Customer Relationship Management

EXECUTIVE BRIEFING

Bari Harlam, Vice President, Marketing Intelligence, CVS Caremark, Inc.

Our group is responsible for analyzing the purchasing data we have on our customers and developing programs and promotions that increase CVS pharmacy's share of wallet. These customer relationship management activities drive off the data we collect from the 50 million cardholders enrolled in our ExtraCare® program. Customers in the program earn ExtraBucks®—2 percent on most in-store and online purchases and $1 for every two prescriptions purchased—that can be used when shopping in our stores or online. ExtraCare® customers also receive e-mails and direct mailings with helpful health and beauty insights, new product information, and valuable coupons, in addition to free merchandise when we have special vendor promotions.

By analyzing the buying behavior of our ExtraCare® customers, we discover some interesting opportunities for cross-promotions. For example, about two-thirds of our customers buying toothpaste did not buy toothbrushes from us. To encourage these customers to buy toothbrushes as well as toothpaste, we target these customers for a special toothbrush promotion.

We also use targeted special promotions to increase the average size of a customer's market basket. For example, we offer a $4 coupon to customers with an average market basket of $15 who buy $25. Customers who normally purchase $25 of merchandise get a $10 coupon if they make a $50 purchase.

Each quarter we distribute over five million messages to our customers. These messages contain information and offers tailored to the customers' buying behavior. Like most drugstore chains, over 20 percent of our sales involve some form of promotion. These promotions

QUESTIONS

What is customer relationship management?

Why do retailers want to treat customers differently?

How do retailers determine who their best customers are?

How can retailers build customer loyalty?

What can retailers do to increase their share of wallet?

What can retailers do to alleviate the privacy concerns of their customers?

CHAPTER 11

increase sales but can lower our gross margin. We experiment with different messaging and offerings and then analyze customer buying behavior to determine which promotions are more profitable.

We are very concerned about our customers' privacy. Our program is an opt-in one, and therefore, we only send mailings to customers who give us permission to do so. At times, we use outside processing companies as our agents to help print and send mailings. But these agents never receive any personal customer information beyond name and address. We value our customers' privacy and never give or sell any specific information about them to any manufacturer or direct marketers.

Ms. Harlam earned a Ph.D. in marketing from the Wharton School at the University of Pennsylvania. Prior to joining CVS, she was a marketing professor at the University of Rhode Island and Columbia University's Graduate School of Business.

The business press and companies are talking a lot about the importance of managing customer relationships. Companies are spending billions of dollars on computer systems to help them collect and analyze data about their customers. With all of this buzz, you'd think that the customer is a popular new kid in the neighborhood. However, the customer is more like an old friend who's been taken for granted—until now.

Consider the following example. Shari Ast is on her third business trip this month. She takes a cab from Boston Logan airport to the Ritz-Carlton, her favorite hotel. As the doorman opens the car door for her, he greets her with, "Welcome back to the Ritz-Carlton, Ms. Ast." When she goes to the registration desk, the receptionist gives her a room key. Then she goes to her room and finds just what she prefers—a room with a view of the Boston Commons, a single queen-size bed, an extra pillow and blanket, a fax machine connected to her telephone, and a basket with her favorite fruits and snacks.

Shari Ast's experience is an example of the Ritz-Carlton's customer relationship management program. **Customer relationship management (CRM)** is a business philosophy and set of strategies, programs, and systems that focuses on identifying and building loyalty with a retailer's most valued customers. Based on the philosophy that retailers can increase their profitability by building relationships with their better customers, the goal of CRM is to develop a base of loyal customers who patronize the retailer frequently. In the following sections of this chapter, we discuss in more depth the objective of CRM programs and the elements of the CRM process.

When guests check into 5-star hotels like the Ritz-Carlton, they are greated by name. Their preferences are known based on past vists. Everything possible is done to meet their needs and wants.

THE CRM PROCESS

Traditionally, retailers have focused their attention on encouraging customers to visit their stores, look through their catalogs, and visit their Web sites. To accomplish this objective, they have used mass media advertising and sales promotions, treating all of their customers the same.

Now retailers are beginning to concentrate on providing more value to their best customers using targeted promotions and services to increase their **share of wallet** from a customer—the percentage of the customers' purchases made from the retailer. This change in perspective is supported by research indicating that all customers are not equally profitable and that more and less profitable customers need to be treated differently.[1]

What Is Loyalty?

REFACT

Fifty-five percent of consumers aged 25 years and older are not truly loyal to the stores at which they shop most frequently.

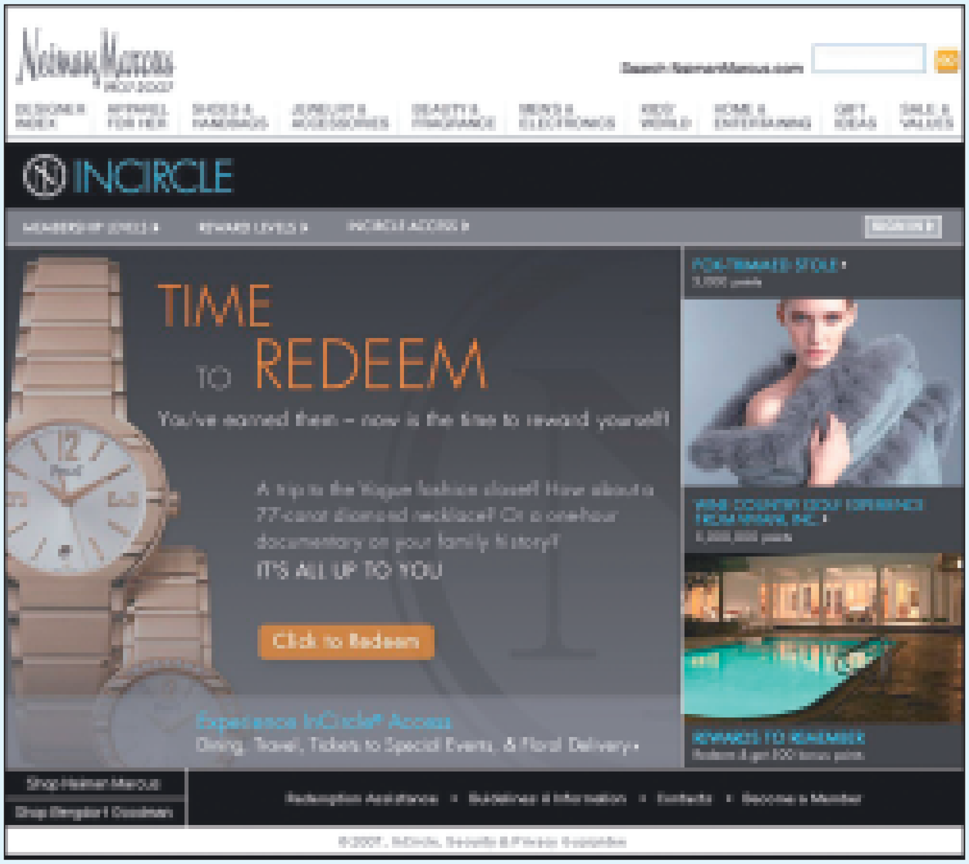
Customer loyalty, the objective of CRM, is more than having customers make repeat visits to a retailer and being satisfied with their experiences. **Customer loyalty** to a retailer means that customers are committed to purchasing merchandise and services from the retailer and will resist the activities of competitors attempting to attract their patronage. They have a bond with the retailer, and the bond is based on more than a positive feeling about the retailer.[2] Retailing View 11.1 describes how Neiman Marcus builds loyalty with its best customers.

Loyal customers have an emotional connection with the retailer. They feel like the retailer is a friend. Their reasons for continuing to patronize a retailer go beyond the convenience of the retailer's store or the low prices and specific brands offered by the retailer. They feel such goodwill toward the retailer that they will encourage their friends and family to buy from it.

Programs that encourage repeat buying by simply offering price discounts can be easily copied by competitors. In addition, these types of price-promotion programs encourage customers to always look for the best deal rather than develop a relationship with one retailer. However, when a retailer develops an emotional connection with a customer, it is difficult for a competitor to attract that customer.[3]

Emotional connections develop when customers receive personal attention. For example, many small, independent restaurants build loyalty by functioning as neighborhood cafés, where waiters and waitresses recognize customers by name and know their preferences. Larger stores like Nordstrom have found that paying personal attention to customers by inviting them to grand opening celebrations, pampering them during private shopping parties, and offering them concierge services,free alterations, and shipping is more important than giving them discounts.[4]

CRM at Neiman Marcus — RETAILING VIEW 11.1



Neiman Marcus's InCircle program provides special benefits to build its share of wallet with its best customers.

One of the best examples of a CRM activity designed to build customer loyalty is Neiman Marcus's InCircle program. The program is designed to focus on its best customers.

Customers spending more than $5,000 annually on their Neiman Marcus credit card are enrolled in the program and get special gifts, awards, and services. Customers whose higher spending levels place them in the "Platinum" or "Chairman's" categories generate additional rewards and services for themselves. There are currently 100,000 InCircle members, whose median household income is $285,000 and who spend an average of over $12,000 per year.

Customers earn one point for each dollar charged on a Neiman Marcus credit card. The points can be redeemed for prizes ranging from a limited-edition Emilio Pucci silk scarf to an eight-night excursion through India or a complete Sony home movie theater. Each year, for 5,000,000 points, a limited edition luxury vehicle is a reward choice. This year, it is the 2008 Lexus LS600h L. Reward options are refined and expanded annually, but the options are always designed to enhance Neiman's exclusive image and reputation for uniqueness.

InCircle members receive frequent communications from Neiman Marcus throughout the year, including the quarterly InCircle newsletter and the semiannual InCircle *Entrée* magazine, a quality publication produced by the creators of *Southern Living* and *Southern Accents*.

Customer relationships are also nurtured at the store level. Neiman's sales associates can tap into information about customers' past purchases and shopping behaviors and are encouraged to contact these customers personally. Sales associates have the freedom to be creative in helping InCircle customers shop in multiple departments and use the various services Neiman Marcus offers, from gift wrapping to travel services. Store managers invite InCircle members to free luncheons on their birthdays.

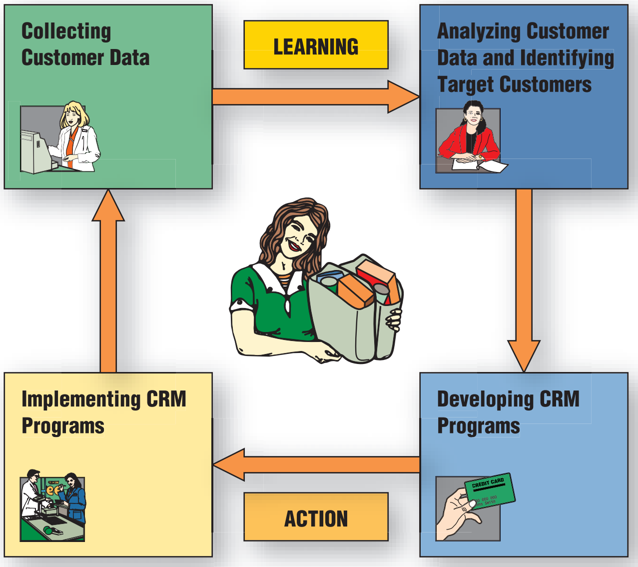
Recognizing the value of these preferred customers, Neiman invites InCircle members to sit on a board that provides feedback and suggestions as to how Neiman can improve its customers' shopping experience and enhance and broaden its role in the community. These board meetings help Neiman Marcus maintain a genuine, ongoing dialogue with its best customers and make these customers feel that the company respects them and values their opinions.

REFACT

In 1984, Neiman Marcus launched the first frequent shopper program sponsored by a retailer.[5]

Sources: Vanessa O'Connell, "Posh Retailers Pile on Perks for Top Customers," *The Wall Street Journal,* April 26, 2007; www.incircle.com (accessed August 29, 2007); www.neimanmarcus.com (accessed August 29, 2007).

EXHIBIT 11–1
The CRM Process Cycle



Unusual positive experiences also build emotional connections. For example, a family was shopping for shoes at Nordstrom for their teenage daughter, who was going through a growth spurt. One of her feet was a size 10, and the other was a 10½. The salesperson broke up two pairs of shoes to make the sale and ensure a satisfied customer. The gesture paid off—that day, the family purchased five pairs of shoes and have remained loyal customers ever since.[6] Providing such memorable experiences is an important avenue for building customer loyalty.[7]

Overview of the CRM Process

REFACT
The modern age of loyalty marketing began in 1981 with the launch of the American Airlines Advantage program. Airlines now have over 255 million members, the most of any industry.[8]

Exhibit 11–1 illustrates that CRM is an iterative process that turns customer data into customer loyalty through four activities: (1) collecting customer data, (2) analyzing the customer data and identifying target customers, (3) developing CRM programs, and (4) implementing CRM programs. The process begins with the collection and analysis of data about a retailer's customers and the identification of target customers. The analysis translates the customer information into activities that offer value to the targeted customers. Then these activities are executed through communication programs undertaken by the marketing department and customer service programs implemented by customer contact employees, typically sales associates. Each of the four activities in the CRM process is discussed in the following sections.

COLLECTING CUSTOMER DATA

The first step in the CRM process is to construct a **customer database.** This database is part of the data warehouse described in Chapter 10. It contains all of the data the firm has collected about its customers and is the foundation for subsequent CRM activities.

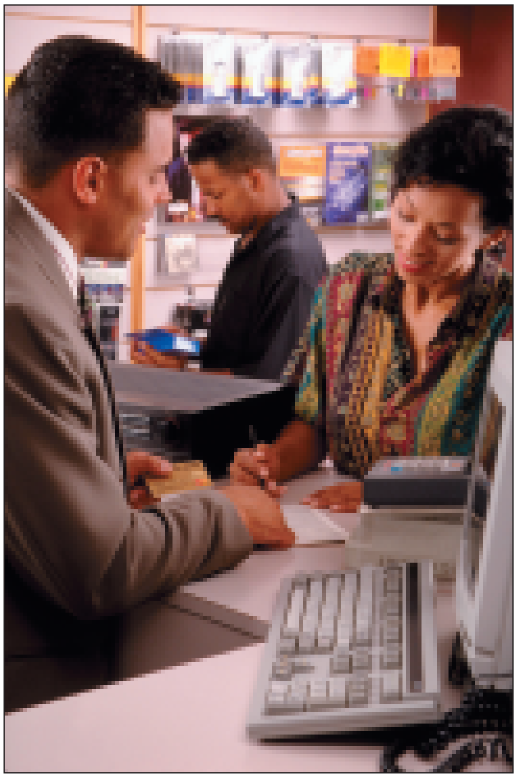
Customer Database

Ideally, the database should contain the following information:

- *Transactions.* A complete history of the purchases made by the customer, including the purchase date, the SKUs purchased, the price paid, the amount of profit, and whether the merchandise was purchased in response to a special promotion or marketing activity.
- *Customer contacts.* A record of the interactions that the customer has had with the retailer, including visits to the retailer's Web site, inquiries made through in-store kiosks, and telephone calls made to the retailer's call center, plus information about

contacts initiated by the retailer, such as catalogs and direct mail sent to the customer.

- *Customer preferences.* What the customer likes, such as favorite colors, brands, fabrics, and flavors, as well as apparel sizes. At a Brooks Brothers store in New York, a sales associate looked up a customer's recent purchases at its POS terminal. She saw that the customer purchased a navy pinstripe suit several months ago. Using this information, she knew exactly which dress shirts would go with the suit and took the opportunity to show him some coordinating ties, too. By the time she rang up the sale, it included three dress shirts, two ties, underwear, and socks.[9]
- *Descriptive information.* Demographic and psychographic data describing the customer that can be used in developing market segments.
- *Responses to marketing activities.* Analyses of transaction and contact data provide information about the customer's responsiveness to marketing activities.



Customers' sales information is recorded at POS terminals, stored in data warehouses, and used in CRM systems.

Different members of the same household also might also have interactions with a retailer. Thus, to get a complete view of the customer, retailers need to be able to combine individual customer data from each member of a household. For example, at Mitchells or Richards, stores in a family-owned apparel chain in Westport and Greenwich, Connecticut, husbands and wives buy things for each other. The chain's database keeps track of both household-level purchases and individual purchases so sales associates can help one spouse buy a gift for the other. The database also keeps track of spending changes and habits. Anniversaries, birthdays, and even divorces and second marriages are tracked along with style, brand, size, and color preferences; hobbies; and sometimes pets' names and golf handicaps.[10] Retailing View 11.2 describes how Harrah's uses its customer database for its loyalty program.

With today's technology, independent companies are able to network with their larger suppliers to increase sales. For example, George Matick Chevrolet in Redford, Michigan, doubled its sales when it installed a CRM program that helped it keep track of potential sales leads. The leads originate both from its own and General Motors' Web site.[11]

Identifying Information

Constructing a database for catalog and Internet shoppers and customers who use the retailer's credit card when buying merchandise in stores is relatively easy. Customers buying merchandise through nonstore channels must provide their contact information, name, and address so that the purchases can be sent to them. When retailers issue their own credit cards, they can collect the contact information for billing when customers apply for the card. In these cases, the identification of the customer is linked to the transaction. However, identifying most customers who are making in-store transactions is more difficult because they often pay for the merchandise with a check, cash, or a third-party credit card such as Visa or MasterCard.

Three approaches that store-based retailers use to overcome this problem are (1) asking customers for their identifying information, (2) offering frequent shopper programs, and (3) connecting Internet purchasing data with store purchases.

Asking for Identifying Information Some retailers have their sales associates ask customers for identifying information, such as their phone number or name and address, when they ring up a sale.[12] This information is then used to create a transaction database for the customer. However, some customers may be reluctant to provide the information and feel that the sales associates are violating their privacy.

REFACT

Eighty-nine percent of consumers believe that retailers are not doing everything they should to protect personal information.[13]

REFACT

Some research has shown that, at least in the U.S. supermarket industry, frequent shopper cards do not lead to increased loyalty. Other factors, such as a convenient location and fast checkout, have a bigger impact on customer loyalty.[14]

Offering Frequent Shopper Programs **Frequent shopper programs,** also called **loyalty programs,** are programs that identify and provide rewards to customers who patronize a retailer. Some retailers issue customers a frequent shopper card, whereas others use a **private-label credit card**—a credit card that has the store's name on it. In both cases, customer information is automatically captured when the card is scanned at the point of sale terminal. When customers enroll in one of these programs, they provide some descriptive information about themselves or their household. The customers then are offered an incentive to use the card when they make purchases from the retailer. Research has shown that customers generally prefer to get something extra—a reward—for their purchases, rather than lower prices.[15] As we see in Retailing Views 11.1 and 11.2, Neiman Marcus and Harrah's both give points for every dollar spent or gambled. The points can be redeemed for special gifts, special privileges, complementary food, drinks, hotel rooms, and even vacations.

11.2 RETAILING VIEW Harrah's CRM

Harrah's is an innovator in using customer relationship management in the gaming industry. In the 1990s, casinos were competing against each other by building more and more elaborate facilities. Harrah's, with more limited resources than some of the large casinos, took a different approach for developing a competitive advantage. It decided to focus on CRM to build customer loyalty and increase share of wallet. Gary Loveman, a Harvard Business School professor, was hired as a consultant to analyze Harrah's customer data and develop its CRM program. He is now the CEO of the company.

Harrah's best customers earn points toward benefits and upgrades on the basis of how much they spend through the Total Rewards loyalty card program. The program helps Harrah's determine the lifetime value of each customer.

Developing customer loyalty in the gaming industry is a challenge. Slot machines and gaming tables are a commodity offered by all casinos. Loveman starting building Harrah's CRM program by collecting customer data from which he could calculate the life time value of each customer. Harrah's decided to focus on avid experience players, who were not really the "high rollers." Avid experience players gamble $100–$500 per trip, visit several times per year, and provide $5,000 in annual revenue.

From this research, Harrah's Total Rewards loyalty card program was born to create closer customer relationships. The program contains four tiers: Gold, Platinum, Diamond, and the highest, Seven Stars, according to the customer's lifetime value. Less than 1 percent of its 40 million customers reach the Seven Stars level, but this group is significant to the company's revenue. Each of the four segments comprises approximately 90 different groups based on geodemographics, psychographics, and play patterns.

Harrah's sophisticated database boasts customer detail like, "Tom likes NASCAR, Clint Holmes, thick steaks." Its CRM program allows it to measure four key metrics: (1) share of its customers' gaming dollars, (2) percentage of revenues from customers visiting more than one site, (3) percentage of Total Rewards members upgraded to a higher tier, and (4) customer satisfaction scores for all properties. Just as it focuses on servicing customers and helping them move up to the next level, it also terminates relationships wih customers that are not significant enough. Dropping nonlucrative customers saves the company $20 million annually and helps it focus on its true customers. The company's share of its customers' wallet increased to more than 43 percent from 36 percent in 1998.

A key CRM component is Harrah's ability to empower its 80,000 employees to take control over customer satisfaction. Employee performance is taken seriously to ensure they do not just provide a minimum service level but really work to make a difference. Gary Loveman, the CEO says, "From housekeepers to slot attendants, from valets to stewards, from receptionists to chefs, all employees are told daily as they arrive at work: If your service can persuade one customers to make one more visit with us, you've had a good shift. If you can persuade three, you've had a great shift." For those casinos that improve customer service by 3 percent in one year,[16] the company pays bonuses to all non-management employees. In the first four years of the program's existence, the company paid out $43 million in bonuses.

With 38 casinos in 15 states, customers have many chances to accumulate points. When a gamer—casino lingo for a customer—gambles, he or she swipes a card through the slot machine or a pit boss estimates his or her bets at a table. As the points accumulate, card holders earn new status titles: 4,000 points earns a gamer Platinum status and a few privileges, such as shorter wait times in line. With 10,000 points, a gamer earns the Diamond card, which entitles him or her to benefits such as free valet parking, room upgrades, and free weekend reservations. Gamers are rewarded on the basis of their value to the hotel chain and encouraged to earn the next loyalty card status level.

Sources: Sudhir H. Kale and Peter Klugsberger, "Reaping Rewards," *Marketing Management,* July/August 2007; Richard Slawsky, "Harrah's Finds Better Service Through Technology," http://www.selfservice.org/article_3094_2.php, August 20, 2007 (accessed August 23, 2007); www.harrahs.com (accessed August 23, 2007).

Frequent shopper programs offer two benefits from the retailer's perspective: (1) customers provide demographic and other information when they sign up for the program and then are motivated to identify themselves at each transaction and (2) customers are motivated by the rewards offered to increase the number of visits and the amount purchased on each visit to the retailer.

Frequent shopper cards are becoming so common that consumers cannot carry all their many cards.

Other retailers and service providers are experimenting with technology to increase customer loyalty and spending. As described in the Executive Briefing at the beginning of the chapter, CVS has implemented its *ExtraCare* loyalty program, in which customers can accrue rewards and are eligible for discounts according to scans of their card.[17] The drugstore chain has partnered with the bank holding company HSBC to launch its innovative loyalty program. Using HSBC's OptiPay technology, the ExtraCare Plus card acts as a debit card and a loyalty card all in one. The card is linked to customers' checking accounts so CVS can better personalize and measure its marketing promotions. This link also eliminates the customer's need for two cards, shortens queue times at the register, and allows a closer relationship with the customer.

Rather than asking for identifying information or requiring a frequent shopper card, some retailers, especially those in the services sector, use a cardless, cashless payment and loyalty system. Using fingerprint scanners, a customer can pay efficiently, and the company can store the customer information quickly and accurately.

Dayton, Ohio–based Dorothy Lane Market is using this technology in its stores. Customers entering the store can either use a finger scan or swipe a card to receive a printout of their personalized product discounts. At check-out, customers can pay using the finger scan and automatically debit the amount from a checking account. This system eliminates all cards completely and fully integrates loyalty programs and customer data, and makes rewards easily available with the simple act of a fingerprint scan.[18]

Connecting Internet Purchasing Data with the Stores When customers use third-party credit cards such as Visa or MasterCard to make a purchase in a store, the retailer cannot identify the purchase by the customer. However, if the customer used the same credit card while shopping the retailer's Web site and provided shipping information, the retailer could connect the credit card purchases with the customer. Imagine a customer purchases a computer at www.staples.com using a credit card and then uses the same credit card to purchase supplies at a Staples store. Then, the store's database can capture the customer's name and shipping address from the Web site transaction and update the customer's purchase record with the supplies obtained in the store.

REFACT

Saks Fifth Avenue has found that shoppers carrying its Saks First credit card visit the store three times as often as regular customers. Saks First shoppers spend five to ten times as much as non-Saks First card users.[19]

Privacy and CRM Programs

Although detailed information about individual customers helps retailers provide more benefits to their better customers, consumers also are concerned about retailers violating their privacy when they collect this information. If customers' data are not secure and susceptible to identity theft, customers would be reluctant to participate in loyalty programs. The data broker ChoicePoint was fined $15 million by the Federal Trade Commission (FTC) because 163,000 consumers' data were accessed. The FBI and the Secret Service also are signaling to retailers that consumer privacy is a much more serious issue than it ever has been before.

REFACT

The FTC says that data theft is now more profitable than illegal drug trafficking.[20]

REFACT

There are an estimated 25 million victims of identity theft each year.[21]

REFACT

Seventy-one percent of consumers believe that protecting personal information and privacy is more of a concern now than a few years ago.[23]

Privacy Concerns The degree to which consumers feel their privacy has been violated depends on:

- Their control over their personal information when engaging in marketplace transactions. Do they feel they can decide the amount and type of information collected by the retailer?
- Their knowledge about the collection and use of personal information. Do they know what information is being collected and how the retailer will be using it? Will the retailer be sharing the information with other parties?[22]

These concerns are particularly acute for customers using an electronic channel because many of them do not realize the extensive amount of information that can be collected without their knowledge. This information is easily collected when the user visits a Web site that installs a cookie on the visitor's computer. **Cookies** are text files that identify visitors when they return to a Web site and track their navigation at the Web site. Due to the data in the cookies, customers do not have to identify themselves or use passwords every time they visit a site. However, the cookies also collect information about other sites the person has visited and what pages they have downloaded.

Protecting Customer Privacy What is personal information? The definition is debatable. Some people define personal information as all information that is not publicly available; others include both public (e.g., driver's license, mortgage data) and private (hobbies, income) information. Retailers need to take the necessary precautions to protect personal information by incorporating privacy safety software such as firewalls to keep out hackers and encrypting data every time it is transferred to prevent it being intercepted.[24]

In the United States, Americans rely on retailers to protect consumer privacy. Existing legislation for consumer privacy is restricted to the protection of information associated with credit reporting, video rentals, banking, and health care. However, the European Union (EU), Australia, New Zealand, and Canada have different and more stringent consumer privacy laws. Some of the provisions of the EU directive on consumer privacy include the following:

- Businesses can collect consumer information only if they have clearly defined the purpose, such as completing the transaction.
- The purpose must be disclosed to the consumer from whom the information is being collected.
- The information can only be used for that specific purpose.
- The business can only keep the information for the stated purpose. If the business wants to use the information for another purpose, it must initiate a new collection process.
- Businesses operating in Europe can only export information from the 27 EU countries to importing countries with similar privacy policies. Thus, U.S. retailers, hotel chains, airlines, and banks cannot transfer information from Europe to the United States because the United States does not have similar privacy policies.

Basically, the EU perspective is that consumers own their personal information, so retailers must get consumers to agree explicitly to share this personal information. This agreement is referred to as an **opt in.** In contrast, personal information in the United States is generally viewed as being in the public domain, and retailers can use it in any way they desire. American consumers must explicitly tell retailers not to use their personal information—they must **opt out.**[25]

The EU has delayed enforcement of its directive. The United States is currently negotiating a safe harbor program that would enable U.S. companies abiding by the EU directives to export information. However, due to increasing concerns about consumer privacy, Congress is considering new legislation on consumer privacy. The Federal Trade Commission has developed the following set of principles for fair information practices:

- *Notice and awareness.* Covers the disclosure of information practices, including a comprehensive statement of information use, such as information storage, manipulation, and dissemination.
- *Choice/consent.* Includes both opt-out and opt-in options and allows consumers the opportunity to trade information for benefits.
- *Access/participation.* Allows for the confirmation of information accuracy by consumers.
- *Integrity/security.* Controls for the theft of and tampering with personal information.
- *Enforcement/redress.* Provides a mechanism to ensure compliance by participating companies.[26]

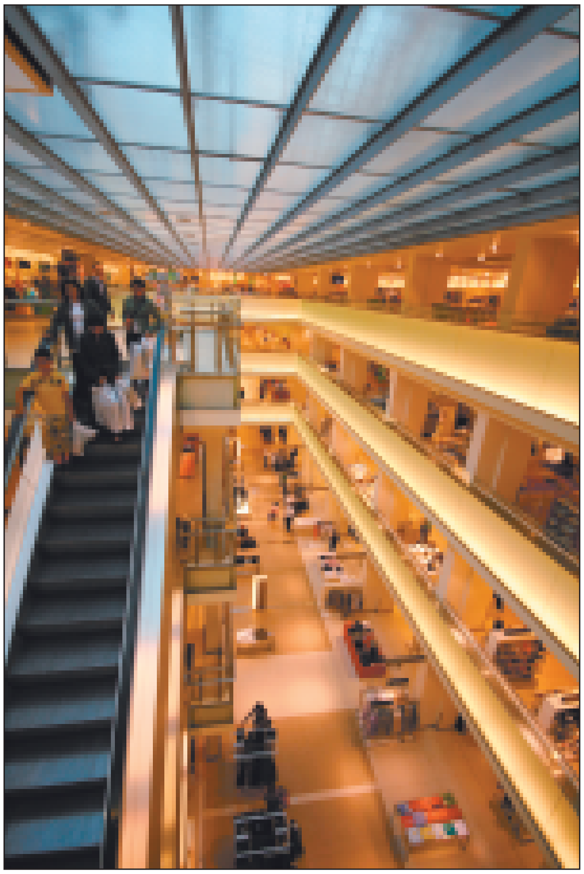
In summary, there is growing consensus that personal information must be fairly collected; that the collection must be purposeful; and that the data should be relevant, maintained as accurate, essential to the business, subject to the rights of the owning individual, kept reasonably secure, and transferred only with the permission of the consumer. To address these concerns, many retailers that collect customer information have privacy policies. The Electronic Privacy Information Center (www.epic.org) recommends that privacy policies clearly state what information is collected from each visitor and how it will be used, give consumers a choice as to whether they give information, and allow them to view and correct any personal information held by an online retail site. Retailers need to ensure their customers that information about them is held securely and not passed on to other companies without the customer's permission.

ANALYZING CUSTOMER DATA AND IDENTIFYING TARGET CUSTOMERS

The next step in the CRM process is to analyze the customer database and convert the data into information that will help retailers develop programs for building customer loyalty. **Data mining,** one approach commonly used to develop this information, identifies patterns in data, typically those that the analyst is unaware of prior to searching through the data. For example, DeBijenkorf, a department store in Amsterdam, Netherlands, was able to increase customers' purchases using data mining. It predicted which customers would not go on vacation in the current year on the basis of whether they went on vacation the year before. Then it targeted the non-vacation goers with double loyalty points and, based on their purchasing history, a special offer in one product category. A striking 45 percent of shoppers responded to the promotion.[27]

Market basket analysis is a specific type of data analysis that focuses on the composition of the basket, or bundle, of products purchased by a household during a single shopping occasion. This analysis is often useful for suggesting where to place merchandise in a store. For example, on the basis of market basket analyses, Wal-Mart changed the traditional location of several items:

- Because bananas are the most common item in Americans' grocery carts, Wal-Mart Supercenters sell bananas in the cereal aisle, as well as in the produce section.



DeBijenkorf department store in Amsterdam uses data mining to targeted non-vacation goers.

- Tissues are in the paper goods aisle and also mixed in with cold medicine.
- Measuring spoons appear in the housewares section and also hang next to baking supplies such as flour and shortening.
- Flashlights are placed in the hardware aisle and with a seasonal display of Halloween costumes.
- Snack cakes are found in the bread aisle and also next to the coffee.
- Bug spray is merchandised with the hunting gear and houshold cleaning supplies.

Retailing View 11.3 examines how U.K.-based Tesco uses the information from its market basket analysis.

Identifying the Best Customers

Traditionally, customer data analysis has focused on identifying market segments—groups of customers who have similar needs, purchase similar merchandise, and respond in a similar manner to marketing activities. But one of the goals of CRM is to identify and cater to the best, most profitable customers. For instance, Home Depot realized that 70 to 80 percent of its kitchen renovation department was coming from 20 to 30 percent of the department's customers.[28] It speculated that these heavy spenders might spend even more if it organized the department around meeting their needs. It knew that heavy spenders want lots of choices and information. So it added more assortment, better-trained associates, a computer-aided design system, and suites of innovative kitchen layouts arranged so that customers could readily sense what their kitchen would look like after a renovation. The results—higher sales and profit per square foot than traditional departments designed to satisfy all customers.

REFACT
Although 50 percent of retail executives say their company collects data about individual customers, only 41 percent of these can identify their best customers.

Using information in the customer database, retailers can develop a score or number indicating how valuable customers are to the firm. This score can then be used to determine which customers to target. A commonly used measure to score each customer is called lifetime customer value. **Lifetime customer value (LTV)** is the expected contribution from the customer to the retailer's profits over his or her entire relationship with the retailer.

To estimate LTV, retailers use past behaviors to forecast future purchases, the gross margin from these purchases, and the costs associated with servicing the customers. Some of the costs associated with a customer include the costs of advertising, promotions used to acquire the customer, and processing merchandise that the customer has returned. Thus, a customer who purchases $200 of groceries from a supermarket every other month would have a lower LTV for that supermarket than a customer who buys $30 on each visit and shops at the store three times a week. Similarly, a customer who buys apparel only when it is on sale in a department store would have a lower LTV than a customer who typically pays full price and buys the same amount of merchandise.

These assessments of LTV are based on the assumption that the customer's future purchase behaviors will be the same as they have been in the past. Sophisticated statistical methods are typically used to estimate the future contributions from past purchases.[29] For example, these methods might consider how recent purchases have occurred. The expected LTV of a customer who purchased $600 on one visit six months ago is probably less than the LTV of a customer who has been purchasing $100 of merchandise every month for the last six months, because the $600 sale might have be a one-time purchase by a person visiting from out of town.

Customer Pyramid Most retailers realize that their customers differ in terms of their profitability or LTV. In particular, they know that a relatively small number of customers account for the majority of their profits. This realization is often called the **80–20 rule**—80 percent of the sales or profits come from 20 percent of the customers. Thus, retailers could group their customers into two categories on the basis of their LTV scores. One group would be the 20 percent of the customers with the highest LTV scores, and the other group would be the rest. However, this two-segment scheme, "best" and "rest," does not consider important differences among the 80 percent of customers in the

Tesco Analyzes Market Baskets RETAILING VIEW 11.3

Tesco uses information collected from its loyalty Clubcards to better serve its customers, tailor assortments, determine prices, develop new product lines, build new stores, and leverage itself against the competition. Up to 80 percent of Tesco shoppers are Clubcard members.

Tesco encourages customers to sign up for the Clubcard to be eligible for promotions on products they purchase and gives them discounts if they provide their name, address, and other personal information.

Tesco analyzes customers' market baskets to alter its merchandise selection in stores, develop new products, and target specific customer groups.

Tesco receives data on 15 million transactions every week. Each product is rated on 50 different characteristics, including price and size, so that the food retailer can compare the shopping baskets of customers who bought similar products. The system then segments the customer into six categories, such as the "Finer Foods" segment, which includes affluent, time-strapped shoppers who buy upscale products, or "Traditional" shoppers who are homemakers with time to cook a meal.

Each quarter, Tesco sends a coupon package to Clubcard members. Three coupons are for products the customer normally buys, and three coupons are for products that the retailer believes the customer may like to try, based on their previous purchases. Approximately 15 to 20 percent of Tesco's coupons are redeemed, compared with the industry average redemption rate of 1 to 2 percent.

Tesco introduced "World Foods," which features Asian herbs and other ethnic food, in Indian and Pakistani neighborhoods. The retailer found that 36 percent of all its shoppers were buying from the line. When it looked at the locations from which the customers traveled, it found that more than 25 percent of customers buying the World Foods line were coming from non-Asian neighborhoods and were not Asian. This discovery spurred an initiative to expand its distribution to more stores.

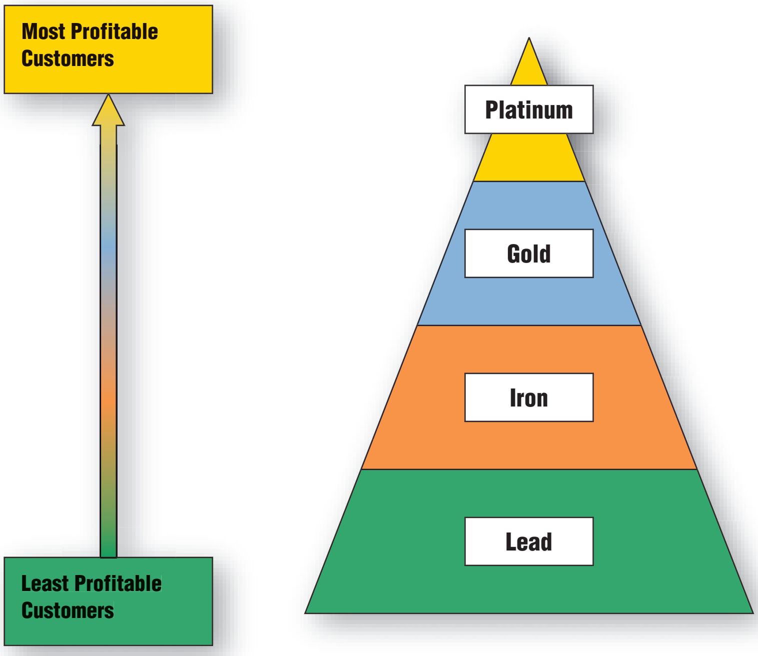
Using its market basket analyis, Tesco also was able to hold onto its price-sensitive customers in the face of rising price competition from Wal-Mart's Asda chain. Tesco lowered its prices on 300 products that price-sensitive customers considered staples. This change in pricing strategy resulted in a 17 percent increase in Tesco's sales.

Tesco develops its new product lines on the basis of its analysis of Clubcard customers. One of its new lines, Tesco Finest, includes duck pâté and other gourmet food items. It decided to roll out this new line in response to a market basket analysis showing that its higher spending customers were not buying wine, cheese, fruit, and other higher priced/higher margin items from Tesco.

Market basket analysis has helped Tesco experience enormous growth, international expansion, and loyal and satisfied customers.

Sources: Cecile Rohwedder, "No. 1 Retailer in Britain uses 'Clubcard' to Thwart Wal-Mart," *The Wall Street Journal,* June 6, 2006, pp. A1–A16; www.tesco.com (accessed August 30, 2007).

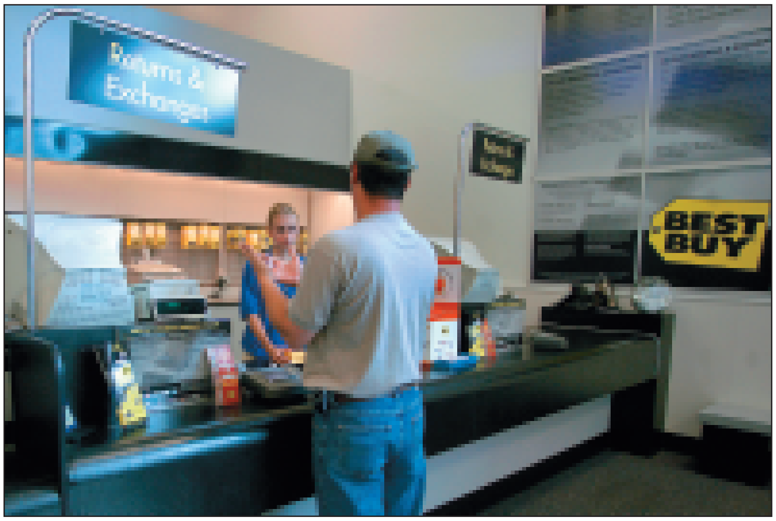
EXHIBIT 11–2
The Customer Pyramid



SOURCE: Valarie Zeithaml, Roland Rust, and Katherine Lemon, "The Customer Pyramid: Creating and Serving Profitable Customers," *California Management Review* 43 (Summer 2001), p. 125. Reprinted by permission.

"rest" segment.[30] A commonly used segmentation scheme divides customers into four segments, as illustrated in Exhibit 11–2. This scheme allows retailers to develop more appropriate strategies for each of the segments. Each of the four segments is described next.

- *Platinum segment.* This segment is composed of the customers who possess the top 25 percent LTVs. Typically, these are the most loyal customers who are not overly concerned about merchandise price and place more value on customer service.
- *Gold segment.* The next 25 percent of customers in terms of their LTV make up the gold segment. These customers have a lower LTV than platinum customers because they are more price sensitive. Even though they buy a significant amount of merchandise from the retailer, they are not as profitable as platinum customers and probably patronize some of the retailer's competitors.
- *Iron segment.* Customers in this third tier probably do not deserve much special attention from the retailer due to their modest LTV.
- *Lead segment.* Customers in the lowest segment can cost the company money. They often demand a lot of attention but do not buy much from the retailer, or they buy a lot of sale merchandise and abuse return privileges. For example, some retailers, like Target and Best Buy, have tightened their return policies to help disuade the "lead" segment.



Target and Best Buy have tightened their return policies to help dissuade the least profitable customers who abuse return privileges.

Many segmentation schemes are based on past or future sales, but the profitability of sales actually is a more appropriate measure for classifying customers. For example, airlines assign rewards in their frequent flier programs on the basis of miles flown. These programs provide the same rewards to customers who take low-cost flights as those who fly first class and pay non-discounted prices. Recently, however, some airlines, such as Lufthansa, have adopted an LTV measure based on the profitability of the miles flown instead of the number of miles.[31]

RFM Analysis An **RFM** (recency, frequency, monetary) **analysis,** often used by catalog retailers and direct marketers, is a scheme for determing the LTV of customers according to how recently they have made a purchase, how frequently they make purchases, and how much they have bought. Exhibit 11–3 is an example of an RFM analysis done by a catalog apparel retailer that mails a catalog each month to its customers.

The catalog retailer divides its customers into 32 groups or segments on the basis of how many orders each customer has placed during the last year, how much merchandise the customer has purchased, and the last time the customer placed an order. Each segment is represented by one cell in Exhibit 11–3. For example, the customers in the upper-left cell have made one or two purchases in the last year, made a purchase within the last two months, and purchased less than $50 of merchandise.

Catalog retailers often use this type of analysis to determine which customer groups should receive catalogs. For each of the RFM groups, they will determine the percentage of customers in the group who made a purchase from the last catalog sent to them. For example, 5 percent of the customers in the upper-left corner of Exhibit 11–3 placed an order from the last catalog sent to them. With information about the response rate and the average gross margin from orders placed by customers in each cell, the catalog retailer can calculate the expected profit from sending catalogs to different customers. For example, if the average gross margin from orders placed by customers in the upper-left cell is $20 and the cost of sending a catalog to customers in the cell is $0.75, the catalog would make $0.25 per customer from each catalog mailed to those customers.

$20 contribution × .05 response
= $1.00 expected contribution − $.75 cost
= $.25 per customer.

Thus, RFM analysis is basically a method of estimating the LTV of a customer using the recency, frequency, and monetary value of his or her past

EXHIBIT 11–3
RFM Analysis for a Catalog Retailer

		RECENCY			
Frequency	Monetary	0–2 months	3–4 months	5–6 months	Over 6 months
1–2	<$50	5.0%*	3.5%	1.0%	0.1%
1–2	Over $50	5.0	3.6	1.1	0.1
3–4	< $150	8.0	5.0	1.5	0.6
3–4	Over $150	8.8	5.0	1.7	0.8
5–6	<$300	10.0	6.0	2.5	1.0
5–6	Over $300	12.0	8.0	2.7	1.2
Over 6	<$450	15.0	10.0	3.5	1.8
Over 6	Over $450	16.0	11.0	4.0	2.0

*Percentage of customers in the cell who made a purchase from the last catalog mailed to them.

SOURCE: Reprinted by permission of Harvard Business School Press. Adapted from Robert Blattberg, Gary Getz, and Jacquelyn Thomas, *Customer Equity: Building and Managing Relationships as Valuable Assets* (Boston: Harvard Business School Press, 2001), p. 18.

EXHIBIT 11–4
RFM Target Strategies

		RECENCY			
Frequency	**Monetary**	**0–2 months**	**3–4 months**	**5–6 months**	**Over 6 months**
1–2	<$50	First-time customers		Low-value customers	
1–2	Over $50				
3–4	<$150	Early repeat customers		Defectors	
3–4	Over $150				
5–6	<$300	High-value customers		Core defectors	
5–6	Over $300				
Over 6	<$450				
Over 6	Over $450				

SOURCE: Reprinted by permission of Harvard Business School Press. Adapted from Robert Blattberg, Gary Getz, and Jacquelyn Thomas, *Customer Equity: Building and Managing Relationships as Valuable Assets* (Boston: Harvard Business School Press, 2001), p. 18.

purchases. Exhibit 11–4 illustrates how RFM can be used to develop customer target strategies.

Customers who have made infrequent, small purchases recently are often first-time customers. The objective of CRM programs directed toward this segment of customers is to convert them into early repeat customers and eventually high-value customers. The CRM programs directed toward customers in the high-value segment (high RFM value) attempt to maintain loyalty, increase retention, and gain a greater share of wallet by selling more merchandise to them. However, customers who have not purchased recently either have a low lifetime value (low-value customers) and therefore are not worth pursuing or are committed to another retailer and may be difficult to recapture (defectors or core defectors). The CRM programs designed to realize objectives related to these different segments are discussed in the following section.

DEVELOPING CRM PROGRAMS

Having segmented customers according to their future profit potential, the next step in the CRM process (see Exhibit 11–1) is to develop programs for the different customer segments. In the following sections, we discuss programs retailers use to (1) retain their best customers, (2) convert good customers into high-LTV customers, and (3) get rid of unprofitable customers.

Customer Retention

Four approaches that retailers use to retain their best customers are (1) frequent shopper programs, (2) special customer services, (3) personalization, and (4) community.

Frequent Shopper Programs As mentioned previously, frequent shopper programs are used to both build a customer database by identifying customers with their transactions and encourage repeat purchase behavior and retailer loyalty.[32] Retailers provide incentives to encourage customers to enroll in the program and use the card. These incentives are either discounts on purchases made from the retailer or points for every dollar of merchandise purchased. The points are then redeemable for special rewards. Some recommendations concerning the nature of the rewards offered are as follows:

- *Tiered.* Rewards should be tiered according to the customer's purchases to motivate them to increase the level of their purchases. These tiers can be based on individual or cumulative transactions. Some programs combine both discounts and points for rewards. For example, a $5 discount on purchases between $100 and $149.99, $10 dollars off purchases from $150 to $249.99, and $15 off purchases of $250 or more. Beyond $250, customers accumulate points that can be redeemed for rewards, such as free merchandise. Customers generally accept the idea that people who spend more should receive greater rewards.

- *Offer choices.* Not all customers value the same rewards. Thus, the most effective frequent shopper programs offer customers choices. For example, Coles Myer, a leading Australian retailer, originally offered customers air miles but shifted to a menu of rewards when it discovered that many customers did not value air miles. Sainsbury, a U.K. supermarket chain, allows customers to use their Nectar points for vouchers at a variety of retail partners, such as Blockbuster and BP Gas.

Some retailers link their frequent shopper programs to charitable causes. For example, Target donates 1 percent of all purchases charged to Target's REDcard to a program that benefits local schools. Although these altruistic rewards can be an effective part of a frequent shopper program, such incentives probably should not be the focal point of the program. Research indicates that the most effective incentives benefit the recipient directly, not indirectly, as is the case with charitable contributions.

- *Reward all transactions.* To ensure they collect all customer transaction data and encourage repeat purchases, programs need to reward all purchases, not just purchases of selected merchandise.
- *Transparency and simplicity.* Customers need to be able to understand quickly and easily when they will receive rewards, what the rewards are, how much they have earned, and how they can redeem the points they have accumulated. The ground rules need to be clearly stated. There should be no surprises or confusion. Some companies mail a separate catalog to customers that describes its reward levels and available prizes. Knowing exactly what the rewards are push customers to move to the next spending level to receive the desired prizes.

Problems with Frequent Shopping Programs Four factors limit the effectiveness of frequent shopping programs.

1. They can be expensive. For example, a 1 percent price discount can cost large retailers over $100 million a year. In addition, for a large retailer, the initial launch and maintenance investments (store training, marketing, fulfillment support, and information technology and systems costs) can be as high as $30 million. Annual maintenance costs can reach $5–$10 million when marketing, program support, offer fulfillment, customer service, and IT infrastructure costs are included. Then there are the marketing support costs needed to maintain awareness of the program.

2. It is difficult to make corrections in programs when problems arise. Programs become part of the customer's shopping experience, so customers must be informed about even the smallest changes in programs. They react negatively to any perceived "take away" once a program is in place, even if they are not actively involved in it. Negative reactions can reduce customer trust in and loyalty toward the retailer.

3. It is not clear that these programs increase customer spending behavior and loyalty toward the retailer.[34] For example, the Wisconsin-based Sun Prairie grocery store polled shoppers throughout its 39 stores regarding its frequent shopper program. Over 80 percent of those surveyed would rather not have to use a card to receive the discounts on their purchases.[35]

4. Perhaps most important, it is difficult to gain a competitive advantage based on a frequent shopper program. Because the programs are visible, they can be easily duplicated by competitors. Between 50 and 70 percent of all grocery retailers offer a loyalty card to their customers, and 80 percent of households have at least one of these grocery stores' cards in their wallets. Yet the perceived value of the

REFACT

U.S. companies spend more than $1.2 billion a year on customer loyalty programs.[33]

cards is low. Supermarkets' loyalty cards allow customers access to price discounts, which encourages the low-price shopper but not necessarily the loyal customer who would shop at the store regardless of whether it offered discounts or points for prizes. In general, consumers see little difference between the programs when they all provide a discount of $.50 on detergent.[36]

To avoid this problem, retailers are offering more personalized benefits to their best customers based on their unique knowledge of the customer; these benefits thus are more "invisible" to competitors.

Special Customer Services Some retailers provide unusually high-quality customer service to build and maintain the loyalty of their best customers. Nordstrom holds complementary private parties for invitees to view new clothing lines. Saks Fifth Avenue offers free fur storage, complementary tailoring, and dinner at the captain's table on a luxury cruise line. Neiman Marcus will provide lunch or champagne to customers that hold a Nieman Marcus credit card, without even asking them to make any purchases.

Personalization An important limitation of CRM strategies developed for market segments, such as a platinum segment in the customer pyramid (Exhibit 11–2) or early repeat customers in the RFM analysis (Exhibit 11–3), is that each segment is composed of a large number of customers who are not identical. Thus, any strategy will be most appealing for only the typical customer and not as appealing to the majority of customers in the segment. For example, customers in the platinum segment with the highest LTVs might include a 25-year-old single woman who has quite different needs than a 49-year-old working mother with two children.

With the availability of customer-level data and analysis tools, retailers can now economically offer unique benefits and target messages to individual customers. They have the ability to develop programs for small groups of customers and even specific individuals. For example, at Harry Rosen, a Canadian men's apparel specialty retailer, customers are occasionally contacted by the salesperson with whom they have developed a personal relationship. If Harry Rosen receives a new shipment of Armani suits, the sales clerk will contact customers who have purchased Armani in the past. If a customer has been relatively inactive, the retailer might send him a $100 certificate on something he has not bought in a while.[37]

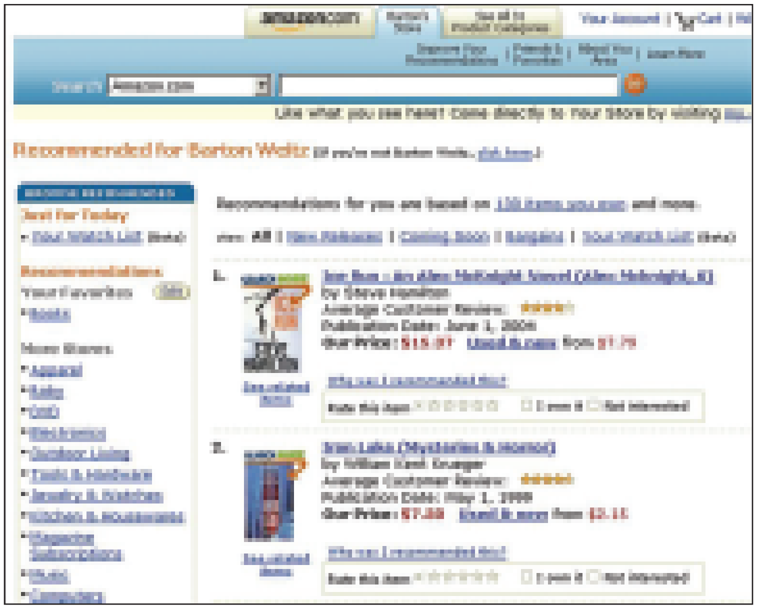
Developing retail programs for small groups or individual customers is referred to as **1-to-1 retailing.** Many small, local retailers have always practiced 1-to-1 retailing. They know each of their customers, greet them by name when they walk in the store, and then recommend merchandise they know the customers will like. These local store owners do not need customer databases and data mining tools; they have the information in their heads. But most large retail chains and their employees do not have this intimate knowledge of their customers. Thus, the CRM process enables larger retailers to efficiently develop relationships similar to those that many small local retailers have with customers.

The Internet channel provides an opportunity for retailers to automate the practice of 1-to-1 retailing. Some use site registration to customize what the shopper sees according to his or her known demographic data and expressed interests.[38] Others have shoppers rate specific products they like the most so they receive "similar item" recommendations.

Nearly every online retailer allows shoppers to search selectively for the items in which they are most interested. Some retailers attempt to match specialized promotions to the customer's search. If someone is searching for cell phones, for instance, the online retailer can offer a "10 percent off" sale on cell phones. The retailer can also customize its homepage so that the next time the customer logs on, he or she will see special promotions on items similar to those previously searched. Amazon.com, for instance, greets customers by name on its homepage, and the products displayed are based on the company's analysis of past purchasing behavior.

The personalized rewards or benefits that customers receive are based on unique information possessed by the retailer and its sales associates. This information, in the retailer's customer database, cannot be accessed or used by competitors. Thus, it provides an opportunity to develop a sustainable competitive advantage.

The effective use of this information creates the positive feedback cycle in the CRM process (see Exhibit 11–1). Increasing repeat purchases from a retailer increases the amount of data collected from the customer, which enables the retailer to provide more personalized benefits, which in turn increases the customer's purchases from the retailer.



Amazon.com provides personalized recommendations based on the past purchases of its customers.

Community A fourth approach for building customer retention and loyalty is to develop a sense of community among customers. The Internet channel offers an opportunity for customers to exchange information using bulletin boards and develop more personal relationships with one another and the retailer. By participating in such a community, customers become more reluctant to leave the "family" of other people patronizing the retailer.

In Seattle, Whole Foods holds a "singles" night every month, during which it offers wine tastings and snacks, as well as an opportunity for people to mingle and interact. The "singles" night extends the brand experience for its customers to more than just a place to buy food.

The Nike store in Portland, Oregon, hosts running groups that meet two times per week, after which the runners meet at the Niketown store for refreshments. Members who have logged more than 100 miles earn special recognition, and the Nike Plus Web site communicates with runners' Apple iPods to track their running metrics. More than half of the 200,000 runners involved in Nike's program use this system, visiting the Web site more than four times per week. In comparison, even Starbucks's core customers frequent its stores only about 15 times per month.[39]

Converting Good Customers into Best Customers

In the context of the customer pyramid (Exhibit 11–2), increasing the sales made to good customers is referred to as *customer alchemy*—converting iron and gold customers into platinum customers.[40] A way to achieve customer alchemy is through **add-on selling,** which involves offering and selling more products and services to existing customers and increasing the retailer's share of wallet with these customers.


Singles night at Whole Foods offers wine tastings and snacks, as well as an opportunity for people to mingle and interact.

Oprah Winfrey is a master of add-on selling. She has capitalized on her popularity by building on her daytime television show (*The Oprah Winfrey Show*) to sell and promote books, movies, and television specials (Harpo Productions), a cable channel (Oxygen Media), a Web site (www.oprah.com), and a widely read

This Shopping Buddy on Stop & Shop's carts stimulates all-on sales.

magazine (*O*) to her target audience—women interested in self-improvement and empowerment. For viewers of the television show, each of these products provides additional value. For example, when a respected celebrity appears on her television show, an article with more detailed information about the celebrity will be published in *O*. Winfrey builds community by using her television show and magazine to encourage her customers to exchange experiences with her and others through her Web site. For example, a customer reading an article about one of "Oprah's Favorite Things" can go online and share her interests and experiences with others interested in purchasing similar items.[41]

Tesco, the U.K. supermarket chain, added a second tier to its frequent shopper program to increase its share of wallet. The first tier has a traditional design to gather customer data. The second tier, targeted at its better customers, is more innovative. Customers earn a "key" when they spend $38 or more in a single transaction. Fifty keys make the customer a "keyholder," 100 keys a "premium keyholder." When customers achieve these higher levels, they get discounts on popular entertainment events, theater tickets, sporting events, and hotel vacations. The key program seeks to convert iron and gold customers into platinum customers.

A retailer's customer database also reveals opportunities for add-on selling. For example, Stop & Shop Co. equipped some of its grocery stores in the New England area with a "shopping buddy," a wireless computer device attached to shopping carts. It utilizes the retailer's loyalty card and the shopping history it collects to alert customers of sale items that they previously purchased and might want to buy again while they are on sale. If the customer's history shows she frequently purchases hamburgers but not ketchup, the shopping buddy might provide her with a special coupon for each. It also shows the running total of the purchases in the cart and gives the customer the ability to order deli products without waiting in line.[42]

Dealing with Unprofitable Customers

In many cases, the bottom tier of customers actually has a negative LTV. Retailers lose money on every sale they make to these customers. For example, catalog retailers have customers who repeatedly buy three or four items and return all but one of them. The cost of processing two or three returned items is much greater than the profits coming from the one item that the customer kept. Customers in the bottom tier may also be there because they stopped buying from the store and then started again. For example, customers may vanish because a competitor is offering a more attractive offer or they are dissatisfied, and then return months or years later as a new customer. The costs of their (re)acquisition make them unprofitable. The process of no longer selling to these unprofitable customers can be referred to as "getting the lead out," in terms of the customer pyramid.[43] Retailing View 11.4 describes how Limited Express and Best Buy are dealing with undesirable customers.

Other approaches for getting the lead out are (1) offering less costly approaches to satisfy the needs of lead customers and (2) charging customers for the services they are abusing. Fidelity Investments has about 550,000 Web site visits a day and more than 700,000 daily calls, about three-quarters of which go to automated systems that cost the company less than a $1 each. The remaining calls are handled by call center agents, who cost $13 per call. Fidelity contacted 25,000 lower-tier customers who placed a lot of calls to agents and told them they must use the Web site or automated calls for simple account and price information. Each name was flagged and routed to a special representative who would direct callers back to automated services and tell them how to use it. "If all our customers chose to go through live reps, it would be cost prohibitive," said a Fidelity spokeswoman.

IMPLEMENTING CRM PROGRAMS

As discussed throughout this chapter, increasing sales and profits through CRM programs is a challenge. Effective CRM strategies require more than appointing a CRM manager, installing a computer system to manage and analyze a customer database, and making speeches about the importance of customers. The effective implementation of CRM programs requires the close coordination of activities by different functions in a retailer's organization. The IT department needs to collect, analyze, and make the relevant information readily accessible to the employees implementing the programs—the frontline service providers and sales associates and the marketers responsible for communicating with customers through impersonal channels (mass advertising, direct mail, e-mail). Store operations and human resource management needs to hire, train, and motivate the employees who will be using the information to deliver personalized services.

Most retailers are product-centric, not customer-centric; as shown in Chapter 9, buyers in a retail firm are organized by type of product. Typically, there is no area of a retail firm organized by customer type and responsible for delivering products and services to different types of customers. Perhaps in the future, retailers will have market managers to perform this coordinating function.

Getting the Lead Out RETAILING VIEW 11.4

One source of unprofitable customers is the practice of fraudulent returns, which costs retailers more than $15 billion each year. Some examples of these costly returns include people who buy a large-screen television for their Super Bowl party and then return it after the game or an expensive dress for a special occasion, returned after they wear it once. Professional returners even use the Internet to make money on fraudulent returns. Some people steal merchandise from a store, return it for credit slips, and then turn the credit slips into cash by selling them at a discount on eBay or other online auction sites.

Retailers like The Limited and Best Buy are fighting back against such high-tech fraud with high-tech defenses. Limited Express's return policy says consumers have up to 60 days to return items. However, the company's return policy also notes that it uses an industrywide service operated by Return Exchange to authorize returns and that "under certain circumstances we reserve the right to deny returns." Return Exchange, based in Irvine, California, analyzes Express's customer database and identifies customers who have an unusually high propensity for returning merchandise. When these customers return merchandise, the POS terminal generates a slip of paper that says "RETURN DECLINED," and the sales associate tells the customer to call the toll-free number at the bottom for more information.

Best Buy is undertaking a strategy to focus on gold and platinum customers and get rid of lead customers. To lure high spenders, it is providing more effective customer service. To discourage undesirable customers, it is reducing promotions that tend to draw them into the store and removing them from direct marketing lists. The trickiest challenge may be to deter bad customers without turning off good ones.

Best Buy's campaign against undesirable customers pits it against dozens of Web sites like FatWallet.com, SlickDeals.net, and TechBargains.com that trade electronic coupons and tips from former clerks and insiders, hoping to gain extra advantages against the stores. At SlickDeals.net, whose subscribers boast about techniques for gaining hefty discounts, a visitor recently bragged about his practice of shopping at Best Buy only when he thinks he can buy at below the retailer's cost.

Best Buy cannot bar undesirable customers from its stores, but it is taking steps to put a stop to their most damaging practices. It's enforcing a restocking fee of 15 percent of the purchase price on returned merchandise. To discourage customers who return items with the intention of repurchasing them at a "returned merchandise" discount, it is experimenting with reselling returned merchandise over the Internet, so the goods don't reappear in the store where they were originally purchased. Best Buy also cut ties to FatWallet.com, an online "affiliate" that had collected referral fees for delivering customers to Best Buy's Web site.

Rejecting customers is a delicate business. Filene's Basement was criticized on television and in newspapers for asking two Massachusetts customers not to shop at its stores because of their frequent returns and complaints. Best Buy's CEO apologized in writing to students at a Washington, DC, school after employees at one store barred a group of black students while admitting a group of white students.

Sources: Jennifer Davis, "Retailers Use Technology to Thwart Would-Be Thieves," *San Diego Tribune,* June 13, 2007; http://www.fashion era.com/Trends_2006/2006_spring_fashion_trends_returns_consumer_fraud.htm (accessed September 20, 2007); http://www.oracle.com/applications/retail/mom/retail-returns-management.html (accessed September 20, 2007).

SUMMARY

To develop a strategic advantage, retailers must effectively manage their critical resources—their finances (Chapter 6), human resources (Chapter 9), real estate and locations (Chapters 7 and 8), inventory and information (Chapter 10), and customers (Chapter 11). This chapter focuses on activities that retailers are undertaking now and will undertake in the future to increase the sales and profits they get from their better customers.

Customer relationship management is a business philosophy and set of strategies, programs, and systems that focuses on identifying and building loyalty with a retailer's most valued customers. Loyal customers are committed to patronizing a retailer and are not prone to switch to a competitor. In addition to building loyalty, CRM programs are designed to increase the share of wallet from the retailer's best customers.

Customer relationship management is an iterative process that turns customer data into customer loyalty through four activities: (1) collecting customer data, (2) analyzing the customer data and identifying target customers, (3) developing CRM programs, and (4) implementing CRM programs. The first step of the process is to collect and store data about customers. One of the challenges in collecting customer data is identifying the customer in connection with each transaction. Retailers use a variety of approaches to overcome this challenge.

The second step is to analyze the data to identify the most profitable customers. Two approaches used to rank customers according to their profitability are calculating the customer's lifetime value and categorizing customers on the basis of characteristics of their buying behavior—their recency, frequency, and monetary value.

Using this information about customers, retailers can develop programs to build loyalty in their best customers, increase their share of wallet with better customers (e.g., converting gold customers into platinum customers), and deal with unprofitable customers (getting the lead out). Four approaches that retailers use to build loyalty and retain their best customers are (1) launching frequent shopper programs, (2) offering special customer services, (3) personalizing the services they provide, and (4) building a sense of community. Unprofitable customers are dealt with by developing lower-cost approaches for servicing them. Effectively implementing CRM programs is difficult because it requires coordinating a number of different areas in a retailer's organization.

KEY TERMS

add-on selling, *321*
cookies, *312*
customer database, *308*
customer loyalty, *306*
customer relationship management (CRM), *305*
data mining, *313*
80–20 rule, *315*
frequent shopper program, *310*
lifetime customer value (LTV), *314*
loyalty program, *310*
market basket analysis, *313*
1-to-1 retailing, *320*
opt in, *313*
opt out, *313*
private-label credit card, *310*
RFM analysis, *317*
share of wallet, *306*

GET OUT AND DO IT!

1. **CONTINUING ASSIGNMENT** Interview the store manager working for the retailer you have selected for the continuing assignment. Ask the manager if the store offers a frequent shopper program and how effective it is in terms of increasing the store's sales and profits. Find out why the manager has these views and what could be done to increase the effectiveness of the program. Then talk to some customers in the store. Ask them why they are members or not. Find out how membership in the program affects their shopping behavior and loyalty toward the retailer.

2. Go to some of the retail sites that you frequent and compare their privacy policies. Which policies make you less concerned about violations of your privacy? Why? Which policies, or lack of policies, raise your concern? Why?

3. Go to the Web site for the Electronic Privacy Information Center (www.epic.org) and review the issues raised by the organization. What does this watchdog organization feel are the most important issues? How will these issues affect retailers and their customers?

4. Go to Macy's credit card homepage at http://www1.macys.com/service/credit/overview.ognc. Read about the different levels of membership for this customer rewards program. Describe how Macy's is using the customer pyramid (Exhibit 11–2) in its CRM program to target and classify customers.

5. Go to the homepage for 1-800-Flowers at www.1800flowers.com. How does this company's CRM program help it grow its business and increase customer loyalty?

DISCUSSION QUESTIONS AND PROBLEMS

1. What is CRM?
2. Why do retailers want to determine the lifetime value of their customers?
3. Why do customers have privacy concerns about the frequent shopper programs that supermarkets offer, and what can supermarkets do to minimize these concerns?
4. What are some examples of opportunities for add-on selling that might be pursued by (a) travel agents, (b) jewelry stores, and (c) dry cleaners?
5. Which of the following types of retailers do you think would benefit most from instituting CRM: (a) supermarkets, (b) banks, (c) automobile dealers, or (d) consumer electronic retailers? Why?
6. Develop a CRM program for a local store that sells apparel and gifts with your college's or university's logo. What type of information would you collect about your customers, and how would you use this information to increase the sales and profits of the store?
7. What are the different approaches retailers can use to identify customers by their transactions? What are the advantages and disadvantages of each approach?
8. A CRM program focuses on building relationships with a retailer's better customers. Some customers who do not receive the same benefits as the retailer's best customers may be upset because they are treated differently. What can retailers do to minimize this negative reaction?
9. Think of one of your favorite places to shop. How does this retailer create customer loyalty and satisfaction, encourage repeat visits, establish an emotional bond between the customer and the retailer, know the customer's preferences, and provide personal attention and memorable experiences to its "best customers"?
10. How would a retailer use transactions, customer contacts, customer preferences, descriptive information, and responses to marketing activities in its customer database?

SUGGESTED READINGS

Bell, Chip R., and John R. Patterson. *Customer Loyalty Guaranteed: Create, Lead, and Sustain Remarkable Customer Service.* Cincinatti, OH: Adams Media Corporation, 2007.

Bell, Simon; Seigyoung Auh; and Karen Smalley. "Customer Relationship Dynamics: Service Quality and Customer Loyalty in the Context of Varying Levels of Customer Expertise and Switching Costs," *Journal of the Academy of Marketing Science* 33 (Spring 2005), pp. 169–84.

Bligh, Philip, and Douglas Turk. *CRM Unplugged: Releasing CRM's Strategic Value.* Hoboken, NJ: Wiley, 2004.

Greenberg, Paul. *CRM at the Speed of Light: Capturing and Keeping Customers in Internet Real Time,* 3d ed. New York: Osborne/McGraw-Hill, 2004.

Gupta, Sunil and Donald R. Lehmann. *Managing Customers as Investments.* Philadelphia, PA: Wharton School Publishing, 2005.

Kumar, V.; Denish Shah; and Rajkumar Venkatesan. "Managing Retailer Profitability—One Customer at a Time!" *Journal of Retailing* 82, no. 4 (2006).

Meyer-Waarden, Lars. "The Effects of Loyalty Programs on Customer Lifetime Duration and Share of Wallet." *Journal of Retailing* 83, no. 2 (2007).

Shugan, Steven. "Brand Loyalty Programs: Are They Shams?" *Marketing Science* 24 (Spring 2005), pp. 185–94.

Tokman, Mert; Lenita M. Davis; and Katherine N. Lemon. "The WOW Factor: Creating Value through Win-Back Offers to Reclaim Lost Customers." *Journal of Retailing* 83, no. 1, (2007).

Venkatesh, Shankar, and Russel S. Winer. "When Customer Relationship Management Meets Data Mining." *Journal of Interactive Marketing* 20, no. 3/4 (2006), pp. 2–4.