The Risk/Reward Barometer of the Retail Value Proposition

> *"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

The rewards of a good shopping experience are straightforward: a satisfied customer is more likely to be loyal, buy more and generate more repeat business. There are related benefits:

- Customer retention is far cheaper than customer acquisition.
- A loyal customer is a strong competitive advantage and generates higher sales and margins.
- A satisfied customer can become "part of the team," helping you recruit other customers via word-of-mouth suggestions.
- Customers participating in loyalty programs provide a great source of market intelligence for new product ideas and retail strategies.

Taken as a whole, the benefits of achieving great customer satisfaction are like a multi-tiered annuity stream. Wall Street rewards annuities because they reduce uncertainty and volatility.

The risks of poor customer service and retention are greater and more insidious because they are less visible. For every unhappy customer you hear from, there are countless more. Negative word of mouth can damage years of good reputation and ripple through countless shoppers who never become customers. Ultimately, unhappy customers become lower sales for you and higher market share for your competitor.

An up-to-date yet deep understanding of customer service performance, consumer behavior and shopping motivations is increasingly critical for any retail business. Customer Service generates unique insight into the customer experience, providing an outside corroboration of the retail value proposition. If service or behavior changes, the faster these insights are proactively converted into strategic and tactical adjustments, the lower the risk and the higher the reward.

However, many retailers place insufficient effort on customer insight and the customer relationship. While they view Customer Service performance as an important and a necessary metric, evaluating customer behavior as a critical barometer of a sustainable value proposition is less obvious. Three significant barriers must be overcome to change this view.

Barrier 1: ***Insufficient insight into the detail of customer shopping perceptions, needs and expectations***

Is the retail value proposition truly aligned with customers, or are there inconsistencies between management's perceptions and the actual customer experience? The question is largely strategic and is broader than looking at service delivery requirements or performance. The required understanding includes segmenting customer groups to identify underlying motivations and shopping patterns. To maximize value, the retailer must understand these patterns and proactively define a range of value packages that target various customer expectation profiles. With the increase of customer shopping data from external data providers or internal programs such as loyalty cards, the ability to mine data and look deeper into the detail is now a competitive necessity. But while the benefits may be recognized, the capability is often insufficient.

Generating detailed customer insights often comes at a significant cost, either in terms of IT investment, staff resources needed to analyze these insights or executive support for a customer-centric point of view. However, in mature markets where competition is intense, the need to target more profitable customer segments is today a critical success requirement. A systematic approach to defining the risks and rewards in servicing different customer needs ensures that an optimal retail strategy is developed. Monitoring the financial success from targeting specific customer types offers the opportunity for further fine-tuning, but also a deeper understanding of the risks and costs to the business if the value proposition is not successful.

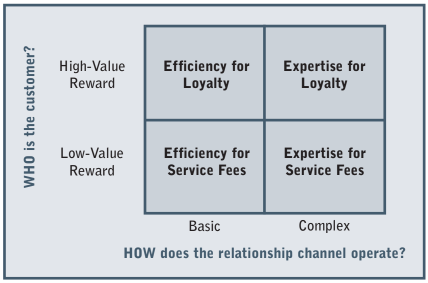
Once a retail operation understands which customer segments are most important, it must gain insight into how the relationship works. In complex customer-retailer interactions, such as advising on high-end or complex products or service-intensive interactions, the relationship depends on expertise. This is a clear market differentiator. If the customer-retailer interaction is more basic, such as fast-moving consumer goods, then the day-to-day efficiency of the relationship becomes more important for both parties. But what are the risks or value-add benefits from good customer service? This brings us to the next barrier.

Barrier 2: ***Insufficient visibility of the risks and benefits of a poor/good customer experience***

Customer service can be thankless and hectic. Picture a room full of service representatives juggling calls from frustrated customers, often in outsourced and offshore call centers. In such a volume-driven environment, it is difficult to determine the context and pattern of the calls received. Equally, in-store check-outs, service desks and customer support teams are constantly dealing with the same customer frustrations, demanding quick service and prompt resolution to problems ranging from returns to quality complaints.

From a service risk perspective, the ability to quickly identify when, where and why the shopping experience is not optimal is key to managing and resolving them. By implication, for service issues to be identified, they must also be logged and captured in a systematic and structured manner. Fortunately, today's technology makes it possible to implement such a systematic approach across the various service functions. From this information, patterns in poor execution such as delivery delays, information requests and complaints can be identified and rectified.

Categorizing the types of issues across channels by complaint type, order error, response time and resolution time can reduce service-related risks and long-term costs to the business. An informed retailer that acts quickly on resolving the causes of dissatisfaction will have a more profitable business. Even when you can't eliminate the root cause, better identification and categorization of issues can speed the time required to resolve problems. Timely responsiveness can salvage many frustrated customer relationships. As one executive of a major airline said, "Customers don't expect you to be perfect. They do expect you to fix things when they go wrong." Achieving this requires that problems and their causes be grouped and studied so that effective action can be taken.



Similarly, what are the benefits of good customer experience, i.e., what is the ROI from such investment? While it may be tempting to focus on hard costs, what does this add to the overall value proposition? Is it possible that an increase in service investment—additional check-outs, better Web site navigation, more training for associates—will actually deliver improved profits, and by how much? Without improved understanding and visibility into service, these types of issues can rarely be evaluated to the degree they require.

A successful retailer needs to understand how customer service levels affect your key and most profitable customer segments. If you don't, you may understate—or overstate—the benefit or risk. Overstating the risk leads to an inefficient allocation of resources, which reinforces the view that Customer Service is an expense. Understating the risk can be even worse, leading to the loss of your most valuable customers—the ones your strategy counts on—and the marketing impact of negative word of mouth on other customers.

When you include the relative value perception of the entire shopping experience, including service, to the customer, you have a useful framework to maximize the rewards for you and the customer. For example, if your expertise in multichannel operations is a differentiator, you may want to extend special offers to high-value customers in return for greater loyalty. At the same time, you may want to have a different pricing scheme for low-value customers for certain services, like delivery. Whatever metrics you choose, you must align them with what the customer perceives as important. *Does the customer value quality or convenience above price? What are acceptable lead or delivery* *times? What customers are willing to pay extra for shorter delivery times?* Understanding the relative importance of such elements will make customer service monitoring more relevant.

Barrier 3: ***The absence of a customer advocate and direct accountability***

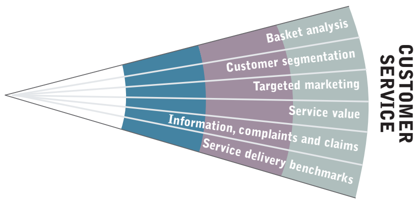
Ideally, your entire organization has common customer service and experience performance goals. You should back up this alignment with accountability and incentives, especially when the drivers of those goals span different functions. Without these incentives, the retailer creates a barrier to achieving a better customer experience. Overcoming this barrier requires clear, credible and aligned customer performance metrics—and the political will and organizational culture to rely on them for tough decisions.

Do you incur higher costs in the short term to secure long-term customer loyalty? Only retailers that understand the risks and rewards of good customer performance and service can make informed decisions on such questions. Customer Service has a key role in generating and sharing this information. Beyond being an insights and service-handling agent, it can become an effective customer advocate to other departments, and an expert on customer performance metrics and their drivers. It has to understand the problems and the operational solutions. Most important, Customer Service must effectively communicate these metrics to the rest of the organization so that other departments can resolve the root causes of customer experience issues.

Excellence in Customer Experience

The decision areas described below equip associates with the critical risk and reward information they need to be more effective customer advocates, bringing excellence to the customer experience. Decision areas in Customer Service include:

- **Basket analysis** ➔ What is driving the typical shopping trip, buying decisions and product affinity?
- **Customer segmentation** ➔ How do different customer segments vary in shopping motivations?
- **Targeted marketing** ➔ What is the best way of reaching and communicating with targeted customer groups?
- **Service value** ➔ What is driving the service cost and benefit?
- **Information, complaints and claims** ➔ What is driving customer concerns and service responsiveness?
- **Service delivery benchmarks** ➔ What is driving service levels



The sequence of these decision areas provides a logical flow of analysis and action, starting with understanding the needs of the customer and the range of value options. What does a customer buy by channel, and how does this vary by different customer types, e.g., geography, age groups or income levels? From this understanding, the question that follows is how to communicate and reach these customers with a relevant value proposition.

Now our focus shifts to the benefits of retaining key customers. *Is the overall value proposition appropriate? Are you reaping the rewards from your operations, what are they, and how much has it cost?* Customers are impatient and expect excellent service, and rapid resolution of issues when they occur. These include simple requests for information, complaints, claims and returns. *Over time, do service levels change, and what is driving these changes? How do your service benchmarks and shopping experience across channels compare against the competition's?*

Basket Analysis

At different times of the day, what constitutes a typical customer shopping visit, and what merchandise is being purchased? What is average transaction spend, and to what extent does this vary? Do customers frequently purchase a combination of items, and can product bundling or promotions be encouraged? If certain merchandise is unavailable, does this impact customer satisfaction, sales or substitutions? To what extent do impulse purchases occur, or are most transaction done by “destination” customers who have planned their shopping journeys?

GOALS	METRICS	DIMENSIONS
Sales ($/%)	Category Coverage ($/#)	Fiscal Month
Transaction Value ($)	Category Share (%)	Year
Margin ($/%)	New Product Sales ($/%)	Quarter
	Customer Frequency & Recency (#)	Month
	Range Changes (#)	Week
	Delistings ($/#)	Day
	New Listings ($/#)	Day Category
	Promotions ($/#)	Organization
	Promotion ROI ($/%)	Division
	Unit Sales (#)	Channel
	Traffic (#)	Store
	Sales/Traffic (%)	Region
	Transactions (#)	Region
	Transaction Time (#)	Territory
	Customer Loyalty Index (#)	Locality
	Own Label Sales ($/%)	Product Hierarchy
	Premium Sales ($/%)	Product Category
	Rebates ($/%)	Product Group
	Shrinkage ($/%)	Product Line
		Customer Segment
		Market Segment
		Weeks on Promotion
		Price Tier

FUNCTION	DECISION ROLES	PRIMARY WORK	CONTRIBUTORY	STATUS
Customer Service				
	Executives	•		
	Analysts	•		
	Professionals	•		
Marketing				
	Executives			•
	Professionals		•	
Merchandising				
	Executives			•
	Professionals		•	
Store/Channel				
	Executives		•	
	Professionals		•	
Supply Chain				
	Executives			•
	Professionals			•

All these insights and more are essential to understand what an appropriate retail offering should include. A multitude of alternatives needs to be examined and evaluated to decide the optimal strategy. By data mining your customer transactions, various buying patterns will be identified. Combining such factual information with strong merchandising strategies is a formidable combination that successful retailers will capitalize on. Certain carefully considered promotions or well positioned merchandise will increase average basket spend, frequency of store visits and multichannel shopping. This will directly impact sales and profits, using the basic retail equation of average basket spend times number of visits!

As new customer buying patterns emerge, the retail operation will need to adjust and plan new offerings that reflect these changes. The faster these insights are generated and acted upon, the better the retail performance and the financial reward.

Customer Segmentation

This decision area builds upon the previous one by recognizing that a typical and homogeneous customer does not exist. At the finest level of detail, we are all unique in our buying behavior. In practical terms, too much detail is neither useful nor practical. A key skill is to determine a customer grouping or segmentation that is useful for defining retail strategy. This is a balancing act between using finer and more targeted segmentation versus a practical segmentation that can be executed on across channels.

The potential dimensions to customer segmentation are vast. One perspective may reflect socio-demographic differences and examining how buying behavior changes. Another dimension may include motivational “need states” to better understand the “frame of mind” behind customer purchases on different occasions. This approach may identify cross-sell and up-sell opportunities that link certain product requirements with given events, such as buying party food and drink for a barbeque. Also, how does customer buying behavior vary across channels? How can you gain a single view of the customer across channels to determine the best way to reach consumers?

GOALS	METRICS	DIMENSIONS	
Sales ($/%)	Category Coverage ($/#)	Fiscal Month	Product Hierachy
Transaction Value ($)	Category Share (%)	Year	Product Category
Margin ($/%)	Cross Category Shopping Score (#)	Quarter	Product Group
	Customer Loyalty Index (#)	Month	Product Line
	New Product Sales ($/%)	Week	Customer Segment
	Customer Frequency & Recency (#)	Day	Market Segment
	Delistings ($/#)	Day Category	Socio-demographic Segment
	New Listings ($/#)	Organization	Loyalty & Spend Segment
	Promotions ($/#)	Division	Weeks on Promotion
	Promotion ROI ($/%)	Channel	Price Tier
	Unit Sales (#)	Store	
	Traffic (#)	Region	
	Sales/Traffic (%)	Region	
	Transactions (#)	Territory	
	Transaction Time (#)	Locality	
	Own Label Sales ($/%)		
	Premium Sales ($/%)		
	Rebates ($/%)		
	Shrinkage ($/%)		

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Marketing				
	Executives			•
	Professionals		•	
Merchandising				
	Executives			•
	Professionals		•	
Store/Channel				
	Executives		•	
	Professionals		•	
Supply Chain				
	Executives			•
	Professionals			•

The greater the segmentation sophistication, the greater the potential to target customers and their particular needs accurately. Such segmentation helps build a customer relationship that secures long-term loyalty and sustainable performance. As buying trends change within these customer segments, they are observed and catered to, not lost in the statistical “average.”

Targeted Marketing

Once customer buying behavior is appropriately segmented, targeted marketing and communication is possible. Historically, direct marketing was a "blunt" tool to communicate with all customers in the same way, but today mailings or email campaigns can be tailored to these specific customer segments. For example, high-income customers with a pattern of buying fine wines can be targeted with a specific premium wine promotion. To the large household shopper concerned with "bargains," a mailing of discount coupons on large packaged products could be appropriate.

GOALS	METRICS	DIMENSIONS	
Campaign Cost ($) Campaign ROI ($/$) Sales uplift ($/%)	Change in Customer Loyalty Score (#) Change in Traffic/Visits (#) Change in Transaction Value ($) Change in Sales/Traffic (%) Change in Frequency & Recency (#) Change in Destination Shoppers (#) Campaign Soft Score (#) Campaign Frequency (#)	Fiscal Month Year Quarter Month Week Day Day Category Organization Division Channel Store Region Region Territory Locality	Product Hierachy Product Category Product Group Product Line Customer Segment Market Segment Socio-demographic Segment Loyalty & Spend Segment Customers Campaign Type

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Customer Service				
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	Analysts	•		
	Professionals	•		
Marketing				
	Executives	•		
	Professionals	•		
Merchandising				
	Executives			•
	Professionals		•	
Store/Channel				
	Executives		•	
	Professionals		•	
Finance				
	Executives			•
	Professionals		•	
Supply Chain				
	Executives			•

The opportunity for one-to-one communication between customer and retailer has become even more powerful in situations where loyalty cards are used. The itemized transaction history of customer shopping records linked to loyalty programs offers retailers a very sophisticated marketing and promotions tool. Increasing conversions and transaction size can be encouraged and visit frequency increased via customized news and promotions. Suppliers also benefit, for example, when new product introductions can be communicated to those customers most likely to consider such a purchase. The ROI on targeted marketing can be very high, and today is a very effective tool to attract and communicate value to the customer.

Service Value

This decision area combines costs and benefits to evaluate the value of the customer service relationship. It segments customers by who they are and how the retailer provides the service. Quantifying customer risk issues and the efforts required to resolve them provides the cost overview. Some issues can be financially quantified, such as the number of calls received, cost per call and dollar value of product claims processed. Others, such as late deliveries or complaints, can be categorized through a service level index. When determining cost, it is also important to understand how the relationship operates. Customer conversations that can be captured as data, i.e., by electronic means, tend to indicate more efficient relationships. You can define sub-categories of complexity based on customer and transaction knowledge, for instance, by tagging relationships based on how many separate steps and hand-offs are required to complete the transaction, solve a complaint, or fulfill a service need.

GOALS	METRICS	DIMENSIONS	
Service Cost ($/%) Service Effectiveness Index (#) Customer Lifetime Value ($)	Claims (#) Claims ($) Complaint Count (#) Customer Satisfaction Score (#) Customer Service Cost ($) Customer Loyalty Index # Customer Frequency & Recency (#) Customers (#) Lost Customer Count (#) Outstanding Service Issues (#)	Fiscal Month Year Quarter Month Organization Division Channel Store Department Region Region Territory Locality	Product Hierachy Product Category Product Group Product Line Customer Segment Market Segment Socio-demographic Segment Loyalty & Spend Segment Customers Complaint Type

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	Analysts	•		
	Professionals	•		
Store/Channel				
	Executives		•	
	Professionals	•		
Finance				
	Executives			•
	Professionals		•	
Marketing				
	Executives			•
	Professionals		•	
Merchandising				
	Executives			•
Supply Chain				
	Executives			•

At the same time, you can categorize the benefits, such as a life-time revenue metric or strategic value index based on expected revenue. When you can analyze value and cost, there is no need to trade one for the other by setting more accurate priorities for use of resources. Poor service performance for routine issues could imply investing more in process automation and improved efficiency. Performance issues around more complex products and services point to increasing investment in skills, expertise and decision-making support when analysis shows that the investment is worth it.

Information, Complaints and Claims

Every complaint is also a proactive customer statement that you are not meeting expectations. It is an opportunity to listen to your customer, whether to a simple request for information, a complaint about product quality or a financial claim on returned goods. Experience shows that each complaint can be the tip of an iceberg—the one frustrated customer who calls may represent many more who don't bother. By tracking and categorizing these complaints, you can gauge the severity of various risks and prevent them in the future.

GOALS	METRICS	DIMENSIONS	
Complaint Count (#)	Claim Payments ($)	Fiscal Month	Product Hierarchy
Customer Satisfaction Score (#)	Claim Payments (#)	Year	Product Category
Returned Sales/Units ($/#)	Claim Settlement ($)	Quarter	Product Group
	Claims (#)	Month	Product Line
	Claims ($)	Organization	Customer Segment
	Customer Recommendations (#)	Division	Market Segment
	Damaged Units (#)	Channel	Socio-demographic Segment
	Failed Deliveries (#)	Store	Loyalty & Spend Segment
	Returned Product ($/%)	Department	Customers
	Service Count (#)	Region	Complaint Type
	Suggestion Count (#)	Region	Suggestion Type
		Territory	Service Type
		Locality	

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Customer Service	Executives	•		
	Analysts	•		
	Professionals	•		
Store/Channel	Executives		•	
	Professionals	•		
Finance	Executives			•
	Professionals		•	
Marketing	Executives			•
	Professionals		•	
Supply Chain	Executives			•
	Professionals		•	
Merchandising	Executives			•

There are three dimensions to monitoring the customer voice: frequency, coverage across customer segments and type of issue. Simply counting complaints will not adequately reflect the nature or risk of a problem. For example, you may receive many complaints about merchandise being out-of-stock, but these may represent a lower risk than complaints about service and poor quality product. In this example, a count of complaint frequency will not adequately reflect the risk of losing critical customers.

Claims are complaints that have been monetized. Perhaps goods have been damaged and the customer now needs compensation or replacement. Claims are a direct cost to the business, have a direct impact on customer profitability and, if poorly handled, lessen customer loyalty.

Service Delivery Benchmarks

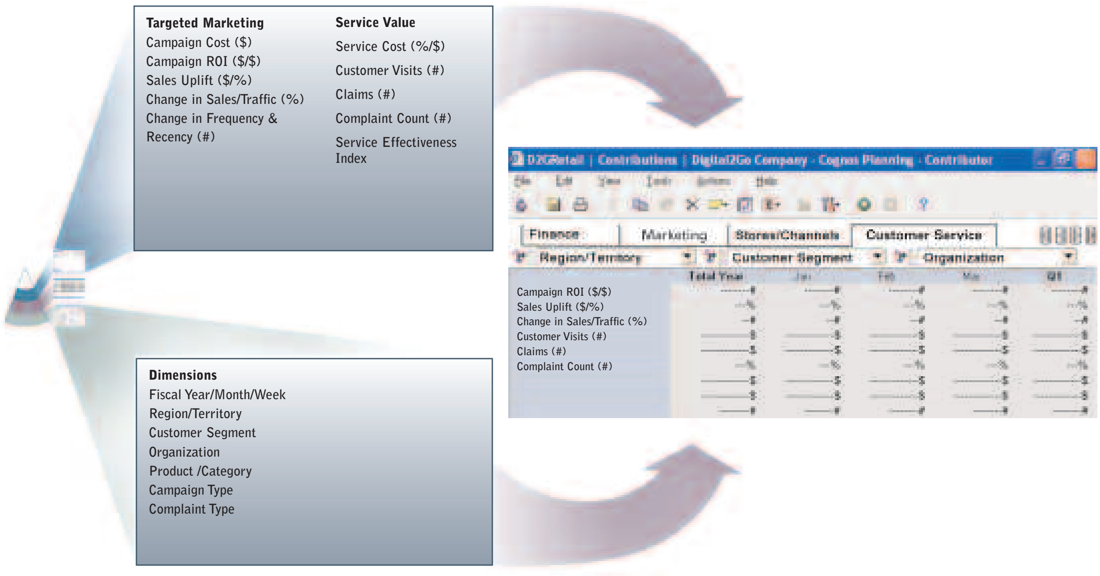
Service benchmarks help evaluate how your service delivery stacks up against internal and external standards. They measure response times and gaps affecting customer satisfaction. Understanding the link between service benchmarks and customer retention, sales and profitability is a key goal. For example, you may find that smaller stores have more complaints about handling product returns. With fewer staff and less space, smaller stores cannot deliver the same service proposition, but any service investment increase may not be attractive from a profit perspective.

GOALS	METRICS	DIMENSIONS	
Average Resolution Response Time (#)	Delivery Performance Score (#)	Fiscal Month	Product Hierachy
Customer Service Scorecard (#)	Service Performance Score (#)	Year	Product Category
Service Effectiveness Index (#)	Outstanding Service Issues (#)	Quarter	Product Group
	Returned Product ($/%)	Month	Product Line
	Service Count (#)	Organization	Customer Segment
	Damaged Products (#)	Division	Customers
	Complaint Count (#)	Channel	Complaint Type
	Supplier Performance Score (#)	Store	Service Type
		Department	
		Region	
		Region	
		Territory	
		Locality	

FUNCTION	DECISION ROLES	PRIMARY WORK	CONTRIBUTORY	STATUS
Customer Service	Executives	•		
	Analysts	•		
	Professionals	•		
Supply Chain	Executives			•
	Professionals	•		
Store/Channel	Executives			•
	Professionals		•	
Finance	Executives			•
	Professionals		•	
Marketing	Executives			•
	Professionals		•	
Merchandising	Executives			•

Various service metrics may be relevant to monitor delivery performance, customer help requests, out-of-stock events, staff availability, problem resolution, customer satisfaction, response time, claims and returns. In addition, if some of these metrics are standard industry criteria, managers can compare external information from third-party assessments with internally driven customer surveys. Gaps in external information can uncover risks not picked up by internal monitoring. Such information can also identify the need for better customer communications about the retailer's delivery of good service performance.

Combined with skilled analysis, service benchmarks can be used to adjust the business and service proposition. You can summarize service benchmarks by region, channel, store and customer segment, and thereby offer a high-level overview or drill down into service performance standards.



The Targeted Marketing and Service Value decision areas illustrate how the Customer Service function can monitor its performance, allocate resources and set plans for future financial and operational targets.