Getting It Right in Retail

A research report by Carlson Marketing and Peppers & Rogers Group

carlson marketing Peppers&RogersGroup MarketTools zoomerang

Getting It Right in Retail

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Executive Overview

It's tough to be a retailer today. Intense competition, instant access to information and endless choice have changed the game. To simply survive, a retailer must now offer customers the best products at the best prices in the best locations. To thrive, a retailer must do much more than master the traditional approaches to retail success. So how does a retailer differentiate itself and achieve organic growth? One word—relationships.

In the most recent chapter of the ongoing *Carlson Relationship Builder* research series, Peppers & Rogers Group partnered with Carlson Marketing to assess the current state of retailers' relationships with customers. Over 1,100 individuals took part in a comprehensive online survey. By quantifying and examining the relationship strength between retailers and customers (i.e., the ability of the ongoing exchange to grow, endure and to resist damaging forces), this research sought to answer the most critical questions on the minds of marketers in the retail industry:

- Do customers have relationships with retailers?
- Does it matter? What impact does relationship strength have on an individual's likelihood to recommend, to remain a customer of, and to shop more at a retailer?
- Is it real? Are positive changes in relationship strength associated with improvements in retail same-store sales?
- Which retailers are especially adept at building profitable customer relationships?
- Which are on a positive trajectory to increasing the strength of relationships with their customers?
- How can marketing strategies and tactics—including loyalty programs—be used to drive stronger relationships?

As a research partnership between renowned customer strategy authority Peppers & Rogers Group and loyalty marketing expert Carlson Marketing, *Carlson Relationship Builder* uncovers the most compelling trends in loyalty marketing. The results from this installment of Carlson Relationship Builder tell a compelling story. Retailers vary widely in their ability to build and maintain authentic and productive relationships with their customers, and the strength of those relationships has a significant impact on their business. What follows is a fact-based look at how marketers can "get it right" with customers and secure a competitive advantage that is differentiated, persistent and resilient to competitive market influences.

In Brief

Who:
Senior marketers and business executives

What:
The new frontier in the quest for organic growth by getting, keeping and growing retail customers

How:
- Demonstrating that stronger retail relationships deliver better business benefits
- Describing which retailers are succeeding or struggling in building robust relationships
- Documenting what it takes to "get it right"
- Dissecting the structure of relationships in retail

Carlson Marketing defines relationship strength as the ability of the ongoing exchange between a company and a customer to grow and endure, and to resist any damaging forces that might destroy it.

Carlson Relationship Builder

What You Need to Know

Carlson Relationship Builder is a research series conducted by Peppers & Rogers Group and Carlson Marketing across numerous vertical industries and global regions, each of which is designed to explore the role of customer relationships in driving business results—and, importantly, in understanding the precursors that serve to enhance those relationships.

This current study was conducted in partnership with MarketTools, a leading research organization, using its Zoomerang zPro online survey software and Zoomerang Sample consumer panel, which consists of over two and a half million opt-in participants in the United States alone. Data was gathered from October 18, 2006 through October 25, 2006, and a total of 1,113 individuals completed the questionnaire. The selection of retailers included in the research was based upon two primary considerations: their size, emphasizing larger retailers; and coverage, to ensure a mix of retailers across the categories of specialty, big box and grocery.

At the core of the research approach resides a model of relationship strength developed by Carlson Marketing and founded upon the seminal investigations of Dr. Robert Morgan at the University of Alabama[i]. This model places customer relationships in a mediating role, residing between the marketing activities or antecedents that influence (positively or negatively) those relationships and the outcomes or consequents that occur as an end result of the changes in relationship strength. This conceptualization has been shown to exhibit a higher degree of explanatory power than the traditional viewpoint in which marketing stimuli directly impact customer responses.

Carlson Marketing defines relationship strength as the ability of the ongoing exchange between a company and a customer to grow and endure, and to resist any damaging forces that might destroy it. Strong relationships are characterized by:

- **Trust:** a belief that the company has the best interest of the customer at heart, and can be depended upon for respect, openness, tolerance and honesty
- **Mutuality and Alignment:** a two-way affiliation resulting in a rewarding experience which meets the mutual expectations of the company and the customer
- **Commitment:** an enduring emotional attachment to the relationship

Relationships in the context of commerce share attributes of interpersonal relationships (e.g., an enduring emotional bond), but are nonetheless distinct. The term relationship strength as used in this white paper does not encompass romantic intimacy, formalized associations (e.g., a marriage by law or by ceremony) or an alliance by ethnicity or kinship. It denotes a considerably more practical construct: namely, the ability of the exchange between the retailer and customer to prosper.

Relationship strength is measured by RSx℠, a proprietary research instrument developed, tested, deployed and refined by Carlson Marketing over the past decade. Consisting of 12 core questions using a seven-point anchored Likert scale ("strongly disagree" to "strongly agree"), the tool allows a robust and practical quantification of the construct of relationship strength. As used in the context of this white paper, the phrase "relationship strength" is synonymous with the RSx℠ measure itself.

The most fundamental question that Carlson Relationship Builder sought to answer was simply whether or not customers have relationships with retailers. The answer is a resounding yes.

"Consumers are statistics. Customers are people."

—Stanley Marcus
Former President and Chairman of the Board of Neiman Marcus

The major outcome variables of interest in the research consist of respondent ratings on a seven-point anchored Likert scale ("strongly disagree" to "strongly agree") to the statements:

- **Recommend:** I encourage my friends and family to shop at this store
- **Retention:** I will still be a customer of this store 12 months from now
- **Shop More:** I am likely to shop for more products from this store within the next 12 months

For brevity, these outcomes are referenced in this white paper using the terms "recommend," "retention," and "shop more."

In addition to these key outcome measures, participants in this research answered questions to provide data on a broad range of topics, including the factors responsible when choosing a retailer, channels through which purchases are made and information is obtained, demographics and—of course—the RSx℠ relationship strength items. An investigation of these data points was performed using a variety of techniques, ranging from simple descriptive statistics through complex multivariate modeling. The key insights that were distilled are shared in the following pages.

Relationships, Results and Retail

The most fundamental question that *Carlson Relationship Builder* sought to answer was simply whether or not customers have relationships with retailers.

As illustrated in Figure 1 (see next page), the answer is a resounding yes. Customers do have relationships with retailers, and the range of the strength of those relationships is broad. Among the retailers with the highest level of relationship strength are Barnes & Noble and Hallmark.

In all cases, there remains substantial room for improvement. The study found that the strength of the relationship between a retailer and each of its individual customers is not uniformly equal. There is an opportunity to "raise the bar" on an overall basis, and individually based on the variances in relationship strength among different customers *within* retailers. Therefore, companies must evaluate their relationship strength holistically as well as on an individual customer basis.

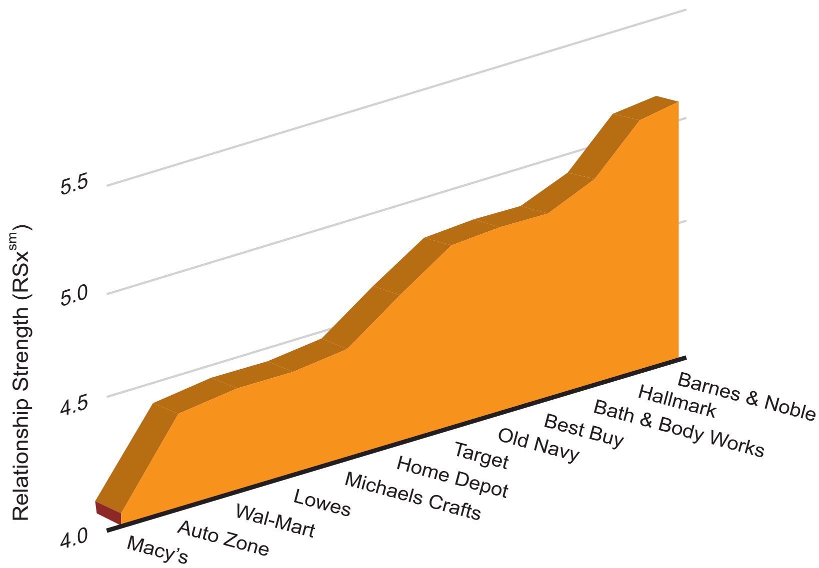
For example, consider Wal-Mart. On average the retailer scores lower in relationship strength than several others examined in this study. This fact obscures the more subtle and actionable point, that the overall relationship strength score is composed of a mixture of some customers who have strong relationships combined with a larger quantity that have weaker relationships (i.e., the distribution of relationship strength for the retailer is positively skewed).

For retailers that both have and understand such a pattern, the opportunity exists to make significant improvements to the strength of their customer relationships. By crafting differentiated marketing strategies, retailers can leverage the affinity of those customers with high levels of relationship strength. They can also separately address the challenges of the remaining customers with the goal of developing the relationships over time.

Knowing that customers have varying degrees of a relationship with retailers, the key question arises: does it matter? Building better relationships in retail certainly makes common sense, but does it actually enhance customer recommendations, retention, and

Figure 1: **Relationship Strength of Retailers**

Relationship strength successfully differentiates among retailers ($p<.01$). Listed here is a selection of retailers examined.



Source: *Carlson Marketing and Peppers & Rogers Group*

When the strength of customers' relationships to the retailer improves from low to high, the occurrence of recommending that retailer will be 1.82 times greater.

intent to shop more at a retailer?

Carlson Relationship Builder addressed this question by classifying survey respondents into low, medium and high categories based upon the strength of their relationship to the retailer with which they are most familiar. The low category consisted of the bottom quartile of the distribution of relationship strength scores, with values less than 3.75; medium, the middle two quartiles; and high, the top quartile with values greater than 5.92.

For each category, the likelihood to recommend the company to friends or family, to remain a customer, and to shop more was examined.

Recommend to Friends and Family. Of all the business outcomes examined, changes in relationship strength had the greatest impact upon a customer's willingness to encourage friends and family to shop at a retailer (see Figure 2).

When comparing the mean recommendation scores for those customers with high as compared to low levels of relationship strength, the impact is significant. The ratio (i.e., $\text{Recommend}_{\text{RSxHigh}} / \text{Recommend}_{\text{RSxLow}} = 6.55 / 3.60 = 1.82$) demonstrates an impressive 82 percent superiority for recommending the retailer to friends and family among customers having a high versus a low level of relationship strength. This implies that when the strength of customers' relationships to the retailer improves from low to high, the occurrence of recommending that retailer will be 1.82 times greater.

Word-of-mouth has always been important in a customer's purchase decision, but today these recommendations are valued 1.5 times more than in the 1970's and twice

Figure 2: **Recommend Retailer to Friends and Family**

As relationship strength increases, so does a customer's willingness to recommend a retailer to friends and family (p<.01).

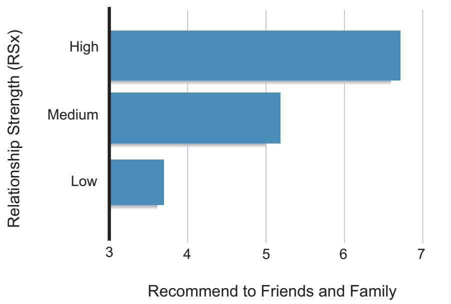


Figure 3: **Remain a Customer of Retailer**

Relationships impact an individual's intention to continue to be customer of the retailer 12 months from now (p<.01).

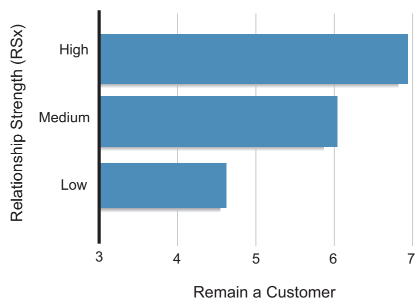
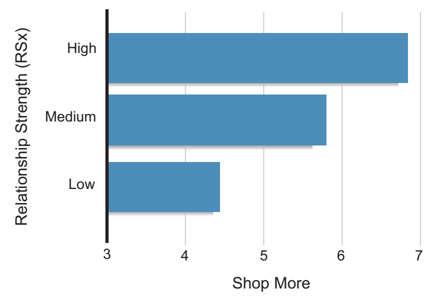


Figure 4: **Shop More at Retailer**

Having a customer shop more at their store is an outcome desired by all retailers, and it increases considerably as relationship strength improves (p<.01).



Source: *Carlson Marketing and Peppers & Rogers Group*

as much as information obtained through traditional media[ii].

Retailers focused on enhancing their marketing effectiveness through word-of-mouth recommendations should concentrate on growing and developing relationships with customers. This action will improve the incidence of customer recommendations, and positively influence customer retention.

Modest improvements in customer loyalty are known to make a dramatic business impact. Increasing the retention rate by 5 percentage points, for example, can increase the value of a customer at least 25 percent.[v]

Remain a Customer. Relationship strength has a strong impact upon a respondent's stated intention to be a customer of the retailer 12 months from now (see Figure 3). Specifically, for those customers with a high as compared to a low level of relationship strength to a retailer, the intention to remain a customer is elevated by 49 percent (i.e., $\text{Remain}_{\text{RSxHigh}}$ / $\text{Remain}_{\text{RSxLow}}$ = 6.87 / 4.60 = 1.49). Retailers wanting to enhance customer loyalty should focus on improving the strength of their customer relationships.

Strengthening this business dimension for retailers is critical given the high levels of customer disloyalty that are now prevalent. A recent study of customers in both the United States and the United Kingdom found that almost two-thirds (64 percent) said that they are likely or very likely to stop purchasing from companies they now patronize, and 60 percent had already done so in the past 12 months[iii].

This issue has specific implications for retailers, because even modest improvements in customer loyalty are known to make a dramatic business impact. Increasing the retention rate by 5 percentage points, for example, can increase the value of a customer at least 25 percent.[v]

Shop More. Consistent with the pattern of results observed for customer recommendations and retention, the likelihood to shop more at a retailer within the next 12 months increases as relationship strength rises (see Figure 4). For customers with a high versus a low level of relationship strength, the size of the effect is significant and noteworthy: 55 percent.

The three business outcomes of referral, retention and shopping more are not independent. When a relationship is strengthened, all three outcomes will improve.

Business Outcomes Overall. The three business outcomes of referral, retention and shopping more are not independent, as may be inferred from the similarity of the pattern of results with respect to relationship strength. For example, an individual's intention to remain a customer of the retailer 12 months from now is positively correlated with the likelihood to recommend the retailer to friends and family (r^2=.51, p<.01) and with the propensity to shop more (r^2=.70, p<.01) at the retailer. As a consequence, when a relationship is strengthened, all three outcomes will improve.

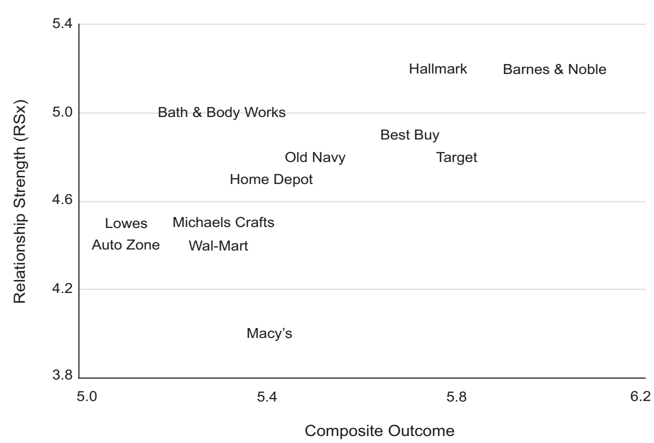
Because these outcomes are interrelated, an average of all three was computed to form a composite, and that score was used together with relationship strength to form a two-dimensional map that depicts one retailer's position relative to another (see Figure 5). In general, as a retailer's relationship strength increases, so does its business performance. Specifically, when a retailer is successful in enhancing relationship strength by one unit on the seven-point scale, it is expected that the performance on the composite of the business outcomes of customer referral, retention, and shopping more will correspondingly improve by 0.71 unit (p<.01).

If the association between relationship strength and the composite outcome measure was perfect, then all retailers depicted on Figure 5 would fall on a single straight line. However, in the "real world" there are many influences contributing to any one effect. In the retail industry, these other contributors include pricing, merchandise selection and location, to name a few. Nonetheless, *Carlson Relationship Builder* demonstrates that the magnitude of the change arising from an improvement in relationship strength is quite high, with 44 percent of the variability in the outcomes explained by changes in relationship strength.

A comparison of retailers on the map in Figure 5 highlights possible opportunities. Hallmark, for example, has the same level of relationship strength among its customers as Barnes & Noble, and yet the latter outperforms the former in terms of the business outcomes measured. As a consequence, Hallmark may have the chance to more fully convert or monetize the relationship strength it has amassed by better leveraging the propensity of its customers to refer the retailer to friends and family.

Figure 5: **Relationships, Results and Retail**

Retailers differ from one another, both in terms of relationship strength and an average of the business outcomes of customer referral, retention and shopping more (denoted as "composite outcome"). A comparison of the position of one retailer to another in this space may be used to identify competitive opportunities and risks.



Source: *Carlson Marketing and Peppers & Rogers Group*

Same Store Sales. Relationships driving results in retail isn't just "theory." There is a significant correlation (r=0.54, p<.05) between the commitment component of relationship strength to a retailer and reported changes in the retailer's 2006 same store sales. Retailers with higher levels of customer commitment have higher levels of improvement in what is regarded as the critical measure of success: same store sales growth.

Retailers with higher levels of customer commitment have higher levels of improvement in what is regarded as the critical measure of success: same store sales growth.

Relationship Trajectory. Relationship trajectory captures the extent to which a retailer is "stable" or on the "upswing" in its journey toward building better relationships with its customers. It is defined as the percent of customers who are in the initial three positive phases of the relationship lifecycle:

- Being a new customer of a retailer and discovering the benefits and obligations of a long-term relationship
- Receiving increasing levels of benefits and satisfaction from the retailer such that the customer is more willing to become committed to a relationship on a long-term basis
- Receiving high levels of benefits and being highly satisfied with this retailer such that the customer shops there whenever possible

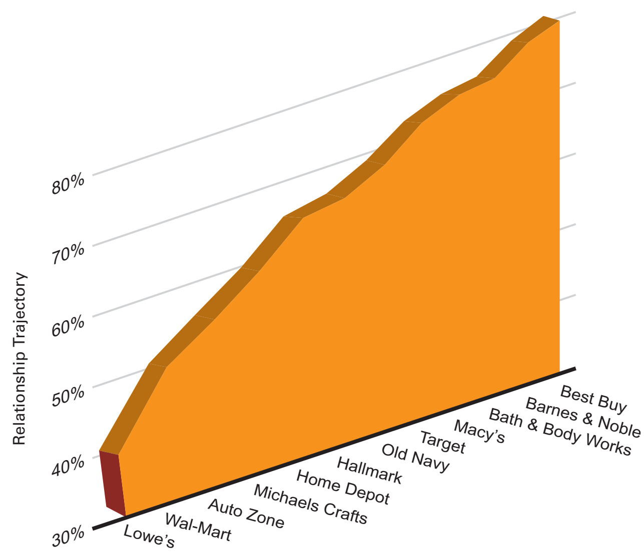
Figure 6 presents a subset of the retailers studied in *Carlson Relationship Builder* to illustrate the wide variation occurring in the relationship trajectory. Those retailers with low values on this measure may experience a constant or deteriorating level of relationship strength in the future, because comparatively few customers are now in the initial three positive phases of the relationship lifecycle. In contrast, high-scoring retailers may be expected to sustain or secure an improvement in relationship strength in the future—and as a consequence realize the associated enhancements to business outcomes.

"There is only one boss. The customer. And he can fire everybody in the company from the chairman on down, simply by spending his money somewhere else."

—Sam Walton
Founder of Wal-Mart and Sam's Club

Figure 6: **Relationship Trajectory**

Customers of retailers differ considerably when examined by the phase of their relationship lifecycle. Presented here is a subset of retailers together with the percent of respondents for each who are in the initial positive phases of relationship development.



Source: *Carlson Marketing and Peppers & Rogers Group*

"All business success rests on something labeled a sale, which at least momentarily weds company and customer."

—Tom Peters
Management consultant and bestselling business author

Ten Things to Remember in Retail

Regardless of size or category, there are 10 key best practices that retailers should keep in mind as they work to build relationships with their customers.

1. Loyalty programs drive incremental purchases

One-third (33 percent) of customers agree that direct participation in a loyalty program has resulted in the purchase of additional products from a retailer that otherwise would not have occurred.

2. Satisfaction is not sufficient

A large segment of customers (41 percent) is at least as satisfied with other retailers as they are with their primary retailer.

3. Here today, gone tomorrow

A majority of customers (51 percent) state that there are many other good retailers, any one of which could serve as an alternative to their primary retailer.

4. Walk a mile in their shoes

Customers agree that "being easy to do business with" (89 percent) and having "good customer service" (90 percent) are important attributes in preferring one retailer versus another.

5. Aim for alignment

When the interests of the customers and the retailer are perceived as resulting in a mutually rewarding experience, the alignment enhances the likelihood to recommend, remain a customer, and shop more at the retailer (68, 39 and 43 percent respectively, for those with high as compared to low levels of alignment; $p<.01$).

6. Brand is big

Almost two-thirds (64 percent) of customers agree that familiarity with a brand name plays a role in the choice of a retailer—and, the effect is larger for those with a high versus a low level of relationship strength ($p<.01$).

7. Customers are human, too

Among the top three most important considerations when interacting with customer service are staff courtesy (59 percent), apologizing when something goes wrong (32 percent), and being empathetic (28 percent).

8. Morality matters

Customers agree that the reputation (70 percent) and the moral values (50 percent) of the retailer are important when choosing where to spend their cash.

9. Web sites work well

Almost two-thirds of customers (65 percent) use a retailer's website for activities such as searching for merchandise, learning more about the store, and reading about news and offers—but the percentage varies considerably by the type of retailer (department stores, 71 percent; grocery stores, 44 percent).

10. Don't botch the basics

Customers overwhelmingly agree that having the best prices (93 percent) and a good selection and availability of merchandise (93 percent) play a role in determining where shopping occurs.

The result of treating different customers differently is an increase in the amount of trust toward, mutuality and alignment with, and commitment to the retailer by the customer over the long term.

"The sale merely consummates the courtship. Then the marriage begins. How good the marriage is depends on how well the relationship is managed by the seller."

—Theodore Levitt
Marketing author, economist and professor

Getting It Right

Knowing that customer relationships play a significant role in enhancing business outcomes for retailers, a key follow-up question arises: "What needs to be done to create and maintain customer relationships?"

At its most fundamental level, the answer is straightforward: *treat different customers differently*. This precept is an essential 1to1® condition for growing relationships for three primary reasons:

- Relationships are developed with *individuals having specific needs*—not market segments, and as a consequence it is necessary to be able to recognize and identify each customer uniquely.
- Relationships require *knowledge* by each party of the other, in order to enable meaningful conversations and dialog—not mass, one-way broadcasts of messages.
- Relationships necessitate *behavioral change* in order to thrive, as each party adapts aspects of their conduct toward the other—not relying upon scripted and static patterns.

The result of treating different customers differently is an increase in the amount of trust toward, mutuality and alignment with, and commitment to the retailer by the customer over the long term.

In the realm of retail, treating different customers differently can be successfully done through a variety of strategies and tactics that allow the company to individually learn about each customer's value and needs—and then adapt interactions based upon that insight to engage customers and influence behavior. Among the techniques that were investigated in *Carlson Relationship Builder* are the use of loyalty programs and the enhancement of the customization, relevancy and frequency of customer communications.

Loyalty Program. Retail loyalty programs have a meaningful impact on business results. Consider these facts:

- Almost two-thirds (63 percent) say that when enrolled in a loyalty program, they use the products and services of that retailer more frequently
- One-third of respondents (33 percent) report that they have purchased additional products from retailers with a loyalty program, representing incremental sales that otherwise would not have occurred
- Almost three in five (57 percent) would join a retailer's loyalty program if one were offered to them

These results suggest that for many retailers enhanced organic growth may be achieved through the introduction and the use of a loyalty initiative. Yet, not all customers are equally disposed to using a loyalty program, nor do they necessarily engage with the program in the same way. By creating a loyalty program that can respond to the differences among its customers, a retailer can fulfill the promise of business impact that a loyalty program offers. For this reason, customers were grouped into clusters in order to better understand the differences.

Loyalty Clusters. Do customers naturally group together into homogeneous subsets or segments with respect to how they view and use retail loyalty programs? To investigate this question, 16 variables from the survey—covering the areas of desired attributes and benefits of a loyalty program, usage of a loyalty program once enrolled, and reasons for participating in a loyalty program—were entered into a statistical data reduction procedure (factor analysis) in order to identify the unique components underlying the entire set of variables. The result was the discovery of four factors that capture and summarize the primary dimensions or ways in which customers interact with retail loyalty programs:

- Recognition: involving delivery of special services and the tailoring of both benefits/awards and communications specifically to the individual based on unique customer needs
- Access: involving the receipt of special rewards as well as special offers from the retailer or its partners
- Economics: involving an expectation of securing immediate benefits and a desire to get more points through purchases
- Affiliation: involving a preference to purchase products and services when enrolled in a loyalty program and a willingness to wait to obtain the associated benefits that the program offers

By understanding the characteristics of customers within each of these loyalty clusters, retailers can optimize the investment in their loyalty program and ultimately build relationship strength.

Scores for each of these factors for each respondent were computed and then used within a statistical clustering algorithm (k-means) to identify four loyalty clusters. Each cluster is a collection of individuals who share many *commonalities* within the cluster while simultaneously exhibiting many *differences* as compared to the other clusters. The four clusters that were identified are described in Table 1 and illustrated in Figure 7. By understanding the characteristics of customers within each of these loyalty clusters, retailers can optimize the investment in their loyalty program and ultimately build better relationships with their customers.

"Without customers, you don't have a business, you have a hobby."

—Don Peppers and Martha Rogers, Ph.D.
Founding Partners of Peppers & Rogers Group

Table 1: **1to1® Loyalty Clusters Defined**

Four clusters or subsets of customers were found that capture the differences in how retail loyalty programs are viewed and used. The percent of respondents within each cluster is noted.

Loyalty Cluster	Percent	Description
Loyalty Fanatics	10%	Demonstrate a strong affiliation toward loyalty programs as well as the associated recognition and economic benefits
Privilege Seekers	21%	Strongly value the recognition and access benefits of loyalty programs
Points Junkies	9%	Place high importance upon the rational and economic exchange components of loyalty programs
Passives	60%	Exhibit low levels of engagement in loyalty programs

Source: *Carlson Marketing and Peppers & Rogers Group*

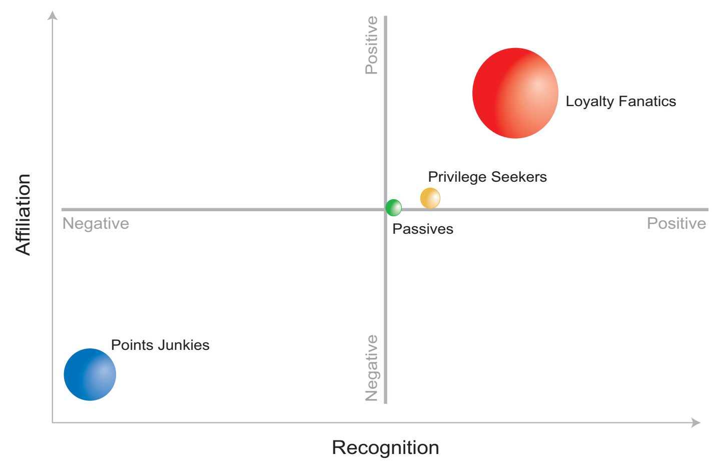
Understanding the cluster to which each customer belongs may allow a retailer to allocate marketing resources (and adjust marketing tactics) in a more focused and effective manner.

"Getting it right in retail means using informed 1to1® marketing to build better relationships that in turn drive enhancements in getting, keeping and growing customers."

—Luc Bondar
Vice President of Loyalty, Carlson Marketing

Figure 7: **1to1® Loyalty Clusters Examined**

Loyalty clusters represent homogeneous groups of customers defined by the dimensions of recognition, access, economics and affiliation. Illustrated in this figure are the four clusters and their relative position to one another along the axes of recognition and affiliation, with the diameter of each proportional to the economics factor.



Source: *Carlson Marketing and Peppers & Rogers Group*

Each cluster exhibits its own pattern of behavior with respect to the development and maintenance of relationships. Loyalty Fanatics, for example, have the highest level of relationship strength and the greatest propensity to recommend, remain a customer, and shop more at the retailer. Privilege Seekers are second only to Loyalty Fanatics in the importance that they place upon brand name familiarity and brand/retailer name recognition as reasons in determining where shopping is done, and in delivering the business benefits of recommending, remaining a customer, and shopping more at the retailer. Points Junkies, in contrast, are more likely to perceive retailer communications as less customized and relevant than either Loyalty Fanatics or Privilege Seekers. Passives—as compared to Points Junkies—place greater importance upon the ease of doing business with a retailer, the degree to which the retailer is helpful, and having good customer service.

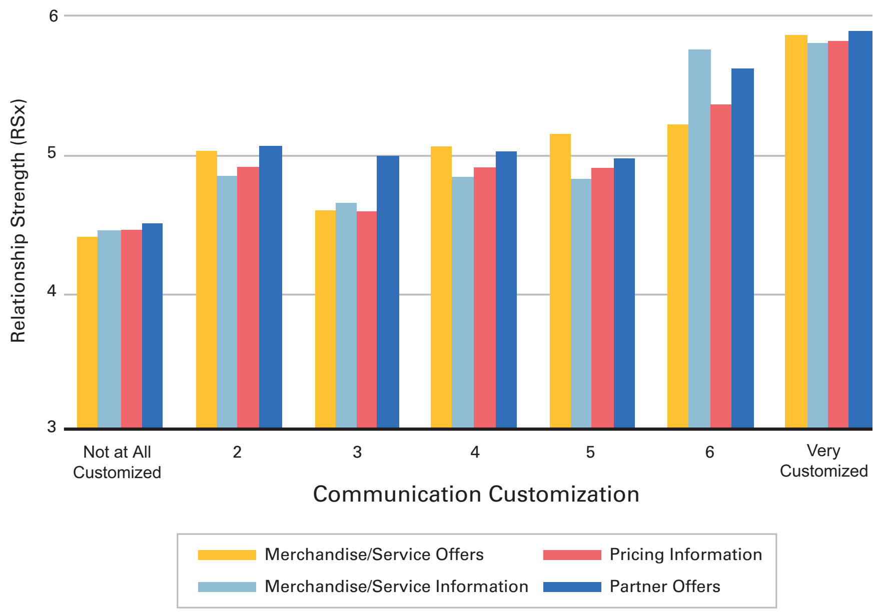
Retailers have customers in these four clusters in differing proportions. Barnes & Noble, for example, has only half as many Passives (32 percent) as compared to the overall distribution, while Bath & Body Works has over twice (20 percent) as many Loyalty Fanatics. Understanding that allocation—plus the cluster to which each customer belongs—may allow a retailer to allocate marketing resources (and adjust marketing tactics) in a more focused and effective manner. Privilege Seekers, for example, place a considerably higher weight upon the recognition benefits of a loyalty program as compared to Points Junkies, and marketing initiatives that address the motivations of each cluster accordingly will have the greatest likelihood of success.

Along with loyalty clusters, *Carlson Relationship Builder* showed that re-engineering the communications program to be more relevant to customers is another important mechanism to assist in the achievement of increasing relationship strength.

The relevance of a communication strongly impacts the strength of the relationship. Moving from a state of being "irrelevant" to "relevant" increases a customer's relationship strength by 37 percent.

Figure 8: **Communication Customization Drives Relationship Strength**

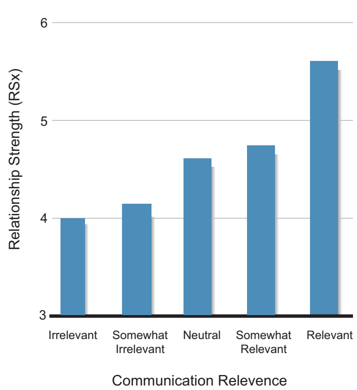
A change in communication customization from low (2) to high ("very customized") increases relationship strength on average by 37 percent.



Source: *Carlson Marketing and Peppers & Rogers Group*

Figure 9: **Communication Relevance Drives Relationship Strength**

The relevance of messages from a retailer to its customers has a direct and meaningful impact upon relationship strength.



Source: *Carlson Marketing and Peppers & Rogers Group*

Retailers should focus on enhancing the customization and relevancy of communications and adjusting their frequency to match each individual's preferences.

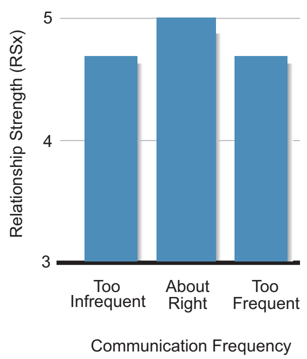
Communication Customization. The customization of communications from the retailer to its customers makes a difference (see Figure 8). As the degree of customization increases, so does relationship strength. The effect holds across a broad range of communication types, including those related to merchandise/service offers and information, pricing information and partner offers.

Communication Relevance. The relevance of a communication—i.e., the extent to which the content of the message is applicable to the customer's current needs—strongly impacts the strength of the relationship (see Figure 9). In particular, moving from a state of being "irrelevant" to "relevant" increases a customer's relationship strength by 37 percent; the propensity to recommend the retailer to friends and family by 42 percent (p<.01); the intent to remain a customer by 35 percent (p<.01); and the likelihood to shop more by 37 percent (p<.01).

Communication Frequency. Communication frequency has a non-linear association to relationship strength (see Figure 10). As may be expected, when communications are too infrequent, relationship strength suffers. However, it is especially noteworthy that when the rate of communication is too high, relationship strength also suffers to

Figure 10: **Communication Frequency Drives Relationship Strength**

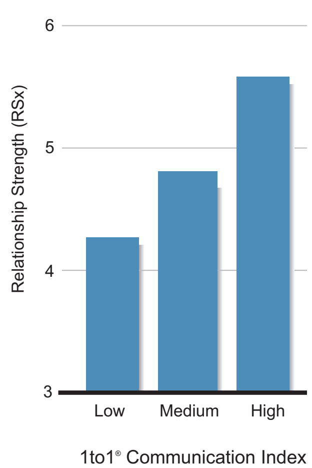
Communication frequency that is too low or too high reduces relationship strength. "Getting it right" involves knowing—at 1to1® level—the preferences and needs of each individual customer and acting upon that insight.



Source: *Carlson Marketing and Peppers & Rogers Group*

Figure 11: **1to1® Communication Drives Relationship Strength**

Retailers would be well advised to pay attention to the joint influence of communication customization, relevance and frequency. As the level of 1to1® communication increases from low to high, a corresponding increase in relationship strength occurs.



Source: *Carlson Marketing and Peppers & Rogers Group*

almost an equal degree. Stated differently, the expenditure of sending too many communications isn't just wasted money: it actually destroys value[iv] by suppressing the quality of the customer relationship. What's the right frequency? The answer, of course, varies by individual, and these customer preferences ought to be known and honored by the retailer. However, on average most customers prefer monthly communications (40 percent), with some desiring a higher (31 percent for weekly) or lower (12 percent for quarterly) frequency.

Individuals who prefer to receive weekly communications demonstrate the highest level of relationship strength ($p<.01$). They also have the greatest likelihood to recommend the retailer to friends and family ($p<.01$) and to shop for more from the retailer within the next 12 months ($p<.01$).

1to1® Communication. To examine the joint influence of communication customization, relevance and frequency, a 1to1® index score was created and used to construct low, medium and high groups. The index was computed by summing the standardized values ($\mu=0$, $\sigma=1$) of each variable and converting the result to a 100-point scale ($\mu=50$, $\sigma=25$). The "high" group was constructed by selecting individuals with a 1to1® communication index value in the top quartile; the "low" group, individuals with the index in the bottom quartile; and the "middle" group, the remainder.

Figure 11 shows the results. Clearly, as the level of 1to1® communication increases so too does relationship strength. A high as compared to a low level of 1to1® communication enhances relationship strength by 25 percent, and improves the business outcomes of recommending the retailer to friends and family by 30 percent ($p<.01$), remaining a customer by 18 percent ($p<.01$) and shopping more by 18 percent ($p<.01$). Among the retailers examined with the highest 1to1® communication index score are Jo-Ann Fabrics and Best Buy; among those with the lowest, Lowe's and Wal-Mart.

1to1® Process. The process of adjusting the customization, relevance and frequency of communications to match the preferences of the individual starts with uniquely and consistently identifying each customer across all products, all channels and all touchpoints. Loyalty programs are used as a friendly way to create and maintain a distinctive and stable customer identifier.

With a mechanism to uniquely identify each customer, a retailer now has the opportunity to enter into a permission-based dialog and establish a learning relationship, in which increasingly more information about (and for) each individual customer over time is gathered and retained.

Finally, when the information is transformed into insight, the retailer has the opportunity to alter aspects of its behavior toward a customer based upon knowledge of the individual—including but not limited to communications—in order to ultimately deliver a superior experience that would be difficult for the competition to duplicate. This occurs through the application of advanced analytics and the use of marketing tests to assess the impact of one course of action over another. By creating competitive differentiation and building relationship strength through a superior customer experience, the retailer avoids the challenge of competing soley on product, price or service. While these factors may create short-term results, they won't contribute to improved relationship strength, lock in loyalty, or grow long-term customer value.

"Customers are your future, representing new opportunities, ideas and avenues for growth."

—Michael Dell, *Founder and CEO of Dell, Inc.*

Conclusion

What must a retailer do to differentiate itself and "get it right" with customers and achieve the organic growth demanded by CEOs? It involves more than executing the well-known basics of retail that are essential for survival. As documented in *Carlson Relationship Builder*, it requires building strong relationships that in turn enhance customer recommendations, retention, and shopping. Today, some retailers are already doing this better than their peers—but there is ample room for improvement across the board. The use of loyalty programs and improvement of communication customization, relevancy and frequency are all 1to1® approaches highlighted in this white paper as mechanisms to "get it right" and to deliver results. n

Endnotes

[i] Morgan, R. M., and Hunt, S. D. (1994, July) The Commitment-Trust Theory of Relationship Marketing. *Journal of Marketing,* 58, 20-38.

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[iii] Accenture (2006) Seller Beware: The Curse of the Disloyal Customer. Retrieved April 16, 2007 from http://www.accenture.com/Global/Research_and_Insights/By_Subject/Customer_Relationship_Mgmt/SellerBewareTheCurseoftheDisloyalCustomer.htm.

[iv] Peppers, D. and Rogers, M., Ph.D. (2005) Return on Customer: Creating Maximum Value from Your Scarcest Resource. New York: Doubleday (pages 103-104).

[v] Reichheld, F. F. and Teal, T. (1996) The Loyalty Effect: The Hidden Force Behind Growth, Profits, and Lasting Value. Boston, MA: Harvard Business School Press.

"We see our customers as invited guests to a party. It's our job every day to make every important aspect of the customer experience a little bit better."

—Jeff Bezos
Founder and CEO, Amazon.com

Appendix: Relationships in Retail

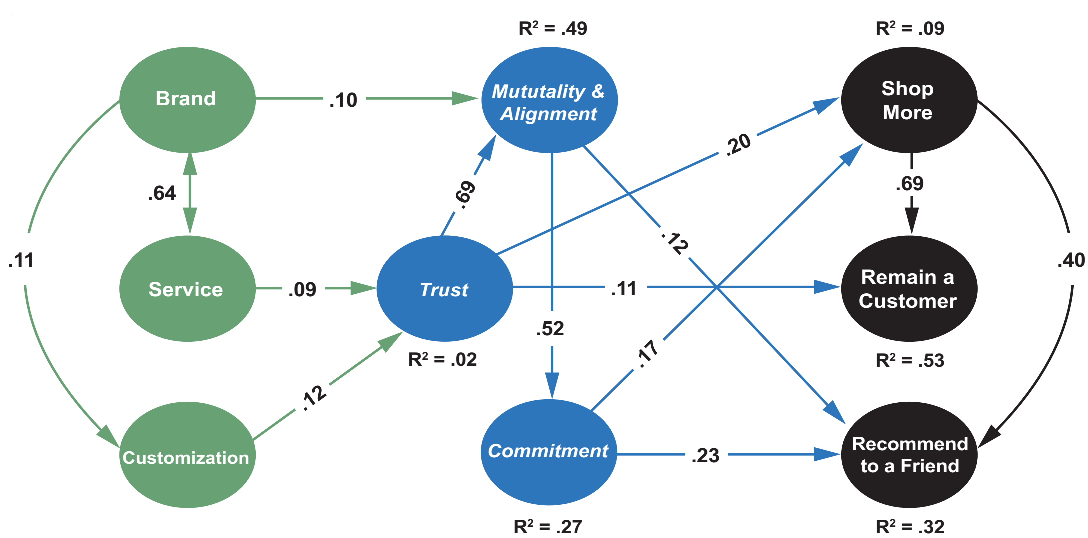
Relationships have many intertwined and complicated facets. To properly discern their structure and understand the causal linkages, a sophisticated analytic approach was employed: namely, structural equation modeling. This technique allows the evaluation of multiple, simultaneous dependencies across a set of variables.

Among those variables examined is value, measured as a composite of a respondent's rating that (1) benefits received are fair for the money spent, (2) quality service is received for the price, and (3) the value received from this retailer is better than the competition. It is well known that value is a key consideration in retail, and when this element was initially included in the model, it was no surprise that it masked the more subtle influences that were of primary interest in this research. For this reason, the impact of value was statistically removed by using in the model only the residuals arising from an individual regression of each of thirty variables upon value.

The primary outcomes of the analysis are a set of estimates of the model effects (i.e., the arrows in Figure 12) together with metrics that allow an evaluation of the parsimony and the fit of the model. "Good models" are commonly considered to be ones that have both low error (i.e., root mean square error of approximation [RMSEA] < 0.080) as well as high fit (i.e., comparative fit index [CFI] > 0.900). By these criteria, the model depicted in Figure 12 is quite good (RMSEA=0.045, CFI=0.976).

Figure 12: **Structure of Retail Relationships**

Retail relationships are a web of interconnections among components influencing the customer experience (green circles), relationship strength (blue circles), and key outcomes (black circles). Understanding the linkages—and the size of each—yields insight that facilitates thoughtful marketing planning.



Source: *Carlson Marketing*

The drivers of relationship strength were found to be (1) brand, measured through a composite of each respondent's rating of the importance of brand name familiarity and brand/retailer name recognition as reasons in determining where shopping is done; (2) service, similarly based upon the ease of doing business, being helpful, having good customer service, and having good merchandise selection/availability; and (3) customization (see page 13). The components of relationship strength in turn impact the key business outcomes of recommend, remain and shop more.

The standardized effect sizes in the model are particularly noteworthy, and each was found to be statistically significant ($p<.01$). To interpret effect sizes, begin by realizing that they are the answer to the question, "If I were successful in altering the input by one unit, how much would the output change?" For example, the effect between customization and trust is 0.12, meaning that a 1.00 unit increase in customization will drive a 0.12 unit increase in trust (both of which are measured on a seven-point anchored Likert scale). When there are multiple paths from one variable to another, the computation is the sum of all direct effects plus the sum of the products of all indirect effects. For example, trust directly influences remain a customer (0.11) and indirectly influences it through shop more (0.20 x 0.69), resulting in a total effect of 0.25 (0.11 + [0.20 x 0.69]). Thus, increasing trust by 1.00 enhances the propensity to remain a customer by 0.25.

The proportion of variance (R^2) for each model component that is explained by its influences is also presented in Figure 12. For example, 53 percent of the variability associated with the outcome of remain a customer is accounted for by the impact of trust and shop more.

The structure of retail relationships uncovered in *Carlson Relationship Builder* may be beneficially used by a retailer to prioritize marketing initiatives, to understand their dependencies, and to estimate the associated benefits.

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More Information

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