Why do Hispanic customers shop so many channels?

Morales: This is due in part to the exploratory nature of their shopping behavior. You need to keep in mind that as many as 60 percent of U.S. Hispanics are foreign born and, therefore, are unfamiliar with the concept of so many channels. Approximately 65 percent of U.S. Hispanics come from Mexico and from many rural areas. Essentially, their exposure to channels was quite limited. As a result, they are often eager to learn what channels are available to them in the U.S. and what benefit each one offers.

Shoppers with limited exposure to U.S. culture are most likely to settle in communities where their language is still spoken and where many of the elements of their culture remain familiar to them. They might frequent local bodegas, or in the case of Mexicans, tienditas—small neighborhood stores. As their needs for more sophisticated products and services emerge, they will likely travel with a trusted friend or family member to a larger outlet—a supermercado (supermarket). There will likely still be people there who speak Spanish, the store will have the right cuts of meats and familiar brands—but there will be more of them. The environment will still be comfortable, however. Once they begin this process, it's not long before they move on to supercenters, club stores, and mass merchandise outlets, malls, and beyond. This is all a part of their enculturation into shopping in the U.S. However, getting them to visit and getting them to buy and remain loyal to the channel is not the same thing.

Trust is critical. The top reason given for store selection by U.S. Hispanic customers in the TNS Hispanic Shopper 360 study was "It is a store I can trust." In contrast, in the general market, the top reason cited was "could get to this store quickly." Clearly, the issue of trust is still central for Hispanic consumers. It's not too hard to think about why this might be the case. We all want to feel welcome and comfortable in our environment. We also want to know that if something goes wrong, we will be understood and treated with fairness. What these data seem to imply is that there is still room to improve in communicating a sense of trust to these Hispanic consumers. After all, we know that smaller bodegas and tienditas tend to charge higher prices and have less selection than larger-format stores, yet Hispanics still shop there. We know that the feeling of trust and comfort is important because they are willing to pay more for that comfort along with the convenience.

Given the popularity of tienditas and other small stores, do U.S. Hispanic shoppers have any interest in larger stores?

Morales: From our Hispanic Shopper 360 data, we know that U.S. Hispanics find mass merchandise, drug, convenience, and club stores attractive. We also found that supercenters in markets in Texas and Miami are visited frequently by Hispanic shoppers. There's a lot to discover, and concepts such as everyday low pricing (EDLP) are attractive, particularly for those with large families. However, once they are in the store, they need to be able to find what they're looking for and be assured that it's the right product for the job. Because U.S. Hispanics have a lower median income than the overall U.S. population, they cannot afford to make product mistakes. This means the power of known and trusted brands can be a powerful guide in their decision making. However, this does not mean they are not open to other brands, which is why it's essential that investment in building and maintaining brand awareness takes place.

At some point in their acculturation process, they absolutely move to the next level. They will visit a Wal-Mart, a Food 4 Less, or a Target, one of the superstores that doesn't just stock grocery items. That's when difficulties may arise. From a friendly and comforting environment, these new shoppers find themselves in a store with potentially limited recognition of Hispanic consumers as a distinct group. For example, the service staff might not speak the language. The signage and often the packaging will be only in English and they might have difficulty in locating someone who looks like them to ask for advice. The store selection may have limited appeal. As the difficulties mount up, these shoppers end up frustrated by their experience.

None of these obstacles is insurmountable individually, but taken as a whole, they can be formidable. One solution can be to take along someone who speaks English, which is why you often see Hispanics shopping together in groups, but this is not always practical. Retailers can further disrupt the process if they suddenly change the mapping of a store without apparent guidance. In one focus group session, a woman spoke about how she used to frequent Costco and seemed happy with her shopping experience. One day, they changed the location of items she had been familiar with, and she could not find a Hispanic to explain where the items had been moved. As she did not want to feel embarrassed given her English proficiency, she left the store, never to return. She now shops at a store with more visible Hispanic workers to avoid a similar situation. Costco never knew they lost her, or why.

How does this use of many channels affect the way Hispanic shoppers plan to shop?

Morales: You've already talked about how U.S. shoppers in general rarely plan their shopping trips. If anything, this is more of an issue for Hispanics. They shop more frequently than the norm, using the store as a pantry and, therefore, don't see the need to make lists.

In our survey, only 36 percent made and brought shopping lists to the store. Many had a specific brand in mind when they went shopping. So what influences their product choices? There's a lot more word-of-mouth referral for products because that's one of the greatest sources of information, particularly if you're struggling with the language. Store circulars, meanwhile, play a very important role in the shopping process for grocery, drug, and even department stores. About a quarter looked at the store circular. This is a consumer segment that does not do online comparisons as such very often. Instead, they rely on printed material.

One area that has, to date, been under-exploited by retailers is coupons. Currently, they are either not being directed as heavily to Spanish-speaking consumers due to distribution challenges, or go unused due to Hispanics' unfamiliarity with the concept. Moreover, our most recent TNS Hispanic Shopper 360 data also shows that U.S. Hispanics are not major coupon users. In fact, they ranked "I redeem a lot of coupons" very near the bottom of a list of attributes, whereas their general market counterparts ranked this same attribute near the top quartile. Clearly, there are issues of education that would benefit retailer, manufacturer, and the consumer in this area. Sometimes, even if they want to use them or have them in their bag, they just forget—and then the coupons have expired. If this happens on a number of occasions, they get disenchanted with the whole process and will not re-attempt. An additional problem, for those with more limited language proficiency, is the very real fear that they hand a clerk the coupon and then start to receive questions about it. This causes them to stand out or be embarrassed if they have limited language proficiency. As we discussed, culturally, that's not something that they want to do.

In our recent Hispanic Shopper 360 data, we discovered that 65 percent of Hispanics were influenced by in-store offers. This was more than twice the impact of general-market shoppers. So, if coupons seem to have limited appeal, it would make sense to develop and invest in more tactical in-store efforts.

Retailers should also work with manufacturers and community-based organizations to sponsor classes on how to save money or be savvy shoppers that would include both frequent shopper card and coupon use. They could produce printed FAQs in both English and Spanish, which saves money and ensures many potential users.

How does the U.S. Hispanic market react to loyalty cards and other mechanisms to collect customer data?

Morales: We know that growth in many multiples is achieved by learning more about existing customers. The rise of Tesco in the UK, for instance, has been built on the back of the Tesco Clubcard, its loyalty card. In the U.S., however, targeting the Hispanic market in this way is likely to present problems. Loyalty cards are very under-represented in such ethnic groups because of a reluctance to provide personal data and information. The institutional trust that retailers have come to rely on just does not exist and creates a barrier for those who rely on loyalty cards as a tool. In their minds, Hispanics simply want to make their purchase at the best possible price and do not understand why they need to provide the retailer with their personal details to do so. In fact, I would not be surprised to see a similar point of view emerge across the board for shoppers in general, given privacy concerns.

This problem eases further up the acculturation curve, but for those who are new to a country—or who might have entered illegally—giving personal information is a no-go. Even Puerto Ricans, who are U.S. citizens from birth, may be reluctant to do so. Such populations are also likely to opt for unlisted phone numbers—behaviors that make it difficult for retailers to gather valuable data. To compound their problems, Hispanics may borrow cards or get someone else to buy for them—not altogether helpful for a retailer trying to identify patterns of buying behavior. To some extent, this reflects a deep-seated cultural norm related to a sense of distrust of institutions.

How does culture drive shopping behavior?

Morales: Culture plays a critical role in the behavior of multicultural and, for that matter, all consumers. In their excellent book, *Hispanic Marketing*, published in 2005, Felipe Korzenny and Betty Ann Korzenny highlight how marketers need to understand culture to develop deeper emotional connections with Hispanic consumers. Of course, this link to deep cultural understanding applies to all consumers and not simply Hispanics.

In their work, they speak of culture as "the cluster of intangible and tangible aspects of life that groups of humans pass to each other from generation to generation."[1] They use an iceberg as a metaphor for culture, with two aspects: the "objective culture," which appears above the surface, and "subjective culture," which is hidden below the surface.

Foods, music, and clothing are examples of objective culture. In the U.S., the objective culture might include hot dogs and hamburgers, rock and roll, and jeans and t-shirts. For Caribbean Hispanics, these tangible external symbols of culture might include arroz con pollo, salsa, and Guayabera's. Although these external cultural elements are quite different, they are nonetheless highly acceptable and taken-for-granted norms within each culture.

You mentioned the second aspect of culture, subjective culture. How does this affect shopper

behavior?

Morales: The second aspect and by far the most important to marketers in my opinion is "subjective culture," a set of beliefs, values, and attitudes that influence how we interact with the world and how the world interacts with us. These aspects are deeply connected to emotions. This emotional connection is exactly where retailers, manufacturers, and all who want to connect with these consumers should focus their efforts. It's not simply that Hispanics tend to have larger families that is important, but rather that your place of business is seen as a welcoming and safe environment where families are welcome and supported with items such as temporary play areas for children, freeing mom to shop at ease.

This notion of connecting to the elements of shoppers' subjective cultural norms and supporting them with objective norms can prove to be a very powerful activator for retailers and marketers. If you have not yet undertaken an exercise to understand the deep emotional connections of your multicultural consumers, it should be a top priority. We will discuss examples later where cultural differences rise to the surface, enabling you to develop products or messaging that appeal to emotional connections.

It is, therefore, essential that before you undertake any serious effort to appeal to multicultural consumers that you truly understand their deeply held beliefs, attitudes, and values. These should guide your development processes whether they are centered on store environment, product development, or advertising and promotion.

In understanding cultures, remember that cultures are not monolithic and will vary even within groups by country of origin. Subjective culture gets to the emotional connection that drives deeply rooted psychological needs. Focus time on deep understanding of beliefs, attitudes, and values of each culture of interest. Then, use these learnings as a touchstone to make investment decisions and guide action.

How does the process of acculturation unfold and what do retailers need to know about it?

Morales: *Acculturation* is the process by which we measure how one culture has adopted the mainstream behaviors of the dominant culture. In the past, it seemed inevitable that people gradually lost touch with their original culture when they put down roots in a new country. However, with significant changes in the thinking about race and ethnicity for many portions of American society, immigrants are no longer forced to adopt the dominant culture. In addition, it is easier than ever before to retain links to homelands. The ability to access print, television, radio, and online media from their country of origin (or at least in their native language) makes it easier to stay connected to their native culture. Our studies found that bilingual Hispanics watched an average of about 3 hours of Spanish television a week (and about 17 hours of English language TV), whereas Spanish-dominant immigrants watched more than 15 hours of Spanish language television (and about 8 hours of English). The presence of large and vibrant support communities also slows the pace of acculturation. Newcomers can subsist quite nicely within relatively small or self-contained communities, continuing to shop at places where they feel comfortable and are welcome. These links may eventually weaken from the first, to the second, and the third generation, but it is a slow and gradual process. My post-election belief is that with an even stronger recognition among these groups, you can have both tight links to your culture and success in America. President Barack Obama is proof positive.

Given the close family relationships in Hispanic culture, how do retailers need to respond?

Morales: Smart retailers latch on to the fact that a welcoming family environment is key. Hispanic Americans tend to shop as families or as groups, and there are often children in tow because the family size/structure is much larger than the median for the U.S. Retailers such as H.E Butt, with its “kid-friendly” zones, have been hailed as a success in marketing to the Hispanic consumer. They have created a tortilleria area, a great concept and very much central to the culture, where they make approximately 10,000 fresh tortillas a day. Bashas, a chain with an Arizona focus, has also had success with the same type of format. It cares for 6,000+ kids a week at its Cub House while parents shop. All of this contributed to H.E Butt being named "Retailer of the Year" a few years back by Progressive Grocer. Wal-Mart has also been moving in this direction, particularly in Texas, and has even added a Central American chain, Pollo Campero, in some of its stores. It makes it easy to spend lots of time in their stores.

What issues of product selection or packaging do retailers and manufacturers need to address for this segment?

Morales: Planning for a shop can present problems for shoppers who are used to products in one shape or form in their country of origin, yet which have undergone a radical transformation in their new home. They may be familiar with soap and body gel in bar form, for instance, which is now viewed as outdated. Or they may be used to buying laundry powder, when in the U.S., it's the liquid version that is the most popular, for example. They may even be used to seeing much larger packages, instead of more concentrated products in small packages, largely prompted by environmental concerns. So, there are obvious opportunities for retailers and producers to make sure that they're communicating about form, use, and benefits adequately to this population.

There are also product genres that Hispanic shoppers are more likely to avoid, such as frozen food or packaged foods in a box that require microwaving. The culture is still such that it often demands homemade food as it's still essential to mom's pride to care for her family appropriately, and pressure comes from both family and peers. Cooking a meal for your kids shows your love for your family. Hispanic moms are willing to take shortcuts, but only if quality and flavor are not compromised—as with chopped tomatoes for salsa, for example. We know that these barriers start to diminish, however, based on the need of "new" Hispanic moms for convenience and kids' "pester power" and with the length of time in the U.S.

How are companies winning with U.S. Hispanic consumers?

Morales: The companies that have maintained sustained efforts and investment in marketing to immigrant populations are now reaping the benefits. Companies such as Procter & Gamble, for instance, and brands such as Colgate—which is strong in Latin America—have done well. Kraft is another example, as is Heineken, which has seen great growth of late, and McDonald's in the U.S.

The winners win because they have a strategy, stay the course, and invest in their communities. They focus on building awareness, which we have already identified as central to success with this group. Those who invest in building awareness also invest in their various communities through community events, sports sponsorship, music or arts events, and the like. Some have created cookbooks that are Hispanic-themed. Others, such as AT&T on the wireless side, have converted all their stores in Spanish-language areas so that they have a high Spanish-speaking quotient of employees, materials, and advertising. They recognize the importance of "localization" and invest in all areas that are necessary to generate success, applying established marketing principles to these groups, but they do it step by step.

How successful have manufacturers and retailers been in responding to the opportunity of the U.S. Hispanic market segment?

Morales: The Hispanic population has been growing apace, yet retailers woke up relatively late to the potential. It is only now, when the mainstream U.S. population is experiencing virtually as many deaths as births, that they are gearing up for change. In fact, it is manufacturers who are at the forefront—companies such as Procter & Gamble, J&J, Unilever, ConAgra, and so on—who have been very aware of the shifting demographics and are asking retailers what they intend to do to be more welcoming to these consumers. Now there is a dialogue between the two so that they can both benefit. They have in troduced new products that leverage the brand at lower price points. This represents both good business and cultural sensitivity for the early movers.

Different retailers and manufacturers are at different stages in the process, however. Some are more aware than others, and many are putting off investment in this area from one year to the next. In some U.S. cities, meanwhile, traditional grocery stores have been losing out due to Hispanics taking their wallets to dollar stores, and have, therefore, had to adapt. A store like 99, in southern California, which is a supermarket with aisles and aisles of everything from housewares to laundry to food and refrigerated produce—all for $0.99—is a definite incentive for change.

Such change requires investment, though, and not just in store design and signage, but also in providing well-trained individuals who can communicate with shoppers in their language of choice. In fact, hiring, training, and retaining bilingual employees who possess the needed levels of proficiency and customer skills is proving to be a real challenge for many retailers. Providing the right experience for a trust-based consumer is very reliant on this high-touch quotient, and you need to find and retain the right people to achieve success.

Can you give an example of how a retailer or manufacturer has used an understanding of multicultural marketing and U.S. Hispanic markets to build its business?

Morales: La Curacao, a Los Angeles-based department store, is often cited as an example of a retailer that's been very successful in appealing to the Hispanic shopper. Credit is seen as the cornerstone of its success, with the chain catering its credit and other services specifically to the needs of Latino immigrants. It is said to approve 75 percent of credit card applications, whatever the status of applicants, by using unconventional and confidential credit-scoring methods and interviewing techniques.

These cardholders then account for the vast majority of the chain's sales, many of which are consumer electronics, appliances, and furniture. And the card's rate of interest, though higher than some general-market retailers, proved lower than others—a factor that stirred up the market somewhat. It sparked discussions as to what rates should be charged to people who have less knowledge and proficiency in the market than traditional consumers. Nevertheless, all of a sudden, other retailers came under pressure to develop plans focused on the Hispanic marketplace in the U.S.

Another reason for its success is that it has more salespeople per customer than its competitors, although this can impact pricing. High service standards are another factor. As for the store design, it is colorful with Mayan and Aztec architecture and décor, plus it features Spanish-language signs.

Although the chain reflects an astute understanding of the market, it was not founded by Hispanic immigrants. The founders were two brothers who immigrated from Israel in 1997, Jerry and Ron Azarkman. They understood the immigrant experience and built a store to meet the needs of a very different group of immigrants.

You've focused on Hispanic markets in the U.S. How do these insights apply to other markets?

Morales: The learnings are relevant to other countries, and wherever immigration and acculturation is a significant market reality. I recently spoke at a conference in Toronto on "The Changing Face of Shoppers." After the conference, a Middle Eastern banker who now lives in Toronto approached me. He first thanked me for speaking openly about the opportunity multicultural markets represent, which is not widely discussed. He then went on to tell me how Maple Lodge Farms, the largest chicken-processing company in Canada, had focused on the unmet needs of the Muslim community for Halal-certified foods, which are prepared according to strict Muslim religious requirements. These foods were met with great success by the Muslim community in Canada and elsewhere. On their website, you'll find a separate link with great information on the company, process, and its branded Zabiha Halal foods. This is proof positive that if marketers invest the time to understand multicultural consumers' needs, they can profit handsomely by owning the category and establishing a reason to believe from which to introduce new products.

Sometimes the shifts are within the country. China's economic growth, for example, has gone hand in hand with the rapid emergence of a new breed of consumers there: an urban middle class, increasingly sophisticated, with retailers at the sharp end of demands for higher-quality goods and services, variety, and innovation. Yet this retail revolution would not be enough to guarantee inclusion in this chapter. What makes the difference is that there has been an unprecedented migration from rural areas to the cities, which has grown the size of the second- and third-tier urban retail markets. In addition to higher disposable incomes, there has been a trend toward greater ownership of refrigerators (meaning a daily shop is no longer required) and changing lifestyles (working mothers). As for the retailer, local protectionism may well decrease the efficiency of distribution and supply chains, leading to fewer choices or higher prices for consumers.

Still, since China's accession to the World Trade Organization, there has been massive deregulation of the retail and distribution sectors and growth. More than 35 of the top global retailers are now in China. With domestic companies, they are catering to this new rush of consumers to the city. This is a multicultural shift within a single country.[2]

In closing, what would be your top tips for retailers and manufacturers who seek to address multicultural shoppers?

Morales: There are many approaches and subtleties to addressing this market, as we've discussed, but some of the core principles to focus on are the following:

- **Create a comfortable and welcoming shopping environment:** Hispanic shoppers spend more time in stores, often shopping with family, and see the shopping process as entertainment. Comfort is a priority and can be valued over convenience. This can be seen in the ease of shopping (wide aisles, translated signage), kids' play areas, in-store dining options, or even customer service (where warmth and friendliness are key).

- **Understand where these consumers come from:** Learn what experiences they were used to in their countries of origin and what their current values are today to understand the familiarity they seek and how to reach them in a culturally relevant way.
- **Recognize that Hispanic moms want to be smart shoppers:** Give them the opportunity to make smart decisions by providing good value and high-quality products.
- **Cater to the entire family:** Shopping can be a family activity, with children sometimes doing the translating for parents who are less fluent. Provide an environment where all members of the family can shop and enjoy themselves.
- **Go the whole way:** Ensure that multicultural efforts resonate by committing to them entirely. Make sure the customer has cultural/in-language support throughout the shopping process and reinforce the commitment with equally relevant marketing and PR efforts.
- **Make education a priority:** These consumers often are unfamiliar with brands or even entire product categories. Make sure to give the explanation of how products work and ideas on ways to use them. In terms of in-store policies (returns, exchanges, loyalty cards, and so on), explain how they work to create a greater sense of trust and comfort. Remember that multicultural shoppers might be uncomfortable about embarrassing themselves by asking.
- **Develop a holistic multicultural marketing strategy:** If you already have a strategy, check to be sure it's still relevant and delivering on its promise. If it's off target, spend the time to find out why and how to get it back on track.
- **Don't fear in-language communications:** Research shows that the vast majority of consumers don't care if your communications and packaging are in two languages. It is becoming a "taken for granted." Also bear in mind that if it works for today's market leaders, it should also work for you.

- **Get out there:** Don't simply rely on reports or the occasional focus groups (although they are both useful). Go out and meet with a few of the more than 46 million U.S. Hispanic shoppers (or African-American or Asian shoppers). It will absolutely change your thinking about the potential of these markets for your business.

Endnotes

1. Korzenny, Felipe and Korzenny, Betty Ann. *Hispanic Marketing: A Cultural Perspective*. Elsevier Butterworth-Heinemann, Oxford, UK. 2005.
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9
Insights into Action: A Retailer Responds: *An Interview with Mark Heckman of Marsh Supermarkets*

The research and insights of this book were tested in the crucible of the supermarket aisle, but we turn now to an experienced retailer to reflect more deeply on how these approaches can be put into action. In this closing interview, Mark Heckman, vice president of marketing of Marsh Supermarkets, discusses how he took the insights of the book into the trenches of retail. Marsh, which was the first grocery store in the world to use electronic scanners to ring up purchases, operates more than 100 supermarkets in Indiana and Ohio.

What are the most important things to keep in mind when implementing changes in the retail format, such as those described in this book?

Heckman: It's a "walk, don't run" environment. Pick out a couple of things to try. For most retailers, it isn't going to be a revolutionary process. It's going to be an evolutionary process. We try to get some small wins at first. We try to keep a few simple things in mind when we design these stores. You need to keep the front ends open and free; you need to make sure that there are a lot of different options for shoppers to diffuse themselves throughout the store. Design a right-hand store whenever you can, as opposed to a left-hand store. Make sure the displays in the aisles are facing toward the rear because most of the traffic is coming from the back to the front. In one store, we removed a "stock-up" center aisle that created a barrier to the center of the store. By taking out this obstacle, we improved the flow of shoppers into the center.

Pay attention to operations. We try to keep our layouts pretty clean; we don't junk them up with shippers and other kinds of displays that an awful lot of retailers do. I think when you talk about the way a store is laid out with its permanent fixtures, its gondolas and its end caps, and its departments, sometimes a very clean and workable layout can be rendered totally useless by poor operations clogging up aisles.

It's amazing to me that after we built a few new stores based on these concepts, I'm starting to see people using these principles as conventional knowledge. It doesn't have to be revolutionary changes. It can just be: Use these basic principles and just prove to yourself that they work because they will. You are not going to turn the world upside down overnight. You are looking for incremental advantages.

What have been the results in the stores you've redesigned?

Heckman: These stores have achieved double-digit sales increases. We have seen increased penetration of private label and center of store categories, and increased overall basket size. The stores have also done well on qualitative measures. Customer satisfaction and intent to return have both increased. At the same time, the exposure of pallet drops and end caps have sustained our low-price image.

How are retailers beginning to implement new designs, such as serpentine or inverted perimeter approaches (discussed in Chapter 3)?

Heckman: Some supermarkets are trying to invert their stores a bit to get more activity into the center of the store, to populate some of those categories that aren't getting as much attention as they used to. In some cases, this is because fewer people are buying those categories, because of consumer trends. In most cases, there are so many other kinds of retailers selling those categories that the supermarkets do not dominate those categories the way they used to. I would also tell you that trying to classify formats gets tied very neatly into different kinds of retailers that are available to the consumer. The retailer is starting to look at a supermarket differently or use it differently than before.

How do retailers decide whether to take new approaches?

Heckman: I think one of the things that are pushing stores to provide a little bit more of a quick, more convenient shop is the fact that they can't win at being the biggest. You can't be all things. I think retailers like Marsh and others have figured out that we shouldn't try to be the biggest. We should try to be the most convenient or the fastest or whatever that "-est" is. So, I think that's driving us to look at our stores a little differently because consumers are looking at us in a different light than they used to.

When you talk about the retailer that can pull off a serpentine store, I think it has to be a lot more unique and a lot more of a specialty orientation than other stores because it would only attract a shopper who is prepared to browse. That format would actually be conducive to success only for a shopper who can spend time to really sniff the roses, so to speak. I think it works at Stew Leonard's and Central Market because the shoppers have a more casual mindset when they come into those stores.

In my opinion, what supermarkets are doing is trying what works willy-nilly. You are going to get a lot more tweaking of what works than you are radical departures. What do you think?

Heckman: This is where it is important to have stores within stores—what you are calling the "compound store." If the compound store is successful, I think then the next question is: Where are these departments vis-à-vis each other, and what is the optimal layout of the departments? Then you almost have two sets of dynamics. You've got the overall positioning of the stores within a store and then what happens to the customers when they get in those stores within a store. How do they shop, and how is that different depending upon what the category is or where the store is or where that department is?

At Marsh, are you moving in the direction of an inverted store (as discussed in Chapter 3)?

Heckman: We have done some things of that nature. We have two stores that are called "circle stores." Essentially, we have inverted those stores in relationship to where the classic departments are in a perimeter-oriented store. We've taken most of the perishables and the *theater* of the store, and we've put it right front and center in the middle of the building. We then pushed all the aisle departments, the traditional center store departments, into perimeter shops, categorized by the function of that shop, such as household cleaning, frozen foods, meat, or dairy. Those kinds of things are in alcoves. The center of the store focuses on produce, international foods, the varieties, the organics, and those kinds of things. People really have an opportunity to see the specialty nature of that format, and that can be the draw. If they need to go into any of those perimeter departments, they know where to go because those are smartly called out. With that said, it took customers a long time to figure this out.

How do shoppers react to these new formats?

Heckman: It was such a radical departure from how they were shopping in any other supermarket, or any other Marsh store for that matter, it took time. Once they have gone through a three- or four-month period where they stay with you, they start to like it. As a matter of fact, our sales in those two stores have dramatically jumped up without really any improvement or any adjustment in the layout. It's just a matter of consumers getting comfortable. Customers that do shop those stores actually say they like it better because it helps them stay on task. Once customers learn the store, there is not only a lift, but also it actually becomes an exit barrier. Once they learn the store, they like the store, and it becomes a positive point of differentiation for them.

On the other hand, retailers want to promote that incremental shop, that incremental item in the basket. We haven't done a lot of detailed empirical work on this, but we have found out that our basket size is still fairly large because they're in areas that are conducive for large basket shopping. Our concern there is that we just don't get as much impulse shopping because we have compartmentalized things.

Those formats got quite a bit of press when they were first launched back in 2002 or 2003. We've decided not to build any more of those. First of all, we haven't been building a great many new stores, period. We've been upgrading and remodeling the ones we have. But we also felt that format was just too radical for folks to make the adjustment. We were just afraid that, because retailers need such an immediate return on their investment, we didn't have the time. If we were a Stew Leonard's or we even had the reputation of an HEB Central Market for specialty, we could probably get away with those kinds of formats.

Shoppers will hang in there to learn the new store formats?

Heckman: Exactly. And again one could weigh the merits of the fact that maybe they're not impulse buying as much as they would in other formats. But if it attracts customers, and it increases your customer count, perhaps you could drive your business without thinking you have to cross-merchandise these departments as heavily as we do in some of the other stores.

Are you comfortable with the idea that customers become shoppers only within the walls of the store?

Heckman: As long as you include what goes on in the vestibule. There's another initiative going on with the folks that manage all the things that happen on the other side of the checkout. They call it the "fifth wall." You've got four walls where they shop for groceries. Now there's a fifth wall where there's a place to get your DVDs, change your coins into cash, use an ATM, or those kinds of things. But clearly within the four walls, a consumer becomes a shopper; there's no dispute about that.

You've looked a lot at pre-shopping, which we have not considered in the book. How do people decide what store to shop at, and what kind of metrics do you look at outside the store?

Heckman: We do know how folks select stores, and that varies somewhat from big box formats to more traditional formats, all the way down to convenience stores. The dynamics change for each one of those kinds of stores. Consumers look for geographically convenient *rooftops*. In urban areas, there typically are three or four supermarkets for every three or four square miles just because there is a demand for that many. You try to put yourself in a "first right of refusal" position to as many conveniently located households as possible. The first right of refusal's very important in our business, and that means that you drive by us either coming from work, going to work, or coming from home to anywhere you go. You have to drive by us to get to somebody else. We feel like if we have first right of refusal to, say, 60 percent of the geographically convenient trade, then if we get our fair share of that—and our fair share is the lion's share—then that store has a chance to be successful. If you're not getting your fair share of that business, you're probably going to have a problem with that store because that means they're rejecting you, even though you're more convenient to them.

Now, convenience means a lot of different things. It can mean that I'm driving by you and it's only a mile from my house, where brand X is two miles from my house. Convenience also means that I can get into your shopping center easily. I can get in and out without spending an hour doing so. The parking lot is laid out well; it's safe, clean, and well lit at night. Upscale people tend to shop in upscale locations; they don't necessarily like to drive into areas that aren't on par with where they live. But more downscale or midscale shoppers don't mind shopping up. They're more likely to do that than the other way around.

Can you shed some light on what are the half dozen most important metrics you use?

Heckman: The most obvious ones are measurements of sales volume, but we also look at item count. Particularly in times of inflation, you want to make sure that your business isn't being driven by just inflation as opposed to items being purchased. So, we look at item counts and average unit price. We measure dollars per square foot and sales area per square foot to talk about how productive our stores are relative to how big they are. That's a metric that a lot of the industry uses to normalize production between chains. Nielsen certainly uses that metric a lot to extrapolate sales volumes. The other big number that most retailers look at is comparative store sales or same store sales year on year. We also look at overall gross margins and our bill out.

One measure we are using is how many seconds it takes for each store to generate a dollar of sales. They run anywhere from 30 seconds to 120 per dollar. What do you think about this measure?

Heckman: It would be a very useful measure if you could effect change and remeasure it to see if you are making headway.

Do you have your own shopper segmentation scheme at Marsh?

Heckman: We do segment our shoppers by their spending and frequency. We have a loyalty card, and we have identified loyal elites, infrequent and occasional shoppers, and a couple of other classifications. We don't have to infer. We can look at coupon usage or we can look at the percentage of sale items that populate a particular shopper's basket, and we can segment against that. If we are going to communicate to a couple of groups of shoppers, if one is going to be more price sensitive than the other, we'll communicate to those folks a little differently than we might communicate to another group. Brands take a different tack. They might want to talk to a retailer's best shoppers just because these shoppers are in the store more often and more likely to see the offer. Beyond that, they differentiate between loyalists and switchers. We also target life stages—college students, moms with kids, or senior citizens.

Retailers do not have a lot of time or a lot of firepower to devote to this. We don't have a team of horses to put on projects. I'd like to have a person who was dedicated to managing two or three customer segments. So, we do the best we can. With loyalty cards, the bar is now too high. If it's just about discounts, it's very difficult to engender loyalty through your card.

Are you doing something distinctly to serve quick trippers?

Heckman: We are. We certainly offer categories of products that are conducive for shoppers to come in, get their meals for that evening, and get out quickly. We do not have them consolidated in a quick-trip store within a store. Some retailers have gone to the point where you're walking into almost a convenience store inside their store. We do have convenience areas toward the front of the store, and that's particularly true in our larger stores. But they aren't necessarily positioned so that they're right next to the home meal replacement center or they're right next to categories of products that people tend to buy on short trips.

Is there a brand/retailer partnership?

Heckman: Brands have figured out that if they get a display in the store, almost any promotion they run with that retailer pays out because of the incremental lift they get from the exposure to display. It really goes right back to the principles that you've been preaching for a number of years that you have to get that conversion process.

Brands have got to reach the shopper. The preponderance of people stay on the perimeter of the store. If you can get a display in the store, and brands know this, they'll pay a premium for that, and they basically wrap up almost all of their promotions around the concept.

Retailers tend, almost to a fault, to let manufacturers dominate their stores with displays just because manufacturers have figured out that's what drives their sales, and so they're ready to pay the retailer almost real estate rental for different end caps. We have a number of different contracts throughout our store. If you walk through our store, you'll see fixed end caps and fixed displays, and the same thing holds true for almost any major retailer in the country. You see Wal-Mart doing it with various brands. Target's been doing it for years with brands of clothing. That kind of exposure gets the sales that brands need. I think there's been some progress made where retailers and brands have figured out a way to get along and to mutually benefit. But when it comes down to what the brands' ultimate objectives are and the retailers' ultimate objectives are, the brand wants to sell more of their own products, and the retailer wants to sell more of that category's product. It's only when those two objectives converge is when you have success.

A very progressive company did some research that showed shoppers don't like to put heavy things on top of light things. That was their total focus. But if shoppers pick up the product early on, then I've got nothing else to sell these folks in the store. What happens if folks don't shop the entire store; what happens to the efficiency of my displays if the category is presented early? They didn't think through any of that. They just kept it on a very singular train: "Shoppers told us this, so let's do it." There's so much more to it than that.

What shoppers tell us is sometimes a very poor source?

Heckman: They lie to you sometimes. They can't tell you, but they can show you.

I think shoppers would love to spend a lot more money in stores, but they can't figure out how to do it. I think there's a huge amount of unfulfilled shopping out there. What do you think?

Heckman: I do think that's true. I don't think a shopper has a conscious mindset that says: "I'll be disappointed if I don't spend a lot of money here." I think most shoppers are consciously thinking that they want to be able to save money. Even the most affluent folks like to save. But at the same time, if you offer them something, if they see something that strikes their fancy, it's a lot more fun. You never hear anybody get back from the store and say: "I went to the store today, and I bought everything on my list. Wow, was that fun!" They usually say: "I went to the store today, and I got everything on my list, but there were three things I didn't expect. They had salmon on sale or they had something that looked so good I had to have it." It's always about that incremental purchase, something that has invoked their sensory program, something they weren't expecting that made their shopping trip successful.

The clubs are successful because they do have the element of: What do you have today that you didn't have yesterday? Traditional retailers can do that as well with promotion and visual merchandising.

What are you doing with new technologies?

Heckman: We are doing text messaging, and we are certainly doing an awful lot online to help the shopper prepare for their trip from the website. We use text messaging to send them the top offers. As we evolve that program, eventually it will be customized offers. Shoppers are relying a lot more on online and electronic programs to help them prepare themselves so that once they get to the store, they can be as efficient as possible. Some programs, for example, help shoppers prepare their lists by putting the items in the order of how they'll encounter the products in the store. We're trying to do that, and we've had an awful lot of requests for that. Making the store shopable doesn't have to begin at the store. It can begin online by getting somebody to look at the ad online before they get to the store. We've set up a special website for a brand-new store where you can look at the store map and you can look at different photographs of the different displays in the areas of the store. You can get a feel of the store even before you walk in.

PART III
Conclusions

10
The Internet Goes Shopping

"To change and improve are two different things."

—German proverb

In Chapter 7, "Integrating Online and Offline Retailing," we discussed with Peter Fader and Wendy Moe the similarities between online and offline shopping behavior. We saw how insights from e-commerce can be applied in brick-and-mortar stores. But the online and offline worlds are converging in a more direct sense through new technologies for interacting with shoppers inside the store. While consumers have gone online to shop, now the Internet is coming into the physical shopping experience. Although we are still in the early stages of this evolution, neither world will ever be the same.

There is a long history of wanting to communicate with shoppers while they are shopping in brick-and-mortar stores, but the early efforts were rather crude. Retailers placed fixed advertising and communications around the store that was contextually sensitive—placing coupons on or near the product, or near a logically related product, for example. But the true goal has long been to communicate with a specific shopper in a particular location and change the message dynamically as the shopper moves through the store (even, perhaps, influencing the shopper's path). This would provide messages that are relevant to that shopper at a specific point in her trip in a specific store.

Entering the VideoCart Age

Online-offline retail fusion began with VideoCart and evolved to the present diverging approaches—a full cart system such as MediaCart with a large screen and Internet connection or a handheld device such as Modiv Media's. Let's take a quick look at this evolution.

VideoCart was developed in the early 1990s by marketing research company Information Resources, Inc. (IRI), which sells family grocery-buying statistics to clients such as Procter & Gamble and Nabisco. VideoCart, the world's first Internet business-to-consumer start-up, operated over 20,000 carts in more than 200 U.S. grocery and chain retailers by 1992. The carts had battery-operated mobile displays about the size of an Etch A Sketch™ mounted on their handles, connected to the company's servers through wireless LANs in stores. The interactive displays received completely new content via download every week, because prices change weekly in grocery stores, including sale items and coupons for that unique store (the same information as in the local newspaper's weekly food section). Each device was location-sensitive, displaying only the on-sale items in the shoppers' immediate vicinity, and changing as they went down the aisle or entered another department.

Other pilot sites for VideoCart included Wal-Mart and Toys-R-Us. The content, or weekly "show," included what may have been the first banner ads, with animation. Coupons and banner ads were similarly location-specific. The device had an ATM screen-with-buttons, the only public digital interface then in common use, which provided coupons at checkout. The Videocart devices also offered entertainment to shoppers in the checkout line.[1] The most advanced systems logged all shopping cart paths and could analyze and play back individual or aggregate paths through a store map. Ultimately, this tied the path data, time-of-day, and day-of-week to effectiveness of sales, coupons, or shelf-placement.

That effort was followed by the less successful ActivityPath, and later, Magellan by Safeway. Stop & Shop has been the most persistent retailer pressing this opportunity, first with Shopping Buddy, with a full-size interactive screen on the cart, which has evolved into a handheld device (Modiv Media). Modiv Media now is operating in more than 100 stores, so it has moved well beyond proof of concept to demonstrate the value of this approach. Building on VideoCart's success, MediaCart now offers a computerized shopping cart that assists shoppers, delivers targeted communications at the point of purchase, and streamlines store operations. The MediaCart system accurately anticipates and responds to shopping needs—letting shoppers download a shopping list from home, plot the quickest and easiest route around the store, locate products, check prices, and scan and bag their items seamlessly while shopping. The system uses passive RFID tracking of the cart through the store and WiFi radio signals to the store's central servers. Shoppers can press a button to ask where a product is and locate the best route there. When the product is selected, the shopper scans the barcode on the screen, and it is added to the total for the cart.

Cell Phone Invasion

So far, most of the tracking and interaction in stores requires specialized devices, either bulky "laptops" mounted on carts or handheld devices. But as iPhones and other powerful cell phones become more ubiquitous, they will play an increasingly important role in interacting with shoppers in the store. Phones already track their locations relative to cell towers and GPS systems. There are RFID reader chips going into cell phones that will permit location-specific communication with shoppers in the aisles of stores. This is not the same as VideoCart, Modiv Shopper, or MediaCart, but it could mean that consumers will carry their connection to retail stores in their own pockets.

Ten years from now, retailers will be communicating with shoppers on a regular basis as they walk around the store using some kind of electronic device, whether it's their cell phone, PDA, or equipment the retailer provides. All retailing will occur under this cloud of electronic communication. This will promote more active participation with the shopper, taking us closer to what I have called the Holy Grail of retailing:

- To know exactly what each shopper wants, or might buy, as they come through the front door
- To deliver that to them right away, accepting their cash quickly and speeding them on their way

The bottom line is that the Internet is moving into the store, which will fully blend online and offline retailing. Retailing itself will be altered to a great extent by this. The offline store will increasingly become a "big head" enterprise (think Stew Leonard's, HEB Central Market, and Tesco's

Fresh & Easy). But Chris Anderson's vision of the "long tail" will take on added relevance, as, for example, supermarkets learn to distinctly manage their center-of-store long tails versus their promotional big head stores.

The wired store may also enable the long tail to hang outside the four walls of the store. This is where Internet maestros like Tesco may sweep a few dinosaurs into the dustbin of history. However, all the largest players are already working both sides of the street (online/offline) and will eventually figure out that pushing 30,000 SKUs into shoppers' faces every time they show up in the "store," when they only buy 200 regularly, is killing their business. (I look at the $20 million of sales of a good supermarket as "death" compared to Stew Leonard's $100 million per store.)

The shifting relationship between the shopper and retailer is bound to further disturb their relationship with the third leg of this stool, the brand owners. Manufacturers and retailers will need to examine their relationship to see if their current systems for interacting, such as a trillion dollars in promotional fees, really serve shoppers well—or any of the three parties in this emerging world. Already these relationships are starting to change to meet the demands of a more shopper-centric world, where shoppers are king and queen. As King Louis discovered many years ago in France, it is hard to hold back such a tide of change. No matter what the current powers may think, these shoppers will not "eat cake"—unless they absolutely want to.

Implications for Retailers and Brand Owners

The primary message of our research for retailers is to *manage the big head and long tail* of in-store products more effectively. This will help you make better use of the 80 percent of shopper time that is wasted moving through the thousands of products in the store to get to the few hundred that shoppers actually purchase. There are many possible solutions, but retailers that don't know how to manage the big head and long tail will not be in business long. As noted previously, online retailing offers opportunities for many new and creative solutions to this challenge.

For brand owners, the key is to improve the *speed of closing*. Although the retailers may control how the shopper moves through the store, the manufacturer influences the speed of closing when the shopper is within striking distance of the product. In addition to packaging, in-store digital media can help to close the sale. If brand owners want to significantly increase their sales, they need to engage with the shopper in real-time conversation through digital media at the point where the purchase is made. This significantly speeds up seconds per dollar, which, as we've discussed, increases overall sales. Brands need to make relevant, timely offers and close the deal quickly.

The Power of Model Makers

New technologies not only create more opportunities to interact with shoppers but also are a rich source of new information to help us understand shopper behavior. As noted previously, smart shopping carts can track consumer pathways through the store and offer insights into their reactions to specific displays or promotions along the way. These are the kind of tools that we only dreamed about having a few decades ago. As we have found with scanners and online clickstreams, however, massive amounts of data do not necessarily lead to better insights. Wharton's Peter Fader has commented that much of the experimentation online is *atheoretical*. People manipulate pages and see what works, but don't use the results to inform a broader theory.

Even in an environment that is so rich in information and offers so many channels for potential interaction as the one emerging, there will be a need to understand shopper behavior. Given that humans are still at the center of this drama and their needs and behaviors are often resistant to the tug of new technology, our past insights into how shoppers behave, as described in this book, are likely to remain very relevant in this new era. It is encouraging to see the research discussed in Chapter 7 about the parallels between online and offline behavior, which shows that while there are important differences, shoppers are shoppers.

In fact, insights and theories about shopper behavior may be even more important in our high-tech environment. If you can interact with shoppers at every moment during their trip, and in many different ways, how do you interact in just the right way? This is similar to online advertising where it may be *possible* to bombard a visitor to a site with a barrage of popup ads —possible, but probably not desirable. A strategy for where and when and how to interact with shoppers becomes crucial. And a solid strategy rests on solid theory tested with empirical results. That is where good models come in.

The Model Business

Online or offline, models matter. The movie *The Flight of the Phoenix* tells the story of an airplane that crashes in the desert, in time of war. With enemies all around, the survivors have no way to fly their damaged plane. It appears that they will perish in the hot desert through exposure and lack of food and water. But, as chance would have it, among the survivors is an aircraft design engineer with many years experience. He suggests that they can make some fundamental changes in the remains of the plane, and this "new" plane can fly them out of their peril. At the last instant before their lifesaving flight, they learn that their aeronautical design engineer has spent his entire career *designing model airplanes*! He is a model maker. Yet they managed to take off and fly to safety.

I have also been a model maker, but am just as confident in the knowledge we have gained from this process. I am grateful to the many retailers and brands who placed their lives—or at least their livelihoods—into the hands of our researchers. The knowledge we have gained has helped them and others improve their stores and lift their sales.

This book is the distillation of nearly forty years of a scientist spending time in stores studying shoppers, with the last decade increasingly spent on understanding the relationship of those shoppers to the store and its management, on the one hand, and to the products and their brand suppliers on the other. During the sixteen years immediately preceding the sale of my own company to a global research and information business, we grew at an annualized rate of 30 percent. I don't need to brag, but you need to understand that I do have somewhat of a single-minded focus on growth.

A Fivefold Increase

As with the survivors of *The Phoenix*, attitude is everything. Attitude at retail is a factor given too little consideration, when a large share of achievement is attitude. The reason many people accomplish very little is that they set out to accomplish very little. Actually, people often *start out* with big ideas, but long before they are anywhere near achievement, they have really, totally forgotten what it was they were going to do.

This book has identified the principles that have allowed retailers to increase sales by a factor of five. These retailers understood better what was going on inside the black box of retail. This should be of interest to any retailer or brand owner. And if you fall short of a fivefold increase in sales, wouldn't you be impressed if you could double your sales? The opportunities are there, but you need the right insights and attitude to seize them.

Endnotes

1. http://www.dodsworth.com/videocart.html

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Game-Changing Retail: A Manifesto

In the months since completing the draft of this book, I have seen growing interest in the practical application of the findings reported here to the opportunities at retail. This manifesto is a distillation of critical action points that will lead to double-digit sales and profit increases, and which have actually led some retailers to achieve as much as *five times* more sales over the past many years.

The adage, "The good is the enemy of the great," is possibly nowhere more applicable than in retailing. With a global population nearing seven billion, the world demand for goods and services is swelling. The movement from developing societies (traditional retailing) to highly developed societies (modern retailing) continues apace. *Demand* alone has been the driving force behind *good* retailing, globally.

A striking feature of good retailing has been almost a single-minded focus on matching the right selection of merchandise to the customer base, with little or no regard to the *time* it costs shoppers to acquire the merchandise. Good retailers, with their suppliers' complicity, regularly squander (waste) 80 percent of the shopper's time. Great retailers will make productive use of that "lost" time.

A new movement in retailing will *change the global game*. The principles outlined next are listed roughly in terms of urgent priority for those who aspire to survive and thrive when their competition is not simply good, but *great*! In most cases, the advance is one of recognizing important distinctions, and responding appropriately, and distinctly, rather than leaving it to shoppers to sort it out for themselves. Although all of these principles are relevant to both retailers and their brand suppliers, the first five deserve the greatest attention by retailers, whereas the last five are most relevant to suppliers:

1. **Focus on the short trip.** For supermarkets around the world (the same principle applies to *all* classes of trade), half of all shopping trips result in the purchase of five or fewer items, with one being the most common. These short trips typically account for one-third of store sales. The *new strategy* is to increase the size of each of those baskets by one or two items. Quick trippers spend money *very* fast, and getting them to buy one or two more items is far easier than motivating stock-up shoppers to buy ten or twenty more items. This focus, focus, focus on the quick trip could deliver an easy 30 percent sales lift (and a lot more when the synergies with other types of trips become apparent).

2. **Focus on the "vital few" *items* that drive success.** Fewer than 1,000 items, and perhaps as few as 100 to 200, make the difference between good retailing and great retailing. Which ones are they? Just as the store transaction log tells how many items are in each shopper's basket (Focus 1), it also identifies the *exact* items. Dump all the baskets together, sort them by item (SKU, UPC, EAN, PLU, and so on), count each item, and rank them from the highest selling to the least sold. Your shoppers are voting every day for what they want to buy. Good retailers don't know (or don't care) about this, but great retailers do. Good retailers are obsessed about what they (and their suppliers) want to sell to shoppers. Great retailers are obsessed about what shoppers want to buy!

3. **Display the "vital few" (or the "big head") *along the dominant path your shoppers take*, rather than expecting them to find them.** Good retailers expect shoppers to find the merchandise they want; great retailers learn all they can about what the shoppers want, and *take it to them*! This, of course, presupposes some modicum of understanding of the shopper's dominant path. Good retailers are unsure; great retailers have this down pat. Points #2 and #3 are components of the new science of *item management*, a far-sharper instrument than the category management used by all good retailers. Point #3 distinguishes high-value real estate, within the store, from the rest.

4. **The most important promotion is place, *not* price.** In a typical store, probably 2 percent of the total items in the store at any one

time are being promoted on end-of-aisle displays or other secondary promotional displays. This 2 percent of items may constitute a full 30 percent of all the sales in the store. However, half the shoppers purchasing an item from one of these promotional displays are unaware that it is at a reduced price. Of the half who are aware, half of those really didn't care about the price. Good retailers are locked in a mindset that price considerations dominate shopping. Great retailers realize that there are other currencies that matter to shoppers in addition to money (time and angst). Great retailers focus on value and convenience: Convenience means fast, *fast*, FAST! Using less of the shopper's time will lead to *more* sales. Hence, Sorensen's primary principle of retail sales is *the faster you sell, the more you will sell*.

5. **Open space attracts!** Shoppers compete with products for space in the store. Good retailers might be oblivious to this competition, and freely tip the balance in favor of the products over the shoppers. Jamming the store with products leads to lots of narrow aisles ("aisleness") and psychic discomfort for shoppers. Great retailers refuse to sacrifice shopper space, and use wide promenades to lead *crowds* of shoppers through a speedy, efficient, high-dollar trip. The allocation of open space is of paramount importance in store design—and there is no single recipe for success.

The following five principles are more closely aligned with the concerns of brand suppliers:

6. **Balance the role of your store's vital few with the rest of your extensive line.** Keep offering the "long tail," but make it easier for the shopper to reach the "big head." Although the sales of the "other" 30,000+ items, the "long tail," do add up to significant sales and profits in aggregate, on an individual basis they are not terribly consequential in total sales. They play a far different and distinct role: Shoppers are attracted to the store by the long tail, but when they get there, they buy the big head (the vital few). The 50 million books Amazon carries encourages me to think they will probably have the few a month that I want. But they would be out of business (I think) if each time I came through their virtual door, they started from scratch to identify what I most likely want to buy. This is the challenge at *all* retail stores, whether online or offline: How to have a

huge product selection (very attractive to shoppers) without suppressing sales by burying the vital few in that massive selection? The key is *distinction*, so that the shopper can immediately reach and recognize the vital few.

7. **Paying to get your own vital few into favorable placement within the store makes sense, depending on the "reach" of the location.** To make a sale, you must reach the shopper with the product; then the product must stop shoppers; and then you close the sale. As noted in point #4, place is more important than price. In fact, charging cut prices at high-value promotional locations devalues both the real estate and the brand. *Selective* price promotion would be more appropriate for long tail items displayed in-aisle, and particularly for those items that are closest in sales rank to the vital few.

8. **Focus on the vital few within your brand, and that of your competition.** Some of your own vital few will not make it into the retailers' vital few. Just as retailers can more readily obtain double-digit sales increases for their vital few, so you can more easily turn your top few sellers into super performers than bring up the laggards. Again, long tail principles apply—the long tail attracts, and the vital few sells. Maintaining a reasonable long tail is essential for both attractive purposes, as well as the competitive imperative. Make clear distinctions in your planning and thinking on these issues.

9. **Reach you can buy, but stopping power and closing power are inherent to the product, primarily through the package.** Both stopping power and closing power can be measured for individual products, as well as categories. The significance is that some products are good at attracting attention, but poor at closing the sale, whereas others are good at closing, but can't seem to stop the traffic. Besides remedial package design, appropriate shelf management and promotional strategies can increase the stopping and closing power of existing products.

10. **Stores have massively excessive verbal communication. Products and packaging are a significant part of the clutter.** Using iconic images, colors, shapes, and appropriate emotional totems is a better way to connect to shoppers than more words. Using category

reinvention, you can upgrade the emotional feel of an entire aisle or department. The coffee aisle, for example, can be redesigned to give it a café ambiance. Remember, the goal is to make your winners win bigger. This will be more easily done with large displays that you can dominate—appropriate to your vital few. And now on the near and far horizon, digital media, even interactive, is a tool of greatest value to you as the brand owner. This means that you can win even in good retailers. Great retailers will expect and appreciate your cooperation with game-changed retailing!

These are just a few of the principles that can be extracted from the research that informs this book. Although these general principles hold across many retail settings and types of products, precise solutions need to be tailored to the specific context. Above all, *great* retailers and brand owners continue to experiment. They test to find out what works, and what doesn't, so they can continue to improve their strategies. This rigorous investigation and testing is how we arrived at the principles discussed previously. Good retailers and brand suppliers, on the other hand, stick with the tried-and-true conventional wisdom. But as the world changes through new technologies, consumer shifts, and new competitors, the great retailers and brand suppliers create the new conventional wisdom and tailor it precisely to their own situations. In that context, the preceding ten points represent an initial hypothesis for this process of ongoing experimentation.

PART IV
Appendix

Appendix
Views on the World of Shoppers, Retailers, and Brands

A pioneer of in-store research, the late Bob Stevens of Procter & Gamble offered a newsletter that he called “Views from the Hills of Kentucky,” where he provided perspectives on shopping. Inspired by Bob, I’ve recently started my own online column in the spirit of his messages, which I’ve called “Views” as a tribute to his earlier work. In this Appendix, I’ve selected two excerpts from his columns that remain highly relevant to understanding shopping to give you a taste of his work. I encourage you to visit our archive of his wonderful columns at http://www.tns-sorensen.com/views/archive/views/. To see my latest “Views” entries on our ongoing studies of in-store retailing, please see http://www.insidethemindoftheshopper.com/.

Excerpts from “Views from the Hills of Kentucky” by Robert Stevens

Testers Versus Users

When asked to test something, do you

- Look at and use it differently than when you just happen to be using the same item?
- See things that you would not normally see in the course of using the same product?
- Look more closely at the physical characteristics of the product?
- Look more closely at the packaging?
- Think performance features take on different meanings?

If you answered “Yes” to most, if not all, of the preceding, you are a typical user and tester. Research has found that when you ask a person to test something for you, they place it under the microscope. They see things that, in the course of normal usage, they would never see or even consider.

If the preceding is true, how is it that almost all research is conducted in the test environment? It would seem to me that we would have some interest in the user environment, especially if there is a substantial difference in the assessment under the two perspectives. We don’t, after all, sell to the world’s testers but to users. It is they who dictate a brand’s success or failure.

Actually, I like using both the tester and the user environment when assessing a brand’s potential. I generally prefer to use testers in the upstream research and, as I get closer to market, I use the user perspective.

I have found that very few companies use the latter when assessing a brand’s potential. Why? I think that few companies realize that two perspectives exist. Among those who do, many don’t use the users because few field services offer both options, and it is perceived to be difficult and expensive. I’ve never found that to be so, but it does, however, take organization and skill to execute properly.

I wonder how many really good ideas are killed in the testing phase because they are being scrutinized so closely, whereas, if the problem appeared in the market, it would never be considered or even seen.

I’m reminded of an experiment in researching the effects of a test protocol in the late 1960s. We were about to conduct a CLT recall of a laundry detergent test among 360 female heads-of-household.

We also had a hand dishwashing detergent study cancel. From the cancelled study, we had 240 blind samples of a current market product. We divided the returning laundry detergent users into two panels, odd- and even-numbered.

After the laundry detergent interview was completed, we asked the even-numbered panelists (120 of them) if they would like to participate in another test. Those who said “Yes” were given a bottle of the dishwashing detergent and were told we would call them in two weeks to conduct the interview.

For the odd-numbered panelists, we told them we had some leftover dishwashing detergent and did not want to send it back to the plant. If they wanted a bottle, they could have one.

After two weeks, both panels were called and interviewed. The results of the study showed dramatic differences in the responses between the odd- and even-numbered panels. Those who were asked to "test" the dishwashing detergent responded in much greater detail than those who were "given" a leftover sample.

Is there a right and wrong protocol? No. I believe there is a time and a place for both types of research. Both approaches bring valuable data to the table. It is important to know when to use each approach. I also expect that the difference between the two panels will be a function of the test product's quality, where excellent and poor products will show bigger differences between panels, while average products will result in smaller differences.

Assessment in Context

Here, I'll outline the results of four in-store packaging studies. The results of three of the studies indicated that the projects should move forward into the market, whereas conventional studies indicated that the projects should not move forward. The results of the fourth study indicated that the project should not move forward, whereas the conventional testing said the project should go forward. In all four cases, the management of the sponsoring companies followed the guidance from the in-store research.

Case Study #1: Package Outage Problem

A new process for making a product was about to be introduced into the market. The warehouse physical properties measurements of the product uncovered an unusual amount of outage (empty space above the product in the container). Quickly, consumer tests were conducted. The results concluded that in no way should this product go to the market. An in-store consumer test of the product was conducted, with the results indicating that the product was highly acceptable: Only one of the 700 consumers interviewed commented about the outage. The market introduction went forward as planned. The test market was a success.

Case Study #2: Package Design Research

A manufacturer wanted to improve the image of its liquid product. To do this, they were about to change both the bottle and the label. They were not changing the product. Conventional, mall intercept, consumer tests were conducted. The results indicated that the changes should not be made. When, however, the new bottle/label product was taken and placed on store shelves and the exact same interview used in the mall study was conducted, the results of the in-store interviews were dramatically different from the mall test. The package changes were well received in-store, and management went forward with the changes. The introduction of the new bottle/label was considered a success.

Case Study #3: Capital-Intensive Product Form Change

A radical form change was being considered for a cleaning product, and a conventional simulated test market (STM) was conducted. The results were neither encouraging nor discouraging. There was, however, a major capital expense involved in moving forward with this initiative. With these results, management could not justify the expense involved with the change. An in-store test was conducted, with the results being dramatically favorable. The project went forward, with product change setting a new standard for the category. Five years later, all major category participants had modified their brands to duplicate the change.

Case Study #4: Package Design Research

A major detergent manufacturer was about to make a major change in the bottle and label of a cleaning product. Conventional test methods encouraged the change. However, one skeptic in the company was holding out on the change, which was a dramatic departure from their current bottle and label. An in-store “shelf appearance test” was requested, using the very same interview used in the conventional testing. The results of the in-store study proved disastrous for the new bottle and label combination. Even before the results were tabulated, however, the initiative was canceled. The marketing research director was present at the testing and heard both the reactions of the shoppers and saw the shelf appearance of the brand. In the conventional testing, the brand was displayed with light on all sides of the bottle, giving it a “halo” appearance. On the store shelf, however, there was no backlighting. The result was a very poor appearance. As one respondent put it, “It looked like dirty motor oil.”

In consumer research, it pays to consider the possible physical and psychological biases involved in your test designs. My experience is that “Assessment in Context” leads to more successes and less financial risk.

Can you imagine trying to assess pricing structures of products sitting on a table in the back room of a mall? How typical is that of the natural environment? Maybe it is typical of research, but not of the consumer’s natural environment of product prices. How about testing the appearance of a container sitting on a table and not on a store shelf? It’s like testing a car’s driving comfort while sitting in it on the showroom floor.

For years, Sorensen Associates has been using real stores to test consumer products. Actually, 90+% of their studies are conducted in the retail environment. That’s why they are called the “In-Store Research Company.” While at Procter & Gamble, I was heavily involved in using the consumer’s home and the store environment as my laboratory. P&G was using homes before I ever came on board, and that was in 1951. I believe Dr. Smelser, the creator of the Market Research Department in 1923, used the consumer’s home as the base of all his research. In the 1970s, we started using real stores as focal points for assessing brand images, brand choices, package design, pricing, purchase motivation, brand rejection, and so on.

It’s called Assessment in Context. I think it is all about reliability and validity of the research.

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Introduction

The truth is, this book is about people like you. It concerns the products and services you buy and use and the ways these fit into your life. First, a bit of jargon: The field of *consumer behavior* is the study of the processes involved when individuals or groups select, purchase, use, or dispose of products, services, ideas, or experiences to satisfy needs and desires. Consumers take many forms, from an eight-year-old child begging her mother for a Webkinz stuffed animal to an executive in a large corporation deciding on a multimillion-dollar computer system. The items we "consume" can include anything from canned peas to a massage, democracy, Reggaeton music, or a celebrity like Lindsay Lohan.

In its early stages of development, researchers called the field *buyer behavior*, reflecting an emphasis on the interaction between consumers and producers at the time of purchase. Most marketers now recognize that consumer behavior is, in fact, an ongoing process; not merely what happens at the moment a consumer hands over money or a credit card and, in turn, receives some good or service. To build bonds with customers, you also need to have them in mind before they ever contemplate buying your product or service and after they've purchased from you. After all, there are lots of good salesmen who can, as the saying goes, sell ice to Eskimos —but probably not more than once.

Why should managers, advertisers, and other marketing professionals bother to learn about consumer behavior? Very simply, understanding consumer behavior is good business. The basic *marketing concept* states that firms exist to satisfy needs. These needs can only be satisfied to the extent that marketers understand the people or organizations who will use the products and services they are trying to sell so that they can meet these needs better than their competitors.

> Understanding consumer behavior is good business.

Consumer response is the ultimate test of whether a marketing strategy will succeed. Thus, knowledge about consumers should be incorporated into every facet of a successful marketing plan. Data about consumers helps organizations to define the market and identify threats and opportunities to a brand. And in the wild and wacky world of marketing, nothing is forever. This knowledge also helps to ensure that the product continues to appeal to its core market.

So, how do we figure out what customers want? There must be 50 ways….

Truth 1. Your customers want a relationship, not a one-night stand

Sony blew it. Big time. In 1979, a company engineer cobbled together a personal listening device at the request of a senior executive who wanted to listen to opera during transatlantic plane trips, and the Walkman was born. Although the company invented the mobile music experience and sold over 300 million Walkmans in the process, today's teens see portable cassette players as dinosaurs (assuming they've even heard of cassettes!).

Fast forward to a new century. Apple continues to innovate—but, more importantly, Jobs & Co. created a mystique around the iPod that makes it the epitome of coolness. So much for being first to market! It's not just the functionality of this MP3 player that has consumers packing Apple stores; people bond with Apple not because of what it *does* but because of what it *means*. This story is hardly unique: In virtually every product or service category, the brand that forges a relationship with its users is the one that commands their undying loyalty.

So, what about poor Sony? Of course, the firm has succeeded with many other innovative electronics products, so it's hard to shed any tears over its loss of dominance in the mobile music market. And, to its credit, its engineers haven't given up: As the Walkman craze faded, they conducted research to understand how teenagers actually used portable music players in their day-to-day lives. Eventually, they figured out that they needed to relaunch the product with a removable "Memory Stick" instead of a cassette player so that it works with MP3 files. In 2006, Sony integrated its noise-canceling technology into both the player and the headphones. Its ergonomically designed Walkman Bean MP3 player (which vaguely resembles a curled-up fetus) fits easily into your hand. In 2007, Sony extended the Video Walkman brand by launching its first digital, flash-based video Walkman, the NW-A800.

> People bond with Apple not because of what it does but because of what it means.

Despite these heroic efforts, the iPod continues to hold about three-fourths of the digital music player market that Sony once owned. Why? Apple understood from the start what Sony is just starting to get: Don't just focus on hardware enhancements. Build in an ongoing connection with customers by providing them with cutting-edge content to put onto their hardware. Apple's iTunes store accounts for about 70 percent of all online music sales.[1] And through creative advertising but also via aggressive world-of-mouth, cultivate a distinct and desirable "brand personality" that makes users eager to display their affiliation with your brand for all the world to see. That's why the Sony store is pleasant to visit, but the Apple store is *awesome*—and, for some, practically a religious experience. And that's why solid marketer-consumer relationships trump technical prowess every time.

> Solid marketer-consumer relationships trump technical prowess every time.

Truth 2. Design it, and they will come

As manufacturing costs go down and the amount of "stuff" that people accumulate goes up, consumers increasingly want to buy things that will provide thrills and chills in addition to simply doing what they're designed to do. A Dilbert comic strip poked fun at this trend when it featured a product designer who declared: "Quality is yesterday's news. Today we focus on the emotional impact of the product." Fun aside, the new focus on emotional experience is consistent with psychological research that finds that people prefer additional experiences to additional possessions as their incomes rise.

In this design-crazed market, form *is* function. Two young entrepreneurs named Adam Lowry and Eric Ryan discovered that basic truth when they quit their day jobs to develop a line of house-cleaning products they called Method. Cleaning products—what a yawn, right?

But, think again. For years, companies such as Procter & Gamble have plodded along, peddling boring boxes of soap powder to generations of housewives who suffered in silence, scrubbing and buffing, yearning for the daily respite of martini time. Lowry and Ryan gambled that they could offer an alternative—cleaners in exotic scents such as cucumber, lavender, and ylang-ylang that come in aesthetically pleasing bottles. The bet paid off. Within two years, the partners were cleaning up, taking in more than $2 million in revenue. Shortly thereafter, they hit it big when Target contracted to sell Method products in its stores.

In this design-crazed market, form *is* function.

There's a method to Target's madness. Design is no longer the province of upper-crust sophisticates who never got close enough to a cleaning product to be revolted by it. The red-hot store chain has helped to make designers such as Karim Rashid, Michael Graves, Philippe Starck, Todd Oldman, and Isaac Mizrahi household names. Mass-market consumers are thirsting for great design, and they're rewarding those companies that give it to them with their enthusiastic patronage and loyalty. From razor blades such as the Gillette Sensor, computers such as the Apple, and even the lowly trashcan, design *is* substance.

Even crotchety old P&G is starting to get the idea. Although it's a bit like turning a battleship, Procter & Gamble now recognizes the importance of integrating design into every product initiative. In the "good old days" (that is, a couple of years ago), design was basically an afterthought. Marketing meant appealing to customers in terms of efficiency rather than aesthetics. Now, its CEO wants P&G to focus on what he calls "the first moment of truth"—winning consumers in the store with packaging and displays. As a result, P&G now has a vice president (VP) of design, strategy, and innovation who reports directly to the CEO. Her philosophy sums it up: "Competitive advantage comes not just from patents, but also from incorporating design into products, much like Apple, Sony, or Dell." [2]

> Design is no longer the province of upper-crust sophisticates who never got close enough to a cleaning product to be revolted by it.

Truth 3. Sensory marketing—smells like profits

Odors can stir emotions or create a calming feeling. They can invoke memories or relieve stress. One study found that consumers who viewed ads for either flowers or chocolate and who also were exposed to flowery or chocolaty odors spent more time processing the product information and were more likely to try different alternatives within each product category.[3]

Many consumers are getting aggressive about controlling the odors in their environments. This olfactory vigilance has spawned a lot of new products since Glade marketed the first air freshener to suburban families in 1956. Today, younger people are at the forefront of scented air as they take advantage of plug-ins, fragrance fans, diffusers, and potpourri. Sensing a growing market, Procter & Gamble introduced Febreze air products in 2004 and appealed to twentysomethings by making air freshener products seem cool. Scentstories is a Febreze dispenser that P&G designed to look like a CD player, complete with "stop" and "play" buttons that radiate scents rather than music.

Some of our responses to scents result from early associations that call up good or bad feelings. That explains why businesses are exploring connections among smell, memory, and mood. Researchers for Folgers found that, for many people, the smell of coffee summons up childhood memories of their mothers cooking breakfast, so the aroma reminds them of home. The company turned this insight into a commercial in which a young man in an army uniform arrives home early one morning. He goes to the kitchen, opens a Folgers' package, and the aroma wafts upstairs. His mother opens her eyes, smiles, and exclaims, "He's home!"

> Some of our responses to scents result from early associations that call up good or bad feelings.

We process fragrance cues in the *limbic system*, the most primitive part of the brain and the place where we experience immediate emotions. One study even found that the scent of fresh cinnamon buns induced sexual arousal in a sample of male students![4] In another study, women sniffed T-shirts that men had worn for two days (wonder how much they paid them to do *that*?) and reported which ones they preferred. The women were most attracted to the odor of men who are genetically similar to themselves, though not too similar. The researchers claimed that the findings were evidence that we are "wired" to select compatible mates, but not those so alike as to cause inbreeding problems.[5]

As scientists continue to discover the powerful effects of smell on behavior, marketers are coming up with ingenious ways to exploit these connections. Ad companies spend about $80 million per year on scent marketing; the Scent Marketing Institute estimates that number will reach more than $500 million by 2016. Sensory marketing is taking interesting turns as manufacturers find new ways to put scents into products, including men's suits, lingerie, detergents, and aircraft cabins. Here are a few recent smelly strategies.

> As scientists continue to discover the powerful effects of smell on behavior, marketers are coming up with ingenious ways to exploit these connections.

- One hundred gas stations in California are trying technology that wafts a coffee aroma at the pump in a bid to tempt its pay-and-go customers into the store for a cup of Joe to go.
- Kraft Foods sponsored a special holiday issue of *People* magazine. Five of its ads in the issue allowed readers to rub a spot to experience the smell of a product being advertised, such as Chips Ahoy and Philadelphia Cream Cheese.
- Mars used scent technology to spread the aroma of chocolate around its M&M's World retail outlets, and it put Pedigree dog food-scented stickers in front of supermarkets and pet stores (presumably to attract hard-core pet lovers and their furry friends).

- A company called ScenAndrea that describes itself as a "multisensory communications" vendor is putting 8,000 scent-delivery systems called Smellavision in stores, including Kroger and Wal-Mart.
- In the summer of 2007, Kentucky Fried Chicken (KFC) launched its new $2.99 Deals in several office buildings by strategically placing a plate of chicken, a side item, and a biscuit in mail carts that pass out interoffice mail. A spokesperson notes that "Mailroom staffers were all fed first so that they would have the strength to deal with the employees clamoring for the KFC." Perhaps the next time you get a letter that's still soggy with gravy, you'll know why.[6]
- To promote the drama series *Cane*, which is set in South Florida where a Cuban-American family runs the Lucia Duque rum and sugar business, editions of *Rolling Stone* included Peel 'n Taste flavor strips that deliver the (nonalcoholic) taste of a fictional Lucia Duque Rum mojito cocktail.

These tactics smell profitable, but beware of stinking the place up in your zeal to reach jaded customers: The California Milk Processor Board (the "Got Milk?" people) had to remove cookie-scented advertisements at five San Francisco bus stops after several groups complained about the smell. The idea was to get passersby to think about cookies, which would then, naturally, lead to fantasies of milk to dip them in. Unfortunately, not everyone got the message; the campaign managed to offend anti-fragrance, anti-allergy, and anti-obesity groups simultaneously. Moo.

Truth 4. Pardon me, is that a breast in your Coke?

Most marketers lose sleep about creating messages that their customers will notice as they compete with all the other things vying for their limited attention. Ironically, a good number of consumers appear to believe that marketers design many advertising messages, so the consumers perceive them unconsciously, or below the threshold of recognition. Another word for threshold is *limen* (just remember "the secret of Sprite"), and we call stimuli that fall below the limen *subliminal*. *Subliminal perception* occurs when the stimulus is below the level of the consumer's awareness.

Subliminal perception is a topic that has captivated the public for more than 50 years, despite the fact that there is virtually no proof that this process has any effect on consumer behavior. A survey of American consumers found that almost two-thirds believe in the existence of subliminal advertising, and more than one-half are convinced that this technique can get them to buy things they do not really want.[7] Most recently, ABC rejected a Kentucky Fried Chicken (KFC) commercial that invited viewers to slowly replay the ad to find a secret message, citing the network's long-standing policy against subliminal advertising. KFC argued that the ad wasn't subliminal at all, because the company was telling viewers about the message and how to find it. The network wasn't convinced.

> A survey of American consumers found that almost two-thirds believe in the existence of subliminal advertising, and more than one-half are convinced that this technique can get them to buy things they do not really want.

Like this KFC ad, most examples of subliminal advertising that people have "discovered" over the years are not subliminal at all—on the contrary, the images are quite apparent. Remember, if you can see it or hear it, it's *not* subliminal; the stimulus is above the level of conscious awareness. Nonetheless, the continuing controversy about subliminal persuasion has been important in shaping the public's beliefs about advertisers' and marketers' abilities to manipulate consumers against their will.

If you believe all the hype, marketers are staying busy as they dream up new ways to send out subliminal messages on both visual and aural channels. *Embeds* are tiny figures they insert into magazine advertising by using high-speed photography or airbrushing. These hidden figures, usually of a sexual nature, supposedly exert strong but unconscious influences on innocent readers.

Does this appeal to latent lust actually work? Some limited evidence hints at the possibility that embeds can alter the moods of men who are exposed to sexually suggestive images presented subliminally, but the effect (if any) is very subtle—and may even work in the opposite direction by creating negative feelings among viewers. To date, the only real impact of this interest in hidden messages is to sell more copies of "exposés" written by a few authors and to make some consumers look a bit more closely at print ads—perhaps seeing whatever their imaginations lead them to see.

The possible effects of messages hidden on sound recordings also fascinate many consumers. We see one attempt to capitalize on subliminal auditory perception techniques in the growing market for self-help audios. These CDs and tapes, which typically feature the sounds of crashing waves or other natural sounds, supposedly contain subliminal messages to help listeners stop smoking, lose weight, gain confidence, and so on. Despite the rapid growth of this market, there is little evidence that subliminal stimuli transmitted on the auditory channel can bring about desired changes in behavior.

So, is this stuff worth the effort? Some research by clinical psychologists suggests that people can be influenced by subliminal messages under *very specific* conditions, though it is doubtful that these techniques would be of much use in most marketing contexts. Effective messages must be very specifically tailored to individuals rather than the mass messages that advertisers *need* to create to reach a larger audience. Here are other discouraging factors.

- There are wide individual differences in threshold levels. For a message to avoid conscious detection by consumers who have low thresholds, it would have to be so weak that it would not reach those who have high thresholds.
- Advertisers lack control over consumers' distance and position from a screen. In a movie theater, for example, only a small portion of the audience would be in exactly the right seats to be exposed to a subliminal message.
- The viewer must be paying absolute attention to the stimulus. People watching a television program or a movie typically shift their attention periodically and might not even be looking when the stimulus is presented.
- Even if the desired effect is induced, it operates only at a very general level. For example, a message might increase a person's thirst but not necessarily for a specific drink. Because basic drives are affected, marketers could find that after all the bother and expense of creating a subliminal message, demand for competitors' products increases as well!

The bottom line: Keep looking for those embedded breasts all you want, but don't stop searching for those UFOs either.

Truth 5. One man's goose…

Two people can see or hear the same event, but their interpretation of it can be as different as night and day, depending on how the message "speaks" to their brains and what they thought they were going to see. A recent study illustrates the power of expectations. Kids ages 3 to 5 who ate McDonald's French fries served in a McDonald's bag overwhelmingly thought they tasted better than those who ate the *same* fries out of a plain white bag. Even carrots tasted better when they came out of a McDonald's bag—more than half the kids preferred them to the same carrots served in a plain package! Ronald would be proud.[8]

The meaning we assign to a stimulus depends on the *schema*, or set of beliefs, to which we assign it. In a process we call priming, certain properties of a stimulus evoke a schema. This, in turn, leads us to compare the stimulus to other similar ones we've encountered in the past.

Identifying and evoking the correct schema is crucial to many marketing decisions, because this determines what criteria consumers will use to evaluate the product, package, or message. Extra Strength Maalox Whip Antacid flopped even though a spray can is a pretty effective way to deliver the product. But, to consumers, aerosol whips mean dessert toppings, not medication.

One factor that determines how we will interpret a stimulus is the relationship we assume it has with other events, sensations, or images in memory. When RJR Nabisco introduced a version of Teddy Grahams (a children's product) for adults, it used understated package colors to reinforce the idea that the new product was for grown-ups. But sales were disappointing. Nabisco changed the box to bright yellow to convey the idea that this was a fun snack, and buyers' more positive associations between a bright primary color and taste prompted adults to start buying the cookies.

Our brains tend to relate incoming sensations to others already in memory, based on some fundamental organizational principles. These principles derive from *Gestalt psychology*, a school of thought that maintains that people interpret meaning from the totality of a set of stimuli rather than from any individual stimulus. The German word *Gestalt* roughly means whole, pattern, or configuration, and we summarize this term as "the whole is greater than the sum of its parts." The Gestalt perspective provides several principles relating to the way our brains organize stimuli.

- The **closure principle** states that people tend to perceive an incomplete picture as complete. That is, we tend to fill in the blanks based on our prior experience. This principle explains why most of us have no trouble reading a neon sign even if several of its letters are burned out. The principle of closure is also at work when we hear only part of a jingle or theme ("You can take Salem out of the country, but…"). Marketing strategies that use the closure principle encourage audience participation, which increases the chance that people will attend to the message.
- The **principle of similarity** tells us that consumers tend to group objects that share similar physical characteristics. Green Giant relied on this principle when the company redesigned the packaging for its line of frozen vegetables. It created a "sea of green" look to unify all its different offerings.
- The **figure-ground principle** states that one part of a stimulus will dominate (the *figure*), and other parts will recede into the background (the ground). This concept is easy to understand if you think literally of a photograph with a clear and sharply focused object (the figure) in the center. The figure is dominant, and the eye goes straight to it. The parts of the configuration that a person will perceive as figure or ground can vary depending on the individual consumer as well as other factors. Similarly, marketing messages that use the figure-ground principle can make a stimulus the focal point of the message or merely the context that surrounds the focus.

The stimuli we perceive are often ambiguous. It's up to us to determine the meaning based on our past experiences, expectations, and needs. A classic experiment demonstrated the process of "seeing what you want to see." Princeton and Dartmouth students separately viewed a movie of a particularly rough football game between the two rival schools. Although everyone was exposed to the same stimulus, the degree to which students saw infractions and the blame they assigned for those they did see were quite different depending on which college they attended.[9]

As this experiment demonstrates, consumers tend to project their own desires or assumptions onto products and advertisements. This interpretation process can backfire for marketers. Planters Lifesavers Company found this out when it introduced a vacuum-packed peanuts package called Planters Fresh Roast. The idea was to capitalize on consumers' growing love affair with fresh-roast coffee by emphasizing the freshness of the nuts in the same way. A great idea—until irate supermarket managers began calling to ask who was going to pay to clean the peanut gook out of their stores' coffee-grinding machines.

> Consumers tend to project their own desires or assumptions onto products and advertisements.

Another recent experiment demonstrated how our assumptions influence our experiences. In this case, the study altered beer drinkers' taste preferences simply by telling them different stories about a specific brew's ingredients. The researcher offered bar patrons free beer if they would participate in a taste test. (Not surprisingly, very few refused the offer.) Participants tasted two beers each—one a regular draft of Budweiser or Samuel Adams, and the other the same beer with a few drops of balsamic vinegar added. Although most beer *aficionados* would guess that vinegar makes the drink taste bad, in fact, 60 percent of the respondents who did not know which beer contained the vinegar actually preferred the doctored version to the regular one! But when tasters knew in advance which beer had vinegar in it before they took a swig, only one-third preferred that version.[10]

Truth 6. Throw 'em a bone, and they'll no longer roam

Are we smarter than dogs? How about pigeons or rats? Although (recent episodes of reality TV to the contrary) we certainly hope so, the truth is that, under some circumstances, we respond to companies in much the same way that our "less-evolved" friends do. Behavioral learning theories assume that learning takes place as the result of responses to external events—whether these consist of cheese versus electric shocks at the end of a maze or friends' compliments when we show up at a party wearing a new outfit.

According to the *behavioral learning* perspective, the feedback we receive as we go through life shapes our experiences. We respond to brand names, scents, jingles, and other marketing stimuli because of the learned connections we form over time. People also learn that actions they take result in rewards and punishments; this feedback influences the way they will respond in similar situations down the road. Consumers who receive compliments on a product choice will be more likely to buy that brand again, but those who get food poisoning at a new restaurant are not likely to patronize it in the future.

> We respond to brand names, scents, jingles, and other marketing stimuli because of the learned connections we form over time.

The plot thickens. People also react to other, similar stimuli in much the same way they responded to the original stimulus; we call this generalization a *halo effect*. A drugstore's bottle of private brand mouthwash deliberately packaged to resemble Listerine mouthwash may evoke a similar response among consumers, who assume that this "me-too" product shares other characteristics of the original. Indeed, consumers in one study on shampoo brands tended to rate those with similar packages as similar in quality and performance as well.[11] This process may help to explain the tendency for Chinese marketers to knock off familiar vehicle brand names when they can get away with it. When executives at Shanghai Automotive Industry Corp. failed in their bid to buy the celebrated Rover brand name for a line of cars they were introducing, they called them Roewe instead. Honda Motor Co. successfully sued a Chinese motorcycle maker for using the name Hongda. More recently, though, a Chinese company called Chery is preparing to export a car to the United States. The company claims the resemblance to Chevy is just a coincidence, as its English name derives from the sound of its Chinese name, Qirui, pronounced *che-ray*, which means, "unusually lucky." That argument is a bit harder to make for a wireless e-mail service that another Chinese company calls Redberry.

Behavioral learning principles apply to many consumer phenomena, ranging from creating a distinctive brand image to the perceived linkage between a product and an underlying need. The transfer of meaning explains why made-up brand names, such as Marlboro, Coca-Cola, Reebok, or Exxon (which a computer generated!) can exert such powerful effects on consumers. These associations are crucial to many marketing strategies that rely on the creation and perpetuation of *brand equity*, in which a brand has strong positive associations in a consumer's memory and commands a lot of loyalty as a result.

Advertisements often pair a product with a positive stimulus to create a desirable association. The choice of a great brand name that will elicit these favorable associations is so important that companies often hire naming consultants to devise a winning selection. These experts try to find *semantic associations* that click because they evoke some desirable connection. That strategy brought us names such as Qualcomm ("quality" and "communications"), Verizon (veritas is Latin for "truth," and "horizon" suggests forward-looking), and Intel ("intelligent" and "electronics"). The name Viagra rhymes with the famous waterfall Niagara. People associate water with both sexuality and life, and Niagara Falls is a honeymoon Mecca.

The conditioning process is what's behind branding and packaging decisions that try to capitalize on consumers' positive associations with an existing brand or company name. We can clearly appreciate the value of this kind of linkage by looking at universities with winning sports teams where loyal fans snap up merchandise, from clothing to bathroom accessories, emblazoned with the school's name. Strategies that marketers base on these ingrained associations include

- **Family branding**—Many products capitalize on the reputation of a company name. Companies such as Campbell's, Heinz, and General Electric rely on their positive corporate images to sell different product lines.
- **Product line extensions**—Marketers add related products to an established brand. Dole, which we associate with fruit, introduced refrigerated juices and juice bars, whereas Sun Maid went from raisins to raisin bread.
- **Licensing**—Companies often "rent" well-known names. This strategy is increasing in popularity as marketers try to link their products and services with popular brands or designers. *Prevention* magazine introduced vitamins, and *Runners World* magazine puts its name on jogging suits.

So, condition your customers—and pass those pigeon pellets, please.

Truth 7. Stay in their minds—if you can

It's too bad we can't market to elephants. In a poll of more than 13,000 adult humans, more than half were unable to remember any specific ad they had seen, heard, or read in the past 30 days.[12] How many can you remember right now? Clearly, forgetting by consumers is a big headache for marketers.

As the popularity of the board game Trivial Pursuit shows us, people have a vast quantity of information stored in their heads that is not necessarily available on demand. Although most of the information that enters our memory does not go away, it may be difficult or impossible to retrieve unless the appropriate cues are present. What influences the likelihood that customers will remember a commercial message?

> Although most of the information that enters our memory does not go away, it may be difficult or impossible to retrieve unless the appropriate cues are present.

Individual cognitive or physiological factors are responsible for some of the differences we see in retrieval ability among people. Some older adults consistently display inferior recall ability for current items, such as prescription drug instructions, although they may recall events that happened to them when they were younger with great clarity. The recent popularity of puzzles like Soduku and centers that offer "mental gymnastics" attests to emerging evidence that we can keep our retrieval abilities sharp by exercising our minds just as we keep our other muscles toned by working out on a regular basis.

Not surprisingly, recall is enhanced when we pay more attention to the message in the first place. Some evidence indicates that we can retrieve information about a *pioneering brand* (the first brand to enter a market) more easily from memory than we can for *follower brands* because the first product's introduction is likely to be distinctive and, for the time being, no competitors divert our attention. In addition, we are more likely to recall descriptive brand names than those that do not provide adequate cues as to what the product is.

The way a marketer presents her message influences the likelihood we'll be able to recall it later. The *spacing effect* describes the tendency for us to recall printed material more effectively when the advertiser repeats the target item periodically rather than presenting it repeatedly in a short period. The viewing environment of a marketing message also affects recall. For example, commercials we see during baseball games yield the lowest recall scores among sports programs because the activity is stop-and-go rather than continuous. Unlike football or basketball, the pacing of baseball gives many opportunities for attention to wander even during play. Similarly, General Electric found that its commercials fared better in television shows with continuous activity, such as stories or dramas, compared to variety shows or talk shows, which are punctuated by a series of acts. A large-scale analysis of TV commercials found that viewers recall commercials shown first in a series of ads better than those they see last; this may be due to the tendency for our attention to wander as we endure a commercial break.[13]

Some advertisers today are experimenting with *bitcoms* that try to boost viewers' retention of a set of ads inserted within a TV show. (We call this a *commercial pod*.) In a typical bitcom, when the pod starts, a stand-up comedian (perhaps an actor in the show) performs a small set that leads into the actual ads. This is one way that marketers are trying to integrate a show's contents with commercial messages and increase viewers' involvement with advertising.

Finally, it goes without saying that the nature of the ad itself plays a big role in determining whether it's memorable. One recent study on print advertising reported that we are far more likely to remember spectacular magazine ads, including multipage spreads, three-dimensional pop-ups, scented ads, and ads with audio components. For example, a Pepsi Jazz two-page spread with a three-dimensional pop-up of the opened bottle and a small audio chip that played jazz music from the bottle's opening as well as a scratch-and-sniff tab that let readers smell its black cherry vanilla flavor scored an amazing 100 percent in reader recall.[14]

Short of putting on a Broadway production, what can we do to improve memory for our messages? As a general rule, prior familiarity with an item enhances its recall. Indeed, this is one of the basic goals of marketers who try to create and maintain awareness of their products. The more experience a consumer has with a product, the better use she makes of product information. Also, stimuli that stand out in contrast to their environments are more likely to command attention which, in turn, increases the likelihood that we will recall them. Almost any technique that increases the novelty of a stimulus also improves recall. This explains why unusual advertising or distinctive packaging tends to facilitate brand recall. *Mystery ads*, in which the ad doesn't identify the brand until the end, are more effective at building associations in memory between the product category and that brand—especially in the case of relatively unknown brands.

How about the way a message gets delivered? Is it true that a picture is worth 1,000 words? There is some evidence for the superiority of visual memory over verbal memory; the available data indicate that we are more likely to recognize information presented in picture form at a later time. Certainly, visual aspects of an ad are more likely to grab a consumer's attention. In fact, eye-movement studies indicate that about 90 percent of viewers look at the dominant picture in an ad before they bother to view the copy.[15]

But here's the fly in the ointment: Although pictorial ads may enhance recall, they do not necessarily improve comprehension. One study found that television news items presented with illustrations (still pictures) as a backdrop resulted in improved recall for details of the news story, even though understanding of the story's content did not improve.[16] Another study confirmed that, typically, consumers recall ads with visual figures more often and like them better.[17] Understanding what they said is another story.

Consumers recall ads with visual figures more often and like them better. Understanding what they said is another story.

Truth 8. These are the good old days

The McDonald's fast-food chain is riding a nostalgia wave as the nerdy Ronald McDonald and other icons from the 1960s became hot with young hipsters who are scrambling to score T-shirts emblazoned with the clown or other Mickey D's characters such as Mayor McCheese, the Hamburglar, and Grimace. This peak in nostalgia was no accident, however. The company recently launched a word-of-mouth marketing campaign to boost its uncool image among fashion-conscious young people. It hired the same company that revived other nostalgia figures, such as Strawberry Shortcake, and for the first time licensed the use of its old ad slogans and characters on merchandise. McDonald's sold retro T-shirts in trendy boutiques and started to use pop stars such as Justin Timberlake and Destiny's Child in its ads.

Nostalgia describes a bittersweet emotion where we view the past with both sadness and longing. References to "the good old days" are increasingly common, as advertisers call up memories of youth—and hope these feelings will translate to what they're selling today. That's why marketers like Mickey D's often resurrect popular characters and stories from days gone by; they hope that consumers' fond memories will motivate them to revisit the past. We had a 1950s revival in the 1970s, and consumers in the 1980s got a heavy dose of memories from the 1960s. Today, it seems that popular characters need to be gone for only a few years before someone tries to bring them back. That's the case with the Teletubbies, four characters aimed at children ages three and under that a BBC television show introduced in 1997. Ragdoll, the British company that owns the rights to these lovable (yet strangely creepy) creatures, brought them back with features including a trivia quiz, podcasts, and a Web site at taketheteletubbiestest.com.

> References to "the good old days" are increasingly common, as advertisers call up memories of youth—and hope these feelings will translate to what they're selling today.

Why do consumers relish nostalgia appeals? According to one consumer analyst, "We are creating a new culture, and we don't know what's going to happen. So we need some warm fuzzies from our past."[18] In the aftermath of September 11, 2001, consumers seem to crave the comfort of items from the past even more. Marketers such as Ford, GE, S.C. Johnson, and Sears are sponsoring campaigns that celebrate their heritage. Other companies are reviving once-popular products such as Breck shampoo, Sea & Ski sun-care lotion, St. Joseph's aspirin, and the Care Bears; or they're bringing back themes and characters from old shows to sell new products, as when Old Navy transforms "The Brady Bunch" into "The Rugby Bunch" to push its shirts. A *retro brand* is an updated version of a brand from a prior historical period. These products trigger nostalgia, and researchers find that they often inspire consumers to think back to an era where (at least in our memories) life was more stable, simple, or even utopian—they let us "look backward through rose-colored glasses".

In addition to liking ads and products that remind us of our past, those experiences help to determine what we like now. Consumer researchers created a *nostalgia index* that measures the critical ages during which our preferences are likely to form and endure over time. For example, liking for specific songs appears to be related to how old a person was when that song was popular—on average, we are most likely to favor songs that were popular when we were 23.5 years old. Preferences for fashion models peak at age 33, and we tend to like movie stars that were popular when we were 26 or 27 years old. Men, but not women, also show evidence of nostalgic attachment to cars from their youth.[19]

Products and ads can themselves serve as powerful retrieval cues. Indeed, the three types of possessions that consumers most value are furniture, visual art, and photos. These objects are most likely to jog memories of the past. Researchers find that valued possessions can evoke thoughts about prior events on several dimensions, including sensory experiences, friends and loved ones, and breaking away from parents or former partners. Food can do the same thing. A recent study looked at how favorite recipes stimulate memories of the past. When the researchers asked informants to list three of their favorite recipes and to talk about these choices, they found that people tended to link them with memories of past events such as childhood memories, family holidays, milestone events (such as dishes they only make on special holidays, like corned beef and cabbage on St. Patrick's Day), heirlooms (recipes handed down across generations), and the passing of time (for example, only eating blueberry cobbler in the summer).[20]

Yearbooks are a favorite way to preserve our memories ("What was I thinking with that haircut?"), but traditional albums are giving way to more high-tech solutions such as MyYearbook.com. This Web site allows users to create a profile with separate sections for high school, college, graduate school, and professional life. Students who sign up are linked automatically to others at their school. They can select friends from among their classmates and "autograph" each others' yearbook pages. Users also can vote for the biggest flirt, best athlete, and most popular students. The traditional players in this area, such as Jostens (which sells almost $350 million of yearbooks annually), aren't sure if hard copy albums are obsolete, so they are hedging their bets by offering students a supplemental DVD that lets them add their own music, photos, and videos.

Products are particularly important as markers when our sense of the past is threatened as, for example, when an event, such as divorce, relocation, or graduation challenges a consumer's current identity. Our possessions often have *mnemonic* qualities that serve as a form of external memory by prompting consumers to retrieve episodic memories. For example, family photography allows consumers to create their own retrieval cues; the 11 billion amateur photos we take annually form a kind of external memory bank for our culture. A stimulus is, at times, able to evoke a weakened response even years after we first perceived it. We call this effect *spontaneous recovery*, and this reestablished connection may explain consumers' powerful emotional reactions to songs or pictures to which they have not been exposed in quite a long time.

Products are particularly important as markers when our sense of the past is threatened.

Truth 9. Why ask why?

About seven percent of the general population is vegetarian, and women and younger people are even more likely to adopt a meatless diet. An additional 10 to 20 percent of consumers are interested in vegetarian options in addition to their normal fare of dead animals. And more and more people are taking the next step and adopting a vegan lifestyle. Although the proportion of consumers who are vegetarian or vegan is quite small compared to those of us who still like to pound down a Quarter Pounder, big companies are taking notice of this growing interest in vegetarian and cruelty-free products. Colgate recently purchased a controlling interest in Tom's of Maine, and Dean Foods (America's largest processor of dairy foods) bought Silk and its parent company White Wave. The beef industry fights back with its high-profile advertising campaign—"Beef: It's What's for Dinner"—and a Web site to promote meat consumption (beefitswhatsfordinner.com). It's obvious that our menu choices have deep-seated consequences.

The forces that drive people to buy and use products are generally straightforward, such as when a person chooses what to have for lunch. As hard-core vegetarians demonstrate, however, even the basic food products we consume relate to wide-ranging beliefs regarding what we think is appropriate or desirable. In some cases, these emotional responses create a deep commitment to the product. Sometimes people are not even fully aware of the forces that drive them toward some products and away from others. Often a person's values—his or her priorities and beliefs about the world—influence these choices.

> Sometimes people are not even fully aware of the forces that drive them toward some products and away from others.

Motivation refers to the processes that lead people to behave as they do. To understand motivation is to understand why consumers do what they do. Why do some people choose to bungee jump off a bridge or compete on reality shows, whereas others spend their leisure time playing chess or gardening? Marketing students are taught from day one that the goal of marketing is to satisfy consumers' needs. However, this insight is useless unless we can discover what those needs are and why they exist.

Psychologists have worked hard to classify human needs. For example, individuals with a high *need for achievement* strongly value personal accomplishment. These consumers are good prospects for products that provide evidence of their achievement. One study of working women found that those who were high in achievement motivation were more likely to choose clothing they considered businesslike and less likely to be interested in apparel that accentuated their femininity.[21] Some other important needs that are relevant to consumer behavior include the following.

- **Need for affiliation (to be in the company of other people)—**The need for affiliation is relevant to products and services for people in groups, such as participating in team sports, frequenting bars, and going to shopping malls, and it serves to alleviate loneliness.
- **Need for power (to control one's environment)—**Many products and services allow consumers to feel that they have mastery over their surroundings. These products range from "hopped-up" muscle cars and loud boom boxes (large portable radios that impose one's musical tastes on others) to luxury resorts that promise to respond to every whim of their pampered guests.
- **Need for uniqueness (to assert one's individual identity)—** Products can satisfy the need for uniqueness by pledging to accentuate a consumer's distinctive qualities. For example, Cachet perfume claims to be "as individual as you are."

The psychologist Abraham Maslow proposed one influential approach to motivation. He originally proposed that we travel up a hierarchy of needs until (if we're lucky) we attain "peak experiences"; marketers later adapted his framework to understand consumer motivations.

The basic lesson of Maslow's hierarchy is that one must first satisfy basic needs before progressing up the ladder. (A starving man is not interested in status symbols, friendship, or self-fulfillment.) That implies that consumers value different product attributes depending on what is currently available to them. For example, consumers in the former Eastern bloc are now bombarded with images of luxury goods, yet may still have trouble obtaining basic necessities.

Marketers' application of this hierarchy has been somewhat simplistic, especially as the same product or activity can satisfy a number of different needs. For example, one study found that gardening could satisfy needs at every level of the hierarchy:[22]

- **Physiological—**"I like to work in the soil."
- **Safety—**"I feel safe in the garden."
- **Social—**"I can share my produce with others."
- **Esteem—**"I can create something of beauty."
- **Self-actualization—**"My garden gives me a sense of peace."

Another problem with taking Maslow's hierarchy too literally is that it is culture-bound; its assumptions may apply only to Western culture. People in other cultures (or, for that matter, even some in Western cultures as well) may question the order of the levels it specifies. A religious person who has taken a vow of celibacy would not necessarily agree that physiological needs must be satisfied before self-fulfillment can occur. Flaws aside, this perspective reminds us that customers have different need priorities in different consumption situations and at different stages in their lives. The best product in the world won't meet a need that doesn't exist.

> The best product in the world won't meet a need that doesn't exist.

Truth 10. He who dies with the most toys wins

More than 8.2 million women in 50 countries read versions of *Cosmopolitan* in 28 different languages—even though, because of local norms about modesty, some of them have to hide the magazine from their husbands! Adapting the *Cosmo* credo of "Fun, Fearless Female" in all these places gets a bit tricky. Different cultures emphasize varying belief systems that define what it means to be female, feminine, or appealing—and what is considered appropriate to see in print on these matters. Publishers of the Chinese version aren't permitted to mention sex at all, so articles about uplifting cleavage are replaced by uplifting stories about youthful dedication. Ironically, there isn't much down-and-dirty material in the Swedish edition either—but for the opposite reason: The culture is so open about this topic that it doesn't grab readers' attention the way it would in the United States.

We characterize every culture in terms of its members' endorsement of a value system. Every individual may not endorse these values equally and, in some cases, values may even seem to contradict one another. (For example, Americans appear to value both conformity and individuality and seek to find some accommodation between the two.) Nonetheless, it is usually possible to identify a general set of *core values* that uniquely define a culture. Core values such as freedom, youthfulness, achievement, and materialism characterize American culture.

> It is usually possible to identify a general set of *core values* that uniquely define a culture.

Did we mention materialism? This value refers to the importance people attach to worldly possessions. During World War II, members of "cargo cults" in the South Pacific literally worshiped cargo salvaged from crashed aircraft or washed ashore from ships. These people believed that their ancestors piloted the ships and planes passing near their islands, so they tried to attract them to their villages. They went so far as to construct fake planes from straw in hopes of luring the real ones!

We may not worship products to that extent, but many of us certainly work hard to attain our vision of the good life, which abounds in material comforts. Most young people can't imagine a life without cell phones, MP3 players, and other creature comforts. Materialistic values tend to emphasize the well-being of the individual versus the group, which may conflict with family or religious values. That conflict may help to explain why people with highly material values tend to be less happy.

Of course, not all of us are materialists and, indeed, large numbers of consumers are trying to reduce their reliance on possessions by *downshifting*. They are learning to get by with less, avoid the use of credit cards and, in extreme cases, live totally "off the grid" without using commercial services. One of the most famous downshifters is the so-called Ditch Monkey, a dapper young lawyer who created quite a stir in the UK when he spent a year living in a ditch on the outskirts of London (and, of course, blogging about his experience). He explained, "I want to make people think about how much they consume that is not necessary. I am trying to prove it is possible to do everything you normally do, maintaining a full existence, while cutting back. I have realized I can lead my life without television, carpets, sofa, electricity, chairs, tables, a fridge, and a freezer." After getting over her initial surprise at this abrupt lifestyle change, his girlfriend eventually grew proud of the statement he was making. However, she notes (in typically understated British fashion) that the move shocked her parents: "They were a bit disappointed he wasn't a homeowner and were certainly perplexed."[23]

Materialists are more likely to value possessions for their status and appearance-related meanings, whereas those who do not emphasize this value tend to prize products that connect them to other people or that provide them with pleasure in using them. As a result, high materialists prefer products likely to be publicly consumed and to be more expensive. A study that compared specific items that low versus high materialists value found that people low on the materialism value cherished items such as a mother's wedding gown, picture albums, a rocking chair from childhood, or a garden, whereas those who scored high preferred things such as jewelry, china, or a vacation home.[24]

U.S. society is struggling to reconcile desires for material goods with the need for environmental consciousness and spirituality. This shift is blurring some of the expected boundaries between "traditional" and "progressive" segments. As one analyst noted, for example, even conservative small towns now often feature "new age" stores and services where people of all ages shop. Retailers that used to be considered "Bohemian" now are mainstream; grocers such as Fresh Fields sell Mayan Fungus soap and vegetarian dog biscuits to a hodgepodge of consumers. Big corporations such as Apple and The Gap use countercultural figures such as Gandhi and Jack Kerouac in their advertising, and Ben & Jerry's boasts of its unconventional corporate philosophy. It's become hard to separate establishment from antiestablishment as Bohemian attitudes of the hippie 1960s have merged with the bourgeois attitudes of the yuppie 1980s to form a new culture that is a synthesis of the two. The people who dominate our culture (this analyst calls them "BoBos," or *Bourgeois Bohemians*) now are richer and more worldly than hippies but more spiritual than yuppies.[25] Even core values change over time; stay tuned to see how our always-evolving culture continues to put a fresh spin on materialism and other values.

U.S. society is struggling to reconcile desires for material goods with the need for environmental consciousness and spirituality.

Truth 11. Your customers are looking for greener pastures

Are U.S. consumers finally going green—for real? In a 2007 survey, fully eight in ten consumers said they believe it's important to buy green brands and products from green companies, and that they'll pay more to do so. The U.S. consumer's focus on personal health is merging with a growing interest in global health. Some analysts call this new value *conscientious consumerism*.[26]

Just who is driving this change? Marketers point to a segment of consumers who practice LOHAS, an acronym for "lifestyles of health and sustainability." This label refers to people who worry about the environment, want products to be produced in a sustainable way, and who spend money to advance what they see as their personal development and potential. These "Lohasians" (others refer to this segment as *cultural creatives*) represent a great market for products such as organic foods, energy-efficient appliances, and hybrid cars, as well as alternative medicine, yoga tapes, and eco-tourism. One organization that tracks this group estimates they make up about 16 percent of the adults in the United States; it values the market for socially conscious products at more than $200 billion.[27]

Marketers and retailers are responding with thousands of new eco-friendly products. Colgate bought a big stake in the natural toothpaste brand Tom's of Maine, and L'Oréal acquired The Body Shop. Kellogg's introduced organic versions of some of its bestselling cereals.

Whereas in the past it was sufficient for companies to offer recyclable products, this new movement is creating a whole new vocabulary as consumers begin to "vote with their forks" by demanding food, fragrances, and other items that are made without genetically modified ingredients (GMOs), are hormone-free, don't involve animal clones or animal testing, are locally grown, and are cage-free, just to name a few of consumers' concerns and requirements. Indeed, between 2005 and 2006, grocery sales of products making ethical claims grew by 17 percent to nearly $33 billion. The food industry predicts sales of $57 billion by 2011.[28]

Although Lohasians have been fueling demand for eco-friendly products for several years, the big news today is that conscientious consumerism now is spreading to the mass market as well. In fact, even Wal-Mart is making the effort to go green. The world's largest retailer developed a survey called the "Live Better Index" that allows it to monitor customers' feelings about eco-friendly products. The first wave of research polled more than 2,500 Americans on five products: compact florescent light bulbs (CFLs), organic milk, concentrated/reduced-packaging liquid laundry detergents, extended-life paper products, and organic baby food. In this survey, 62 percent of respondents said they would buy more eco-friendly products if there were no price difference. Nearly half (47 percent) said they completely agree that buying environmentally friendly products makes them feel like smart consumers, and 68 percent agree that "even the small act of recycling at home has an impact on the environment."[29]

> The big news today is that conscientious consumerism now is spreading to the mass market.

As mainstream marketers recognize this change, they are starting to alter their practices to satisfy Americans' desires for healthy and earth-friendly products. Here are some recent examples.

- Home Depot, the nation's second-largest retailer, introduced an Eco Options label for almost 3,000 products, such as fluorescent light bulbs that conserve electricity and natural insect killers that promote energy conservation, sustainable forestry, and clean water. The company expects products it certifies under this program to represent 12 percent of its total sales by 2009.
- H&M is selling clothes made from organic cotton fabrics to fashion-conscious shoppers. Gap introduced an organic cotton T-shirt for men in more than 500 of its stores.
- Procter & Gamble Co. reduced the size of its packaging for its liquid detergent. It's switching to a double concentrate formula to serve its

$4 billion North American liquid detergent market.
- Scotts' Organic Choice brand is part of the giant gardening company's move toward less dependence on synthetically created chemicals, which include the main components in its distinctive blue Miracle-Gro plant food.

Not content to wait for companies to change their practices, everyday consumers also are taking action. Many are joining organizations such as Slow Food to advocate for lifestyle changes. One such movement called "Local First" stresses the value of buying locally made products. This group (some members call themselves "locavores") values small community businesses, but it formed as a reaction to waste that results from people importing things they need from long distances. One proponent of this movement calculates that the average U.S. meal travels 1,500 miles before it lands on our dinner plates. This cause already is affecting the grocery industry; the U.S. Department of Agriculture reports that the number of farmers markets grew from 1,755 in 1994 to 4,388 in 2006. The popular Whole Foods chain recently tightened up its definition of local, using the label only if products traveled less than 7 hours from farm to store.

Still other consumers are rebelling against the huge market for bottled water. They object to the fact that some brands come from as far away as Fiji. These imports contribute to the creation of pollution because of the tanker ships that cart them halfway around the world and the waste that millions of discarded plastic bottles create. In the summer of 2007, San Francisco's mayor decreed that city government would not use city money to buy bottled water for its employees.

The environmental effect of an object seemingly as innocent as a plastic water bottle points to the concern many now have about the size of a product's *carbon footprint*; this measures, in units of carbon dioxide, the impact that human activities have on the environment in terms of the amount of greenhouse gases they produce. The average American is responsible for 9.44 tons of C02 per year![30]

Thousands of consumers use services such as Climate Clean and TerraPass that sell them *greenhouse gas (GHG) offsets*. These businesses enable individuals and businesses to reduce their GHG emissions by offsetting, reducing, or displacing the GHG to another place, typically where it is more economical to do so. Whether you're concerned (yet) about global warming, expect to see your business engulfed by a tidal wave of consumer interest in products that reduce our carbon footprint.

> Expect to see your business engulfed by a tidal wave of consumer interest in products that reduce our carbon footprint.

Truth 12. "Because I'm worth it"

When Sara Lee developed a new line of snack cakes, the company discovered that consumers with low self-esteem preferred portion-controlled snack items because they felt they lacked self-control. Self-esteem refers to the positivity of a person's self-concept. People with low self-esteem expect that they will not perform very well, and they will try to avoid embarrassment, failure, or rejection. Most of us don't seem to have that problem. We believe we deserve good things, and we want them now.

> We believe we deserve good things, and we want them now.

Alberto-Culver uses a self-esteem appeal to promote a new product that reflects our changing society: Soft & Beautiful Just for Me Texture Softener, an alternative to hair pressing or relaxing. It's targeted to white mothers who don't know how to care for the hair of their multiracial children who have "hair texture" issues. The self-esteem portion of the campaign, dubbed "Love Yourself. Love Your Hair," includes a Web site, texturesoftener.com, that offers "conversation starters" to help parents find ways to talk to their daughters about self-image.

Indeed, many people must have really strong egos these days to judge by the bravado they display in offering themselves up for inspection on the Web. Millions have posted their photos to be rated by visitors to hotornot.com, a hot Web site where visitors rate each picture on a scale from 1 to 10. One of the site's two creators remembers, "Basically, we were sitting around drinking beers in the middle of the afternoon when a comment Jim made about a woman he had seen at a party made us think, wouldn't it be cool if there was a Web site where you could tell if a girl was a perfect 10?" The phenomenal success of the site spawned hundreds of copycats, many of them not exactly the PG-rated environment that this site offers. Some of the photos people send in aren't what you would call flattering (especially the ones submitted as jokes on unsuspecting friends); one possible explanation is the psychological concept of *self-*

handicapping, where we set ourselves up for failure so that, in case ratings are low, we can blame the picture rather than ourselves. Another is that the world is crowded with people so hungry for attention that they will submit to any number of indignities to have others look at them.[31]

Marketing communications can influence a consumer's self-esteem. Exposure to ads portraying (often unrealistic) buff men and svelte women can trigger a process of *social comparison*, where the person tries to evaluate herself by comparing it to the people these artificial images depict. This act of evaluating is a basic human tendency, and many marketers tap into our need for benchmarks by supplying idealized images of happy, attractive people who just happen to be using their products. A recent ad campaign for Clearasil is a good example. In one typical ad, two teenage boys enter a kitchen where a 40-ish mother is mixing something in a bowl. When her son leaves the room, his friend hits on Mom. The ad's tagline: "Clearasil may cause confidence."

> Many marketers tap into our need for benchmarks by supplying idealized images of happy, attractive people who just happen to be using their products.

A study that illustrates the social comparison process showed that female college students tend to compare their physical appearance with models in advertising. Furthermore, study participants who were exposed to beautiful women in advertisements afterward expressed lowered satisfaction with their own appearance, as compared to other participants who did not view ads with attractive models.[32] Another study demonstrated that young women alter their perceptions of their own body shapes and sizes after they watch as little as 30 minutes of TV programming.[33] Researchers report similar findings for men.[34]

Self-esteem advertising attempts to change our attitudes toward products by stimulating positive feelings about the self. One strategy is to challenge the consumer's self-esteem and then show a linkage to a product that provides a remedy. For example, the Marine Corps uses this strategy with its theme "If you have what it takes…." Another strategy is outright flattery, as when Virginia Slims cigarette ads proclaim, "You've come a long way, baby."

Truth 13. Love me, love my avatar

In the influential cyberpunk novel *Snow Crash*, author Neal Stephenson envisioned a virtual world, called the Metaverse, as a successor to the Internet. In the Metaverse, everyday people take on glamorous identities in a three-dimensional immersive digital world. The book's main character delivers pizza in real life, but in the Metaverse, he's a warrior prince and champion sword fighter. The hugely popular *Matrix* movie trilogy paints a similar (though more sinister) picture of a world that blurs the lines between physical and digital reality.

Today, these fictional depictions come to life as we witness the tremendous growth of real-time, interactive virtual worlds that allow people to assume virtual identities in cyberspace. More than nine million people worldwide belong to the virtual world of *Second Life*, more than eight million play the online game *World of Warcraft*, and one-third of Korean adults socialize in CyWorld. Add to that the millions more who play *The Sims Online* or who visit other computer-mediated environments (CMEs) such as Webkinz, There, Whyville, Entropia Universe, MTV's Virtual Laguna Beach, and so on, and you're looking at a lot of serious role-playing.

On these sites, people assume visual identities, or *avatars*, ranging from realistic versions of themselves to tricked-out versions with "exaggerated" physical characteristics or winged dragons or superheroes. Researchers are just starting to investigate how these online selves will influence consumer behavior and how the identities we choose in CMEs relate to our real life (RL) or "meat-world" identities. Already we know that when people take on avatar forms, they tend to interact with other avatars much as their meat-world selves interact with other RL people. For example, just as in the RL, males in *Second Life* leave more space between them when talking to other males versus females, and they are less likely to maintain eye contact than are females. And when avatars get very close to one another, they tend to look away from each other. The norms of the RL are creeping into the virtual world.

> People assume visual identities, or avatars, ranging from realistic versions of themselves to tricked-out versions with "exaggerated" physical characteristics or winged dragons or superheroes.

If you don't know it already, you heard it here first: Virtual worlds will be the next huge marketing platform. Don't miss the (virtual) boat on this one!

> You heard it here first: Virtual worlds will be the next huge marketing platform.

Truth 14. You really are what you wear

Some stores are testing a new interactive mirror that doubles as a high-resolution digital screen. When you choose an article of clothing, the mirror superimposes it on your reflection so that you can see how it would look on you. A camera relays live images of you modeling your virtual outfit to an Internet site where your friends can log to instant message (IM) you to tell you what they think; their comments pop up on the side of the mirror for you to read. They can also select virtual items for you to try on that will be reflected in the "magic" mirror.

Sociologists call the process of imagining the reactions of others toward us "taking the role of the other," or the *looking-glass self*. According to this view, our desire to define ourselves operates as a sort of psychological sonar: We take readings of our own identity by "bouncing" signals off others and trying to project the impression they have of us. Of course, like the distorted mirrors in a funhouse, our appraisal of who we are varies depending on whose perspective we consider and how accurately we predict their evaluations of us.

How does this process impact on the bottom line? Plenty. Since the reflection we see in this psychological mirror includes the products we are wearing, driving, eating, and so on, it follows that customers' identities reflect what they choose to buy from you (or from your competitors). In fact, in our consumption-oriented society, people increasingly bond with favorite products—to the extent that they may literally become walking billboards that promote their choices to others. *Identity marketing* is a promotional strategy where consumers alter some aspects of their selves to advertise for a branded product. For example, The Internet Underground Music Archive (IUMA) paid a Kansas couple $5,000 to name their baby boy Iuma. The Daytona Cubs baseball team awards free season tickets for life to anyone who will tattoo the Cubs logo on their body. Play ball!

> Customers' identities reflect what they choose to buy from you (or from your competitors).

Our use of consumption information to define the self is especially important when we have yet to totally form a social identity, such as when we find ourselves playing a new role in life. Think, for example, of the insecurity many of us felt when we first started college or reentered the dating market after leaving a really long relationship. *Symbolic self-completion theory* suggests that people who have an incomplete self-definition tend to complete this identity by acquiring and displaying symbols they associate with that role. As we mature into a role, we actually rely less on the products people associate with it. For example, when kids start to skateboard, they often invest in pro skateboard "decks" with graphics and branding that cost between $40 and $70 even without the "trucks" (wheels and axles). But—to the chagrin of the skateboard industry—as kids get more serious about boarding, many think it's just fine to buy "blank decks"; the plain wood boards cost only $15 to $30.

Because many consumption activities are related to self-definition, it is not surprising to learn that consumers demonstrate consistency between their values and the things they buy, including products such as beer, soap, toothpaste, and cigarettes relative to their least preferred brands, as well as between their self-images and their favorite stores. One of the earliest studies to examine this process found that car owners' ratings of themselves tended to match their perceptions of their cars: Pontiac drivers saw themselves as more active and flashy than did Volkswagen drivers.[35] Indeed, a recent German study found that observers were able to match photos of male and female drivers to pictures of the cars they drove almost 70 percent of the time.[36]

The external objects that we consider a part of us comprise what researchers call the *extended self*. In some cultures, people literally incorporate objects into the self—they lick new possessions, take the names of conquered enemies (or in some cases eat them), or bury the dead with their possessions. We don't usually go that far, but some people do cherish possessions as if they were a part of them.

Consider shoes, for example. You don't have to be Carrie of *Sex and the City* fame to acknowledge that many people feel a strong bond to their footwear. One study found that people commonly view their shoes as magical emblems of self—Cinderella-like vehicles for self-transformation.[37] In addition to shoes, of course, many material objects ranging from personal possessions and pets to national monuments or landmarks help to form a consumer's identity. Just about everyone can name a valued possession that has a lot of the self "wrapped up" in it, whether it is a beloved photograph, a trophy, an old shirt, a car, or a cat. Indeed, usually we can construct a pretty accurate "biography" of someone simply by cataloging the items on display in his bedroom or office. Clothes (and many other products) do make the man.

Clothes (and many other products) do make the man.

Truth 15. Real men don't eat quiche (but they do moisturize)

Sony created a TV ad for its Bravia line of liquid-crystal-display (LCD) televisions that offers different endings to men and women. The spot shows a man and a woman gazing through a storefront window at a Bravia LCD. Unaware of each other, the two simultaneously whisper: "Nice picture." Suddenly, two buttons appear on the screen that read: "Ending for Men" and "Ending for Women." The male ending is either a funny clip from a sports show or a cartoon spoof of a martial-arts movie. Women see either a 1950s-era musical centered on shoes or a tear-jerker about a female doctor who saves the life of an orphan.

Sexual identity is an important component of a consumer's self-concept. People often conform to their culture's expectations about how those of their gender should act, dress, or speak. Of course, these guidelines change over time, and they differ radically across societies. It's unclear to what extent gender differences are innate versus culturally shaped—but they're certainly evident in many consumption situations.

> Sexual identity is an important component of a consumer's self-concept.

Consider the gender differences that market researchers observe when they compare the food preferences of men to those of women. Women eat more fruit; men are more likely to eat meat. As one food writer put it, "Boy food doesn't grow. It is hunted or killed."[38] The sexes also differ sharply in the quantities of food they eat: When researchers at Hershey discovered that women eat smaller amounts of candy, they created a white chocolate confection called Hugs, one of the most successful food introductions of all time. However, a man in a Burger King Whopper ad ditches his date at a fancy restaurant, complaining that he is "too hungry to settle for chick food." Pumped up on Whoppers, a swelling mob of men shake their fists, punch one another, toss a van off a bridge, and sing, "I will eat this meat until my innie turns into an outie," and "I am hungry. I am incorrigible. I am man."

Society sends mixed messages to men. Our culture's stereotype of the ideal male is a tough, aggressive, muscular man who enjoys "manly" sports (and *The Man Show* on Comedy Central). Just as for women, however, the true story is more complicated than that. One consequence is that men are concerned as never before with their appearance. Men spend $7.7 billion on grooming products globally each year.

> Men are concerned as never before with their appearance.

Men are showing a willingness to use other traditionally feminine products, such as depilatories, to give them that smooth-torso look. They're even buying vanity products that alter their shape, including Bodyslimmers underwear that holds in the waist, Super Shaper Briefs that round out the buttocks, and the C-In2 "sling" brief that provides a lift similar to the Wonder Bra (along with a new version of this gravity-defying product called the Trophy Shelf).

No doubt one of the biggest marketing buzzwords over the past few years is the *metrosexual*, a straight, urban male who is keenly interested in fashion, home design, gourmet cooking, and personal care. A gay writer named Mark Simpson actually coined the term way back in a 1994 article when he "outed" British (and now American) soccer star and pop icon David Beckham as a metrosexual. Simpson noted that Beckham is "almost as famous for wearing sarongs and pink nail polish and panties belonging to his wife, Victoria (aka Posh from the Spice Girls), as he is for his impressive ball skills."[39]

Hype aside, how widespread is the metrosexual phenomenon? Although there's no doubt that "everyday guys" are expanding their horizons, many actively resist this label because they don't want others to question their sexual preferences. Clearly, our cultural definition of masculinity is evolving as men try to redefine sex roles while they stay in a "safety zone" of acceptable behaviors bounded by danger zones of sloppiness at one extreme and effeminate behavior at the other. For example, a man may decide that it's okay to use a moisturizer but draw the line at an eye cream that he considers too feminine. Some cultural observers even report the emergence of "retrosexuals;" men who want to emphasize their old-school masculinity by getting plastic surgery to create a more rugged look that includes hairier chests and beards, squarer chins, and more angular jaw lines.

Indeed, in many circles, the "M word" has become taboo and other (perhaps less threatening) labels are popping up instead. One such label is the übersexual, which *The Urban Dictionary* defines as

> metro-sexuality for the noughties (2000–2009)…. Übersexuals are the most attractive (not just physically), most dynamic, and most compelling men of their generations. They are confident, masculine, stylish, and committed to uncompromising quality in all areas of life…without giving into the negative stereotypes such as chauvinism, emotional unavailability, and a brain only filled with sports stats, beer, and burgers….

The current icon of übersexuals is Bono. He's global and socially aware, confident, and compassionate. Other notable übersexuals are Bill Clinton, George Clooney, Jon Stewart, Pierce Brosnan, Donald Trump, and Ewan McGregor.

Miller Genuine Draft recently conducted a survey of American men aged 21 to 34 to try to get a handle on these new definitions. The company found that, indeed, many "average Joes" are moving on from the days of drinking whatever beer is available and wearing baseball hats backward, but they also don't want to sacrifice their identities as regular guys. They care more about preparing a good meal, meeting friends for a beer, and owning a home than they do about amassing shoes, savoring fine wine, or dining at expensive restaurants. Indeed, 57 percent of men aged 25 to 29 say that if a woman were simply to pop in, they could whip up a full meal in a moment's notice with the items they have in the house.[40] The survey is silent about preferences for quiche.

Truth 16. Girls just want to have fun

In the 1949 movie *Adam's Rib*, Katherine Hepburn played a stylish and competent lawyer. This film was one of the first to show that a woman can have a successful career and still be happily married. Today, the evolution of a new managerial class of women has forced marketers to change their traditional assumptions about women as they target this growing market. For example, Suzuki is going out of its way to appeal to the growing number of women in India who are achieving financial independence and buying their own cars. Its Zen Estilo (Estilo means "style" in Spanish) model comes in eight colors, including purple fusion, virgin blue, and sparkling olive.

These changes have forced marketers to reexamine their strategies. For example, most sporting goods manufacturers have long sold products for women, but this often meant simply creating an inferior version of the male product and slapping a pink label on it. Then the companies discovered that many women were buying products intended for boys because they wanted better quality, so some of them figured out that they needed to take this market segment seriously. Burton Snowboard Company was one of the early learners. When the company started to offer high-quality clothing and gear made specifically for women, female boarders snapped them up. Burton also changed the way it promoted these products. It redesigned its Web site after getting feedback from female riders. Now, models in the women's section are shot from the bottom looking up, which makes them look more empowered. In contrast, the photos in the men's section feature tighter shots of the gear itself, since Burton's research showed that males are more interested in the technical details.

Some smart marketers have figured out that products men traditionally love appeal to women as well. In the automotive industry, they are discovering that a growing number of women spend big bucks to add extra horsepower to their cars, along with 17-inch wheels, custom racing seats, and other accessories. Although attributes such as safety, security, and reliability still appeal to women, like men they are increasingly drawn to power, speed, and hot looks. The so-called tuner industry, which includes aftermarket products such as spoilers, Xenon headlights, and turbochargers, is feeling this change—women now buy almost 25 percent of the $2.2 billion in merchandise and services that car freaks purchase each year.

> Smart marketers have figured out that products men traditionally love appeal to women as well.

Similarly, the high-tech industry launched a "Technology is a girl's best friend" campaign to entice women to buy more electronics products. This makes sense, because the Consumer Electronics Association estimates that about 75 percent of consumer-electronics purchasing decisions involve women. Gateway even managed to get a pink laptop computer prominently placed in the movie *Legally Blonde 2*. Other manufacturers are coming out with products ranging from headphones to cell phone covers in pink and other feminine colors to attract women. Palm's Zire Handheld PDA emphasizes its clear packaging and simple name. Palm's new focus evidently worked: For the first time with any Palm product, more than half of Zire buyers are women.

> The Consumer Electronics Association estimates that about 75 percent of consumer-electronics purchasing decisions involve women.

And women are invading that bastion of maleness we call video games. They make up about 40 percent of the total gaming audience. Some 64 percent of online gamers in the United States are female according to a recent Nielsen study. And in the emerging mobile-game market, women account for 55 percent of players. For example, Buena Vista Games targets women aged 18 to 49 with a PC game based on *Desperate Housewives*.

Sex roles constantly evolve. In a complex society like ours, we often encounter contradictory messages about "appropriate" behavior. We can clearly see this in the messages girls have been getting from the media for the past several years: It's cool to be slutty. Role models like Paris Hilton, Lindsay Lohan, Britney Spears, and even Bratz dolls convey standards about how far preteens and teens should go in broadcasting their sexuality. Now, as these messages seem to go over the top (at least in the eyes of some concerned parents), we start to see early signs of a backlash. At the Pure Fashion Web site, girls get style tips including skirts and dresses that fall no more than four fingers above the knee and no tank tops without a sweater or jacket over them. Several other sites, such as ModestApparelUSA.com and ModestByDesign.com, advocate a return to styles that leave almost everything to the imagination. Is our culture moving from a celebration of "girls gone wild" to "girls gone mild"?

> Is our culture moving from a celebration of "girls gone wild" to "girls gone mild"?

Truth 17. Queer eye for the spending guy

Mars aired a commercial during the 2007 Super Bowl that stirred up a lot of controversy. Eventually, the company agreed to stop airing the ad after organizations such as the Gay and Lesbian Alliance against Defamation protested. The ad shows two mechanics eating from opposite ends of a Snickers candy bar until their lips touch. Shocked and dismayed by this linkup, they rip out their chest hair in a desperate attempt to "do something manly."

Mars probably managed to insult more consumers than the company realizes. The proportion of the population that is gay or lesbian is difficult to determine, and efforts to measure this group have been controversial. The respected research company Yankelovich Partners Inc., which has tracked consumer values and attitudes since 1971 in its annual Monitor survey, now includes a question about sexual identity in its instrument and reports that about 6 percent of respondents identify themselves as gay/homosexual/lesbian. This study was virtually the first to use a sample that reflects the population as a whole instead of polling only smaller or biased groups (such as readers of gay publications) whose responses may not be as representative of all consumers.

These results help to paint a more accurate picture of the potential size and attractiveness of the Gay, Lesbian, Bisexual, and Transgendered (GLBT) market segment. To put things in perspective, the GLBT market is at least as large, if not larger, than the Asian American population (currently at about 12 million people). These consumers spend in the range of $250 billion to $350 billion a year. A Simmons study of readers of gay publications found that readers are almost 12 times more likely to hold professional jobs, twice as likely to own a vacation home, and eight times more likely to own a notebook computer compared to heterosexuals.

> The GLBT market is at least as large, if not larger, than the Asian American population.

In the mid-1990s, IKEA, a Swedish furniture retailer with stores in several major U.S. markets, broke new ground by running a TV spot featuring a gay couple that purchased a dining room table at the store. For many consumers, gay culture is more familiar largely because of the prominence of gay people in popular shows such as *The L Word* and because of decisions by stars such as Ellen DeGeneres and Rosie O'Donnell to openly discuss their sexuality.

Also, although it has been common for years for these companies to run ads in gay publications (often unbeknown to their straight customers), now major marketers, including American Express, Audi, Cartier, Chili's, Diageo, Marshall Field's, General Motors, Target, Volkswagen, and Wrigley, are using openly gay and lesbian celebrities in campaigns aimed at the wider general audience. They are hiring personalities such as singers k.d. lang and Melissa Etheridge; designers Isaac Mizrahi and Todd Oldham; actor John Cameron Mitchell; and John Amaechi, a former NBA center and the first professional basketball player to disclose that he is gay.

> Major marketers are using openly gay and lesbian celebrities in campaigns aimed at the wider general audience.

American Express, Stolichnaya vodka, Atlantic Records, and Naya bottled water are among those corporations that run ads in lesbian publications (an ad for American Express Travelers Cheques for Two shows two women's signatures on a check). Acting on research that showed lesbians are four times as likely as the average consumer to own one of their cars, Subaru of America decided to target this market in a big way. And in one of the first mainstream pitches to directly address the controversy over gay marriage, Grand Marnier, a French cognac, launched print ads that read, "Your sister is finally getting remarried. Her fiancée's name is Jill."

Don't ignore the vast spending power of this consumer segment. As the saying goes, "We're here, we're queer, and we're going shopping."

Truth 18. Yesterday's chubby is today's voluptuous

The size and shape of the "average" U.S. consumer today is dramatically different from what it was 60 years ago. Nevertheless, apparel companies still develop clothing lines based on a 1941 military study that set sizing standards based on a small sample of mostly white, young (and presumably physically fit) female soldiers. Those standards are finally starting to change based on the fact that the typical woman's body is no longer as "petite" as it used to be. The most commonly purchased dress today is a size 14; it was a size 8 in 1985!

Standards based upon an outdated snapshot of U.S. women need to recognize the diversity of today's ethnic population: According to current criteria, fully 78 percent of African American women and 72 percent of Hispanic women are overweight, compared to 58 percent of white women. And non-Caucasian body shapes differ as well—for example, Hispanic Americans and Asian Americans tend to be shorter than their Caucasian counterparts. The clothing industry can't take the market potential of this segment lightly—women spent about $47 billion on plus-size garments in 2005, accounting for 20 percent of the total apparel market.

> Standards based upon an outdated snapshot of U.S. women need to recognize the diversity of today's ethnic population.

The standards we use to evaluate physical attractiveness go more than skin deep. Beauty affects a wide range of outcomes, as we *do* tend to judge a book by its cover. By the way, this bias affects both men and women—men with above-average looks earn about five percent more than those of average appearance, and those who are below average in appearance make an average of nine percent less than the norm.

> Beauty affects a wide range of outcomes, as we *do* tend to judge a book by its cover.

Although beauty may be only skin deep, throughout history women have worked hard to attain it. They have starved themselves; painfully bound their feet; inserted plates into their lips; spent countless hours under hair dryers, in front of mirrors, and beneath tanning lights; and opted for breast reduction or enlargement operations to alter their appearance and meet their society's expectations of what a beautiful woman should look like.

In retrospect, we can characterize periods of history by a specific "look," or ideal of beauty. Often these relate to broader cultural happenings, such as today's emphasis on fitness and toned bodies. One study compared measures of the public's favorite actresses with socioeconomic indicators between 1932 and 1995. When market conditions were bad, people preferred actresses with mature features, including small eyes, thin cheeks, and a large chin. When the economy was in good shape, however, the public embraced women with babyish features, such as large eyes and full cheeks.

In much of the nineteenth century, the desirable waistline for U.S. women was 18 inches, a circumference that required the use of corsets pulled so tight that they routinely caused headaches, fainting spells, and possibly even the uterine and spinal disorders common among women of the time. Although modern women are not quite as "straight-laced," many still endure such indignities as high heels, body waxing, eyelifts, and liposuction. In addition to the millions women spend on cosmetics, clothing, health clubs, and fashion magazines, these practices remind us that—rightly or wrongly—the desire to conform to current standards of beauty is alive and well.

Our culture communicates these standards—subtly and not so subtly—virtually everywhere we turn: on magazine covers, in department store windows, on TV shows. Feminists argue that fashion dolls, such as the ubiquitous Barbie, reinforce an unnatural ideal of thinness. When we extrapolate the dimensions of these dolls to average female body sizes, indeed they are unnaturally long and thin. If the traditional Barbie doll were a real woman, her dimensions would be 38-18-34! In 1998, Mattel conducted "plastic surgery" on Barbie to give her a less pronounced bust and slimmer hips, but she is still not exactly dumpy.

A provocative campaign by Dove that started in Europe featuring women with imperfect bodies in their underwear may help. One ad reads, "Let's face it, firming the thighs of a size 8 supermodel wouldn't have been much of a challenge." Unilever initiated the campaign after its research showed that many women didn't believe its products worked because the women shown using them were so unrealistic. Perhaps at least partly because of the success of the Dove campaign, other companies also are turning to ordinary people instead of professional models when they advertise. McDonald's held a casting call for consumers who will appear on its world cup and bag packaging as an extension of its "I'm lovin' it" campaign. Nike and Wal-Mart also have run advertisements with average Janes.

Will the backlash against the pressure to be thin reach the more rarefied air of the *haute couture* industry, whose customers can never (as the saying goes) be too thin or too rich? A few recent tragedies have certainly fueled the fire; in less than two months, four young Brazilian women died in widely publicized cases of anorexia, which sparked an international debate about body image and eating disorders. Unilever banned the use of so-called "size 0" models in its ads for products ranging from Lux shower gel and Sunsilk shampoo to Slim-Fast diet drinks. How permanent will these changes be? For now, we'll simply have to weight and see.

Truth 19. Men want to sleep with their cars

Consider the case of a Tennessee man who tried to marry his car. His plan was thwarted after he listed his fiancée's birthplace as Detroit, her father as Henry Ford, and her blood type as 10W40. Under Tennessee law, only a man and a woman can legally wed.

His attachment may be a bit extreme (or so we hope), but there's no doubt that cars function as sexual surrogates. This example underscores the ways that some of our possessions "speak" to us. In fact, these relationships start to look positively Freudian…Sigmund Freud proposed that much of one's adult personality stems from a fundamental conflict between a desire to gratify physical needs and the necessity to function as a responsible member of society. Perhaps products like red convertibles provide an outlet to do just that.

> There's no doubt that cars function as sexual surrogates.

Back in the 1950s, a school of thought called motivational research started to borrow Freudian ideas to understand the deeper meanings of products and advertisements. This approach adapted psychoanalytical (Freudian) interpretations with a heavy emphasis on unconscious motives. It basically assumed that we channel socially unacceptable needs into acceptable outlets—including product substitutes.

Ernest Dichter, a psychoanalyst who trained in Vienna in the early part of the twentieth century, pioneered this work. Dichter conducted in-depth interview studies on more than 230 different products, and actual marketing campaigns incorporated many of his findings. For example, Esso (now Exxon in the United States) for many years reminded consumers to "Put a Tiger in Your Tank" after Dichter found that people responded well to this powerful animal symbolism containing vaguely sexual undertones. These are some other insights that surfaced from this research:

- Women equate the act of baking a cake from scratch with giving birth. Instant cake mixes didn't sell well when they were introduced; they did better when they were reformulated to require the cook to break an egg into the mix.
- Men are reluctant to donate blood because they fear their "vital fluids" will be depleted. The Red Cross addressed this fear with the slogan, "Give the gift of life" so that men would feel they were (symbolically) fertilizing others rather than being drained.
- Men feel secure if they have a full drawer of neatly ironed shirts or folded socks.
- White bread, cotton fabrics, and harsh household cleaning chemicals connote moral purity and cleanliness.
- Kitchen appliances, boats, sporting goods, and cigarette lighters convey mastery over the environment.
- Soups have magical healing powers, and carbonated drinks possess a magical effervescent property.
- Houses with large doorknobs will sell better because they subconsciously remind prospective buyers of how the entrance to their own home felt when they were little and had tiny hands.

Although this Freudian perspective has not been in vogue among researchers for quite some time, the basic notion that marketers need to understand the "deep meanings" of products that go well beyond their basic functions is alive and well. For example, Carl Jung, another of Freud's disciples, continues to influence some advertisers' strategies (including the major ad agency Young & Rubicam). Freud was grooming Jung to be his successor, but his protégé was unable to accept Freud's emphasis on sexual aspects of personality, and the two men went their separate ways. Jung went on to develop his own method of psychotherapy he called *analytical psychology*.

Jung believed that the cumulative experiences of past generations shape who we are today. He proposed that we each share a *collective unconscious*—a storehouse of memories that we inherit from our ancestors. For example, Jung would argue that many people are afraid of the dark because their distant ancestors had good reason to fear it. These shared memories create archetypes, or universally recognized ideas and behavior patterns. Archetypes involve themes, such as birth, death, or the devil, that appear frequently in myths, stories, and dreams.

> These shared memories create *archetypes*, or universally recognized ideas and behavior patterns. These images appear frequently in marketing messages that use characters such as wizards, revered teachers, or even Mother Nature.

Jung's ideas may seem a bit far-fetched, but advertising messages, in fact, do often include archetypes. For example, two that Jung and his followers identified are the "old wise man" and the "earth mother." These images appear frequently in marketing messages that use characters such as wizards, revered teachers, or even Mother Nature. Our culture's infatuation with stories such as *Harry Potter* and *The Lord of the Rings* speaks to the power of these images.

Truth 20. Your PC is trying to kill you

In 1886, a momentous event occurred in marketing history—the Quaker Oats man first appeared on boxes of hot cereal. Quakers had a reputation in nineteenth-century America for being shrewd but fair, and peddlers sometimes dressed as members of this religious group to cash in on their credibility. When the cereal company decided to "borrow" this imagery for its packaging, this signaled the recognition that its customers might make the same association.

Today, thousands of brands borrow personality traits of individuals or groups to convey an image they want customers to form of them. A brand personality is the set of traits people attribute to a product as if it were a person. Many of the most recognizable figures in popular culture are spokescharacters for long-standing brands, such as the Jolly Green Giant, the Keebler Elves, Mr. Peanut, and Charlie the Tuna.

> Brands borrow personality traits of individuals or groups to convey an image they want customers to form of them.

Our feelings about a brand's personality are part of brand equity, which refers to the extent to which a consumer holds strong, favorable, and unique associations with a brand in memory—and the extent to which she or he is willing to pay more for the branded version of a product than for a nonbranded (generic) version. Building strong brands is good business. If you don't believe it, consider that, in a study of 760 Fortune 1,000 companies after the stock market took a nosedive in October of 1997, the 20 strongest corporate brands (for example, Microsoft and GE) actually gained in market value, whereas the 20 weakest lost an average of $1 billion each.[41]

An advertising agency wrote the following memo to help it figure out how to portray one of its clients. Based on this description of the "client," can you guess who he is? "He is creative…unpredictable…an imp…. He not only walks and talks, but also has the ability to sing, blush, wink, and work with little devices like pointers…. He can also play musical instruments…. His walking motion is characterized as a 'swagger.'…. He is made of dough and has mass." Of course, we all know today that packaging and other physical cues create a "personality" for a product (in this case, the Pillsbury Doughboy).

A product that creates and communicates a distinctive brand personality stands out from its competition and inspires years of loyalty. However, personality analysis helps marketers identify a brand's weaknesses that have little to do with its functional qualities. adidas asked kids in focus groups to imagine that the brand came to life and was at a party, and to tell what they would expect the brand to be doing there. The kids responded that adidas would be hanging around the keg with its pals, talking about girls. Unfortunately, they also said Nike would be *with* the girls!"[42] These results reminded adidas' brand managers that they had some work to do. We compare this process to animism, the common cultural practice whereby people give inanimate objects qualities that make them somehow alive.

A brand's positioning strategy is a statement about what that brand wants to be in the eyes of its customers—especially relative to the competition. Marketers typically think in these terms (even if they haven't read this book); they routinely describe their brands and the competition as if they were people. For example, here's how the marketing director for Philips Electronics in Asia sums up the problem he faces in updating his brand so that it's seen as hip and young by Chinese consumers: "To put it bluntly, we are received well by middle-aged gentlemen…. But a brand like Sony is seen as younger, more arrogant, with a space-age personality."[43]

In a sense, then, a brand personality is a statement about the brand's market position. Understanding this is crucial to marketing strategy, especially if consumers don't see the brand the way its makers intend them to and they must attempt to reposition the product (give it a personality makeover). That's the problem Volvo now faces; its cars are renowned for safety, but drivers don't exactly see them as exciting or sexy. A safe and solid brand personality makes it hard to sell a racy convertible like the C70 model, so a British ad tries to change that perception with the tagline, "Lust, envy, jealousy. The dangers of a Volvo." Just as with people, however, you can only go so far to convince others that your personality has changed. Volvo has been trying to jazz up its image for years, but for the most part consumers aren't buying it. In an earlier attempt in the United Kingdom, the company paired action images like a Volvo pulling a helicopter off a cliff with the headline "Safe Sex"—but market research showed people didn't believe the new image. As one brand consultant observed, "You get the sort of feeling you get when you see your grandparents trying to dance the latest dance. Slightly amused and embarrassed."[44]

> Brands personality is a statement about the brand's market position.

Truth 21. Birds of a feather buy together

Nike makes a lot of shoes and athletic apparel, but now the company wants to play an even bigger role in your daily life. It commissioned original workout music for its "Nike + Original Run" series that you can buy at Apple's iTunes Music Store. It teamed up with Apple to offer the Nike + shoes that feature a built-in pocket under the insole for the Nike + iPod sensor that lets you track your run and set goals while listening to your favorite tunes. It's releasing other CDs featuring music and voice-over coaching in activities such as yoga, dance, and weight training.

In traditional societies, class, caste, village, or family largely dictate a person's consumption options. In a modern consumer society, however, people are freer to select the set of products, services, and activities that define themselves and, in turn, create a social identity they communicate to others. One's choice of goods and services (do you choose to "just do it" with Nike?) makes a statement about who one is and about the types of people with whom one desires to identify—and even those whom we wish to avoid.

A lifestyle marketing perspective recognizes that people sort themselves into groups on the basis of the things they like to do, how they like to spend their leisure time, and how they choose to spend their disposable income. The growing number of niche magazines that cater to specialized interests reflects the rainbow of choices available to us in today's society. In one recent year, *WWF Magazine* (World Wrestling Federation) gained 913,000 readers, and *4 Wheel & Off Road* gained 749,000, whereas mainstream *Reader's Digest* lost more than 3 million readers, and *People* lost more than 2 million.

> Brand personality is a statement about the brand's market position and makes a statement about who one is and about the types of people with whom one desires to identify—and even those whom we wish to avoid.

These finely tuned choices, in turn, create opportunities for market segmentation strategies that recognize the potency of a consumer's chosen lifestyle in determining both the types of products purchased and the specific brands most likely to appeal to a certain lifestyle segment. For example, the popularity of wrestling is creating other lifestyle marketing opportunities. The WWE (World Wrestling Entertainment) is lending its name to the Socko Energy line of beverages that Wal-Mart sells. The drinks include "WWE Slammin' Citrus Powered by Socko" and "WWE Raw Attitude Powered by Socko." In turn, Bliss Beverages, which makes the beverages, will sponsor WWE pay-per-view matches. Now that's opening a can of lifestyle marketing Whoop-ass!

Marketers often find it useful to develop products that appeal to different lifestyle groups. Simply knowing a person's income doesn't predict whether he will drive a Cadillac Escalade SUV pickup or a Cadillac El Dorado sedan. To do this, they need a way to "breathe life" into demographic data to identify, understand, and target consumer segments that will share a set of preferences for their products and services. When they combine personality variables with knowledge of lifestyle preferences, they have a powerful lens they can focus on consumer segments. We call this approach *psychographics*. Adidas, for example, describes different types of shoe buyers in terms of lifestyles so that it can address the needs of segments, such as *gearheads* (hard-core, older runners who want high-performance shoes), *popgirls* (teeny-boppers who hang out at the mall and wear Skechers), and fastidious *eclectus* (Bohemian, cutting-edge types who want hip, distinctive products).

Most contemporary psychographic research attempts to group consumers according to some combination of three categories of variables—activities, interests, and opinions—that we call AIOs. Using data from large samples, marketers create profiles of customers who resemble each other in terms of their activities and patterns of product usage. It's according to a general rule of thumb that marketers call this the 80/20 rule—only 20 percent of a product's users account for 80 percent of the volume of product a company sells. Researchers attempt to determine who uses the brand and try to isolate heavy, moderate, and light users.

The latest and hottest extension of lifestyle marketing is *behavioral targeting*, which refers to presenting people with advertisements based on their Internet use. Today, it's fairly easy for marketers to tailor the ads you see to Web sites you've visited. Some critics feel this is a mixed blessing, because it implies that big companies are tracking where we go and keeping this information.

Indeed, there are important privacy issues still to be resolved, but, interestingly, many consumers seem more than happy to trade off some of their personal information in exchange for information they consider more useful to them. A 2006 survey on this issue reported that 57 percent of the consumers it polled said they were willing to provide demographic information in exchange for a personalized online experience. And three-quarters of those involved in an online social network felt that this process would improve their experience because it would introduce them to others who shared their tastes and interests. However, a majority still expressed concern about the security of their personal data online.[45]

Pro or con, it's clear that behavioral targeting is starting to take off in a big way. For example, Blockbuster.com uses software that recommends videos to a customer based on attributes the flick shares with other movies she has already ordered. This results in some suggestions that may not be immediately obvious. Thus, someone who watched *Crash* might receive a recommendation for *Little Miss Sunshine* because both involve dysfunctional social groups, dynamic pacing, and an interdependent ensemble cast. Blockbuster says the service has increased its average customer's "to watch list" by almost 50 percent.

> Behavioral targeting is starting to take off in a big way.

Truth 22. Sell wine spritzers to squash players

Because a goal of lifestyle marketing is to allow consumers to pursue their chosen ways to enjoy their lives and express their social identities, a key aspect of this strategy is to focus on product usage in desirable social settings. The desire to associate a product with a social situation is a long-standing one for advertisers, whether they include the product in a round of golf, a family barbecue, or a night at a glamorous club surrounded by the hip-hop elite.

We get a clearer picture of how people use products to define lifestyles when we see how they make choices in a variety of product categories. A lifestyle marketing perspective implies that we must look at *patterns of behavior* to understand consumers. Sadly, most marketers don't get this; they are so busy focusing on their immediate competitors within the same product space that they fail to understand how their brand "fits" into the consumer's broader pattern of consumption. They are missing out on a lot by looking too hard at a few trees instead of surveying the entire forest!

> A lifestyle marketing perspective implies that we must look at *patterns of behavior* to understand consumers.

When we do take the forest view, we quickly realize that many products and services do "go together," usually because the same types of people tend to select them. In many cases, products do not seem to "make sense" if they are unaccompanied by companion products (for example, fast food and paper plates, or a suit and tie) or are incongruous in the presence of others (for example, a Chippendale chair in a high-tech office or Lucky Strike cigarettes with a solid gold lighter).

Therefore, an important part of lifestyle marketing is identifying the set of products and services that consumers seem to link together into a specific lifestyle. And research evidence suggests that even a relatively unattractive product becomes more appealing when consumers link it with other, liked products. Marketers who pursue co-branding strategies where they team up with other companies to promote their products understand this. For example, Wendy's and Procter & Gamble joined forces to offer Wendy's Custom Bean, a Folgers Gourmet Selection coffee that the restaurant chain says will become a centerpiece of its new breakfast menu. Some marketers even match up their spokescharacters in ads; the Pillsbury Doughboy appeared in a commercial with the Sprint Guy to pitch cellphones, the lonely Maytag repairman was in an ad for the Chevrolet Impala, and the Taco Bell Chihuahua showed up in a commercial for Geico insurance.

Product complementarity occurs when the symbolic meanings of different products relate to one another. Consumers use these sets of products we call a consumption constellation to define, communicate, and perform social roles. For example, we defined the American "yuppie" of the 1980s by such products as a Rolex watch, a BMW automobile, a Gucci briefcase, a squash racket, fresh pesto, white wine, and brie cheese. We find somewhat similar constellations for "Sloane Rangers" in the United Kingdom and "Bon Chic Bon Genres" in France. Although people today take pains to avoid being classified as yuppies, this social role had a major influence on defining cultural values and consumption priorities in the 1980s.

One powerful perspective that is based on understanding complex patterns of consumption is geodemography. This describes a set of analytical techniques that combine large amounts of data on consumer expenditures and other socioeconomic factors with geographic information about the areas in which people live, to identify consumers who share common consumption patterns. Researchers base this approach on the common assumption that "birds of a feather flock together." People who have similar needs and tastes also tend to live near one another. So, it should be possible to locate "pockets" of like-minded people who marketers can reach more economically by direct mail and other methods. A marketer who wants to reach white, single consumers who are college educated and tend to be fiscally conservative may find that it is more efficient to mail catalogs to zip codes 20770 (Greenbelt, Maryland) and 90277 (Redondo Beach, California) than to adjoining areas in either Maryland or

California, where there are fewer consumers who exhibit these characteristics. Birds of a feather do buy together.

> People who have similar needs and tastes also tend to live near one another.

Truth 23. They think your product sucks—but that's not a bad thing

Have you checked out one of those crazy Mentos/Diet Coke videos yet? At least 800 of them flooded the Internet after people discovered that when you drop the quarter-size candies into bottles of Diet Coke, you get a geyser that shoots 20 feet into the air. Needless to say, Mentos got a gusher of free publicity out of the deal, too.

Consumer-generated content—where everyday people voice their opinions about products, brands, and companies on blogs, podcasts, and social networking sites like Facebook and MySpace, and even film their own commercials that thousands view on sites like YouTube—probably is the biggest marketing phenomenon of the past few years (even bigger than the iPhone or Paris Hilton's jail stay!). This important trend helps to define the era of so-called *Web 2.0*—the rebirth of the Internet as a social, interactive medium from its original roots as a form of one-way transmission from producers to consumers.

Although many marketers find this change threatening because they are now forced to "share" ownership of their brands with users, this new form of user participation is here to stay. The reality is that companies no longer can rely solely upon a "push method" to inform their customers about their products; there is now a vibrant two-way dialogue that allows consumers to contribute their evaluations of products within their respective Web communities.

> Companies no longer can rely solely upon a "push method" to inform their customers about their products.

Consumers are embracing this trend for several reasons: The technology is readily available and inexpensive to use; Internet access allows any surfer to become (somewhat of) an expert on anything in a matter of hours; and people trust their peers' opinions more than they do those of big companies. So, marketers need to accept this new reality—even when they don't necessarily like what customers have to say about their brands. When it comes to consumer-generated content, they're either on the train or under it! Here are a few of the many consumer-generated campaigns we've seen recently:

- At MasterCard's priceless.com Web site, consumers can write advertising copy for two filmed commercials by contributing four lines of dialogue, ending with the kicker, "Priceless."
- A Converse campaign that allowed customers to send in homemade commercials to Conversegallery.com attracted about 1,500 submissions. Converse ran several of them on television.
- Kao Corp., which makes Ban deodorant, asked young women to create ads that talk to fellow teens who worry about underarm odor. Readers of teen magazines submitted an image and filled in the blanks in the company's "Ban It" slogan. One typical submission shows four girls in similar jeans and tank tops, with their backs to the camera and the headline: "Ban Uniformity."
- PepsiCo sponsored a Creative Challenge in China that invited consumers to develop the next Pepsi TV commercial starring Asian pop-music superstar Jay Chou. Pepsi got almost 27,000 scripts in six weeks. To help promote the contest, China's Back Dorm Boys, a pair of lip-syncing "net celebrities" that Pepsi sponsored, acted out scripts in their dorm room. In the United States, Pepsi offered consumers a chance to design a new can for the beverage, with the winning design appearing on 500 million Pepsi cans.
- Lucasfilm made clips of Star Wars available to fans on the Internet to mash up (remix) at will to celebrate the 30th anniversary of the epic's release. Working with an easy-to-use editing program, fans can cut, add to, and retool the clips. Then they can post their creations to blogs or social networking sites like MySpace.
- Now that TV spin-offs from the Star Trek series have ended, bereft fans are filling the void by banding together to make their own episodes. Up to two dozen of these fan-made "Star Trek" projects are in various stages of completion, depending on what you count as a full-fledged production. You can view a Scottish production at www.ussintrepid.org.uk. A Los Angeles group has filmed more than

40 episodes, some of which explore gay themes that the original didn't get near. (Check out www.hiddenfrontier.com.)

- The Nokia Concept Lounge invited designers in Europe to share ideas for the next new, cool phone, while Nespresso's contest yielded coffee-drinking ideas like the Nespresso InCar coffee machine and the Nespresso Chipcard that, upon being inserted into a vending machine, communicates with a central database to brew a personalized cup of coffee.

Chevrolet learned the hard way about the downside of giving control over its brands to consumers. The carmaker introduced a Web site allowing visitors to take existing video clips and music, insert their own words, and create a customized 30-second commercial for the 2007 Chevrolet Tahoe. The idea was to generate interest for the Tahoe by encouraging satisfied drivers to circulate videos of themselves around the Web. Sure enough, plenty of videos circulated—but many of the messages for the gas-hungry SUV weren't exactly flattering. One ad used a sweeping view of the Tahoe being driven through a desert. "Our planet's oil is almost gone," it said. "You don't need G.P.S. to see where this road leads." Another commercial asked: "Like this snowy wilderness? Better get your fill of it now. Then say hello to global warming." A spokeswoman for Chevrolet commented, "We anticipated that there would be critical submissions. You do turn over your brand to the public, and we knew that we were going to get some bad with the good. But it's part of playing in this space."[46]

Indeed. If you're worried about what some of your customers might say about your brand, get over it. Listen to their complaints and improve your product rather than shutting the comments down.

> If you're worried about what some of your customers might say about your brand, get over it.

Truth 24. When to sell the steak, when to sell the sizzle

Should marketers worry more about what is said, or how it's said and who says it?

The answer is (drum roll)…it depends. Your target market's level of involvement with your product determines how much effort they will put into processing what you say. The situation is comparable to a traveler who comes to a fork in the road. She chooses one path or the other, and this choice has a big impact on the factors that will make a difference in persuasion attempts.

Depending on the personal relevance of this information, your customer will follow one of two routes to persuasion. Under conditions of high involvement, she takes the *central route.* Under conditions of low involvement, she takes a *peripheral route* instead. Let's take a closer look at each route:

> Your customer will follow one of two routes to persuasion.

The Central Route to Persuasion—When the consumer finds the information in a persuasive message to be relevant or somehow interesting, she will carefully attend to the message content. In this case, she's likely to actively think about the arguments the marketer presents and generate *cognitive responses* to these arguments. On hearing a radio message warning about drinking while pregnant, an expectant mother might say to herself, "She's right. I really should stop drinking alcohol now that I'm pregnant." Or she might offer counterarguments, such as "That's a bunch of baloney. My mother had a cocktail every night when she was pregnant with me, and I turned out fine." If a person generates counterarguments in response to a message, it is less likely that she will yield to the message, whereas if she generates further supporting arguments, it's most likely she'll comply. The implication is that message factors, such as the quality of arguments an ad presents, will determine attitude change. Prior knowledge about a topic results in more thoughts about the message and increases the number of counterarguments. Sell the steak.

The Peripheral Route to Persuasion—We take the peripheral route when we're not motivated to think about the arguments that the marketer gives us. Instead, we're likely to use other cues to decide how to react to the message. These cues include the product's package, the attractiveness of the source, or the context in which the message appears. We call sources of information extraneous to the actual message *peripheral cues* because they surround the actual message.

The peripheral route to persuasion highlights an interesting paradox: When consumers don't care about a product, the style in which it's presented (for example, who endorses it or which visuals go with it) becomes more important. The implication here is that we may buy low-involvement products chiefly because the marketer has done a good job in designing a "sexy" package, choosing a popular spokesperson, or perhaps just creating a pleasant shopping environment. Sell the sizzle.

When consumers don't care about a product, the style in which it's presented becomes more important.

Truth 25. People are dumber than robots (lazier, too)

Consider the following scenario: You've scored a free ticket to a major football game. At the last minute, though, a sudden snowstorm makes getting to the stadium somewhat dangerous. Would you still go? Now, assume the same game and snowstorm, except this time you paid handsomely for the ticket. Would you head out in the storm in this case?

Analyses of people's responses to this situation and to other similar puzzles illustrate principles of *mental accounting*. This process demonstrates that the way we pose a problem (we call this *framing*) and whether it's phrased in terms of gains or losses influences our decisions.[47] In this case, researchers find that people are more likely to risk their personal safety in the storm if they paid for the football ticket than if it's a freebie. Only the most die-hard fan would fail to recognize that this is an irrational choice, as the risk is the same regardless of whether you got a great deal on the ticket. Researchers call this decision-making bias the *sunk-cost fallacy*—having paid for something makes us reluctant to waste it.

At the risk of understatement, many of the decisions customers make aren't rational—or even in their best interest. For example, the degree of external search we do for most products is surprisingly small, even when we would benefit by having more information. And lower-income shoppers, who have more to lose by making a bad purchase, actually search less prior to buying than do more affluent people.

> Many of the decisions customers make aren't rational—or even in their best interest.

Indeed, many consumers typically visit only one or two stores and rarely seek out unbiased information sources prior to making a purchase decision, especially when they have little time available to do so. This pattern is especially prevalent for decisions about durable goods such as appliances or autos, even when these products represent significant investments. One study of Australian car buyers found that more than a third had made two or fewer trips to inspect cars prior to buying one.[48]

In addition, consumers can be amazingly fickle. They often engage in brand switching, even if their current brand satisfies their needs. For example, researchers for British brewer Bass Export who were studying the American beer market discovered a consumer trend toward having a repertoire of two to six favorite brands, rather than sticking to only one. This preference for brand switching led the firm to begin exporting its Tennent's 1885 lager to the United States, positioning the brew as an alternative to young drinkers' usual favorite brands. Sometimes, it seems that people just plain like to try new things—we crave variety as a form of stimulation or to reduce boredom. Variety seeking, the desire to choose new alternatives over more familiar ones, even influences us to switch from our favorite products to ones we like less! This can occur even before we become *satiated* or tired of our favorite. Research supports the idea that we are willing to trade enjoyment for variety simply because the unpredictability itself is rewarding.

Another irrational impulse we often experience is *loss aversion.* This means that we emphasize our losses more than our gains. For example, for most people, losing money is more unpleasant than gaining money is pleasant. Our sense of risk differs when we face options involving gains versus those involving losses. To illustrate this bias, consider the following choices. For each, would you take the safe bet or choose to gamble?

> We emphasize our losses more than our gains.

> **Option 1**—You're given $30 and a chance to flip a coin: Heads you win $9; tails you lose $9.
>
> **Option 2**—Get $30 outright, or you accept a coin flip that will win you either $39 or $21.

In one study, 70 percent of those given option 1 chose to gamble, compared to just 43 percent of those offered option 2. Yet, the odds are the same for both options! The difference is that people prefer "playing with the house money"; they are more willing to take risks when they perceive they're using someone else's resources. So, contrary to a rational decision-making perspective, we value money differently depending on where it comes from. This explains, for example, why someone might choose to blow a big bonus on some frivolous purchase but would never consider taking that same amount out of her savings account for this purpose.

Finally, research in mental accounting demonstrates that extraneous characteristics of the choice situation can influence our selections, even though they wouldn't if we were totally rational decision makers. As one example, researchers gave survey participants one of two versions of this scenario:

You are lying on the beach on a hot day. All you have to drink is ice water. For the past hour, you have been thinking about how much you would enjoy a nice cold bottle of your favorite brand of beer. A companion gets up to go make a phone call and offers to bring back a beer from the only nearby place where beer is sold (either a fancy resort hotel or a small, run-down grocery store, depending on the version you're given). He says that the beer might be expensive and asks how much you are willing to pay for it. What price do you tell him?

Participants who read the fancy resort version offered a median price of $2.65, but those who got the grocery store version were only willing to pay $1.50. In both versions, the consumption act is the same, the beer is the same, and they don't consume any "atmosphere" because they drink the beer on the beach.[49] So much for rational decision making!

Truth 26. Your customers have your brand on the brain

Is there a "buy button" in your brain? Some corporations are teaming up with neuroscientists to find out. This work in *neuromarketing* uses functional magnetic resonance imaging (F.M.R.I.), a brain-scanning device that tracks blood flow as we perform mental tasks. In recent years, researchers have discovered that regions such as the amygdala, the hippocampus, and the hypothalamus are dynamic switchboards that blend memory, emotions, and biochemical triggers. These interconnected neurons shape the ways that fear, panic, exhilaration, and social pressure influence our choices.

> Is there a "buy button" in your brain?

Scientists know that specific regions of the brain light up in these scans to show increased blood flow when a person recognizes a face, hears a song, makes a decision, or senses deception. Now they are trying to harness this technology to measure consumers' reactions to movie trailers, choices about automobiles, the appeal of a pretty face, and loyalty to specific brands. British researchers recorded brain activity as shoppers toured a virtual store. They claim to have identified the neural region that becomes active when a shopper decides which product to pluck from a supermarket shelf. DaimlerChrysler took brain scans of men as they looked at photos of cars and confirmed that sports cars activated their reward centers. The company's scientists found that the most popular vehicles—the Porsche- and Ferrari-style sports cars—triggered activity in a section of the brain called the *fusiform face area*, which governs facial recognition. Apparently, the cars reminded the men of faces with two lit eyes.

> DaimlerChrysler took brain scans of men as they looked at photos of cars and confirmed that sports cars activated their reward centers.

A study that took brain scans of people as they drank competing soft-drink brands illustrates how loyalty to a brand colors our reactions even at a basic, physiological level. When the researchers monitored brain scans of 67 people who did a blind taste test of Coca-Cola and Pepsi, each soft drink lit up the brain's reward system, and the participants were evenly split as to which drink they preferred—even though three out of four participants said they preferred Coke. When told they were drinking Coke, the regions of the brain that control memory lit up, and this activation drowned out the area that reacts simply to taste cues. In this case, Coke's strong brand identity trumped the sensations coming from respondents' taste receptors.

In another study, researchers reported that pictures of celebrities triggered many of the same brain circuits as images of shoes, cars, chairs, wristwatches, sunglasses, handbags, and water bottles. All of these objects set off a rush of activity in a part of the cortex that neuroscientists know links to a sense of identity and social image. The scientists also identified types of consumers based on their responses. At one extreme were people whose brains responded intensely to "cool" products and celebrities with bursts of activity but who didn't respond at all to "uncool" images. They dubbed these participants "cool fools," likely to be impulsive or compulsive shoppers. At the other extreme were people whose brains reacted only to the unstylish items, a pattern that fits well with people who tend to be anxious, apprehensive, or neurotic.

Many researchers remain skeptical about how helpful this technology will be for consumer research. If indeed researchers can reliably track consumers' brand preferences by seeing how their brains react, there may be many interesting potential opportunities for new research techniques that rely on what we (at least our brains) do rather than on what we say.

Truth 27. Let their mouseclicks do the walking

As anyone who's ever typed a search phrase like "home theatres" into Google knows, the Web delivers enormous amounts of product and retailer information in seconds. In fact, the biggest problem Web surfers face these days is narrowing down their choices, not beefing them up. In cyberspace, simplicity is The Holy Grail.

> The biggest problem Web surfers face these days is narrowing down their choices, not beefing them up.

With the tremendous number of Web sites available and the huge number of people surfing the Web each day, how can people organize information and decide where to click? A cybermediary often is the answer. This is an intermediary that helps to filter and organize online market information so that customers can identify and evaluate alternatives more efficiently. Many consumers regularly link to comparison-shopping sites like Bizrate.com or Pricegrabbers.com, for example, to get a list of the online retailers that sell a given item along with the price each charges.

Cybermediaries take different forms:

- Directories and portals like Yahoo! or The Knot are general services that tie together a large variety of different sites.
- Web site evaluators reduce the risk to consumers by reviewing sites and recommending the best ones. For example, Point Communications selects sites that it designates as Top 5 percent of the Web.
- Forums, fan clubs, and user groups offer product-related discussions to help customers sift through options. It's becoming clear that customer product reviews are a key driver of satisfaction and loyalty. In one large survey, about half of respondents who bought an item from a major Web site remembered seeing customer product reviews.

This group's satisfaction with the online shopping experience was 5 percent higher than for shoppers who didn't recall customer reviews.[50] Another advantage is that consumers get to experience much wider options—and products like movies, books, and CDs that aren't "blockbusters" are more likely to sell. At NetFlix, the online DVD rental company, for example, fellow subscribers recommend about two-thirds of the films that people order. In fact, between 70 and 80 percent of NetFlix rentals come from the company's back catalog of 38,000 films rather than recent releases.

Incidentally, this aspect of online customer review is one important factor that's fueling a new way of thinking that writer Chris Anderson calls the long tail. The basic idea is that we need no longer rely solely on big hits (like blockbuster movies or best-selling books) to find profits. Companies can also make money by selling small numbers of items that only a few people want—if they sell enough different items. For example, Amazon.com maintains an inventory of 3.7 million books compared to the 100,000 or so you'll find in a Barnes & Noble retail store. Most of these will sell only a few thousand copies (if that), but the 3.6 million books that Barnes & Noble doesn't carry make up a quarter of Amazon's revenues! Other examples of the long tail include successful microbreweries and TV networks that make money on reruns of old shows on channels like the Game Show Network.

- Financial intermediaries authorize payments from buyer to seller. Payment systems include electronic equivalents to credit card charges (PayPal), writing checks (Checkfree), paying in cash (Digicash), and sending secure electronic mail authorizing a payment (First Virtual).
- Intelligent agents are sophisticated software programs that use collaborative filtering technologies to learn from past user behavior to recommend new purchases. For example, when you let Amazon.com suggest a new book, it's using an intelligent agent to propose novels based on what you and others like you have bought in the past. Collaborative filtering is still in its infancy. In the next few years, expect to see many new Web-based methods to simplify the consumer decision-making process. Now if only someone could come up with an easier way to pay for all the great stuff you find courtesy of shopping bots!

Researchers are working hard to understand how consumers go about finding information online and, in particular, how they react to and integrate recommendations they receive from different kinds of online agents into their own product choices. An electronic recommendation agent is a software tool that tries to understand the criteria a human decision maker uses to choose among competitors within a product category via a series of questions about what the person likes and dislikes. Based on that data, the software then recommends a list of alternatives sorted by the degree that they fit these criteria. The Music Genome Project is one of the newest technologies that enable music fans to discover new artists. At Pandora.com, you type in the name of a band or song and immediately begin hearing similar tunes that the site's recommender system has determined you'll enjoy. By rating songs and artists, you can refine the suggestions, allowing Pandora to create a truly personalized station. The service employs 45 analysts, many with music degrees, who rank 15,000 songs a month on 400 characteristics. Similarly, Liveplasma.com graphically "maps" consumers' interests in movies and music. If you search for music by The Decemberists, for example, you'll get a graphical representation of what previous Decemberists customers have purchased, presented in clusters of circles of various sizes. The bigger the circle, the greater the popularity of that band.

Research on how consumers use intelligent agents is starting to connect the dots regarding just how influential these digital decision aids are.

- Consumers who consult recommendation agents select the recommended products twice as often as those who do not.

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- The extent to which a consumer has agreed with the agent on past recommendations influences the likelihood he will accept the advice now.
- Recommendation agents have a greater impact on decisions when consumers feel the decision is risky—for example, if the

consequences of making a poor decision are high or if the item is expensive.

- When a recommendation agent asks the consumer about his preferences for a particular product attribute, the consumer will weigh that attribute more when making an actual product choice.

Truth 28. Nothing shouts quality like leather from Poland

A product's "address" matters. We seek out Italian shoes and microwave ovens built in South Korea, but we may take a pass on Italian ovens and South Korean shoes. Consumers strongly associate certain items with specific countries, and products from those countries often attempt to benefit from these linkages. In addition, the consumer's own expertise with the product category moderates the effects of this attribute. When other information is available, experts tend to ignore country-of-origin information, whereas novices continue to rely on it. However, when other information is unavailable or ambiguous, both experts and novices will rely on a product's birthplace to make a decision.

Predicting the quality of a product by looking at its country of origin is but one example of a common strategy that customers use all the time. Instead of thinking carefully about the pros and cons of a purchase, we often rely on heuristics—mental rules-of-thumb that lead to a speedy decision. These rules range from the very general ("higher-priced products are higher-quality products" or "buy the same brand I bought last time") to the very specific ("buy Domino, the brand of sugar my mother always bought" or "you can't go wrong with shoes from Italy").

> Instead of thinking carefully about the pros and cons of a purchase, we often rely on *heuristics*—mental rules-of-thumb that lead to a speedy decision.

One shortcut we often use is to infer hidden dimensions of products from attributes we can observe. In these cases, the visible element acts as a product signal that communicates some underlying quality. This explains why someone trying to sell a used car makes sure the car's exterior is clean and shiny: Potential buyers often judge the vehicle's mechanical condition by its appearance, even though this means they may drive away in a clean, shiny clunker.

When we have only incomplete product information, we often base our judgments on our beliefs about *covariation*—the associations we have among events that may or may not actually influence one another. For example, a shopper may judge product quality by the length of time a manufacturer has been in business. Other signals or attributes that consumers tend to believe coexist with good or bad products include well-known brand names, country of origin, price, and the retail outlets that carry the product.

Unfortunately, many of us estimate covariation quite poorly. And our erroneous beliefs persist despite evidence to the contrary—we tend to see what we're looking for. In other words, we look for product information that confirms our guesses and ignore or explain away information that contradicts what we already think. In one experiment, consumers sampled four sets of products to determine their price related to their quality. Those who believed prior to the study that a higher price means higher quality elected to sample higher-priced products, thus creating a self-fulfilling prophecy.[51]

> We look for product information that confirms our guesses and ignore or explain away information that contradicts what we already think.

How valid are heuristics? For example, do higher prices in fact mean higher quality? This *price–quality relationship* is one of the most pervasive heuristics around. Novice consumers may, in fact, consider price as the only relevant product attribute. Experts also consider this information, although they tend to use price for its informational value, especially for products (for example, virgin wool) that they know vary widely in quality. When this quality level is more standard or strictly regulated (for example, Harris Tweed sport coats), experts do not weigh price in their decisions. For the most part, this belief is justified; you do tend to get what you pay for. However, let the buyer beware: The price-quality relationship is not always justified.

Truth 29. Consider investing in a drive-thru mortuary

It's no secret that environmental factors influence what we feel like buying, not to mention how much. One study even reported that pumping certain odors into a Las Vegas casino actually increased the amount of money patrons fed into slot machines!

A particularly important situational factor is simply how pressed we are for time—and we often feel we are. Many consumers believe they are more pressed for time than ever before—a feeling marketers call time poverty. This feeling appears to be due more to perception than to fact. The reality is that we just have more options for spending our time, so we feel pressured by the weight of all these choices. The average working day at the turn of the twentieth century was 10 hours (six days per week), and women did 27 hours of housework per week, compared to less than five hours weekly now. About a third of Americans report always feeling rushed—up from 25 percent of the population in 1964.[52]

> Many consumers believe they are more pressed for time than ever before—a feeling marketers call *time poverty*.

Our experience of time is largely a result of our culture, because different societies have varying perspectives on this experience. To most Western consumers, time is a neatly compartmentalized thing: We wake up in the morning, go to school or work, come home, eat dinner, go out, go to sleep, wake up, and do it all over again. We call this perspective *linear separable time*: Events proceed in an orderly sequence, and "There's a time and a place for everything." There is a clear sense of past, present, and future. We perform many activities as the means to some end that will occur later, as when we "save for a rainy day".

This perspective seems "natural" to us, but not all others share it. Some cultures run on *procedural time* and ignore the clock completely—people simply decide to do something "when the time is right." For example, in

Burundi people might arrange to meet when the cows return from the watering hole. If you ask someone in Madagascar how long it takes to get to the market, you will get an answer like, "in the time it takes to cook rice".

Alternatively, in circular or cyclic time, natural cycles, such as the regular occurrence of the seasons, govern people's sense of time (a perspective many Hispanic cultures share). To these consumers, the notion of the future does not make sense—that time will be much like the present. Because the concept of future value does not exist, these consumers often prefer to buy an inferior product that is available now rather than wait for a better one that may be available later. Also, it is hard to convince people who function on circular time to buy insurance or save for a rainy day when they don't think in terms of a linear future.

The psychological dimension of time—how we actually experience it—is an important factor in queuing theory, the mathematical study of waiting lines. As we all know, our experience while waiting for something has a big effect on our evaluations of what we get at the end of the wait. Although we assume that something must be pretty good if we have to wait for it, the negative feelings that long waits arouse can quickly turn people off. In a recent survey, NCR Corp. found that standing around the local Department or Division of Motor Vehicles is the most dreaded wait of all. Waiting in line at retail outlets came in a close second, followed by registering at clinics or hospitals, checking in at airports, and ordering at fast-food restaurants or deli counters. On average, consumers estimate that they spend more than two days per year waiting in line for service, and half believe they waste between 30 minutes to two hours each week waiting for service.[53]

> Our experience while waiting for something has a big effect on our evaluations of what we get at the end of the wait.

Marketers use "tricks" to minimize psychological waiting time (just think about your last visit to Disney World). These techniques range from altering customers' perceptions of a line's length to providing distractions that divert attention away from waiting. One hotel chain, after receiving excessive complaints about the wait for elevators, installed mirrors near the elevator banks. People's natural tendency to check their appearance reduced complaints, even though the actual waiting time was unchanged.

Truth 30. Go to the Gemba

How much are your favorite pants worth? A judge in Washington, D.C. made headlines when he filed a $54 million lawsuit against his neighborhood dry cleaner that he accused of losing a pair of his pinstriped suit pants. He claimed that a D.C. consumer protection law entitled him to thousands of dollars for each day over nearly four years in which signs at the shop promised "same day service" and "satisfaction guaranteed." The suit dragged on for several months, but at the end of the day, the plaintiff went home with empty pockets.

If you're not happy with a product or service, what can you do about it? You have three possible courses of action (though sometimes you can take more than one).

- **Voice response**—You can appeal directly to the retailer for redress (for example, a refund).
- **Private response**—You can express your dissatisfaction to friends and boycott the product or the store where you bought it.
- **Third-party response**—Like the pantsless judge, you can take legal action against the merchant, register a complaint with the Better Business Bureau, or perhaps write a letter to the newspaper.

In one study, business majors wrote complaint letters to companies. When the company sent a free sample in response, this significantly improved their feelings about the company. This didn't happen, however, when they received only a letter of apology but no swag. Even worse, students who got no response reported an even more negative image than before, indicating that *any* kind of response is better than none.[54]

A number of factors influence which route to dealing with dissatisfaction we will choose. People are more likely to take action for expensive products such as household durables, cars, and clothing than for inexpensive products. Ironically, consumers who are satisfied with a store in general are more likely to complain if they experience something bad; they take the time to complain because they feel connected to the store.

Older people are also more likely to complain, and they are much more likely to believe the store will actually resolve the problem. Shoppers who get their problems resolved feel even *better* about the store than if nothing had gone wrong. However, if the consumer does not believe that the store will respond well to a complaint, the person will be more likely to simply switch than fight. The moral: Marketers should *encourage* consumers to complain to them. People are more likely to spread the word about unresolved negative experiences to their friends than they are to boast about positive occurrences.

> Shoppers who get their problems resolved feel even better about the store than if nothing had gone wrong.

To be more responsive to its customers, Dell created a social networking community it calls *Idea Storm*. This is an online forum for users to submit suggestions about its products, and people have deluged the site with thousands of recommendations and comments. Increasingly, companies are figuring out that they're better off revealing their flaws to their customers than pretending to be foolproof—and having to explain away failures later. For example, Delta Airlines (an established player in an industry notorious for low customer satisfaction) recently created its own Web site, http://blog.delta.com, that hosts suggestions from consumers —"Bring the pillows back, please"—as well as polls about features and offerings.

Many analysts who study consumer satisfaction or who are trying to design new products or services to increase it recognize that it is crucial to understand how people actually interact with their environment to identify potential problems. They typically conduct these investigations in focus groups where a small set of consumers comes into a facility to try a new item while company personnel observe them from behind a mirror.

However, some researchers advocate a more up-close-and-personal approach that allows them to watch people in the actual environment where they consume the product. This perspective grew out of the Japanese approach to *total quality management* (*TQM*); a complex set of management and engineering procedures aimed at reducing errors and increasing quality.

To help them achieve more insight, these researchers go to the *Gemba*, which to the Japanese means the one true source of information. According to this philosophy, it's essential to send marketers and designers to the precise place where consumers *use* the product or service rather than asking laboratory subjects to interact with it in a simulated environment.

It's essential to send marketers and designers to the precise place where consumers *use* the product or service rather than asking laboratory subjects to interact with it in a simulated environment.

Host Foods, which operates food concessions in major airports, sent a team to the *Gemba*—in this case, an airport cafeteria—to identify problem areas. Employees watched as customers chose to (or didn't) enter the facility and then followed them as they inspected the menu, procured silverware, paid, and found a table. The findings were crucial to Host's redesign of the facility to make it easier to use. For example, the team identified a common problem that many people traveling solo experience: the need to put down one's luggage to enter the food line, and the feeling of panic you get because you're not able to keep an eye on your valuables while you're getting your meal.

Get out of your office, and experience your product or service precisely the way your customers do. You may be in for a rude awakening.

Truth 31. Your customers want to be like Mike (or someone like him)

Will a few pieces of leather and rubber really improve your game? In the movie *Like Mike*, the main character believes that he can fly higher when he dons his magical Air Jordans. Even those of us who would need a rocket pack to jump higher still get caught up in beliefs like this—if we didn't, all those sweet celebrity endorsement deals would be "nothing but net." Whether we're influenced by another individual or by a group, many of our product choices are strongly influenced by what others do. (No, this force didn't go away after junior high school.) A *reference group* is "an actual or imaginary individual or group that significantly influences the way we think about ourselves and the things we buy. It's hard to discount the power these groups exert upon us.

> Many of our product choices are strongly influenced by what others do.

For example, in the United States and around the world, many thousands of weekend Hell's Angels drop huge sums on motorcycles and biker paraphernalia. Harley-Davidson's most important marketing tool is not slick TV ads but its network of Harley Owners Groups (HOGs) that provide a feeling of community and camaraderie to members. Fellow riders bond via their consumption choices, so total strangers feel an immediate connection with one another when they meet. The publisher of *American Iron*, an industry magazine, observed, "You don't buy a Harley because it's a superior bike; you buy a Harley to be a part of a family."[55]

Why are reference groups so persuasive? The answer lies in the social power they wield over us. You have power over another person if you can make him do something—even if that person does it willingly. Social scientists describe several categories of social power.

You have power over another person if you can make him do something—even if that person does it willingly.

- **Referent power**—If a person admires the qualities of a person or a group, he tries to imitate them by copying the referent's behaviors (for example, choice of clothing, cars, and leisure activities). Prominent people in all walks of life can affect our consumption behaviors by virtue of product endorsements (50 Cent for Reebok), distinctive fashion statements (Fergie's displays of high-end designer clothing), or championing causes (Lance Armstrong's work for cancer). Referent power is important to many marketing strategies because consumers voluntarily modify what they do and buy to identify with a referent.
- **Information power**—A person can have power simply because she knows something others would like to know. Editors of trade publications such as Women's Wear Daily often possess tremendous power because of their ability to compile and disseminate information that can make or break individual designers or companies.
- **Legitimate power**—Sometimes we grant power by virtue of social agreements, such as the authority we give to police officers, soldiers, and yes, sometimes even professors. The legitimate power that a uniform confers wields authority in consumer contexts, including teaching hospitals where medical students don white coats to enhance their standing with patients. Marketers may "borrow" this form of power to influence consumers. For example, an ad featuring a model wearing a white doctor's coat can add an aura of legitimacy or authority to the presentation of the product. ("I'm not a doctor, but I play one on TV.")
- **Expert power**—To attract the casual Internet user, U.S. Robotics signed up British physicist Stephen Hawking to endorse its modems. A company executive commented, "We wanted to generate trust. So we found visionaries who use U.S. Robotics technology, and we let them tell the consumer how it makes their lives more productive." Hawking, who has Lou Gehrig's disease and speaks via a synthesizer, said in one TV spot, "My body may be stuck in this chair, but with the

Internet, my mind can go to the end of the universe." Hawking's expert power derives from the knowledge he possesses about a content area. This helps to explain the weight many of us assign to professional critics' reviews of restaurants, books, movies, and cars—even though, with the advent of blogs and open-source references such as Wikipedia, it's getting a lot harder to tell just who is really an expert!

- **Reward power**—A person or group with the means to provide positive reinforcement has reward power. The reward may be the tangible kind, such as what the contestants on *Survivor* experience when they get to stay on the island. Or it can be more intangible, such as the approval that the judges on *American Idol* (except Simon) deliver to contestants.
- **Coercive power**—We exert coercive power when we influence someone because of social or physical intimidation. A threat is often effective in the short term, but it doesn't tend to stick because we usually revert back to our original behavior as soon as the bully leaves the scene. Fortunately, marketers rarely try to use this type of power—unless you count those annoying calls from telemarketers! However, we can see elements of this power base in fear appeals that some companies use to scare us into buying life insurance ("who knows when you might walk into a bus?") as well as in intimidating salespeople who try to succeed with a "hard sell."

Truth 32. Go tribal

Before it released the popular Xbox game Halo 2, Microsoft put up a Web site to explain the story line. However, there was a catch: The story was written from the point of view of the Covenant (the aliens who are preparing to attack Earth in the game)—and in their language. Within 48 hours, avid gamers around the world worked together by sharing information in gaming chat rooms to crack the code and translate the text. More than 1.5 million people preordered the game before its release. This cooperative effort illustrates a major trend in consumer behavior.

A *brand community* is a group of consumers who share a set of social relationships based on usage or interest in a product. Unlike other kinds of communities, these members typically don't live near each other—except when they may meet for brief periods at organized events or *brandfests* that community-oriented companies such as Jeep, Saturn, or Harley-Davidson sponsor. These events help owners to "bond" with fellow enthusiasts and strengthen their identification with the product as well as with others they meet who share their passion. Researchers find that people who participate in these events feel more positive about the products as a result, and this enhances brand loyalty. They are more forgiving than others of product failures or lapses in service quality, and they're less likely to switch brands even if they learn that competing products are as good or better. Furthermore, these community members become emotionally involved in the company's welfare, and they often serve as brand missionaries by carrying its marketing message to others.

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A *consumer tribe* is similar to a brand community; it is a group of people who share a lifestyle and who can identify with each other because of a shared allegiance to an activity or a product. Although these tribes are often unstable and short-lived, at least for a time members identify with others through shared emotions, moral beliefs, styles of life, and, of course, the products they jointly consume as part of their tribal affiliation. Some companies, especially those that are more youth-oriented, rely on a *tribal marketing strategy* that links their product to, say, a group of shredders (skateboarders to us ancient folks). However, there also are plenty of tribes with older members, such as car enthusiasts who gather to celebrate such cult products as the Citroën in Europe and the Ford Mustang in the United States, or "foodies" who share their passion for cooking with other Wolfgang Puck wannabees around the world. Pontiac opened a community hub on Yahoo! it calls Pontiac Underground—"Where Passion for Pontiac Is Driven By You." The carmaker does no overt marketing on the site; the idea is to let drivers find it and spread the word themselves. Users share photos and videos of cars using Flickr and Yahoo! Video. A Yahoo! Answers zone enables knowledge sharing. Meanwhile, a list of Pontiac clubs in the physical world and on Yahoo! Groups allows users to connect offline and online.

Truth 33. People like to do their own thing —so long as it's everyone else's thing too

The early Bohemians who lived in Paris around 1830 made a point of behaving, well, differently from others. One flamboyant figure of the time became famous for walking a lobster on a leash through the gardens of the Royal Palace. His friends drank wine from human skulls, cut their beards in strange shapes, and slept in tents on the floors of their garrets. Sounds a bit like some fraternity houses we've visited.

Although in every age there certainly are those who "march to their own drummers," most people tend to follow society's expectations regarding how they should act and look (with a little improvisation here and there, of course). *Conformity* is a change in beliefs or actions as a reaction to real or imagined group pressure. For a society to function, its members develop norms, or informal rules that govern behavior. Without these rules, we would have chaos. Imagine the confusion if a simple norm such as stopping for a red traffic light did not exist.

We conform in many small ways every day—even though we don't always realize it. Unspoken rules govern many aspects of consumption. In addition to norms regarding appropriate use of clothing and other personal items, we conform to rules that include gift-giving (we expect birthday presents from loved ones and get upset if they do not materialize), sex roles (men often pick up the check on a first date), and personal hygiene (our friends expect us to shower regularly).

> We conform in many small ways every day—even though we don't always realize it.

We don't mimic others' behavior all the time, so what makes it more likely we'll conform? These are some common culprits:

- **Cultural pressures**—Different cultures encourage conformity to a greater or lesser degree. The American slogan "Do your own thing" in the 1960s reflected a movement away from conformity and toward individualism. In contrast, Japanese society emphasizes collective well-being and group loyalty over individuals' needs.

- **Fear of deviance**—The individual may have reason to believe that the group will apply *sanctions* to punish nonconforming behaviors. It's not unusual to observe adolescents shunning a peer who is "different" or a corporation or university passing over a person for promotion because she is not a "team player."
- **Commitment**—The more people who are dedicated to a group and value their membership in it, the more motivated they are to do what the group wants. Rock groupies and followers of TV evangelists may do anything their idols ask of them, and terrorists are willing to die for their cause. According to the *principle of least interest*, the person who is *least* committed to staying in a relationship has the most power, because that party doesn't care as much if the other person rejects him.

The more people who are dedicated to a group and value their membership in it, the more motivated they are to do what the group wants.

- **Group unanimity, size, and expertise**—As groups gain in power, compliance increases. It is often harder to resist the demands of a large number of people than only a few—especially when a "mob mentality" rules.
- **Susceptibility to interpersonal influence**—This personality trait refers to an individual's need to have others think highly of him. Consumers who don't possess this trait are *role-relaxed*; they tend to be older, affluent, and highly confident. Subaru created a communications strategy to reach role-relaxed consumers. In one of its commercials, a man proclaims, "I want a car…. Don't tell me about wood paneling, about winning the respect of my neighbors. They're my neighbors. They're not my heroes."

Intrepid marketers don't fear: These consumers are in the minority. Most of us are mindful of what our friends and neighbors buy, and people who belong to groups do tend to display patterns of similarity—even *after* high school!

Truth 34. Catch a buzz

Altoids breath mints had been around for 200 years, but suddenly their popularity skyrocketed. How did this happen? The revival began when the mint began to attract a devoted following among smokers and coffee drinkers who hung out in the blossoming Seattle club scene during the 1980s. Until 1993, when Kraft bought manufacturer Callard & Bowers, only those "in the know" sucked the mints. The brand's marketing manager persuaded Kraft to hire advertising agency Leo Burnett to develop a modest promotional campaign. The agency decided to publicize the candy with subway posters sporting retro imagery and other "low-tech" media to avoid making the product seem mainstream—that would turn off the original audience. As young people started to tune into this "retro" treat, its popularity rocketed.

As the Altoids success story illustrates, "buzz" makes a hit product. *Word of mouth (WOM)* is product information that individuals transmit to other individuals. Because we get the word from people we know, WOM tends to be more reliable and trustworthy than messages from more formal marketing channels. And, unlike advertising, WOM often comes with social pressure to conform to these recommendations. Ironically, despite all the money that marketers pump into lavish ads, WOM is far more powerful: It influences two-thirds of all consumer goods sales.

> WOM influences two-thirds of all consumer goods sales.

So, how can marketers harness the enormous power of WOM? In the "old days" (a few years ago), a toy company would launch a new product by unveiling it during a Spring trade fair, and then it would run a November–December saturation television ad campaign during cartoon prime time to sell the toy to kids. In contrast, consider the Picoo Z helicopter, a $30 toy helicopter made by Silverlit Toys in Hong Kong. In March 2007, a Google search for the Picoo produced more than 109,000 URLs, whereas the URLs for Silverlit Toys was more than 597,000, with many of those links pointing to major online global gift retailers, such as Hammacher-Schlemmer and Toys-R-Us.

Do you think this huge exposure was the result of a meticulously planned promotional strategy? Think again. By most accounts, a 28-year-old tech worker in Chicago started the Picoo Z buzz when he bought his helicopter after reading about it on a hobbyist message board. A few months later, he uploaded his homemade video of the toy on YouTube. Within two weeks, 15 of his friends bought the toy, and they, in turn, posted their own videos and pointed viewers to the original video. Internet retailers who troll online conversations for fresh and exciting buzz identified the toy and started adding their own links to the clips. In just a few short months, there were hundreds of Picoo Z videos, and more than a million people viewed them.

So, how can you stimulate word of mouth? Consider enlisting brand ambassadors to announce a new brand or service. AT&T sent its ambassadors to high-traffic areas of California and New Jersey, doing random favors such as handing dog biscuits to people walking their dogs and providing binoculars to concertgoers to promote its new AT&T Local Service. Hyatt Hotels unleashed 100 bellhops in Manhattan, who spent the day opening doors, carrying packages, and handing out pillow mints to thousands of consumers.

Consider enlisting brand ambassadors to announce a new brand or service.

Or go for *viral* marketing, the strategy of getting visitors to a Web site to forward information on the site to their friends to make still more consumers aware of the product—usually by creating online content that is entertaining or just plain weird. To promote a use for a razor that it could never discuss on TV, Philips launched a Norelco Web site, shaveeverywhere.com. The ad features a guy in a bathrobe explaining how to use the shaver in places, well, not on your head. The site uses pictures of fruit and vegetables to refer to male body parts. This viral strategy did its job, as thousands of people worldwide forwarded the URL to their friends. Catch the buzz.

Truth 35. Go with the flow—get shopmobbed today

Odds are you (or your kid) have already logged some serious time on Facebook, MySpace, or LinkedIn before you started reading this paragraph today. *Social networking*, where members post information about themselves and make contact with others who share similar interests and opinions, may well be the biggest development in consumer behavior since the TV dinner! Almost daily we hear about yet another social networking site where users can set up a home page with photos, a profile, and links to others in their social networks. They can browse for friends, dates, partners for activities, or contacts of all kinds and invite them to join the users' personal networks as "friends."

Social networking is an integral part of what many call Web 2.0, which is like the Internet on steroids. (Learn more about social networking in *The Truth About Profiting from Social Networking*.) The key change is the interactivity among producers and users, but these are some other characteristics of a *Web 2.0* site.

> Social networking is an integral part of what many call Web 2.0, which is like the Internet on steroids.

- It improves as the number of users increases. For example, Amazon's capability to recommend books to you based on what other people with similar interests have bought gets better as it tracks more and more people who are entering search queries.
- Its currency is eyeballs. Google makes its money by charging advertisers according to the number of people who see their ads after typing in a search term.
- It's version-free and in perpetual beta. *Wikipedia*, the online encyclopedia, gets updated constantly by users who "correct" others' errors.

- It categorizes entries according to "folksonomy" rather than "taxonomy." In other words, sites rely on users rather than preestablished systems to sort contents. Listeners at Pandora.com create their own "radio stations" that play songs by artists they choose, as well as other similar artists.

This last point highlights a key change in the way some new media companies approach their businesses: Think of it as marketing strategy by committee. The *wisdom of crowds* perspective (from a book by that name) argues that, under the right circumstances, groups are smarter than the smartest people in them. If this is true, it implies that large numbers of (nonexpert) consumers can predict successful products.

> The *wisdom of crowds* perspective argues that, under the right circumstances, groups are smarter than the smartest people in them.

For example, at Threadless.com, customers rank T-shirt designs ahead of time, and the company prints the winning ideas. Every week, contestants upload T-shirts designs to the site, where about 700 compete to be among the six that it will print during that time. Threadless visitors score designs on a scale of 0 to 5, and the staff selects winners from the most popular entrants. The six lucky artists each get $2,000 in cash and merchandise. Threadless sells out of every shirt it offers.

Here are some more crowd-based sites to watch:

- Sermo.com is a social network for physicians. It has no advertising, job listings, or membership fees. It makes its money (about $500,000 a year so far) by charging institutional investors for the opportunity to listen in as approximately 15,000 doctors chat among themselves. Say, for example, a young patient breaks out in hives after taking a new prescription. A doctor might post whether she thinks this is because of a rare symptom or perhaps the drug's side-effect. If other doctors feel it's the latter, this negative news could affect the drug manufacturer's stock, so their opinions have value to analysts.

Doctors who ask or answer a question that paying observers deem especially valuable receive bonuses of $5 to $25 per post.

- How about social networking sites that "create" a concert by persuading an artist to perform in a certain city or country? At Eventful.com, fans can demand events and performances in their town and spread the word to make them happen. Or how about actually buying a piece of the bands you like? Go to SellaBand.com, where fans ("believers") buy "parts" in a band for $10 per share. After the band sells 5,000 parts, SellaBand arranges a professional recording, including top studios, A&R (Artists & Repertoire managers (industry talent scouts), and producers. Believers receive a limited edition CD of the recording. They also get a piece of the profits, so they're likely to promote the band wherever they can.
- Individual consumers gain crowd clout by *shopmobbing* with strangers. So far, this is most popular in China, where the *tuangou* ("team purchase") phenomenon involves strangers organizing themselves around a specific product or service. Members who meet online at sites such as Taobao.com and Liba.com/index arrange to meet at a certain date and time in a real-world store and literally mob the unsuspecting retailer—the bargain-hungry crowd negotiates a group discount on the spot.

Truth 36. Find the market maven, and the rest is gravy

As Cold Stone Creamery expands to Japan, the ice cream store projects a somewhat different image than it has in the United States. The chain wants to be ultra cool by generating a buzz among fashion-conscious "office ladies," as the Japanese call young, single, female professionals. These women are very influential in Japan; their reactions to a new product can make or break it. To woo this group, Cold Stone sponsored a fashion show for young women (assuming the models can fit into the dresses after sampling a few of the chain's caloric creations), and fashion magazines staged photo shoots at the stores.

Although consumers get information from personal sources, they do not usually ask just *anyone* for advice about purchases. If you decide to buy a new stereo, you will most likely seek advice from a friend who knows a lot about sound systems. This friend may own a sophisticated system or may subscribe to specialized magazines such as *Stereo Review* and spend free time browsing through electronics stores. However, you may have another friend who has a reputation for being stylish and who spends his free time reading *Gentleman's Quarterly* and shopping at trendy boutiques. You might not bring up your stereo problem with him, but you may take him with you to shop for a new fall wardrobe.

Everyone knows people who are knowledgeable about products and whose advice others take seriously. Like one of the Japanese office ladies, this individual is an *opinion leader*; a person who is frequently able to influence others' attitudes or behavior. Clearly, some people's recommendations carry more weight than others. Opinion leaders are extremely valuable information sources because they prescreen, evaluate, and synthesize product information in an unbiased way. They tend to be socially active and highly interconnected in their communities. These individuals are often among the first to buy new products, so they absorb much of the risk. This experience reduces uncertainty for others who are not as courageous.

Some people's recommendations carry more weight than others.

Early conceptions of the opinion leader role assumed that the opinion leader absorbs information from the mass media and, in turn, transmits data to opinion receivers. This view has turned out to be overly simplified; it confuses the functions of several different types of consumers. Indeed, we now know that opinion leaders also are likely to be *opinion seekers*. They are generally more involved in a product category and actively search for information. As a result, they are more likely to talk about products with others and to solicit others' opinions. Contrary to the static view of opinion leadership, most product-related conversation does not take place in a "lecture" format in which one person does all the talking. (Even husbands get a word in now and then.) A lot of product-related conversation occurs in the context of a casual interaction rather than as formal instruction. One study, which found that opinion seeking is especially high for food products, revealed that two-thirds of opinion seekers also view themselves as opinion leaders.[56]

Consumers who are expert in a product category may not necessarily share their trade secrets with others but, on the other hand, we all know people who love to talk about what they buy—whether or not we want to hear about it. A *market maven* loves to transmit marketplace information of all types. These shopaholics are not necessarily interested in certain products, and they may not necessarily be early purchasers; they're simply into staying on top of what's happening in the marketplace. Researchers use the following scale items, to which respondents indicate how much they agree or disagree, to identify market mavens:[57]

1. I like introducing new brands and products to my friends.
2. I like helping people by providing them with information about many kinds of products.
3. People ask me for information about products, places to shop, or sales.
4. If someone asked me where to get the best buy on several types of products, I could tell him or her where to shop.

5. My friends think of me as a good source of information when it comes to new products or sales.

Ironically, marketers often overlook yet another type of consumer in their quest to convince shoppers to buy. A *surrogate consumer* is a person whom we hire to provide input into our purchase decisions. Unlike the opinion leader or market maven, the surrogate is usually compensated for his advice. Interior decorators, stockbrokers, professional shoppers, and college consultants are surrogate consumers.

Regardless of whether they actually make the purchase on behalf of the consumer, surrogates' recommendations can be enormously influential. The consumer, in essence, relinquishes control over several or all decision-making functions, such as information search, evaluation of alternatives, or actual purchase. For example, a client may commission an interior decorator to redo her house, and we may entrust a broker to make crucial buy/sell decisions on our behalf. Marketers tend to overlook surrogates when they try to convince consumers to buy their goods or services. This can be a big mistake, because they may mistarget their communications to end consumers instead of to the surrogates who actually sift through product information and decide among product alternatives on their behalf.

> Regardless of whether they actually make the purchase on behalf of the consumer, surrogates' recommendations can be enormously influential.

Truth 37. Hundreds of housewives can predict your company's future

Are all of us smarter than any of us? A *prediction market* is one of the hottest new trends in forecasting the future. This approach asserts that groups of people with knowledge about an industry are jointly better predictors of the future than are any individuals—especially when each person stands to benefit from picking winners, just as they would if they were choosing companies to invest in on the New York Stock Exchange.

> A prediction market is one of the hottest new trends in forecasting the future.

Companies from Microsoft to Eli Lilly and Hewlett-Packard empower their employees as "traders" who place bets on what they think will happen regarding future sales, the success of new products, or how other firms in a distribution channel will behave. For example, the pharmaceutical giant Eli Lilly routinely places multimillion-dollar bets on drug candidates that face overwhelming odds of failure—the relatively few new compounds that do succeed need to make enough money to cover the losses that the others incur. Obviously, the company will benefit if it can do a better job of separating the winners from the losers earlier in the process. Lilly ran an experiment where about 50 of its employees involved in drug development, including chemists, biologists, and project managers, traded six mock drug candidates through an internal market. The group correctly predicted the three most successful drugs.[58]

In another emerging application, many companies are finding that it's both cost efficient and productive to call on outsiders from around the world to solve problems that their own scientists can't handle. Just as a firm might outsource production to a subcontractor, these companies are *crowdsourcing*. For example, InnoCentive is a network of more than 90,000 "solvers" that member companies, such as Boeing, DuPont, Procter

& Gamble, and Eli Lilly, invite to tackle problems they are wrestling with internally. If a "solver" finds a solution, he or she gets a $10,000 to $100,000 reward.

Truth 38. Know who wears the pants in the family

The decision process within a household unit resembles a business conference. Certain matters go on the table for discussion, different members have different priorities and agendas, and there may be power struggles to rival any tale of corporate intrigue.

So, who "wears the pants" in the family? Sometimes it's not obvious which spouse makes the decisions. Indeed, although many men still wear the pants, it's women who buy them. When Haggar's research showed that nearly half of married women bought pants for their husbands without them being present, the firm started advertising its menswear products in women's magazines.[59]

Figuring out who makes buying decisions in a family is an important issue for marketers, because this information tells them who to target and whether they need to reach both spouses to influence a choice. For example, marketing research in the 1950s indicated that women were beginning to play a larger role in household purchasing decisions. In response, lawn mower manufacturers began to emphasize the rotary mower over other power mowers to downplay women's fears of injury.

> Figuring out who makes buying decisions in a family is an important issue for marketers.

In traditional families (and especially those with low educational levels), women are primarily responsible for family financial management—the man makes it, and the woman spends it. Each spouse "specializes" in certain activities. The pattern is different among families where more modern sex-role norms operate. These couples believe both people should participate in family maintenance activities. In these cases, husbands assume more responsibility for laundering, housecleaning, grocery shopping, and so on, in addition to such traditionally "male" tasks as home maintenance and garbage removal. Shared decision making is becoming the norm for most American couples today—a Roper poll reported that 94 percent of partnered women say they make the decision or share equally in home furnishings selections (not a huge surprise), but in addition, 81 percent said the same for financial savings/investments, and 74 percent participate in deciding what car to buy.[60]

> Shared decision making is becoming the norm for most American couples today.

As Hallmark well knows, women across the social spectrum still are primarily responsible for the continuation of the family's *kinnetwork system*: They perform the rituals that maintain ties among family members, both immediate and extended. Women are more likely to coordinate visits among relatives, stay in touch with family members, send greeting cards, and arrange social engagements. This organizing role means that women often make important decisions about the family's leisure activities, and they are more likely to decide with whom the family will socialize.

Truth 39. Youth is wasted on the young

Carmakers are wooing a new kind of consumer: one who's too young to drive. Many are advertising in child-oriented areas such as gyms that cater to kids, social networking sites where young people hang out, and the Saturday morning cartoons. In Whyville.net, a digital world where nearly two million children aged 8 to 15 hang out, kids can buy virtual Scion xBs if they have enough "clams" (Whyville's monetary unit). If not, they can meet with Eric, a virtual Toyota Financial Services adviser, to finance an xB replica they can use to tool around while in-world. Why bother pushing cars on kids? That's easy: About one-third of parents say their children "actively participate" in car-buying decisions.

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Young consumers make up three distinct markets:

- **Primary market**—Kids spend a lot on their own wants and needs that include toys, apparel, movies, and games. When marketers at M&Ms candy figured out who was actually buying a lot of their products, they redesigned vending machines with coin slots lower to the ground to accommodate shorter people, and sales rose dramatically. Most children choose their own brands of toothpaste, shampoo, and adhesive bandage. A large survey of kids aged 6 to 11 also revealed these tidbits:[61]
  - Seven percent have visited or used MySpace.com in the past month.
  - Ten percent have downloaded music online in the past month.
  - Six percent have written or read an online journal or blog in the past month.
  - Fifty-four percent have televisions in their rooms.
  - Twenty-six percent have stereos in their rooms.

    - Nineteen percent have computers in their rooms.
- **Influence market**—*Parental yielding* is the polite way to describe what occurs when a parent "surrenders" to a child's request. Yielding drives many product selections, because about 90 percent of requests to a parent are by brand name. Researchers estimate that children directly influence about $453 billion worth of family purchases in a year. They report that, on average, children weigh in with a purchase request every 2 minutes when they shop with parents.[62] In recognition of this influence, Mrs. Butterworth's Syrup created a $6 million campaign to target kids directly with humorous ads that show the lengths to which adults will go to get the syrup bottle to talk to them. An executive who worked on the campaign explained, "We needed to create the *nag factor* [where kids demand their parents buy the product]."[63]

> Researchers estimate that children directly influence about $453 billion worth of family purchases in a year.

- **Future market**—Kids have a way of growing up to be adults, so savvy marketers try to lock in brand loyalty at an early age. That explains why Kodak encourages kids to become photographers. Currently, only 20 percent of children aged 5 to 12 own cameras, and they shoot an average of only one roll of film a year. The company produces ads that portray photography as a cool pursuit and as a form of rebellion. It packages cameras with an envelope to mail the film directly back so parents can't see the photos.

Truth 40. Make millions on Millennials

In 1956, the label "teenage" entered the general American vocabulary when Frankie Lymon and the Teenagers became the first pop group to identify themselves with this new subculture. Believe it or not, the concept of a teenager is a fairly new idea. Throughout most of history, a person simply made the transition from child to adult, and many cultures marked this abrupt change in status with some sort of ritual or ceremony.

So-called Generation Y kids go by several names, including "Echo Boomers" and "Millennials." They already make up nearly one-third of the U.S. population, and they spend $170 billion a year of their own and their parents' money. They love brands like Sony, Patagonia, Gap, Aveda, and Apple. Echo Boomers are the most diverse generation ever. Thirty-five percent are nonwhite, and many grow up in nontraditional families. Today, one in four 21-year-olds was raised by a single parent, and three out of four have a working mother.

Unlike their parents or older siblings, Gen Y-ers tend to hold relatively traditional values, and they believe in the value of fitting in rather than rebelling. Their upbringing has stressed teamwork—team teaching, team grading, collaborative sports, community service, service learning, and student juries. Violent crime among teenagers is down 60 percent to 70 percent. The use of tobacco and alcohol is at an all-time low, as is teen pregnancy. Five out of ten Echo Boomers say they trust the government, and virtually all of them trust Mom and Dad.[64]

> Unlike their parents or older siblings, Gen Y-ers tend to hold relatively traditional values, and they believe in the value of fitting in rather than rebelling.

Millennials are the first generation to grow up with computers at home, in a 500-channel TV universe. They are multitaskers with cell phones, music downloads, and instant messaging on the Internet. They are totally at home in a *thumb culture* that communicates online and by cell phone (more likely via text and IM than by voice). These consumers truly are *digital natives*. Many young people prefer to use the Internet to communicate because its anonymity makes it easier to talk to people of the opposite sex or of different ethnic and racial groups.

> They are totally at home in a *thumb culture* that communicates online and by cell phone (more likely via text and IM than by voice).

Young consumers think that wired phones or computers are antiques. They're jugglers who value being both footloose and connected to their "peeps" 24/7. The advertising agency Saatchi & Saatchi labels this new kind of lifestyle *connexity*. When Toyota was developing its youth-oriented Scion model, its researchers learned that Echo Boomers practically live in their cars; one-quarter of Gen Y-ers, for example, keep a full change of clothes in their vehicles. So Toyota's designers made the Scion resemble a home on wheels: It has fully reclining front seats so that drivers can nap between classes and a 15-volt outlet so that they can plug in their computers.

One pair of researchers took an in-depth look at how 13- and 14-year-olds integrate the computer into their lives and how they use it to express their *cyberidentities*. These tweens have limited mobility in real life (too young to drive), so they use the computer to transport themselves to other places and modes of being. The researchers explored the metaphors these kids use when they think about their computers. For some, the PC is a "fraternity house" where they can socialize; it also can be a "carnival" where they play games and an "external brain" that helps with homework.[65] Clearly, young people are forging intimate relationships with these portals to online spaces we are only beginning to understand.

Because modern teens were raised on TV and tend to be more "savvy" than older generations, marketers must tread lightly in attempts to reach them. In particular, Gen Y-ers must see the messages as authentic and not condescending. So, what are the rules of engagement for young consumers?

- **Rule 1:** Don't talk down—Younger consumers want to feel they are drawing their own conclusions about products. In the words of one teen: "I don't like it when someone tells me what to do. Those drug and sex commercials preach. What do they know? Also, I don't like it when they show a big party and say, 'Come on and fit in with this product.' That's not how it works."
- **Rule 2:** Don't try to be what you're not. Stay true to your brand image—Kids value straight talk. Firms that back up what they say impress them. Procter & Gamble appealed to this value with a money-back guarantee on its Old Spice High Endurance deodorant with an invitation to phone 1-800-PROVEIT.
- **Rule 3:** Entertain them. Make it interactive and keep the sell short—Gen Y kids like to find brands in unexpected places. The prospect of catching appealing ads is part of the reason they're watching that TV show in the first place. If they want to learn more, they'll check out your Web site.
- **Rule 4:** Show that you know what they're going through, but keep it light—A commercial for Hershey's Ice Breakers mints subtly points out its benefit when it highlights the stress a guy feels as he's psyching himself up to approach a strange girl at a club. "I'm wearing my lucky boxers," he reassures himself. "Don't trip. Don't drool. Relax. How's my breath?"

Truth 41. Grownups don't grow up anymore

Restylane is the top-selling dermal injection to reduce the appearance of wrinkles. In 2007 the company decided to pitch it directly to consumers for the first time so, in keeping with new media trends, it launched a multipronged campaign that recognized the technical prowess of many middle-aged people. A conventional TV spot features before-and-after results, along with women who talk about how frequently men check them out after the treatment. But a second component is a video skit on YouTube that supposedly takes place during a woman's fiftieth birthday party. While her son works on a video birthday card, Mom gets caught smooching with a younger man on a couch. Viewers don't know the skit is an ad until the last 15 seconds. A third prong is a contest to name the "Hottest Mom in America"; contestants will submit videos to a Web site, and the winner gets cash, free treatments for a year, and an interview with a modeling agency. Today's Mom isn't exactly June Cleaver.

Today's Mom isn't exactly June Cleaver.

The baby boomer age cohort (people born between 1946 and 1964) consists of people whose parents established families following the end of World War II and during the 1950s when the peacetime economy was strong and stable. (As a general rule, when people feel confident about how things are going in the world, they are more likely to decide to have children.) As teenagers in the 1960s and 1970s, the "Woodstock generation" created a revolution in style, politics, and consumer attitudes. As they have aged, they have fueled cultural events as diverse as the Free Speech movement and hippies in the 1960s to Reaganomics and yuppies in the 1980s. Now that they are older, they continue to influence popular culture.

As the Restalyne campaign demonstrates, this generation is much more active and physically fit than its predecessors, and they're now in their peak earning years. As one commercial for VH1, the music video network that caters to those who are a bit too old for MTV, pointed out, "The generation that dropped acid to escape reality…is the generation that drops antacid to cope with it."

Levi Strauss is a good example of a company that has built its core business on the backs (or backsides) of boomers. More recently, though, the apparel maker faced the challenge of keeping aging customers in its franchise as former jeans-wearing hippies lost interest in traditional styles. Levi Strauss answered this challenge when it created its "New Casuals" product category with pants that are more formal than jeans but more casual than dress slacks. The target audience is men aged 25 to 49 with higher-than-average education and income, who work in white-collar jobs in major metropolitan areas. The Dockers line was born.

Consumers aged 35 to 44 spend the most on housing, cars, and entertainment. Baby boomers are busy "feathering their nests"; they account for roughly 40 percent of all the money consumers spend on household furnishings and equipment. In addition, consumers aged 45 to 54 spend the most of any age category on food (30 percent above average), apparel (38 percent above average), and retirement programs (57 percent above average).[66] To appreciate the impact that middle-aged consumers have and will have on our economy, consider this: At current spending levels, a one percent increase in the population of householders aged 35 to 54 results in an additional $8.9 billion in consumer spending.

In addition to the direct demand for products and services that this age group creates, these consumers have fostered a new baby boom of their own to keep marketers busy in the future. Because fertility rates have dropped, this new boom is not as big as the one that created the baby boom generation; we can best describe the new upsurge in the number of children as a *baby boomlet*. Many boomer couples postponed getting married and having children because of the new opportunities and options for women. They began having babies in their late 20s and early 30s, resulting in fewer (but perhaps more pampered) children per family. This new emphasis on children and the family creates opportunities for products such as cars (the success of the SUV concept among "soccer

Moms"), services (the day-care industry and big chains such as KinderCare), and media (magazines such as *Working Mother*).

Although advertisers are always lured by youth, many are reconsidering this fixation in light of boomers' huge spending power. An ad for the Toyota Highlander, which shows boomers whose nests are emptying, declares, "For your newfound freedom, it's about how you are going to reinvent yourself for what could be 30 or 40 years of retirement, which is very different from your parents and grandparents." Even mobile marketers who typically blast messages to kids on their cell phones are beginning to target the middle-aged. For example, *Redbook* readers can bid on a year's worth of movie tickets via text messaging.

> Although advertisers are always lured by youth, many are reconsidering this fixation in light of boomers' huge spending power.

Truth 42. Dollar stores make good cents

About 14 percent of Americans live below the poverty line, and most marketers largely ignore this segment. Still, although poor people obviously have less to spend than do rich ones, they have the same basic needs as everyone else. Low-income families purchase staples, such as milk, orange juice, and tea, at the same rates as average-income families. Minimum wage–level households spend more than average on out-of-pocket health-care costs, rent, and food they eat at home. Unfortunately, they find it harder to obtain these resources because many businesses are reluctant to locate in lower-income areas. On average, residents of poor neighborhoods must travel more than 2 miles to have the same access to supermarkets, large drugstores, and banks as do residents of more affluent areas.

> Low-income families purchase staples, such as milk, orange juice, and tea, at the same rates as average-income families.

Still, a lot of companies are taking a second look at marketing to the poor because of their large numbers. The economist C. K. Pralahad added fuel to this fire with his book *The Fortune at the Bottom of the Pyramid*, which argued that big companies could profit and help the world's four billion poor or low-income people by finding innovative ways to sell them soap and refrigerators.

Some companies are getting into these vast markets by revamping their distribution systems or making their products simpler and less expensive. When Nestlé Brazil shrank the package size of its Bono cookies (no relation to the U2 singer) from 200 grams to 140 grams and dropped the price, sales jumped 40 percent. Unilever called a new soap brand Ala so that illiterate people in Latin America could easily recognize it. In Mexico, the giant Cemex cement company improved housing in poor areas after it introduced a pay-as-you-go system for buying building supplies.

Muhammad Yunus, a Bangladeshi economist, won the 2006 Nobel Prize in Economics for pioneering the concept of *microloans.* His Grameen Bank loans small sums—typically less than $100—to entrepreneurs in developing countries. Many of these go to "cell-phone women," who rent time on the phones to others in their remote villages. The bank has issued about six million loans to date, and almost 99 percent of recipients repay them (compared to a 50 percent repayment rate for a typical bank in a developing country).

The success of La Curacao, a chain of department stores in southern California with a Hispanic focus, comes from the company's desire to serve the needs of lower-income consumers. The stores are the brainchild of two Israeli brothers who share a similar experience with many of their customers: They were once illegal immigrants searching for a better life in the United States. They realized that poor people can be good credit risks, *if* the retailer gives them reason to be grateful that someone has taken a chance on them. This trust seems to be working: Shoppers use store credit cards for 95 percent of purchases, and for eight out of ten of these customers, the La Curacao credit card is the first one they've ever had. The chain's slogan is *Un Poco de Su Pais* or "A Little Bit of Your Country." Everything about the stores—from the exterior emblazoned with Mayan and Aztec statues to the piped-in salsa music, Spanish-speaking sales staff, and Spanish-language sale signs inside—strives to make the customers feel as if they're back home. And because many of the immigrant families who shop there can't afford to take their kids to places such as Disneyland, every store also has a stage that features mariachi bands, clowns, and other family entertainment.

> Poor people can be good credit risks.

Truth 43. The rich are different

If you've got enough Benjamins (translation for readers over age 25: $100 bills), you can buy a Pink Splendor Barbie complete with crystal jewelry and a bouffant gown sewn with 24-karat threads. To dress a "living doll," Victoria's Secret offers its Million Dollar Miracle Bra, with more than 100 carats of real diamonds.

Obviously, many companies love to sell to affluent, upscale markets. This focus often makes sense, because these consumers have the resources to spend on costly products (often with higher profit margins). However, it is a mistake to assume that we should place everyone with a high income into the same well-lined bucket. After all, social class involves a lot more than absolute income. It is also a way of life, and factors including where they got their money, how they got it, and how long they have had it significantly affect affluents' interests and spending priorities.

> It is a mistake to assume that we should place everyone with a high income into the same well-lined bucket.

Despite our stereotype of rich people living it up, the typical millionaire is a 57-year-old man who is self-employed, earns a median household income of $131,000, has been married to the same wife for most of his adult life, has children, has never spent more than $399 on a suit or more than $140 for a pair of shoes, and drives a Ford Explorer. (The humble billionaire investor Warren Buffett comes to mind.) Interestingly, many affluent people don't consider themselves to be rich. One tendency researchers notice is that they indulge in luxury goods while pinching pennies on everyday items—buying shoes at Neiman Marcus and deodorant at Wal-Mart, for example.[67]

To generalize, people who are used to having money use their fortunes a lot differently. Old money families (the Rockefellers, DuPonts, Fords, and so on) live primarily on inherited funds. Merely having wealth is not sufficient to achieve social prominence in these circles. You also need to demonstrate a family history of public service and philanthropy, and tangible markers of these contributions often enable donors to achieve a kind of immortality (Rockefeller University, Carnegie Hall, or the Whitney Museum). "Old money" consumers distinguish among themselves in terms of ancestry and lineage rather than wealth. And, they're secure in their status: In a sense, they have trained their whole lives to be rich.

Pity the poor nouveau riches who actually earn their money; many suffer from *status anxiety*. They monitor the cultural environment to ensure that they do the "right" thing, wear the "right" clothes, get seen at the "right" places, use the "right" caterer, and so on. In major Chinese cities such as Shanghai, some people have taken to wearing pajamas in public as a way to flaunt their newfound wealth. As one consumer explained, "Only people in cities can afford clothes like this. In farming villages, they still have to wear old work clothes to bed."[68]

Nouveau or not, we all have a deep-seated tendency to evaluate ourselves, our professional accomplishments, our appearance, and our material well-being relative to others. The rise of a *mass-class* market means that many luxury products have gone down-market; once-exclusive designer names appear on the bodies, homes, and garages of many consumers who used to only look at them longingly in magazines or on *Lifestyles of the Rich and Famous*. Does this mean we no longer yearn for status symbols? Hardly. The market continues to roll out ever-pricier goods and services, from $130,000 Hummers and $12,000 mother-baby diamond tennis bracelet sets to $600 jeans, $800 haircuts, and $400 bottles of wine. Although it seems that almost everyone can flout a designer handbag (or at least a counterfeit version with a convincing logo), our country's wealthiest consumers employ 9,000 personal chefs, visit plastic surgeons, and send their children to $400-an-hour math tutors.

> The rise of a *mass-class* market means that many luxury products have gone down-market.

The social analyst Thorstein Veblen first discussed the motivation to consume for the sake of consuming at the turn of the twentieth century.

For Veblen, we buy things to inspire envy in others through our display of wealth or power. Veblen coined the term *conspicuous consumption* to refer to people's desires to provide prominent visible evidence of their ability to afford luxury goods. The material excesses of his time motivated Veblen's outlook; he wrote in the era of the "Robber Barons," where the likes of J. P. Morgan, Henry Clay Frick, and William Vanderbilt built massive financial empires and flaunted their wealth as they competed to throw the most lavish party.

Sounds like they really lived it up back in the old days, right? Well, maybe the more things change, the more they stay the same: The recent wave of corporate scandals involving companies such as Enron, WorldCom, and Tyco infuriated many consumers when they discovered that some top executives lived it up even as other employees were laid off. One account of a $1 million birthday party that the chief executive of Tyco threw for his wife is eerily similar to a robber baron shindig: The party reportedly had a gladiator theme and featured an ice sculpture of Michelangelo's David with vodka streaming from his penis into crystal glasses.

The rich *are* different.

Truth 44. Out with the ketchup, in with the salsa

Marketers cannot ignore the stunning diversity of cultures that are reshaping mainstream society. Ethnic minorities spend more than $600 billion a year on products and services, so firms must tailor products and communications strategies to their unique needs. Immigrants now make up 10 percent of the U.S. population and will account for 13 percent by 2050.

> Ethnic minorities spend more than $600 billion a year on products and services, so firms must tailor products and communications strategies to their unique needs.

This important change encourages advertisers to rethink their old strategies, which assumed that virtually all of their customers were Caucasians hailing from Western Europe. For example, as part of Crest toothpaste's fiftieth-anniversary celebration, Procter & Gamble revived its "Crest Kid," who first appeared as an apple-cheeked urchin that Norman Rockwell illustrated in 1956. Now, a Cuban-born girl plays the character. Although some people feel uncomfortable with the notion that marketers should explicitly take into account people's racial and ethnic differences when they formulate their strategies, the reality is that these subcultural memberships do shape many consumers' needs and wants. Research indicates, for example, that members of minority groups find an advertising spokesperson from their own group more trustworthy, and this enhanced credibility in turn translates into more positive brand attitudes. However, marketers need to avoid the pitfall of painting all members of an ethnic or racial group with the same brush; these generalizations not only are inaccurate, but they also are likely to turn off the very people a company wants to reach.

Ethnic marketing is in vogue with many firms, but actually defining and targeting members of a distinct ethnic group is not always so easy in our "melting pot" society. In the 2000 U.S. Census, some 7 million people identified with two or more races, refusing to describe themselves as only white, black, Asian, Korean, Samoan, or one of the other racial categories. The popularity of golfer Tiger Woods illuminates the complexity of ethnic identity in the United States. Although we laud Tiger as an African American role model, in reality he is a model of multiracialism. His mother is Thai, and he also has Caucasian and Indian ancestry. Other popular multiracial celebrities include actor Keanu Reeves (Hawaiian, Chinese, and Caucasian), singer Mariah Carey (black Venezuelan and white), and Dean Cain of *Superman* fame (Japanese and Caucasian).

> In the 2000 U.S. Census, some 7 million people identified with two or more races, refusing to describe themselves as only white, black, Asian, Korean, Samoan, or one of the other racial categories.

The bulk of American immigrants historically came from Europe, but immigration patterns have shifted dramatically. New immigrants are much more likely to be Asian or Hispanic. As these new waves of immigrants settle in the United States, marketers try to track their consumption patterns and adjust their strategies accordingly. It's best to market to these new arrivals—whether Arabs, Asians, Russians, or people of Caribbean descent—in their native languages. They tend to cluster together geographically, which makes them easy to reach. The local community is the primary source for information and advice, so word of mouth is especially important.

In the past, marketers used ethnic symbolism as shorthand to convey certain product attributes. They often employed crude and unflattering images when they depicted African Americans as subservient or Mexicans as bandits. Aunt Jemima sold pancake mix, and Rastus was a grinning black chef who pitched Cream of Wheat hot cereal. The Gold Dust Twins were black urchins who peddled a soap powder for Lever Brothers, and Pillsbury hawked powdered drink mixes using characters such as Injun Orange and Chinese Cherry—who had buck teeth. As the Civil Rights Movement gave more power to minority groups and their rising economic status began to command marketers' respect, these negative stereotypes began to disappear. Frito-Lay responded to protests by the Hispanic community and stopped using the Frito Bandito character in 1971, and Quaker Foods gave Aunt Jemima a makeover in 1989.

Now, the Mars company is taking an interesting risk with its Uncle Ben's rice brand. For more than 60 years, packages featured the black Uncle Ben character. He wore a bow tie evocative of servants and Pullman porters, and his title reflects how white Southerners once used "uncle" and "aunt" as honorary names for older African Americans because the whites refused to call the African Americans "Mr." and "Mrs." Mars is reviving the character, but he's been remade as Ben, an accomplished businessman with an opulent office who shares his "grains of wisdom" about rice and life on the brand's Web site.

Truth 45. Look for fly-fishing born-again environmentalist jazz-loving Harry Potter freaks

Our group memberships within our society-at-large define us. A *subculture* is a group whose members share beliefs and common experiences that set them apart from others. Every one of us belongs to many subcultures, depending on our age, race, ethnic background, or place of residence.

The staggering diversity of consumers' interests and activities today means that it's usually no longer meaningful to speak of a mass market. We are witnessing a continuing spiral of *market fragmentation* that requires us to speak with increasingly greater precision to smaller groups of consumers—but the upside is that we can focus our messages very sharply to reach them.

> We are witnessing a continuing spiral of *market fragmentation* that requires us to speak with increasingly greater precision to smaller groups of consumers.

In contrast to larger, demographically based subcultures like Hispanic-Americans or baby boomers (that Nature usually determines), people who are part of a *microculture* freely choose to identify with a lifestyle or aesthetic preference. A good example is the microculture that automobile hobbyists call "Tuners." These are single men in their late teens and early 20s, usually in Latino or Asian communities, who share a passion for fast cars, high-tech auto upgrades, and specialized car parts. This microculture started with late night meets among illegal street racers in New York and L.A. Now, Tuners are more mainstream; magazines including *Import Tuner* and *Sport Compact Car* and major companies such as Pioneer eagerly court these high-tech hot-rodders. A commercial for the Honda Civic aimed straight for Tuners; it showed a fleet of cars sporting customized features such as chrome rims and tinted windows.

Whether Tuners, Dead Heads, or skinheads, each microculture exhibits its own unique set of norms, vocabulary, and product insignias (think of the Grateful Dead subculture's distinctive skull and roses). A study of contemporary "mountain men" in the western United States illustrates the binding influence of a microculture on its members. Researchers found that group members shared a strong sense of identity that they expressed in weekend retreats, where they reinforced these ties by using authentic items like *tepees*, buffalo robes, buckskin leggings, and beaded moccasins to create a sense of community among fellow mountain men.

These microcultures can even gel around fictional characters and events, and they often play a key role in defining our self-concept. Many devotees of *Star Trek*, for example, immerse themselves in a make-believe world of starships, phasers, and Vulcan mind melds. Our microcultures typically command fierce loyalty: *Star Trek* fans are notorious for their devotion to the cause, as this excerpt from a fan's email illustrates:

> I have to admit to keeping pretty quiet about my devotion to the show for many years simply because people do tend to view a *Trek* fan as weird or crazy…[after attending her first convention she says:] Since then I have proudly worn my Bajoran earring and not cared about the looks I get from others…. I have also met…other Trek fans, and some of these people have become very close friends. We have a lot in common and have had some of the same experiences as concerns our love of *Trek*.[69]

Star Trek is a merchandising empire that continues to beam up millions of dollars in revenues. Needless to say, it's not alone in this regard. Numerous other microcultures are out there, thriving on their collective worship of mythical and not-so-mythical worlds and characters ranging from the music group Phish to Hello Kitty. Indeed, it's fascinating to realize just how many microcultures are out there (often reinforced by our obsession with blogging about anything and everything that we experience) and the products they can coalesce around. Consider, for example, the devotion to Peeps; every year people buy about 1.5 billion of these mostly tasteless marshmallow chicks; about two-thirds of them sell around Easter. They have no nutritional value, but they do have a shelf life of two years. Maybe that's why not all Peeps get eaten. Devotees use them in decorations, dioramas, online slide shows, and sculptures. Some fans feel challenged to test their physical properties: On more than 200 Peeps Web sites, you can see fetishists skewering, microwaving, hammering, decapitating, and otherwise abusing the spongy confections.

> It's fascinating to realize just how many microcultures are out there (often reinforced by our obsession with blogging about anything and everything that we experience) and the products they can coalesce around.

If a homely marshmallow candy can attain icon status in a microculture, might your product be next?

Truth 46. Ronald McDonald is related to Luke Skywalker

A *myth* is a story with symbolic elements that represents a culture's ideals.

Consider, for example, a familiar story in our culture: *Little Red Riding Hood*. This myth started as a peasants' tale in sixteenth-century France, where a girl meets a werewolf on her way to granny's house. (There is historical evidence for a plague of wolf attacks during this time, including several incidents where men were tried for allegedly transforming themselves into the deadly animals.) The werewolf has already killed granny, stored her flesh in the pantry, and poured her blood in a bottle. Contrary to the version we know, however, when the girl arrives at the house, she snacks on granny, strips naked, and climbs into bed with the wolf! To make the story even more scandalous, some versions refer to the wolf as a "gaffer" (a contraction of "grandfather"), implying incest as well.

This story first appeared in print in 1697 as a warning to the loose ladies of Louis XIV's court. (The author puts her in red in this version, because this color symbolizes harlots.) Eventually, the Brothers Grimm wrote their own version in 1812, but they substituted violence for sex to scare kids into behaving. And, to reinforce the sex-role standards of that time, in the Grimm version, a man rescues the girl from the wolf. So, this myth sends vivid messages about such cultural no-nos as cannibalism, incest, and promiscuity.

An understanding of cultural myths is important to marketers who, in some cases (most likely unconsciously), pattern their messages along a mythic structure. Consider, for example, the way that McDonald's takes on "mythical" qualities. The "golden arches" are a symbol that consumers everywhere recognize as virtually synonymous with American culture. They offer sanctuary to Americans around the world; Americans know exactly what to expect once they enter. Basic struggles involving good versus evil play out in the fantasy world that McDonald's advertising creates, for example, when Ronald McDonald confounds the Hamburglar.

McDonald's even has a "seminary" (Hamburger University) where inductees go to learn the Ways of The Golden Arches.

> An understanding of cultural myths is important to marketers who, in some cases (most likely unconsciously), pattern their messages along a mythic structure.

We associate myths with the ancient Greeks or Romans but, in reality, comic books, movies, holidays, and yes, even commercials embody our own cultural myths. Consider the popularity of the elaborate weddings that Disney stages for couples who want to reenact their own version of a popular fairy tale. At Disney World, the princess bride wears a tiara and rides to the park's lakeside wedding pavilion in a horse-drawn coach, complete with two footmen in gray wigs and gold lamé pants. At the exchange of vows, trumpets blare as Major Domo (he helped the Duke in his quest for Cinderella) walks up the aisle with two wedding bands gently placed in a glass slipper on a velvet pillow. Disney stages about 2,000 of these extravaganzas each year. Disney is expanding the appeal of this myth as it moves into the bridal gown business. It sells a line of billowing princess gowns complete with crystal tiaras. Fairy-tale brides can walk down the aisle posing as Cinderella, Snow White, Belle, Sleeping Beauty, Jasmine, or Ariel.

> We associate myths with the ancient Greeks or Romans but, in reality, comic books, movies, holidays, and yes, even commercials embody our own cultural myths.

Comic book superheroes demonstrate how a culture communicates myths to consumers of all ages. Marvel Comics' Spiderman character tells stories about balancing the obligations of being a superhero with the need of his alter ego, Peter Parker, to succeed in school and have a normal love life. Indeed, some of these fictional figures embody such fundamental properties that they become a *monomyth*, a myth that is common to many cultures. Consider Superman; a father (Jor-El) gives his only son to save a world with his supernatural powers. Sound familiar?

Truth 47. Sign a caveman to endorse your product

People love the Geico caveman. He appeared in commercials as a throwback dressed in "yuppie" clothing who struggles against Geico's insensitivity when its ads claimed, "It's so easy even a caveman can do it." How much do viewers love him? Well, ABC decided to develop a sitcom (okay, a short-lived one) about a group of caveman roommates who battle prejudice in modern-day America. This nouveau Fred Flintstone isn't alone. Burger King's creepy "King" mascot shows up in a series of video games, and the fast-food chain is arranging for him to star in a feature film. And the mythical Simpsons family debuted in real life as 7-Eleven transformed many of its stores into Kwik-E-Marts to promote the cartoon series' movie. During the promotion, customers snapped up KrustyO's cereal, Buzz Cola, and ice Squishees, all products from the show.

Reality engineering occurs when marketers appropriate elements of popular culture and use them as promotional vehicles. Reality engineers have many tools at their disposal; they plant products in movies, pump scents into offices and stores, attach video monitors in the backs of taxicabs, buy ad space on police patrol cars, or film faked "documentaries" such as *The Blair Witch Project* and *Cloverfield*. A New York couple funded their $80,000 wedding by selling corporate plugs; they inserted coupons in their programs and tossed 25 bouquets from 1-800-FLOWERS. Internet casino GoldenPalace.com paid people a total of $100,000 to tattoo the company name on their foreheads, cleavage, and pregnant bellies. In one poll, about half of the respondents said they would consider accepting money from corporations in exchange for naming rights to their babies. Others do it for free: In 2000, the latest year for which data is available, 571 babies in the United States were named Armani, 55 were named Chevy, and 21 were named L'Oréal.

> *Reality engineering* occurs when marketers appropriate elements of popular culture and use them as promotional vehicles.

Traditionally, TV networks demanded that producers "geek" (alter) brand names before they could appear in a show, as when *Melrose Place* changed a Nokia cell phone to a "Nokio." Nowadays, though, real products pop up everywhere. A script for ABC's soap opera *All My Children* was reworked so that one of the characters would plug a new Wal-Mart perfume called Enchantment. Daytime TV stars eat Butterball turkeys, wear NASCAR shirts, and use Kleenex tissue. And the characters on the soap have been drinking a lot of Florida orange juice—not only because they're thirsty. *Product placement* is the insertion of real products in fictional movies, TV shows, books, and plays. Many types of products play starring (or at least supporting) roles in our culture; in 2007, for example, the most visible brands ranged from Coca-Cola and Nike apparel to the Chicago Bears football team and the Pussycat Dolls band.

> Many types of products play starring (or at least supporting) roles in our culture.

For better or worse, products are popping up everywhere. Worldwide product placement in all media was worth $3.5 billion in 2004, a 200 percent increase from 1994. New advances in technology are taking product placement to the next level, as producers can insert brands into shows after filming them. Virtual product placement put a box of Club Crackers into an episode of *Yes, Dear*; producers also inserted Cheez-It crackers, a can of StarKist tuna, and Nutri-Grain bars into the show. This new procedure means that a brand doesn't have to be written into the script, and it can't be deleted by late editing changes.

Is the placement worth the effort? A 2006 study reported that consumers respond well to placements when the show's plot makes the product's benefit clear. It found that the year's most effective brand integration occurred on ABC's now-cancelled *Miracle Workers* reality show, where physicians performed novel, life-changing surgeries. Audiences reacted strongly to CVS Pharmacy's role in covering the costs of medications that patients needed after the procedures.

Truth 48. Make your brand a fortress brand—and make mine a Guinness

A *ritual* is a set of multiple, symbolic behaviors that occurs in a fixed sequence and is repeated periodically. Bizarre tribal ceremonies, perhaps involving animal or human sacrifice, may come to mind when you think of rituals but, in reality, many contemporary consumer activities are ritualistic.

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Consider, for example, a ritual that many beer drinkers in the United Kingdom and Ireland hold near and dear to their hearts—the spectacle of a pub bartender "pulling" the perfect pint of Guinness. According to tradition, the slow pour takes exactly 119.5 seconds as the bartender holds the glass at a 45-degree angle, fills it three-quarters full, lets it settle, and tops it off with its signature creamy head. Guinness wanted to make the pull faster so that the bar could serve more drinks on a busy night, so it introduced FastPour, an ultrasound technology that dispenses the dark brew in only 25 seconds. Did you guess the outcome? The brewer had to scrap the system when drinkers resisted the innovation. You just don't mess with consumers' rituals.

The BBDO Worldwide advertising agency labels brands that we closely link to our rituals *fortress brands* because, once they become embedded in our rituals—whether brushing our teeth, drinking a beer, or shaving—we're unlikely to replace them. The agency reported that people it observed in 26 countries practice some rituals in common, including one it labels *preparing for battle*. For most of us, this ritual means getting ready for work. Relevant activities include brushing our teeth, taking a shower or bath, having something to eat or drink, talking to a family member or partner, checking e-mail, shaving, putting on makeup, watching TV or listening to the radio, and reading a newspaper. The study claims that 89 percent of people use the same brands for these sequenced rituals, and three out of four are disappointed or irritated when something disrupts their ritual or their brand of choice isn't available.

Rituals occur at several levels. Public rituals such as the Super Bowl, presidential inaugurations, and graduation ceremonies are communal activities that affirm our membership in the larger group and reassure us that we are reading from the same script as everyone else. Other rituals occur in small groups or even in isolation. Market researchers discovered that, for many people, the act of late-night ice cream eating has ritualistic elements, often involving a favorite spoon and bowl! And rituals are not always set in stone; they change with the times. For example, when we throw rice at a wedding, we are expressing our desire for the couple to be fertile. In recent years, many newlyweds have substituted soap bubbles, jingling bells, or butterflies for the rice, because birds eat the rice, which expands inside their bodies with nasty results.

Many businesses owe their livelihoods to their capability to supply *ritual artifacts* to consumers. These are items we need to perform rituals, such as wedding rice, birthday candles, diplomas, specialized foods and beverages (for example, wedding cakes, ceremonial wine, or even hot dogs at the ball park), trophies and plaques, band uniforms, greeting cards, and retirement watches. In addition, we often follow a ritual script to identify the artifacts we need, the sequence in which we should use them, and who uses them. Examples include graduation programs, fraternity manuals, and etiquette books. Make your brand a fortress brand.

> Many businesses owe their livelihoods to their ability to supply ritual artifacts to consumers.

Truth 49. Turn a (pet) rock into gold

In the early 1980s, Cabbage Patch dolls were all the rage among American children. Faced with a limited supply of the product, some retailers reported near-riots among adults as they tried desperately to buy the dolls for their children. A Milwaukee DJ jokingly announced that people should bring catcher's mitts to a local stadium, because an airplane was going to fly overhead and drop 2,000 dolls. He told his listeners to hold up their American Express cards so their numbers could be photographed from the plane. More than two dozen anxious parents apparently didn't get the joke; they showed up in subzero weather, mitts in hand.

The Cabbage Patch craze lasted for a couple of seasons before it eventually died out, and consumers moved on to other things, such as Teenage Mutant Ninja Turtles, which grossed more than $600 million in 1989. The Mighty Morphin Power Rangers eventually replaced the Turtles, and Beanie Babies and Giga Pets, in turn, deposed them before the invasion of Pokémon followed by Yu-Gi-Oh! cards and now Webkinz. What will be next?

Although the longevity of a particular style can range from a month to a century, fashions tend to flow in a predictable sequence. Like a person, an item or idea progresses through basic stages from birth to death. The fashion acceptance cycle is pretty predictable, but the rate at which it occurs is speeding up dramatically in our global and high-tech economy. This means that companies have to work harder than ever to continually innovate rather than simply introduce a great product and rest on their laurels. Product development cycles accelerate in many industries from apparel (which used to have four seasons but now has six per year) to computers.

> Although the longevity of a particular style can range from a month to a century, fashions tend to flow in a predictable sequence.

We distinguish among products in terms of the length of their acceptance cycle. A classic is a fashion with an extremely long acceptance cycle. It is, in a sense, "antifashion" because it guarantees stability and low risk to the purchaser for a long period. Keds sneakers, introduced in 1917, appeal to those who are turned off by the high fashion, trendy appeal of Nike or Reebok. When researchers asked consumers in focus groups to imagine what kind of building Keds would be, a common response was a country house with a white picket fence. In other words, consumers see the shoes as a stable, classic product. In contrast, participants described Nikes as steel-and-glass skyscrapers, reflecting their more modern image.

In contrast, a *fad* is a short-lived fashion. Relatively few people adopt a fad product. Adopters may all belong to a common subculture, and the fad "trickles across" members but rarely breaks out of that specific group. Indeed, others are likely to ridicule the fad (which may add fuel to the fire). Some notable past fad products include hula hoops, snap bracelets, and pet rocks. More recently, an entrepreneur named Johnny Earle caught the fad wave by turning his nickname—"Cupcake"—into a booming business. He started selling his T-shirts featuring cupcakes in unlikely situations (for example, one with a cupcake and crossbones) out of the trunk of his car. He wound up with two retail stores, including one on upscale Newbury Street in Boston. Customers walk away with the shirts wrapped in doughnut boxes rather than bags.

The first company to identify a trend and act on it has an advantage, whether the firm is Starbucks (gourmet coffee), Nabisco (Snackwells low-fat cookies and crackers), Taco Bell (value pricing), or Chrysler (retro cars). Nothing is certain, but some guidelines help to predict whether the innovation will endure as a long-term trend or if it's just a fad destined to go the way of hula-hoops, pet rocks, and little rubber spiders called Wally Wallwalkers that slowly crawled down walls instead of just dropping to the ground:

> The first company to identify a trend and act on it has an advantage.

- **Does it fit with basic lifestyle changes?** If a new hairstyle is hard to care for, this innovation isn't consistent with women's increasing time demands. However, the movement to shorter-term vacations is more likely to last, because this innovation makes trip planning easier for harried consumers who want to get away for a few days at a time.
- **What are the benefits?** The switch to poultry and fish from beef came about because these meats are healthier.
- **Can it be personalized?** Enduring trends tend to accommodate a desire for individuality, whereas styles such as Mohawk haircuts or the grunge look tend to lock followers in to a fairly restricted set of styles.
- **Is it a real trend or just a side effect of something else?** An increased interest in exercise is part of a basic trend toward health consciousness, although the specific form of exercise that is "in" at any given time will vary (for example, low-impact aerobics versus Pilates).
- **What other changes are occurring in the market?** Sometimes *carryover effects* influence the popularity of related products. The miniskirt fad in the 1960s boosted hosiery purchases substantially. Now, sales of these items are in decline because of today's more casual styles.
- **Who has adopted it?** If working mothers, baby boomers, or some other important market segment don't adopt the innovation, it is not likely to become a longer-term trend.

Truth 50. Think globally, act locally

When Wal-Mart started to open stores abroad in the early 1990s, it offered a little piece of America to foreign consumers—and that was the problem. The retail behemoth promoted golf clubs in soccer-mad Brazil and pushed ice skates in Mexico. It trained its German clerks to smile at customers—who thought they were flirting. Now Wal-Mart is adapting (though not in Germany—the company had to throw in the towel there). Its Chinese stores sell live turtles and snakes and lure shoppers who come on foot or bicycle with free shuttle buses and home delivery for refrigerators and other large items.

As corporations compete in many markets around the world, the debate intensifies regarding the need to develop separate marketing plans for each culture versus crafting a single plan that a firm implements everywhere. Let's briefly consider each viewpoint.

- **Adopt a standardized strategy**—Proponents of a standardized marketing strategy argue that many cultures, especially those of industrialized countries, have become so homogenized that the same approach will work throughout the world. By developing one approach for multiple markets, a company can benefit from economies of scale because it does not have to incur the substantial time and expense to develop a separate strategy for each culture. For example, Starbucks is becoming a household name in Japan (where it is pronounced *STAH-buks-zu*). Like their American counterparts, local Japanese outlets feature comfortable sofas, and hip-hop and reggae tunes play in the background.
- **Adopt a localized strategy**—Disney learned the hard way about the importance of being sensitive to local cultures after it opened its Euro Disney Park in 1992. The company got slammed for creating an entertainment venue that re-created its American locations without catering to local customs (such as serving wine with meals). Visitors to Euro Disney from many countries took offense, even at what seemed to be small slights—such as the sin of serving only French sausage to Germans, Italians, and others who believed their own local

version to be superior. Disney applied the lessons it learned in cultural sensitivity to its newer Hong Kong Disneyland. Executives shifted the angle of the front gate by 12 degrees after they consulted a *feng shui* specialist, who said the change would ensure prosperity for the park. Cash registers are close to corners or along walls to increase prosperity. The company burned incense as it finished each building, and it picked a lucky day (September 12) for the opening. One of the park's main ballrooms measures 888 square meters because eight is a lucky number in Chinese culture.

In some cases, consumers in one place simply do not like some products that are popular elsewhere, or their different lifestyles require companies to adapt the way they make their products. IKEA finally realized that Americans use a lot of ice in their drinks, so they weren't buying smaller European glasses. The Swedish furniture chain also figured out that, compared to Europeans, Americans sleep in bigger beds, need bigger bookshelves, and like to curl up on sofas rather than sit on them. Snapple failed in Japan because the drink's cloudy appearance and the pulp floating in the bottles were a turnoff. Similarly, Frito-Lay stopped selling Ruffles potato chips (too salty) and Cheetos there. (The Japanese didn't appreciate having orange fingers after they ate a handful.) The company still makes Cheetos in China, but the local version doesn't contain cheese, which is not a staple of the Chinese diet. Instead, local flavors come in varieties such as Savory American Cream and Japanese Steak.

So, what's the verdict—does global marketing work? Perhaps the more appropriate question is, "When does it work?" Although the argument for a homogenous world culture is appealing in principle, in practice it hasn't worked out too well. One reason for the failure of global marketing is that consumers in different countries have varying conventions and customs, so they simply do not use products the same way. Kellogg, for example, discovered that, in Brazil, people don't typically eat a big breakfast—they're more likely to eat cereal as a dry snack.

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Some large corporations such as Coca-Cola have been successful in crafting a single, international image. Still, even the soft drink giant must make minor modifications to the way it presents itself in each culture. Although Coke commercials are largely standardized, the company permits local agencies to edit them so that they highlight close-ups of local faces. To maximize the chances of success for these multicultural efforts, marketers must locate consumers in different countries who nonetheless share a common worldview. This is more likely to be the case among people whose frame of reference is relatively more international or cosmopolitan, or who receive much of their information about the world from sources that incorporate a worldwide perspective. The best candidates for standardization: affluent people who are "global citizens" and who come into contact with ideas from around the world through their travels, business contacts, and media experiences; and young people whose tastes in music and fashion are strongly influenced by MTV and other media that broadcast many of the same images to multiple countries.

> Young people whose tastes in music and fashion are strongly influenced by MTV and other media.

And that's the truth.

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