

Knowing your customer

How customer information will revolutionise food retailing



Project VII March 1997

A study conducted for

The Coca-Cola Retailing Research Group, Europe

by

The Boston Consulting Group

Introduction

The Coca-Cola Retailing Research Group, Europe (CCRRG,E) comprises leading European grocery retailers. It is sponsored by the Coca-Cola Company to conduct research into key topics in grocery retailing.

This report represents the findings of a study commissioned by the CCRRG,E to assess opportunities to use customer information to create value in food retailing and to suggest practical directions for retailers.

The project was carried out by The Boston Consulting Group in 1996.

The previous reports of the group are:

- I Staffing Supermarkets in the 1990s;
- II Food Retailing in Europe post 1992;
- III Grocery Distribution in the 90s – Strategies for Fast Flow Replenishment;
- IV Building Customer Loyalty in Grocery Retailing;
- V Supplier-Retailer Collaboration in Supply Chain Management;
- VI The Future for the Foodstore – Challenges and Alternatives.

Copies of these studies are available from:

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About the study

Objectives of the report

Can companies in the food retailing industry use customer specific information to create competitive advantage? This study sets out to look at the huge potential of customer data now being generated. It examines in detail the experience of other industries – the fundamental changes to the relationship between retailer and customer, the organisational impact, and the new skillsets that are required.

Innovative retailers have already started. What early lessons have been learned? What are the time frames and strategic implications?

One thing is clear: retailers will achieve substantial competitive advantage by moving away from traditional mass marketing (the concept of the “average” customer) towards a more-focused approach. For those prepared to go the distance the ultimate stage is the transformation from a product-based to a truly customer-based organisation.

How to use this report

The first part of this report (chapters 3, 4, and 5) delivers the key messages and describes the vision of why and how customer information will dramatically transform the retailing industry over the next ten years.

The second part (chapters 6, 7, and 8) describes the key lessons for retailers who would like to use customer information. These chapters correspond to the three major stages of the transformation described in the earlier chapters.

This report is designed to be readable on several levels.

- Readers who want to focus on the key conclusions should focus on chapter 2 (executive summary)
- Detailed messages and illustrations are included in the body of each chapter. A synopsis at the beginning of each chapter highlights the key elements
- Readers who are interested in the practical lessons from experiments so far and on how to get started should read chapters 6, 7 and 8 in detail



Confidentiality

We conducted many interviews to prepare this report. Many retailers or other best-practice companies are building a competitive advantage by using information sooner or better than their competitors. Understandably many asked to remain anonymous. In the interests of confidentiality we have refrained from identifying the sources of some of the examples and comments we include in the report.

2

Executive summary

The information revolution in other industries

The use of customer information has revolutionised industries other than retailing. It has transformed the way companies do business and are organised and has led to very different relationships with their customers.

Issues and organisational consequences are strikingly similar across industries. Common lessons can provide insight into how retailers and their customers can benefit from information and how retailers should approach this challenge.

These revolutions have occurred because information has allowed companies better to understand and serve their customers, providing them with appropriate products and services and giving them better prices.

These companies communicate better with individual customers, by sending directly relevant information to each customer segment and establishing a two-way communication link, giving customers the opportunity to express themselves through a dialogue with the company.

They have increased customer retention, acquired new customers at lower cost, and increased their business with their best customers.

In all cases pioneers have been quickly followed by their competitors.

Three major stages in using information can be identified.

First, companies start to do more sophisticated MASS MARKETING, usually with loyalty programmes and basic direct marketing initiatives such as newsletters. Little changes in the organisation.

In a second stage, companies start to explore their customer data. They realise the value of TARGETED MARKETING. Loyalty programmes become more sophisticated, communication and pricing are differentiated for different customers. Skills need to be significantly upgraded: programme managers, analysts, and superior customer service are required.

The third stage is REORGANISATION AROUND CUSTOMER SEGMENTS. Customers have different profiles and needs. The most advanced companies have built a sophisticated customer segmentation based on customer profiles as well as behavioural attributes. To satisfy each segment individually, rather than upgrading a uniform offer for all customers, all parts of the organisation must be aware of each segment's particular needs. Products, services, pricing and communication are all tailored to each segment. A permanent dialogue reinforces the relationship. At this stage, the company needs to undertake a thorough reorganisation. Customer segment managers control the whole



experience of their customers. All levers and incentives need to be aligned with the specific needs of each of these customer segments.

The transformation invariably takes time because it implies major organisational changes.

Industries that have started first are those with the highest potential for value creation and the lowest complexity and costs of implementing and running information-based initiatives.

This revolution is starting in retailing

Most of the ingredients of this revolution are present in retailing. Many factors foster the use of information today. Technology makes it possible to manage large databases at an affordable price. Customers are getting accustomed to Segment-of-One Marketing® and they increasingly seek relevant information and advice. Electronic commerce is just around the corner and could be a significant threat to retailers. Last but not least, information is becoming a main means for retailers to differentiate themselves from their competitors.

But retailing faces more hurdles than other industries. Among them are the need to build the customer information database, the cost associated with it, the enormous amounts of information available, the infinite number of ways to use that information, the commercial and financial risks associated with some applications, and, last but not least, the complexity of the retail organisation.

Retailers are still in the early stages of using information. Product and store information usage is the most advanced. Retailers are improving their operational performance, sometimes in collaboration with their suppliers. Many have upgraded their category management.

They have now started to use customer information. Loyalty programmes are developing across the US and more recently in Europe.

Many applications are being tested, often in pilots. However, no single application has proved to be a “silver bullet”. Instead, value creation comes from a well-designed package of applications and services.

The first results are encouraging. Retailers claim margin gains (1–2%, according to various sources), increased retention rates (up to 11%), reduced advertising costs, more visits (+10–20%), market share gains, etc. On the other hand, a few European retailers report mixed results on the effectiveness of their first targeted promotions or cross-selling initiatives.

But food retailers who choose simply to follow the leaders and launch a basic loyalty programme without exploiting the customer data are bound to achieve only a mediocre financial return, at best.

Benefits and solutions depend heavily on the retailer's particular situation. However, some key lessons from the retail experiments can be generalised and are described in the second part of this report.

From what we observed while talking to dozens of retailers and customers, information can be used in a multitude of ways to create value for customers and improve the performance of retailers and suppliers. Therefore, we are now convinced that the information revolution will happen in retailing and has already started in many places. It will take five to ten years for retailers to realise the full benefits. The road is **dangerous both financially and commercially**, especially in the first years, **and will be paved with failures** as well as successes. However, retailers **will not** have to wait five to ten years before beginning to enjoy the benefits. These start to appear earlier.

In that context we think that retailers have a lot to learn from each other, but because retailing is still in the early stages of development, maybe even more from other industries.

Using information will completely change the way retailers view their business, from distributing packaged goods to fulfilling customer needs throughout the shopping experience and from focusing on categories and stores to reorganising around customers.

This will have an impact on the assortment, on the services they offer, on pricing, on promotions, maybe on the store layout, and of course on communication and advertising.

The major challenge for retailers is to redesign their organisation to seize these opportunities. Those who succeed will reinforce the relationship with their customers and build a sustainable competitive advantage.

Beyond this already major impact, long-term strategies and competitive dynamics will be deeply affected. Using customer information offers a unique way of competing with other more segmented distribution channels, like category killers or electronic commerce, and to build commercial synergies between store formats.

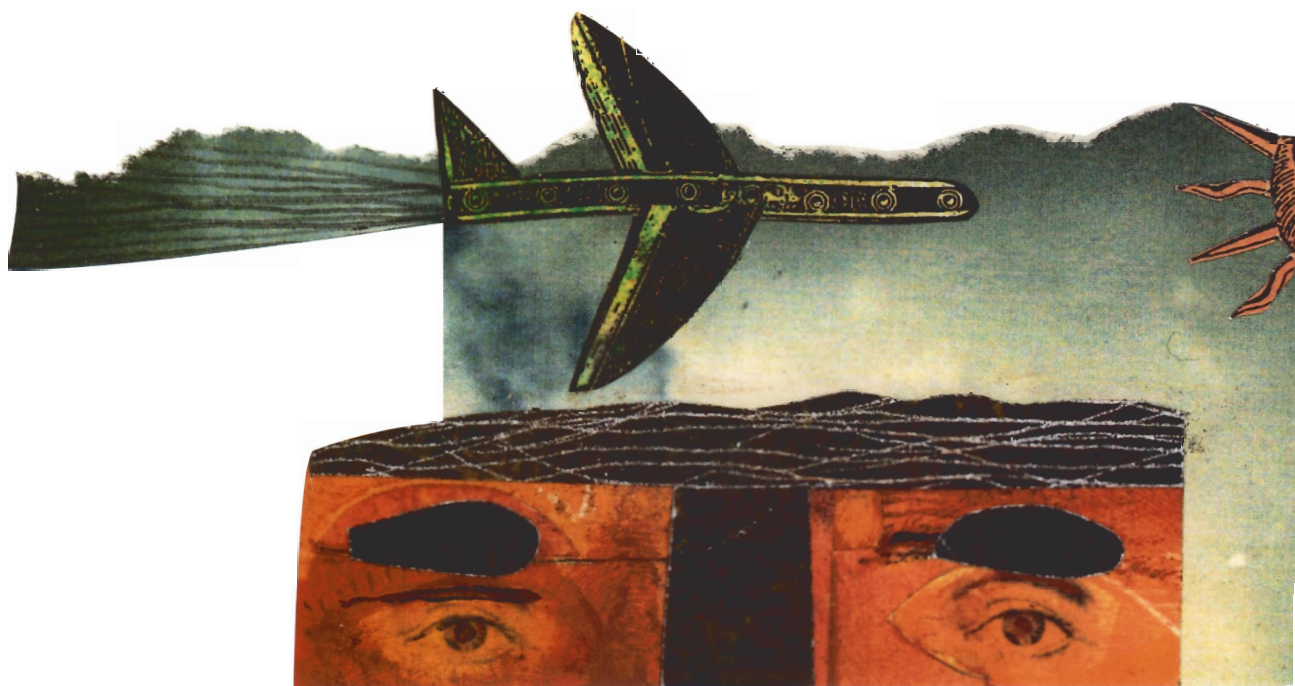
We are now convinced that using information appropriately will be the most important challenge for retailers in the next five to ten years.

3

The information revolution in other industries

Chapter Synopsis

- **Many industries have been revolutionised by the use of customer information**
- **Strikingly similar lessons can be drawn from these industries**
- **Industries in which customer information is being used have been able to create value for the customer and the companies**
- **First movers have been followed rapidly by the whole industry**
- **Achieving a full leverage of customer information follows a progressive three-stage approach**
- **The first two stages consist of sharpening existing marketing capabilities through the use of customer profiles. The third stage is a complete overhaul of the company's strategy around customer segment needs**
- **Understanding customer needs is a continuous process made possible by established communication channels with the customer and ongoing training programmes for employees**
- **Industries with the most favourable economics have moved first to customer information usage**
- **The transformation invariably takes years**



3.0 Why is it relevant to look at other industries?

Many industries have been revolutionised by the use of information: airlines, telecommunications services, mail order, financial services to name but a few. Using information has transformed the way companies do business and are organised and has led to very different relationships with their customers.

These revolutions have happened because information has allowed companies to understand and serve their customers better, providing them with appropriate products and services and giving them better prices.

These companies communicate better with their customers. They select relevant information to send to each customer segment. They establish a two-way communication link, giving customers the opportunity to express themselves and establish a dialogue with the company.

Most ingredients are present in retailing to make the same revolution happen. We think that retailers have a lot to learn from each other but as we are in the early stages of development in retailing, there may be even more to learn from other industries.

The nature of information, the way companies have exploited it and the results vary by industry. However, some common lessons can provide insight into how retailers and their customers can benefit from using customer information.

These lessons are actually strikingly similar across industries:

- 3.1** Using information has created tangible customer value
- 3.2** Using information has created value for the industry and the companies in it
- 3.3** First movers have been followed rapidly by the whole industry
- 3.4** The transformation goes through three stages
- 3.5** Using information requires the development of new skills
- 3.6** Using information has a major impact on organisations
- 3.7** Understanding customer needs is a continuous process
- 3.8** Using information transforms the relationship with the customer
- 3.9** The more favourable the economics, the earlier the move to information usage
- 3.10** The transformation invariably takes years

3.1 Using information has created tangible customer value

When companies started to use customer information, customers benefited from better adapted products and services, lower prices, greater convenience, faster and more accurate information, and recognition.

Airlines and British Airways in particular have delivered that value to their customers.

Creating value for the customer: British Airways' response

Products and services

Airlines improved their offering by completely rethinking the travel experience after extensive studies of their high-value customers' needs. During the 1980s, British Airways transformed itself from a "bloody awful" transportation company to the "world's favourite airline".

Prices

Frequent travellers value the free flights and upgrades that come with their frequent flyer programmes. These became so popular that in a few years most airlines (except discount airlines) had to invest in such programmes. Customers also benefit from preferred rates with their favourite airline's partners.

Convenience

British Airways observed and listened to its customers and launched innovative and useful services, responding to the simple needs of business travellers, for example. These included a telephone check-in option, priority check-in and boarding, and faster immigration clearance, to name but a few.

Information

Customers now have access to more timely and accurate information through interactive voice response systems and an efficient customer service centre.

Recognition

Frequent travellers receive highly personalised service in recognition of their business. This includes a personal greeting and free access to VIP lounges.

British Airways has established direct communication channels with its customers. The Customer Service Department resolves 80% of all complaints within three days. With on-line access to all relevant customer and flight information, agents are empowered to offer immediate compensation to customers over the phone. Customers feel that they are recognised for their patronage and become more loyal. Over 80% of customers who filed a complaint indicated they would fly British Airways again, up from 40% in 1993.

Telecommunications service providers offered similar value, with, for example:

- Fast and accurate access to information through dedicated representatives;
- Direct access to multilingual representatives for recent immigrants;
- Unique services for specific customer segments with particular needs.

Financial services companies are able to anticipate customer needs by managing their customer life cycle. A US insurance company tracks specific events in the lives of its customers, such as moving house, and is therefore able to anticipate their needs and give them professional advice. The company designed a sophisticated information system enabling each highly trained customer service representative to access all relevant information on each customer. By knowing their customers' personal situations more precisely, these representatives become counsellors from whom customers seek advice. The company built trust in the consumers' minds and achieved an impressive 98% retention rate.

By placing their customers at the centre of their strategy, these companies were able to identify new opportunities to create value for them. By managing comprehensive customer information in real time, they were then able to respond to individual needs.

3.2 Using information has created value for the industry and the companies in it

Information-based competitors create value in several ways.

- They usually increase their customers' loyalty with attractive loyalty programmes. Once they have secured their highest value customers, they build exit barriers by customising and improving service, by increasing the complexity involved in switching to a competitor (bundled products or services by banks or telecommunications companies) or by preventing defection ("winback" programmes by telecommunications companies). They use their information advantage to identify opportunities and tailor their communication to the individual's needs, which competitors cannot do as precisely.
- They deepen their understanding of their customers continuously. This continuous customer discovery highlights opportunities to sell new products or to identify emerging needs.
- By managing their customers' life cycles more accurately (customer acquisition, retention, penetration rates and costs) they improve their economics (see chart below).

Companies that have participated in the information revolution have increased their customer retention (by over 20% for financial services or telecommunications services providers), acquired new customers at lower costs (up to 50% lower than in the past), and increased their share of their best customers.

Examples of value creation in Financial Services and Telecommunications Services

	US financial services providers	Major telecom services providers
Customer retention	25% above average	20% above average for high-value customers Win back rate: x4 -30% in cost per winback
New customer acquisition	+50% in response rates	15% higher hit ratio
Acquisition costs	30-50% below average	-50%
Cross-selling	50% above average Relationships with high-value customers: x2	Additional services subscription through targeted counselling
Source: BCG experience and database		

These measures have translated into a direct impact on the bottom line. British Airways' revenues and profits increased on average 10% per year from its privatisation in 1987 to 1994, making it the world's most profitable airline. The reorganisation around the customer was a key component of this success, along with the cost savings associated with the airline's restructuring.

3.3 First movers have been followed rapidly by the whole industry

In all cases pioneers have been followed rapidly by their competitors.

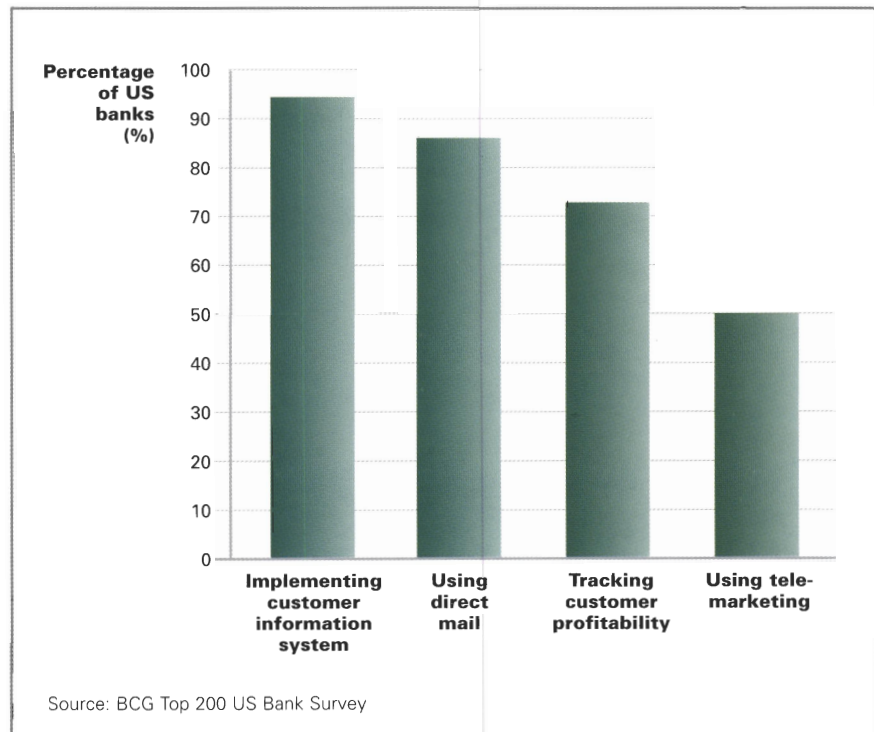
Since the introduction of the first frequent flyer programme by American Airlines in 1981, all major US and European airlines have followed with the exception of discount airlines. Air miles are no longer a differentiating factor. However, using customer information collected from the programmes has become a new source of competitive advantage.

A similar trend has been observed in other industries:

- Today over 80% of US banks are using direct mail, and 70% track their customer profitability (see chart).
- All major mail order companies target their customers on the basis of their profile and their previous purchases.
- All major US telecommunications service providers are also leveraging their customer database to retain customers and sell them additional services.

First movers have been followed rapidly

Illustration: Financial Services



3.4 The transformation goes through three stages

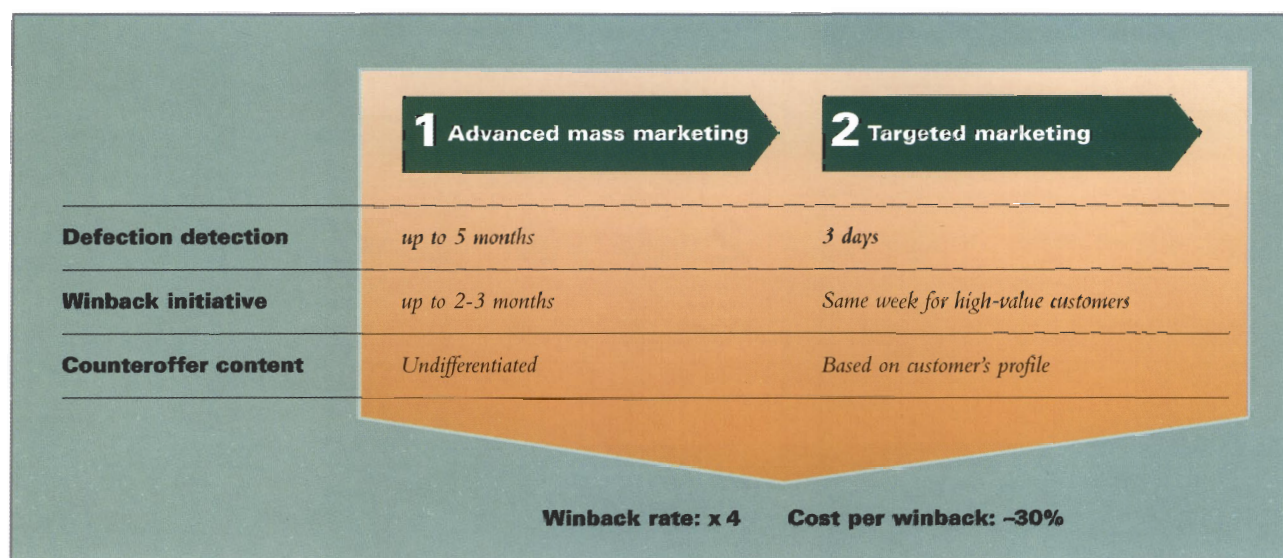
The transformation is a long but progressive process.

Consider the telecommunications service industry and the residential long distance market in the US.

The industry started to evolve with two major stages:

- **Advanced mass marketing:** after deregulation in 1984, companies started to use their customer database to upgrade their commercial strategy. Direct promotion of services, basic loyalty programmes, and undifferentiated winback programmes were launched. There was very little targeting at this stage. Companies were simply accessing their customers directly.
- **Targeted marketing:** providers started to differentiate in the way they treated customers, with targeted promotions, differentiated winback offers, and different levels of service (with dedicated representatives, for example) depending on the customer's value.

Positive results were achieved.



The first two stages improve the efficiency of marketing tools Illustration: Winback programme at a telecommunications service provider

However, targeting customers comes up against limits when conflicts of interest arise within the organisation. In vertical organisations, the norm for most companies, product and service managers focus on their area of responsibility. No one is in charge of the customers and their needs across the company.

For example, in the US telecommunications services industry the calling card product manager was responsible for the sales and profitability of his product, regardless of other services customers subscribed to. (US calling cards are usually referred to as charge cards in Europe.)

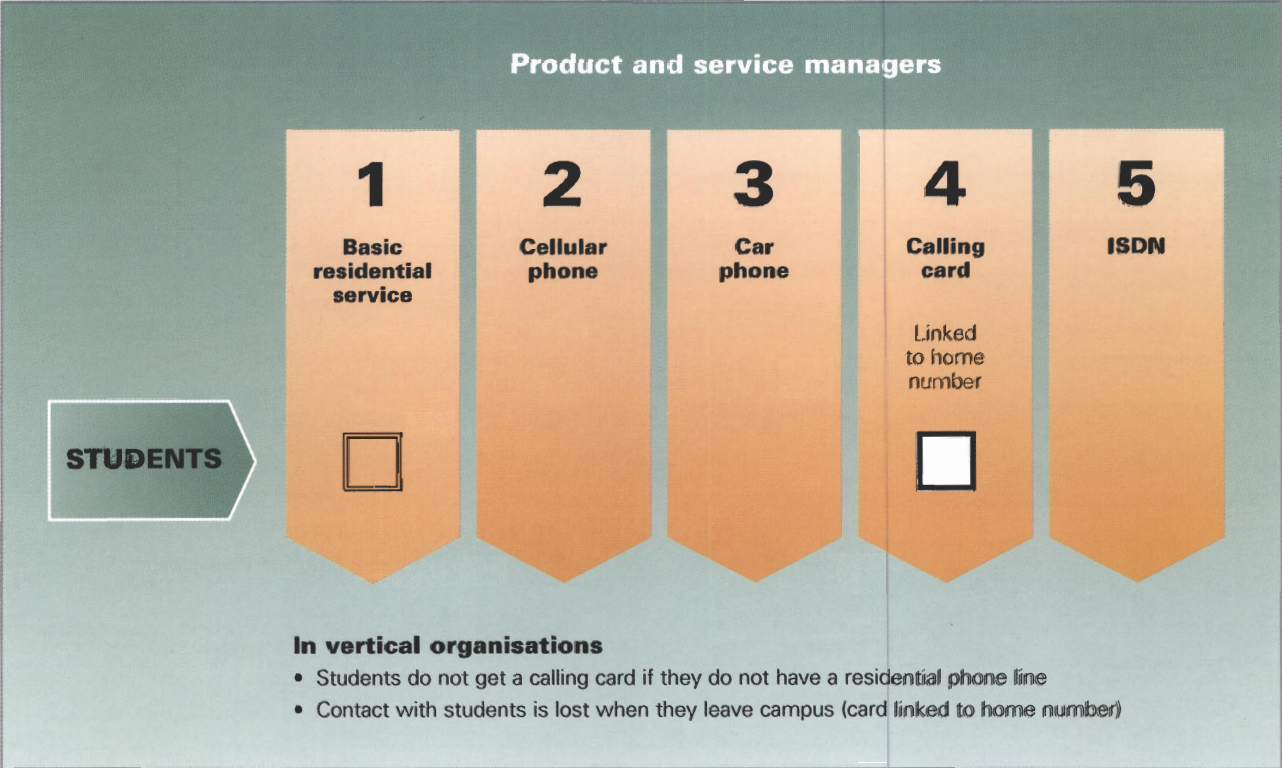
A calling card is linked to a home phone number. But students, who are a fairly low-value customer group, do not necessarily have a home phone number on campus, so they cannot get a calling card. If they do have a residential line and a calling card, the company loses track of them when they graduate, since the card is linked to their campus line. The risk of their signing up with a lower-priced competitor is high, which represents a major revenue loss for the company, since after graduation students become extremely valuable customers.

For the calling card manager, students were never a priority. Nobody in the organisation really paid attention to their specific situation.

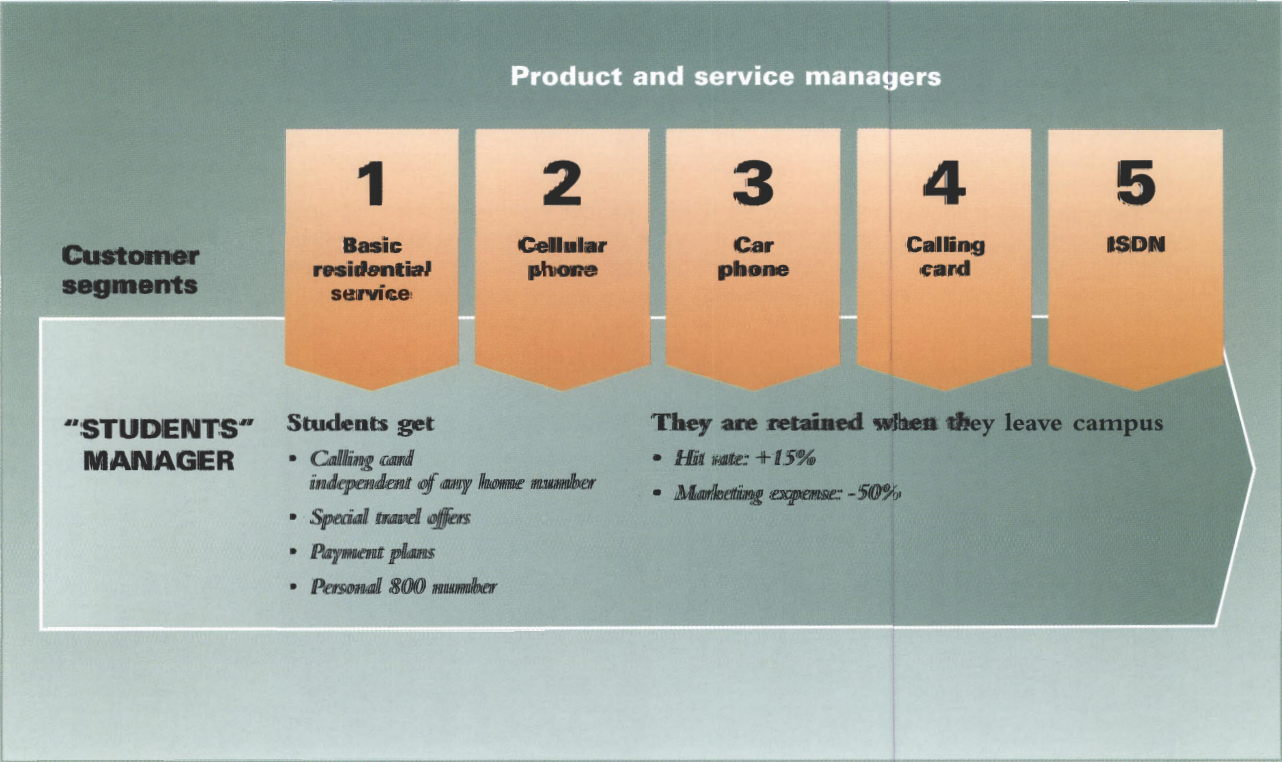
Recognising that different customers have different needs, one of the players in the industry realised the value of building a sophisticated customer segmentation based on customer profiles as well as behavioural attributes. The customer database was the primary source of information for the segmentation. The company spent three years establishing and fine-tuning its segments.

It went further by creating customer segment managers who were in charge of developing specific segments. Students were one of these segments.

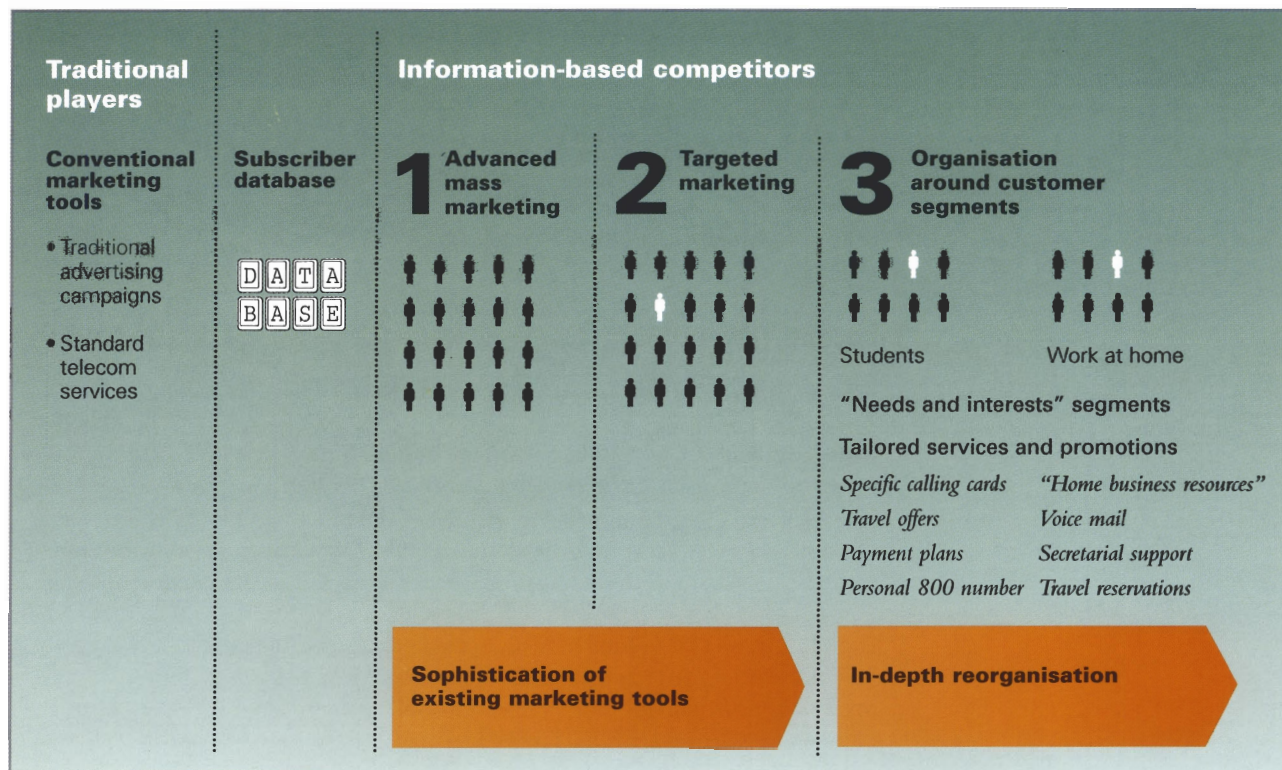
Reorganising around the customer: Telecommunications services



By creating customer segment managers, telecommunications companies created new business opportunities and increased customer loyalty



Telecommunications services went through three stages



After examining the students' needs, the students manager decided to create a new product: a calling card independent of any home phone number. All students could now get cards.

The company exploited the opportunity to secure the students' business by purchasing student lists from universities. By offering them the new calling card, they could avoid the graduation hurdle and the risk of losing the young graduates.

To reinforce the relationship, the company offered additional targeted services, like special travel offers, or flexible payment plans, as well as a personal toll-free number enabling students to call their parents and charge the call directly to their parents' bill.

The company increased its students' conversion rate at graduation by 15% and decreased its marketing expense by 50%.

Other segment managers identified other new service opportunities, like business and secretarial services for professionals at home.

The most successful innovations, like the student calling card, were later offered to other customers.

These examples illustrate the quantum-leap improvement in going to the third stage: *organising around sophisticated customer segments*. Whereas the first two stages are about improving existing marketing tools, the third stage is about *deeply reorganising the company and its processes*. Not only are customers' specific needs and dissatisfactions identified but the organisation gives itself the tools to meet those needs.

Leading airlines and financial services providers went or are going through the same stages.

3.5 Using information requires the development of new skills

Most companies either have a strong product culture or a strong mass marketing approach. Switching to a customer marketing logic means building new skills and upgrading analytical power. Marketers now need to answer questions like "Who are my best customers?", "What is their consumption pattern?", "What are the unsatisfied needs for each customer segment?".

Building these skills requires hiring people from outside as well as major internal training investments. British Airways hired 50% of its senior marketers from fast-moving consumer goods or consumer services companies, starting with Sir Colin Marshall.

3.6 Using information has a major impact on organisations

The first two stages of the transformation require only limited or departmental organisational changes.

Companies start to develop their mass marketing, usually with loyalty programmes and direct marketing initiatives like newsletters. Little changes in the organisation.

When they start to explore their customer data, they realise the value of targeted marketing. Loyalty programmes become more sophisticated, and communication and pricing are differentiated for different customer groups. Skills need to be significantly upgraded: programme managers, analysts, and superior customer service are required.

Mail order companies have built these targeting capabilities. For each new product launch, teams of analysts test the product on a customer sample, say 1,500 households, analyse the response rates, and identify the key purchasing drivers by conducting statistical analysis on more than 500 variables. They establish a customer segmentation based on the likelihood of purchase and apply the relevant criteria to the whole database, which gives them accurate sales forecasts and a list of target customers.

Their approach starts with a given product, however, for which they build a one time customer segmentation. They have not yet reached the third stage, in which products and services are designed for the key customer segments.

In the final stage, the whole organisation needs to consider the needs of each customer segment at each stage of the consumer experience. The company needs to satisfy better each individual segment rather than upgrade a uniform offer to all customers. Products, services, pricing, and communication are then tailored to each segment. A permanent dialogue reinforces the relationship with the customer. At this stage, the company goes through a deep reorganisation. Customer segment managers control the whole experience of their customers. New products and services are developed to serve specific segments' needs. All levers and incentives in the company are aligned with the customer segments.

Companies that make this step undergo major organisational changes. They usually adopt a matrix structure, adding customer marketing or customer segments to the traditional product and geographic dimensions. For example, a leading mutual fund company created customer segment departments while retaining its product marketing department. The former manage the current customers and develop the direct marketing strategy, while the product marketers develop new product ideas and manage new customer acquisition.

New positions are created: a vice-president for customer satisfaction at a telecommunications service provider, a customer loyalty director at a mail order company.

Changing the organisation focus requires the alignment of objectives and performance measures with the new strategy. Traditional outcome-focused measures must be combined with customer-focused measures.

A major US insurance company relies 60% on customer service quality measures and only 40% on efficiency to evaluate its performance. Customer-service-based measures are also used at British Airways.

Implementing these new organisational models completely changes the structure, the processes and even the culture of companies. After three years, a telecommunications company is still fine-tuning its processes. Retailers that choose to follow this route should expect a long-term effort.

3.7 Understanding customer needs is a continuous process

In general, mining the information base is a continuous process. The first analyses hardly scratch the surface of customer understanding. In addition, customers and competitors are continually changing. The most advanced companies have set up permanent processes to develop their understanding of their customers. These include:

- Channels for continuous communication with customers (British Airways' complaint centre, for example);
- Customer satisfaction measures;
- Continuous training programmes (skills upgrading).

3.8 Using information transforms the relationship with the customer

Even in industries with a low emotional content in the relationship with the customer, the most advanced competitors have achieved customer bonding, the highest step in the customer loyalty ladder.

Ritz Carlton guests are very loyal to the chain because they know that the company systematically tracks their habits and preferences in all its hotels and that it is organised to deliver superior service consistently. The company has managed to build a personal relationship and to some extent an emotional link with its customers.

3.9 The more favourable the economics, the earlier the move to information usage

Structural situations vary across industries. The information lever is more powerful or economically more adaptable in some industries. Industries with the highest potential for value creation, the least complexity, and the lowest costs of implementing and running information-based initiatives have started first.

Airlines first began using customer information in the early 1980s. The economics were very favourable:

- Airlines' margins are generated by a limited number of high-value business travellers;
- Access to these travellers' names is easy to obtain since reservations are always linked to a traveller's name;
- Offering future free tickets or upgrades does not represent a huge up-front investment, especially when capacity utilisation is low.

Today most airlines have frequent flyer programmes. The most advanced have not only increased the loyalty of their customers, but have also built a sustainable competitive advantage through a deeper customer understanding and superior services tailored for their high-value travellers.

Telecommunications services and mail order followed a few years later. Their absolute margins on their highest-value customers were lower than those of the airlines.

The sources of value creation and the implementation costs vary across industries. They determine the speed of the transformation.

Most of the value created by airlines came from increased traveller loyalty. The largest share of the costs were the incentives (the free tickets and upgrades). The relationship between free tickets and loyalty was fairly straightforward.

In financial services, a large share of the value comes from using the customer relationship to sell additional high-margin products or services. This implies a very deep understanding of customers. The largest part of the costs are operational and information technology costs. The complexity of integrating different information systems and reorganising processes around the customer is much higher. The number and the complexity of the products and services offered are also higher. This explains why the transformation will take more time in financial services.

Nonfood and food retail should follow shortly.

3.10 The transformation invariably takes years

The transformation always takes time. Complete migration can easily take ten years and more when complexity is high, as in financial services, for example, but the benefits of the first two stages obviously come earlier.

Mail order companies have not yet reached the third stage and telecommunications companies are struggling to fine-tune their reorganised structure and processes.

They have started to reap the substantial benefits of becoming information-based competitors, however, and they know that customer information will continue to be one of their major sources of competitive advantage over the next few years.

3.11 “Do’s and don’ts”

These industries have shown the direction to follow. A few practical and simple lessons can be drawn and should be considered by retailers.

Do’s and don’ts

Application design	<ul style="list-style-type: none">• Focus on high-value customers• Show value to the customers
Implementation process	<ul style="list-style-type: none">• Follow the three-stage approach• Start with the easiest applications• Use pilots before full-scale rollout
Organisational requirements	<ul style="list-style-type: none">• Dedicate teams• Upgrade skills• Empower employees who interface with customers• Align measures with objectives
Legal requirements	<ul style="list-style-type: none">• Go beyond the legal requirements• Establish an ethical code
IT requirements	<ul style="list-style-type: none">• Build a comprehensive central database• Enable access to information at different levels of aggregation within the organisation

4

The revolution is starting in retailing

Chapter Synopsis

- **Using information is becoming a major opportunity in retailing**
- **Using customer information in retailing will create value for customers along the price, information, recognition, convenience, and product choice dimensions**
- **Retailers and suppliers will benefit from increased customer loyalty, deep customer understanding, and improved business economics**
- **The economics are less favourable in retailing than in other industries. The database needs to be built and is complex to manage: it must encompass a larger share of the customer base and consolidate huge amounts of data coming from various sources. Commercial risks linked to customer differentiation and low margin levels may limit the choice of applications**
- **Nevertheless, the high grocery spending per customer makes customer-information usage attractive in retailing**
- **Results achieved by pioneering retailers are quite encouraging, but experience underlines the financial risks linked to the transition phase: the costs of incentives offered to customers for access to their information must be minimised while incentives are made attractive enough to reach the targeted population**
- **Like other industries, retailing will go through three transformation phases: after having optimised their operations and built their customer database, retailers will improve their customer targeting efficiency. The final stage will be to reorganise the company around customer segments**
- **This process will take time and results will vary widely, depending on markets and retailers' specific conditions**



4.0 Using information is becoming a major opportunity in retailing

Conditions now exist for retailers to follow other industries in using customer information.

Several major environmental changes foster information usage:

- Decreasing information technology costs;
- Customers accustomed to Segment-of-One Marketing®;
- Threats from electronic commerce and specialist retailers.

Decreasing information technology costs

Technology now makes it possible to manage large databases at an affordable price. Computing costs typically decrease by an average of 20 to 30% each year. Data storage and processing are becoming affordable. Software packages are now available to exploit customer data. Most information technology suppliers, whether of hardware, database management systems, software, or middleware, are investing to develop their data warehousing capabilities and product lines. They consider retailing one of their major targets.

Customers accustomed to Segment-of-One Marketing®

Customers are increasingly willing to share information about themselves. They have experienced the information revolution in other industries and understand the value they can derive from it. Consumer focus groups revealed that consumers expect special treatment in exchange for giving retailers access to personal information. In particular, they seek relevant information, advice, and recognition.

Threats from electronic commerce and specialist retailers

Home shopping and electronic commerce are just around the corner. Customers have discovered home shopping with Telemarket or James Telesuper in Europe and electronic commerce with Peapod in the US, which offers real value for certain segments of customers. Peapod manages to retain 80% of its customers, and thereby captures them from traditional retailers.

Specialist retailers that target specific customer segments (e.g. Petsmart) or specific product categories also represent a major threat.

Established retailers know that they need to react quickly to these external competitors.

Finally, information has become a strategic priority in food retailers' efforts to differentiate themselves from competitors.

In most countries the food retailing environment is becoming more structured. Most retailers have reached or are reaching critical mass. They have increased their purchasing power and little competitive advantage will derive from reinforcing it. Opening new stores is increasingly difficult given the high density of food stores in Europe and the strict local regulations.

**Using information
creates value for the
customer in retailing**

At the same time, retailers have focused their commercial strategy on price. Once the industry becomes more structured, there is little advantage in continuing to compete on price, which decreases the return for everyone in the industry. Instead retailers need to differentiate themselves on other factors. In addition, conventional marketing tools have become less cost-effective, on both the supplier and the retailer side.

Using information reveals many differentiation opportunities.

Most European and US retailers have experience in product scanning, data treatment, and, to some extent, category management. The next stage is to integrate customer data and identify opportunities to expand product ranges and services.

4.1 Using information creates value for the customer in retailing

As in other industries, using information in retailing creates value for the customer. Focus groups confirm that consumers recognise this value. In particular, they are familiar with the benefits offered by all major frequent shopper programmes.

Loyalty programmes

“With my points at Safeway I can get free bubble bath that I would not buy otherwise”

Cheques

“As they know me, I can write cheques more often and with a higher amount than somebody they don't know”

Self-scanning

“I think it's fantastic; you do not have to unload and load your cart again and you have an idea of how much you're spending”

Cliplless coupons

“Since I've gotten the card, redeeming coupons is much faster and more convenient than before”

Source: Focus groups, interviews

Consumers get more relevant information, their loyalty is recognised and financially rewarded, and their shopping experience is enhanced through multiple services. New products are better adapted to their specific needs. And by giving permanent feedback they reinforce the relationship and the dialogue with their preferred retailer.

Many of these benefits have been detailed in previous studies on customer loyalty programmes.

Information

Instead of flooding customers' mailboxes with standard leaflets, retailers who use customer information are able to send targeted mailings that create some value for the individual customer.

Tesco has developed five versions of its Clubcard magazine which correspond to a basic segmentation of its customer base: cardholders over 60 years of age, between 40 and 60 (without family), between 20 and 40 (without family), families, and students. Some articles are specific, others are published in all versions. Yet they differ in wording and illustrations better to fit the tastes of the various customer groups. The coupons enclosed with these quarterly magazines also differ by group.

Cofinoga, which manages more than 3.7 million credit cards for about 70 retailers in France, issues a personalised magazine for its premium cardholders (Cofinoga Plus card). Three of the 20 pages of the magazine are tailored to the customer's specific profile or situation. For example:

- New cardholders are welcomed by a special introduction in the newsletter;
- Customers who have bought much less than usual in the most recent period are offered free phone counselling services;
- Cardholders who subscribe to the Points Ciel loyalty programme (free airline tickets) are reminded of rewards already earned.

Delhaize sends its Delhaize Plus programme members electronic mail messages to remind them when new information corresponding to their declared interests is available on the Delhaize Web site (information about the programme, current offers on cultural and leisure events, etc.).

Recognition

Shopping in supermarkets remains a very anonymous process. Focus groups regularly confirm that many loyal customers are frustrated when they are not recognised as such. They usually are not asking for better prices or services. They would like some personal recognition, and most supermarkets are unable to identify their customers. Loyalty cards make it possible to demonstrate this recognition. Tesco invites its best customers to special events; a US retailer organises a special contest among its store managers to identify their top 50 customers and call them by name.

Convenience

Multiple service opportunities have been identified by foodstore chains and are currently being implemented or tested. Many do not require any information on customers, but some exploit customer-specific information and create tangible value for customers.

SuperMarkets Online, a subsidiary of Catalina Marketing, gives access at home through the Internet to weekly promotions offered by 11 retailers (Albertson's, Food4Less, Lucky's, Safeway, Vons, etc.) and partnering suppliers. The millions of monthly new users can print the selected money-off coupons and add the ingredients in the suggested recipes to their personalised shopping list.

Vons and Ukrop's, like many US retailers, offer clipless coupons with their loyalty programmes (Vons Value Programme and Ukrop's Value Card), so frequent shoppers do not need to spend hours cutting coupons to get their discounts.

Roundy's (Milwaukee, WI) has installed coupon printing kiosks at the entrances to its 85 stores, so that customers do not have to remember to bring their coupons from home and can start shopping with tailored promotions.

Colruyt offers customers the option of ordering meat by phone and picking it up at the store, instead of waiting in the queue.

Price and rewards

Loyalty schemes usually offer cash rewards for in-store purchases (Tesco, Sainsbury, Delhaize, etc.), gifts (Superquinn, Delhaize, Casino, etc.), exclusive product promotions (Ukrop's), or affinity discounts (Safeway).

Product offering

So far most retailers are tailoring their product offerings and their merchandising to the demands of their local shopping areas. Retailers will increasingly adapt their offerings to the needs of their key customer segments.

Evolution of the customer-retailer relationship

The relationship between customer and retailer is becoming more direct and new opportunities to communicate are being developed. In addition to direct communication at the point of sale, customer service centres or complaint centres maintain a permanent feedback channel. Ukrop's has set up a toll-free phone number to handle complaints about wrongly packed items.

4.2 Using information creates value for retailers and suppliers

Using information allows the creation of value across the value chain not only for consumers, but also for retailers and suppliers. Retailers benefit from the increased loyalty of their high-value customers, develop a continuous and deeper understanding of these customers, and improve their economics by gaining a clearer view of the activity and increasing the return on their targeted initiatives. They can also enlarge their customer base by acquiring new high-value customers with targeted value propositions.

As in other industries with loyalty programmes, retailers build exit barriers for their customers. The immediate impact of the programme needs to be reinforced by customised assortment, pricing, communication, and services by segment.

Permanent access to customer data enables retailers to discover their customers continuously. Two European retailers have appointed customer segment managers to analyse the behaviour and the needs of their highest-value customers. Superquinn organises exclusive singles evenings and observes what single people buy so it can understand their needs.

Information can contribute to reducing operating costs by giving a clearer view of the activity. Staffing can be planned according to the expected workload (meat preordered by phone, for example, at Colruyt). Improving targeting accuracy may also decrease advertising and promotional costs.

- Gregerson's Foods claims a 10 to 20% reduction in its advertising costs by switching from broadcast to targeted advertising.
- The use of Catalina's targeted coupons may reduce by two thirds the customer acquisition costs.

Retailers can also improve their margin mix by increasing the share of their private-label products. Both customer understanding and targeting capabilities developed through the Vons loyalty programme contributed to increasing the share of private-label products from 13% of sales in 1993 to 20% in 1995.

Suppliers partnering retailers can obtain crucial data on their ultimate customers. Working together enables retailers and suppliers better to fulfil the needs of their high-value consumers.

4.3 Economics appear less favourable than in other industries

Retailing faces more implementation hurdles than other industries. Overall, the economics appear less attractive in the short-term.

First, retailers need to build a customer database, whereas telecommunications services providers and banks already know their subscribers. Building the database implies significant costs: high costs of incentives for the customer to adopt the card (1% of sales in some cases) and additional IT costs.

Secondly, the share of high-value customers is lower than in other industries. Food retailers' top 30% of customers typically generate around 70% of revenues. The top 20% of telecommunications service providers' customers generate up to 80% of their revenues. Therefore, retailers need to track a wider share of their customer base to maximise the financial impact of their initiatives. This implies high penetration objectives (60 to 70% of sales minimum) for loyalty card programmes.

Such penetration levels allow them to switch from broadcast to direct marketing and save part of the communication expenses.

Managing information is much more complex in retailing. The amount of data is greater than in other industries by several degrees of magnitude. There are multiple information sources, possible users, and potential applications.

Margins are low, except for private-label products, which limits the bottom-line impact of incremental sales.

Using information presents substantial commercial risks. Unlike telecommunications services, where providers can discreetly treat different customers very differently, the shopping experience is highly visible and customers usually react badly to visible discrimination in the store. Focus groups have highlighted the social role of supermarkets, and retailers prefer to move slowly on these sensitive issues. Alienating customers and public opinion would be unacceptable. Erring on the safe side can limit the potential benefits.

Given the high spending per customer and the very large customer base, however, using information is still attractive. Retailers have much higher revenues per customer than manufacturers do, and can economically target individuals.

Getting the full benefits of using information, however, will take more time in retailing than in other industries.

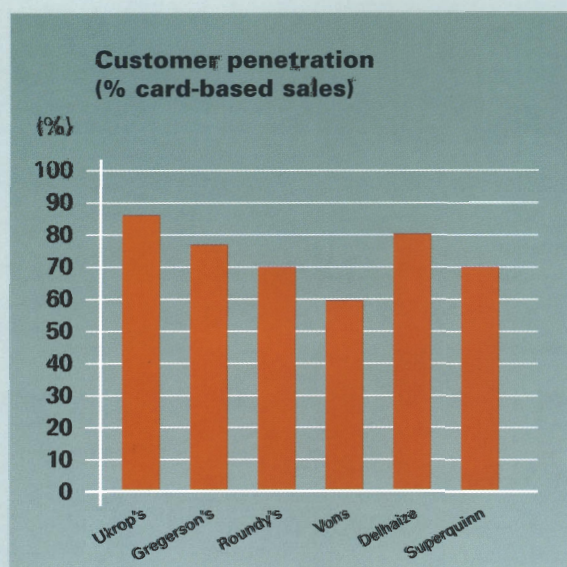
4.4 First results are encouraging

Retailers are still at an early stage of using information.

The use of product and store information is the most advanced application. Retailers are improving their operational performance, sometimes in collaboration with their suppliers. Many have engaged in upgrading their category management.

The use of customer information is increasing. Industry expert Carlene Thissen believes that the number of US retailers offering electronic instant promotions will grow rapidly, from 27% in 1996 to 50% in 1998. Loyalty programmes are developing fast in Europe and some have reached very high penetration rates.

Loyalty programmes are developing rapidly



Selected recent programme introductions in Europe

	1992-94	1995	1996
UK		Tesco (95)	Sainsbury's (96)
		Safeway (95)	Somerfield (96)
			Asda (test)
France	Casino (92)	Continent (95)	Cora (96)
	Monoprix (94)	Mammoth (95-97)	System U (96)
			Match (test)
			Leclerc (test)
			Comptoirs
			Modernes (test)
Others	Delhaize (92-94)		Standa (97)
	Superquinn (93)		

65% of US retailers have a relationship/database programme ~ 15% are planning one

Source: press search, interviews, 1994-DMA survey, BCG estimates

Hundreds of innovations are being tested.

Little comprehensive information is available, since most programmes have been launched in the last two or three years and applications are usually tested progressively in pilots. No single application has proved to be a "silver bullet". Instead value creation comes from a well-designed package of applications and services. Most experiments have focused on the "easiest" initiatives, like direct mail promotions or basic purchasing pattern analyses (Recency Frequency Spending). More advanced applications are often considered medium-term next steps: namely, cross-selling and new product or service development for specific customer segments.

The most successful experiments have been carried out by small, family-run retailers, like Ukrop's, Gregerson's Foods, or Superquinn. They have been followed only recently by larger chains like Tesco and Delhaize.

At this stage, becoming an information-based retailer still requires an act of faith.

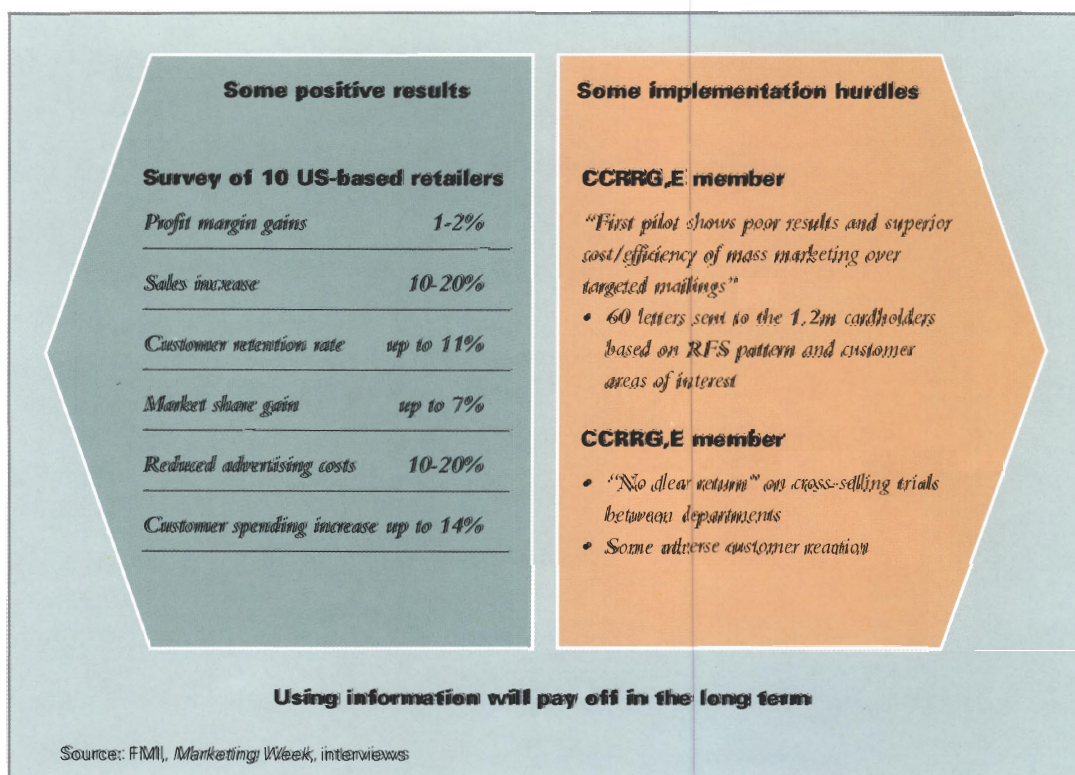
- "I just know it is profitable, even if I cannot prove it" CRRG,E MEMBER

First results are encouraging. Retailers claim margin gains (1-2%, according to a FMI survey), increased retention rates (up to 11%), reduced advertising costs, etc.

On the other hand, a few European retailers report mixed results on the effectiveness of targeted promotions and cross-selling initiatives.

We believe that ultimately such programmes will pay off.

First figures are encouraging but the transition may be financially difficult



Exhaustive analysis of customer information generates deep customer insight

Illustration:
US Retailer

However, food retailers that choose simply to follow the leaders and launch a basic loyalty programme without exploiting the resulting customer data are bound to achieve mediocre financial returns at best. Using detailed customer data is essential to uncover new opportunities, to exploit the cross-selling potential, and to bond customers through services.

A US food retailer that initiated a loyalty programme in 1996 developed deep customer insight by mining its customer information database and used the findings to challenge internal beliefs.

<i>Conventional wisdom</i>	Consumer reality
<i>"Convenience and price are the most important reasons for selecting a primary store."</i>	Quality meat and produce most important
<i>"Meat department penetration declines in higher-income stores because these shoppers eat less meat."</i>	Penetration lower because higher-income shoppers more likely to buy meat elsewhere
<i>"We don't have that many higher-income shoppers in our market."</i>	Issue is low share, not market composition
<i>"My customers are just as loyal as my competitors' customers."</i>	7% customer share gap vs. competitor worth almost 15% in meat sales growth

4.5 The transition phase needs to be carefully managed

A few retailers have tested targeted promotions with disappointing results. There are many implementation pitfalls, although a few poorly designed promotions should not discourage initiatives.

In the short-term, the retailers' challenge is twofold:

- Minimise the cost of building the database;
- Select the levers adapted to each retailer's situation.

To minimise the cost of the database, retailers should find a balance between offering attractive incentives to customers and limiting the incentives' cost. Involving manufacturers is an option, as they can finance the cost of cardholder promotions. Teaming up with partners, like nonfood retailers or other service companies, is another option. In any case the physical database should be built progressively.

Applications should also be implemented progressively and commercial risks should be limited.

4.6 Benefits vary widely, depending on market conditions and choices made

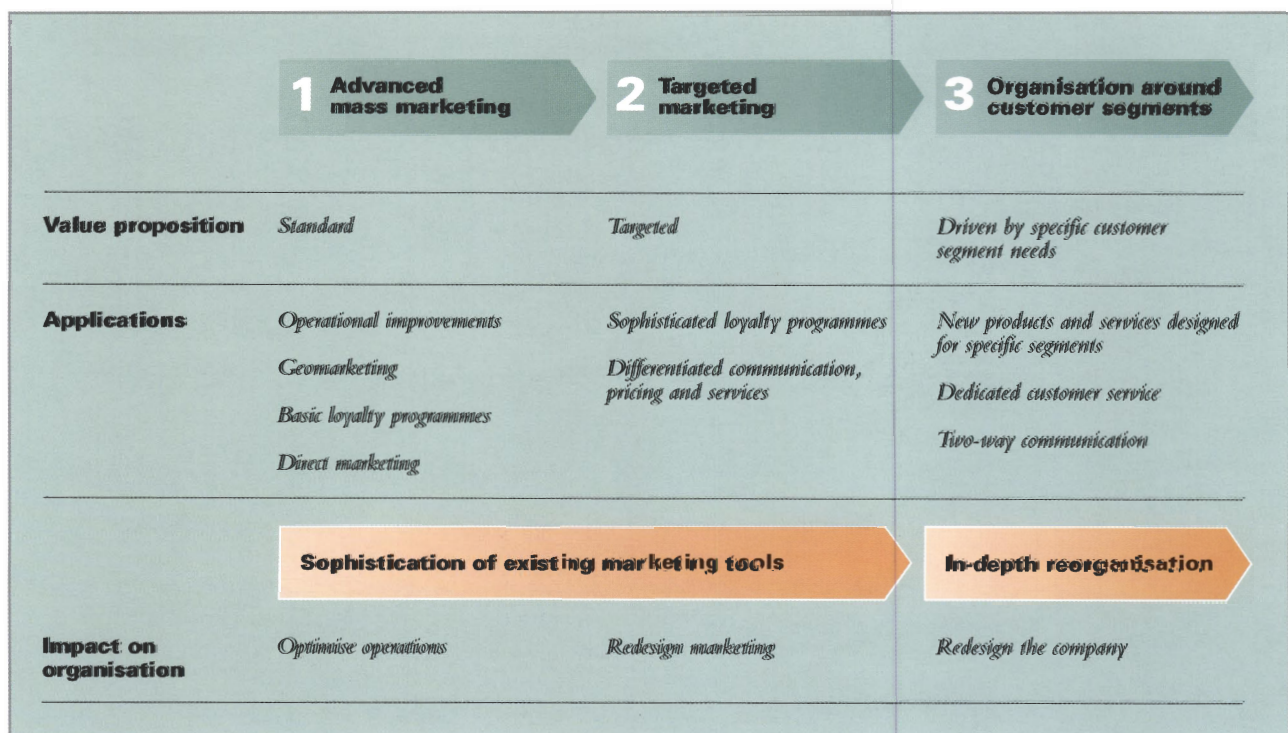
In the US, retailers without private-labels have transferred the cost of incentives to manufacturers that have substituted promotions exclusive for cardholders for across-the-board promotions. In that case a minimal sales increase allows them to break-even.

In Europe, many retailers still carry the cost of incentives (typically 1% of the card sales). In the initial phase, programmes run close to break-even and are highly sensitive to the effectiveness of initiatives. In that case a more significant sales increase or margin mix improvement is needed to recover the investment without increasing prices.

4.7 Retailers will go through the same three stages as other industries

Over the last five to ten years, most retailers in Europe and the US have focused on reaching critical mass and improving their operations. Category management, automatic reordering systems, electronic data transfers with suppliers, etc. have been the buzzwords in food retailing. More recently, retailers have introduced their first loyalty programmes, with limited targeted initiatives. This is the era of advanced mass marketing.

Retailers will go through the same three stages as other industries



Food retailing is now entering the targeted marketing era, with more sophisticated loyalty programmes and innovative targeted initiatives. As in other industries, there are many opportunities to use customer information and it will take several years for retailers to master them.

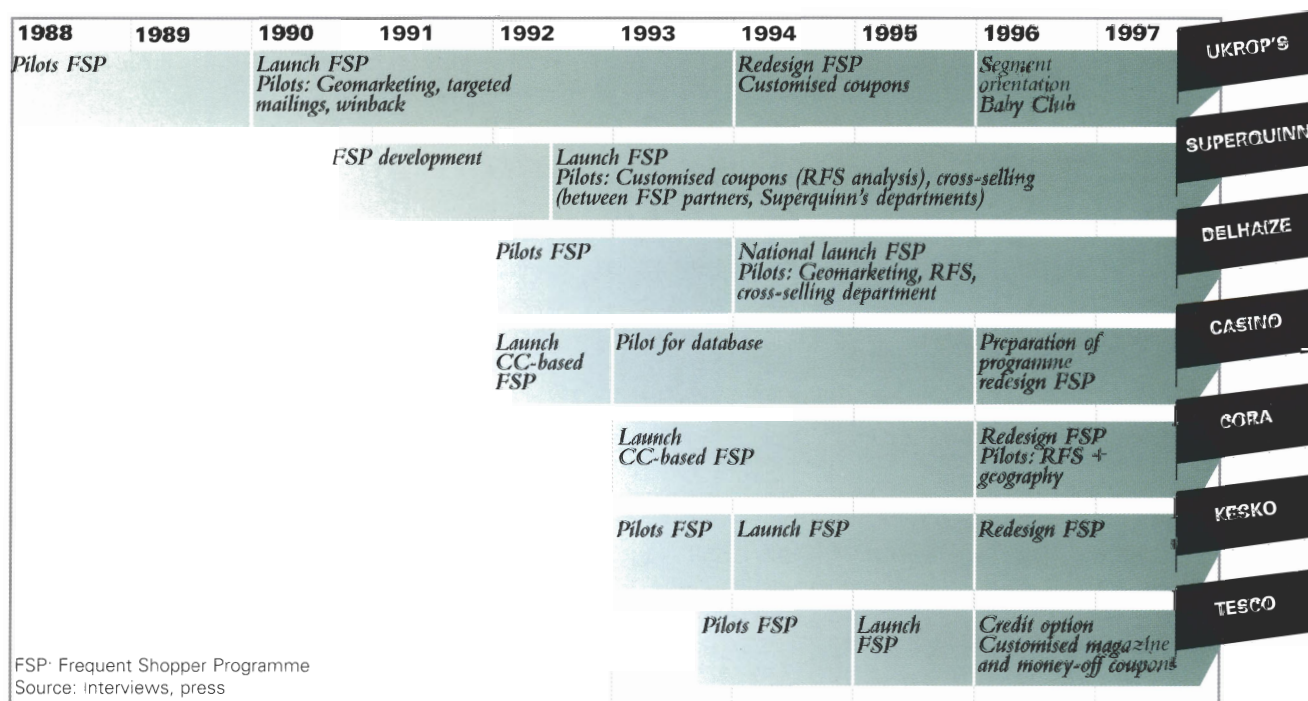
The third stage is further away. However, the most advanced chains realise that their organisations, built around categories and stores, are not yet able or willing to implement new initiatives for specific customer segments. A few visionary retailers are thinking about shifting to an empowered customer marketing organisation, as telecommunications and financial services did a few years ago.

4.8 The transformation will take years

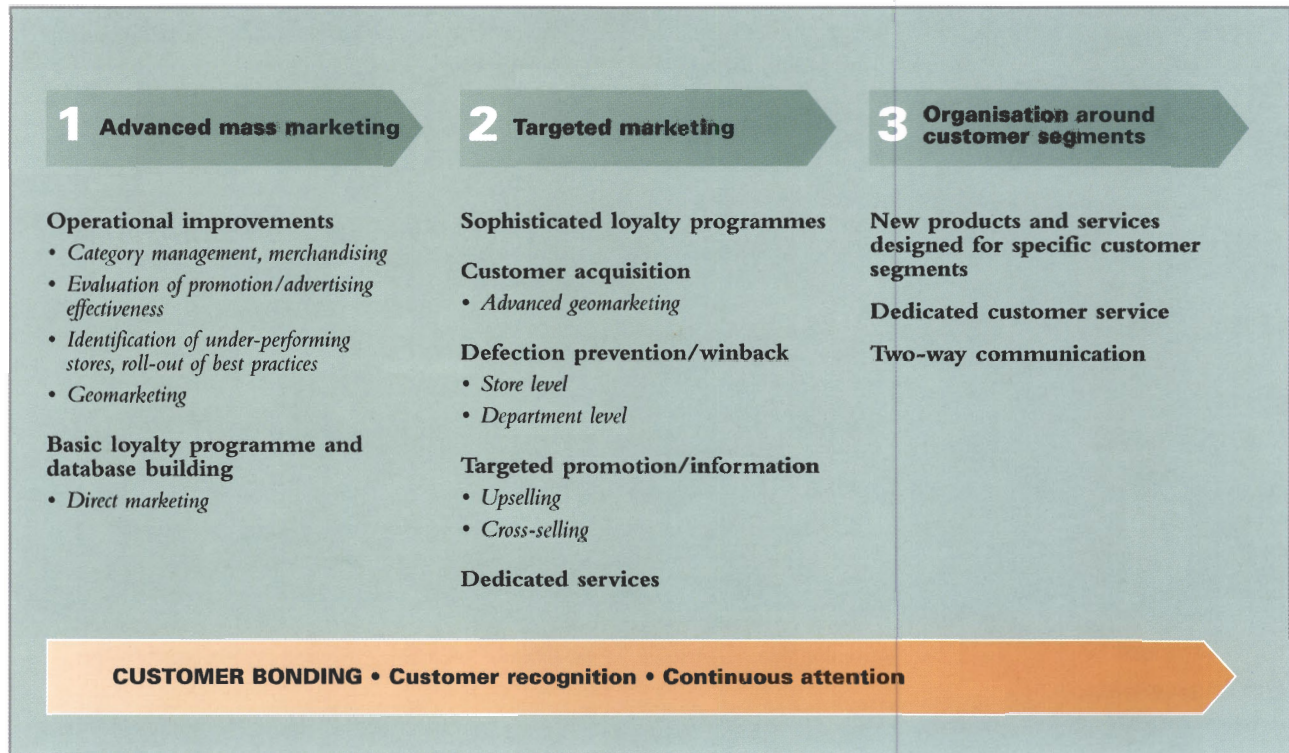
The transformation of other industries took about ten years. It is likely to take even longer in retailing given the greater complexity and the less favourable economics. However, benefits can be obtained at all stages.

All experiments took several years to develop. Ukrop's, which pioneered a loyalty programme in 1988, did not introduce its first customised coupon programme until 1994. Others that started later are still at the beginning of the second phase.

The transformation will take years



Many applications exist at each stage of the transformation



However, several opportunities exist at each stage of the transformation. Retailers can spend a few years working on these before reorganising around the customer.

5

The retailing industry will be transformed

Chapter Synopsis

- **As in other industries, full use of customer information will have major implications for long-term strategies and competitive dynamics. Quantum-leap improvements in customer understanding will contribute to building a sustainable competitive advantage for the most advanced retailers not only over their peers but also over more specialised distribution channels focused on particular customer segments**
- **Relationships with customers and suppliers will be transformed**
- **The speed and outcome of transforming into an information-based player will depend on each retailer's situation. For example, multiformat retailers will find the transformation even more attractive than those in one retailing category only**



5.0 Vision 2005

Using information will completely change the way retailers view and operate their business, from distributing packaged goods to fulfilling customer needs throughout the shopping experience and from focusing on categories and stores to reorganising around customers.

Reorganising around the customer will drastically change the way retailers view their business

Vision 2005	Today	Tomorrow
Vocation	<i>Distributing packaged goods</i>	<i>Fulfilling customer needs throughout the shopping experience</i>
Focus	<i>Product categories Stores</i>	<i>Consumers</i>
Market intelligence	<i>Heavy reliance on "standard" industry research</i>	<i>Emphasis on proprietary unique customer understanding</i>
Promotion	<i>Across-the-board discounts</i>	<i>Customised incentives</i>
Advertising	<i>Mass communication Print advertising</i>	<i>Direct marketing Multiple and interactive media</i>
Measures	<i>Sales, profit Direct Product Profitability Market share</i>	<i>Customer satisfaction Direct customer profitability Customer-share</i>
New product/service development	<i>Designed for an average customer</i>	<i>Designed for specific consumer segments</i>
Key success factors	<i>Purchasing power Operational effectiveness Store locations</i>	<i>Customer understanding Ability to design products, services, promotions to penetrate and retain high-value customers</i>

5.1 Relationships with customers will be transformed

Using information will change the relationship between retailers and their customers.

Reorganising around the customer has proved its efficiency in other industries. Retailers will ultimately follow the same path. The most advanced are now expanding their vision of the customer along two dimensions.

They are expanding their view of the shopping experience and realising that opportunities exist to create value for customers when they prepare their shopping list at home, when they go to the store, when they are in the store, and when they consume the products.

7-Eleven in Japan is expanding the shopping experience by offering innovative and valuable services such as the ability to pay utility bills at its stores.

Retailers are also managing the customer life cycle more closely, rethinking ways to capitalise on information and increase acquisition, retention and penetration of their key customers. For example, Tesco communicates with students through a dedicated Clubcard magazine according to a tailored schedule: the quarterly mailings are stopped during the summer holidays.

In the new relationship, customers and retailers have a mutual desire to share information.

5.2 Relationships with suppliers could be transformed

Using information may also change the relationships between retailers and their suppliers.

Partnership with manufacturers at each stage of the process offers significant value to both sides from sharing category expertise and a better understanding of customer behaviour and needs to designing specific products, services, and promotions.

But each retailer's situation is specific. Retailers with predominantly national brands have a vested interest in deepening category and customer expertise. Retailers concentrating on private-label have a lower incentive to co-operate with suppliers.

5.3 The revolution will have important strategic consequences

Long-term strategies and competitive dynamics will be deeply affected. Beyond the positive economic impact and the new opportunities it offers, using customer information is a unique way of competing with more segmented distribution channels, like specialist retailers (such as Petsmart) or electronic commerce.

Opportunities exist for diversified groups to leverage their data across formats or even across businesses.

Auchan, for example, could track its customers in hypermarkets, supermarkets, clothing stores, sporting goods, DIY, electronics, etc., and build commercial synergies between businesses that have very little in common today. Knowing the customer and establishing a dialogue with him or her will facilitate a much more efficient brand extension programme for retailers: Carrefour could market its new services, such as travel agencies, financial services, insurance, or catering, much more efficiently than today.

Long-term strategies and competitive dynamics will be deeply affected

"The" new source of competitive advantage

Quantum-leap improvement in

- Customer understanding
- Assortment-building
- Service design
- Customer relationships

A unique way of competing with more segmented distribution channels

- Category killers
- Electronic commerce

Long-term strategic advantage to multiformat retailers

Opportunities to leverage customer information across different businesses

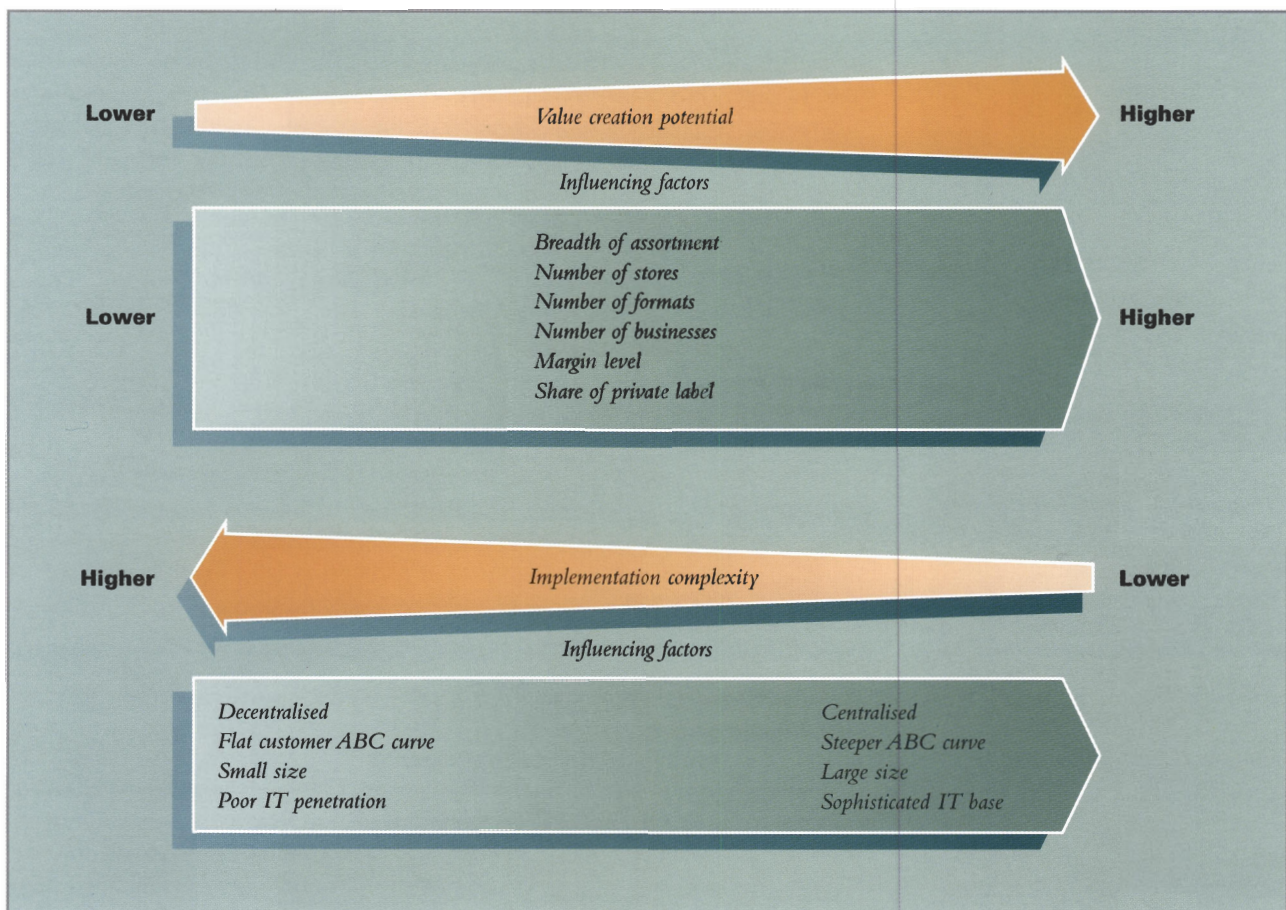
The creation of relationship marketing consortia in Australia shows that such combinations are not that far away. Two major consortia, Fly Buys and Telstra Visa, group the leading players in a few selected consumer services, such as food retailing, banks, petrol, and airlines. Each consortium offers a combined loyalty scheme.

In a very concentrated market like Australia, the incentive for consumers to be loyal to one of the consortia is very high. Exploiting customer information across so many purchasing fields gives a very complete view of customer behaviour and preferences. Consortia members can better tailor their offers and communication to customers.

Each retailer's situation is specific and requires an investigation of opportunities and economics. The value of using information varies. All else being equal, it tends to increase with the number of formats, the breadth of the assortment, and the share of private-labels. The speed of transformation to an information-based competitor also depends on each retailer's starting point in terms of customer loyalty.

Each retailer's situation is specific and requires an investigation of opportunities and economics

Some observations apply to most retailers, however. The following three chapters summarise the key practical lessons at each stage of the transformation.



6

First stage: advanced mass marketing

Chapter Synopsis

- **This first stage is essential to progress successfully into customer information usage: retailers must both improve their operations to increase the overall value proposition offered to customers and build the customer information database**
- **The loyalty programme is the preferred tool for building the customer database. The objective should be to capture at least 60 to 70% of sales with the card while minimising the costs of incentives offered to customers. The package proposed to customers should include both incentives to use the card and rewards for loyalty**
- **Many implementation pitfalls can be avoided by using store pilots, obtaining internal support of operations, and training point of sale employees**
- **European regulations concerning personal data treatment are not a real constraint on retailers' initiatives. Local marketing practices vary by country and may reduce retailers' scope for action, but minimising commercial risks with customers may lead to even more restrictions**
- **Information technology infrastructure can be built progressively by starting with pilots and using scalable systems**
- **Most experiments observed in Europe so far run close to break-even: a significant sales or margin increase may be required to cover the costs of attractive incentives**



6.0 Description of applications and information used

We characterised the first stage as “advanced mass marketing”. Marketing practices at this level still target a generic consumer with a standard value proposition.

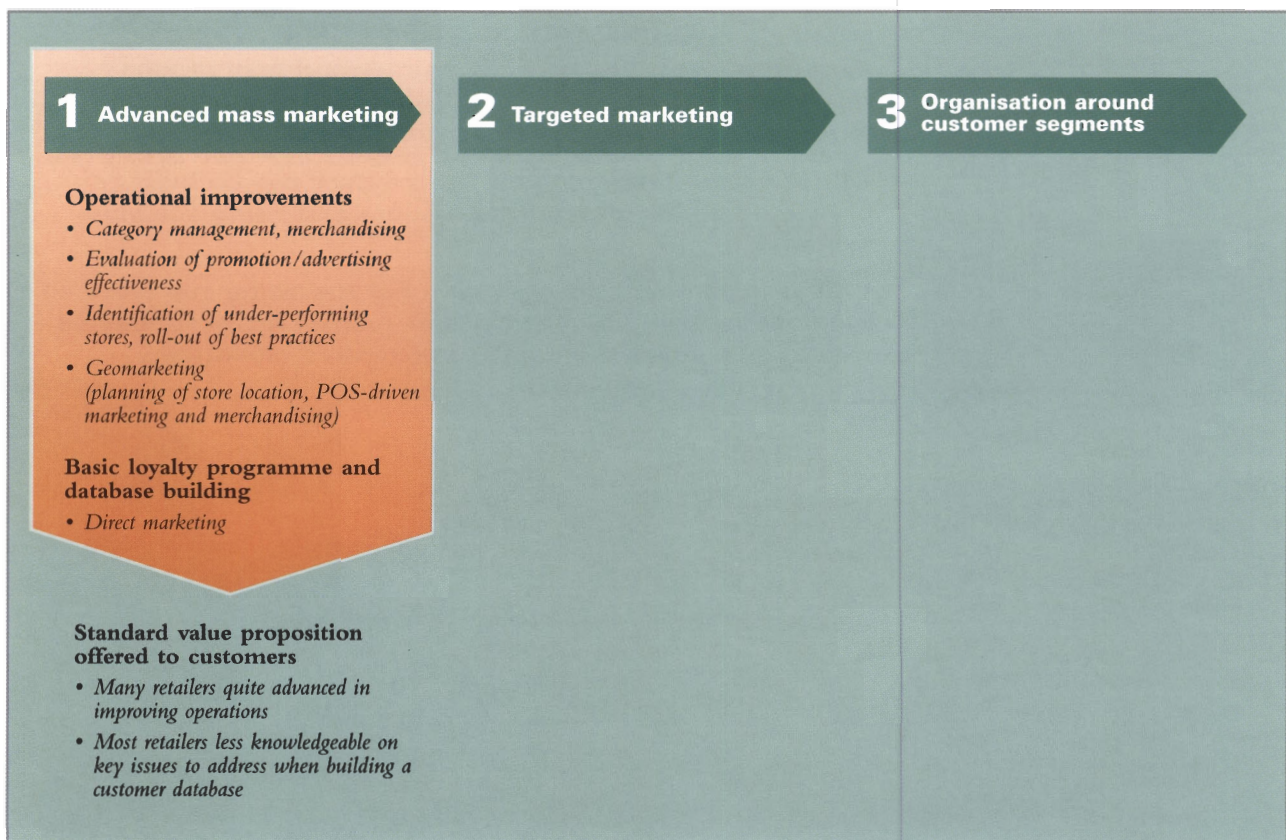
The objectives of the first stage are twofold:

- Focus on operational improvements to improve the offer and the level of service in the store;
- Prepare for the second stage by launching a loyalty programme to build a customer database.

We will not describe the numerous sources of operational improvement, since they do not require access to customer data. The largest share of their value can be achieved with product data, including basket analyses. They are a prerequisite for successful targeted marketing. Building an innovative loyalty programme and using customer information efficiently will not compensate for poor operational performance (out-of-stocks, etc.).

The objective of the first stage is to improve operations and build the customer database

We focus in this chapter on building the customer database.



6.1 “Do’s and don’ts”

Some basic rules to follow when building the customer database “Do’s and Don’ts”

Application design	<ul style="list-style-type: none">▪ Use an identification card as a penetration tool▪ Give valuable incentives to customer without endangering your economics<ul style="list-style-type: none">– Give card usage incentives as well as loyalty rewards– Do not allow partners to take programme leadership
Implementation process	<ul style="list-style-type: none">• Run pilots before full-scale launch of the programme
Organisational requirements	<ul style="list-style-type: none">• Obtain top management support• Involve operations in the process• Dedicate a cross-functional taskforce
Legal requirements	<ul style="list-style-type: none">• Pre-empt consumer fears about information usage<ul style="list-style-type: none">– Follow the legal path– Be transparent about future information usage
IT requirements	<ul style="list-style-type: none">• Go progressively<ul style="list-style-type: none">– Use scalable systems <p><i>Anticipate future needs in the system architecture</i></p>

6.2 Programme and application design

Designing the loyalty programme is a prerequisite for building the customer database. Since retailers need very high coverage of their customer base (60 to 70% of their total sales) and permanent monitoring of the customers’ purchases, the loyalty card is the most appropriate way to collect the information.

The purpose of the programme should be extremely clear and agreed upon by the retailer’s management from the start. The primary objective is to gain access to customer data. It is not to build a loyalty programme and generate an immediate increase in customer loyalty (replicable, low value added) nor to sell financial products.

6.2.1. Use an identification card

With the objectives described above, the choice of an identification card for the loyalty programme, as opposed to a payment or credit card, is logical, at least during the penetration phase.

Consumers need a clear message.

- “Do not dilute the loyalty message with financial add-ons”

CCRRG, E MEMBER

Credit-card-based programmes in Europe have failed to attract masses of customers. Historically, many retailers used them to limit their initial investment and avoid the complexity of managing a database, leaving this task to their financial partner. French retailers have used the credit card for 15 years without ever managing to reach over 15% penetration.

- *"As a penetration tool, credit cards are inappropriate, as they target only 15 to 20% of the customer base"* CCRRG, E MEMBER

In addition, customers most likely to sign up for the credit card may be the ones who need credit, and are therefore not necessarily the most attractive ones for the retailer (lower budgets seeking lower prices).

Retailers know that without 60 to 70% penetration, they will not reach their objectives.

- *"Retailers say that at least two thirds of their customers should be active cardholders to achieve satisfying results"* FMI, PLANNING A FREQUENT SHOPPER PROGRAM
- *"An early target of 50% of transactions on the card is the minimum. A true devotee of customer-specific marketing captures over 80% of transactions and over 90% of sales on his card"* BRIAN WOOLF, CUSTOMER SPECIFIC MARKETING

In contrast to the inability of French credit cards to penetrate the customer base, the introduction in 1995-1996 of loyalty cards in the UK by the leading foodstore chains, Tesco, Sainsbury, and Safeway, has been an exceptional success, with respectively approximately 8.5 million, 6 million, and 4 million cardholders.

Starting with a pure loyalty programme does not prevent retailers from offering optional financial products once they have achieved a high penetration level. These can be a source of additional high margins and of supplemental personal information on customers. Tesco successfully launched its Clubcard Plus 18 months after the initial launch of the Clubcard, with an attractive financial proposition to its customers. At that time the card had already reached very high penetration.

6.2.2. Give attractive incentives without endangering your economics

To reach the dual objectives of penetration and systematic usage, one must offer attractive incentives to join the programme and use the card.

One European and one US retailer chose to limit the cost of the incentives and offered promotions either on low-velocity products (choice of promotions controlled by manufacturers) or on a narrow range of products only. Both programmes failed to offer clear value to customers and therefore fell short of their penetration targets. They had to be modified and withdrawn.

There is no unique way to design the reward scheme. On the contrary, retailers should be creative and adapt their incentives to their own situation (national or regional preferences, consistent with retailer positioning, etc.). However, a few basic rules should be considered:

- The programme should provide incentives to use the card. For example, Somerfield in the UK gives one point for every £1 spent for baskets under £10 (five points for baskets above £10) as an incentive to present the card at every visit. Other retailers, like Ukrop's, periodically reinforce card use by offering automatic sweepstakes participation.
- Customers value a choice among cash rewards, gifts, or free services. Many retailers now offer packages. Safeway in the UK offers more than 70 ways to redeem points: money-off vouchers, free Safeway products and services (dry cleaning, nursery pass, etc.), and affinity discounts (cultural and leisure events, travel offers, home and car insurance policies). Even programmes based primarily on gifts, like Superquinn's, offer customers an alternative (money-off vouchers at Superquinn or partnering companies). Gifts, especially free travel offers, provide a dream component valued by customers beyond their financial cost to the retailer.
- Rewards must be gained within a reasonable period of time to avoid discouraging customers from using the card.
- Differentiation from competing programmes should not be based on discounts only. Retailers do not have anything to gain from a "reward war". After a few years airlines have reached more or less the same levels of rewards, recognising that free travel was becoming very costly.

Incentives can be costly. Tesco and Sainsbury offer 1% cash back on all card purchases. Several retailers claim that incentives can exceed the 1% of sales they generally forecast. Superquinn's weekly bonus points on a specific basket can be converted into a 10% discount. Ukrop's Baby Club gives a 10 dollar credit to its members each time they buy more than 100 dollars of baby products.

Incentives need to be carefully planned from the start. Stopping or decreasing rewards may be very badly perceived by customers and damaging for retailers.

- *"Once you have started, you cannot stop"* SUPERQUINN

Beyond cash or gifts, innovative services could be offered to cardholders or even to the highest-value customers. Many opportunities exist to create services throughout the shopping experience.

Service opportunities should be carefully assessed, however.

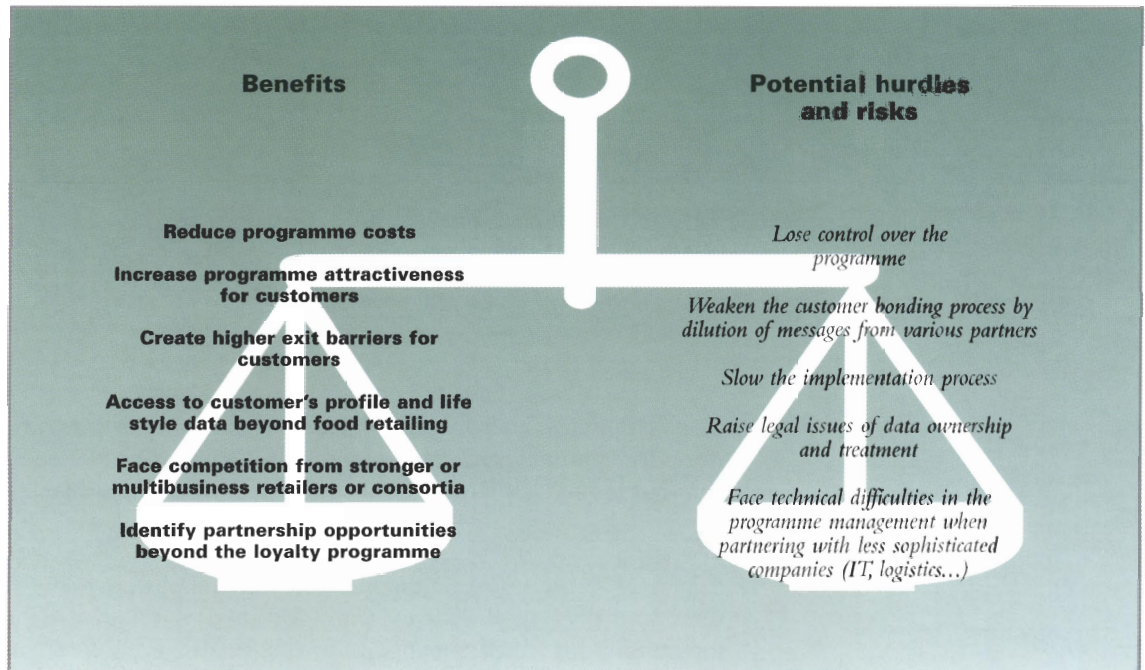
- In most cases each service opportunity creates limited value in itself. In particular, if services are not differentiated by customer group, few groups are likely to value them.
- Attractive services may not be cost-effective, especially if they have to be offered to all customers to avoid negative reactions to visible discrimination. They often imply manpower costs (valet parking and home delivery, for example) or up-front investments (interactive kiosks).

Many opportunities to satisfy customers' needs with new services through the shopping experience

Shopping event Customer needs	Preparation	Transportation	Shopping and buying	Transportation	Consumption
Prices			<i>Customised promotions (Ukrop's)</i> <i>Affinity discounts (Safeway)</i>		
Convenience	<i>Product preordering (Colruyt)</i>		<i>Home shopping (James Telesuper)</i> <i>Self-scanning (Safeway)</i>	<i>Valet parking</i> <i>Home delivery</i>	
Product offering			<i>New in-store services</i> <i>Additional products via a catalogue (Colruyt)</i>		
Information	<i>Web site (Delhaize)</i> <i>Customised magazine (Cofinoga, Tesco)</i>		<i>Interactive party kiosk (HE Butt)</i>		<i>Summary list of purchases (Spart & Store)</i>
Recognition	<i>Targeted event invitation (Tesco)</i>		<i>Personal greeting</i> <i>Follow-up after mistake (Goof Points at Superquinn)</i>		<i>Feedback channel (Ukrop's for badly packed items)</i>

- The real value will come from a well-balanced package of services, consistent with each retailer's objectives and positioning, creating goodwill at an affordable cost. They should ultimately be designed to meet the needs and interests of specific customer segments.
- A few "quick hits" should be explored in the short term. These are low-cost initiatives valued by customers, like clipless coupons, cheque authorisation, invitations to exclusive cardholder events, etc.
- Other opportunities should be tested in pilots with limited investment, in particular targeted services (Baby Club, for example).

Partnerships offer attractive opportunities but should be carefully assessed by each retailer



Partnering with suppliers, non competing retailers or services providers must be carefully considered.

Benefits from such partnerships include:

- Shared rewards costs;
- Greater programme attractiveness;
- Access to customers' profiles and lifestyle data.

Ukrop's has been working with suppliers from the beginning of its programme, transferring most of the costs of incentives to suppliers. Instead of giving cash or gifts, Ukrop's offers exclusive promotions to its cardholders. Suppliers switched from across-the-board promotions to cardholder-specific promotions.

Another US supermarket chain has recently teamed up with local community partners to launch a successful loyalty programme, offering discounts on movie tickets, money transfers, local festivals and amusement parks and other attractions.

Partnerships need to be carefully studied to avoid potential problems:

- Risk of loss of control over the rewards;
- Legal issues of data ownership;
- Technical difficulties when partnering with less sophisticated companies.

6.3 Implementation process

Launching a loyalty programme presents multiple operational and commercial risks.

Experiments by US and European retailers suggest choosing a progressive approach.

Starting with pilots before the full scale launch is the best way to test various options, fine-tune the programme, and identify potential issues.

- *“Tests, while expensive, will not break a company; but an ill-conceived plan will from an economic and customer-relationship standpoint”*

AL MALORY, SEARS BEST CUSTOMER PROGRAMME

Tesco conducted a 15-month pilot before launching its card, first in three stores for approximately three months, then in 14 stores for about a year. Sainsbury tested the SaverCard in 1995 before launching the Reward Card in 1996.

Testing or starting the programme with store employees is an easy way to train shop-floor employees and transform them into knowledgeable programme advocates. Superquinn offered premium points to its employees to motivate them to use and promote the programme and give them experience prior to the launch.

Implementation of targeted marketing initiatives is dealt with in Chapter 7.

6.4 Organisational requirements

The programme needs to be supported internally

- By top management, since engaging in a customer information-based strategy is a major decision implying heavy future investments and risks;
- By Operations, since the programme's success will depend on its penetration and therefore on the right organisation in the stores.

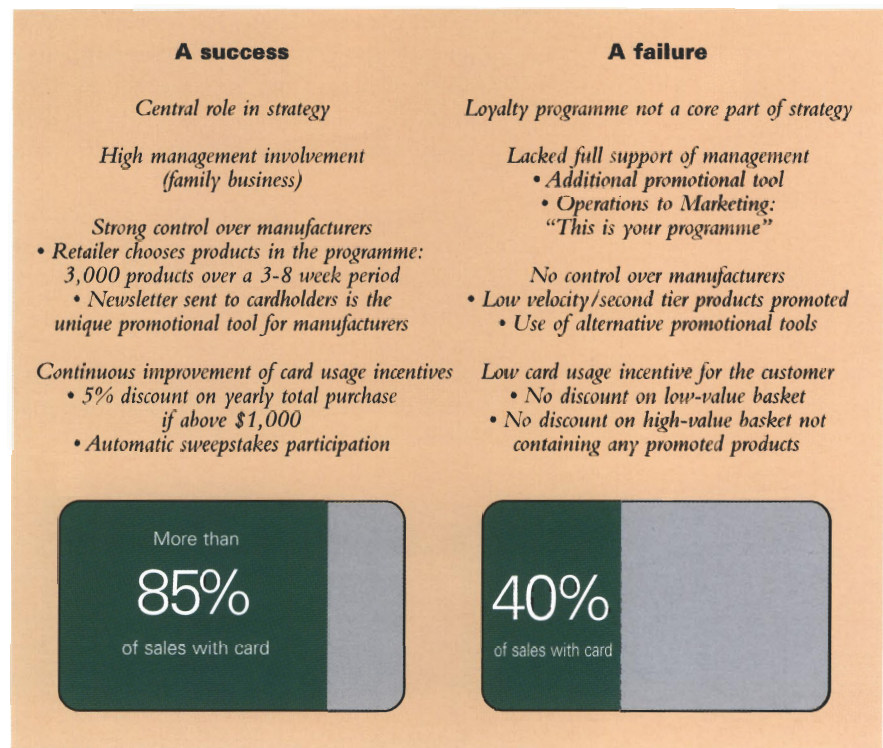
Experiments have so far demonstrated the critical need for a dedicated core team to manage the programme. According to a study by the Direct Marketing Association, 85% of database marketing programmes in the US are managed by Marketing and related functions. The team should ideally include representatives from Operations; at the least, it should work in close cooperation with the stores.

6.5 Legal and moral requirements

Regulation is more a framework than a real limitation in Europe at this point. Local rules concerning personal data protection and treatment should tend toward European harmonisation over the next two years. Processing personal data requires attention but appears manageable in the food retailing

Badly designed and internally unsupported programmes are bound to fail

Illustration: Two US retailers



environment. Local restrictions are more rigid when personal data is being incorporated in other databases.

More significant differences appear in marketing practices. No European regulation yet exists and no directive is foreseen in the near future. A few countries have adopted restrictions on coupons. For example, Germany and Denmark do not allow retailers to mail coupons to their customers; Swedish point-based loyalty programmes must be convertible into cash. These restrictive regulations may limit targeted marketing opportunities in these countries.

Retailers should obviously follow the legal framework carefully. However, the real risks stem from highly intrusive practices rejected by consumers, consumer associations, and public opinion.

Retailers should therefore make it very clear to customers when they join the programme how they intend to use the data they are collecting. They should set themselves very high ethical standards, probably beyond the legal requirements.

Some retailers limit access to customer information to a restricted number of employees. A large French food retailer has decided to centralise access to data. Approximately 20 people are authorised to access the customer database, at least in the first phase. Only the CEO and the president can access customer data at the family-run Lees Supermarkets (Westport, MA).

Many US and European retailers have clearly stated that they would not share any personal data directly with any other party. The golden rule at Roundy's,

a US food retailer, is that no name and address files will be released to parties outside the company. This commitment is usually stated on the application form: Delhaize and Superquinn, for example, guarantee that no data will be transferred to third parties. Other retailers like Wegmans reinforce their commitment by establishing a policy statement.

Consumer focus groups show that customers are becoming accustomed to sharing data. They also reveal, however, that customers still have doubts about how information is used. Retailers should diffuse these fears by clarifying their position at the outset.

Beyond data usage, retailers must minimise all other commercial risks when they design their initiatives. The risks and the lessons in that area are described in Chapter 7.

6.6 IT requirements

Databases and applications should be built progressively. Information technologies are now scalable and allow companies to start with limited investments and upgrade their architecture on a step by step basis.

Implementing a customer information system is an iterative process. After defining their needs, retailers should test initiatives in pilots first.

- *"A pilot programme makes it possible to identify and quantify benefits at a very reasonable cost. Broad solutions can be implemented in a second wave."* NCR

Since customer information databases and applications are bound to develop rapidly, the retailer should build an evolving architecture, taking into account the long-term objectives for the information systems. For example, Standa is designing software giving access to restricted customer data for check-out employees even if no card has been launched yet.

6.7 Build the business case for going forward

Before launching any large-scale loyalty programme, retailers should build the business case for going forward. It is a prerequisite to planning the necessary investments and assessing their expected return, and to convincing the rest of the organisation of the value of using customer information.

As mentioned earlier, however, the economics in the short term are potentially positive but not very compelling. The long-term benefits are difficult to quantify, since no retailer has yet reached that stage.

The business case should at least be clear on the cost side, and clarify the order of magnitude of potential benefits.

6.8 Expected impact

Experiments observed so far run close to break-even. Simple simulations on operating costs only suggest that a 2 to 4% sales increase is required to break-even. The largest cost component is the cost of rewards. Information technology and operating costs are limited at this stage.

But the outcome of Stage 1 is extremely sensitive to the costs of incentives and to the increase in margin, both of which can vary widely. Each retailer's challenge is to monitor both dimensions closely and to find a compromise between reducing the rules-based rewards and making customers use the card so the retailer can collect their purchase data.

Basic loyalty programmes run close to break-even

Some may achieve a 2-4% sales increase

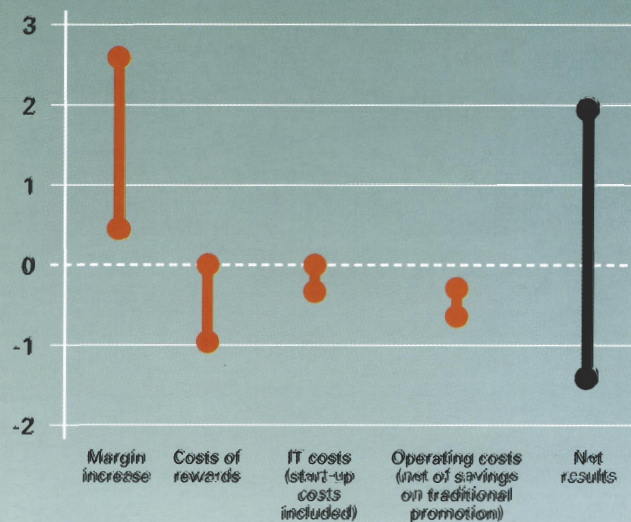
Delhaize	2% above national average
Tesco	2-4%
Sainsbury's	3% expected

... 10-20% advertising cost reduction

Tesco	20%
Gregerson's Foods	10% (in the early stages of the programme)

Economics vary heavily by retailer

% sales



Economics depend heavily on rewards funding

Minimise several investments and operating costs

- US programme funding transferred to suppliers, European standard cash back financed by retailers

Source: Press, BCG estimates

7

Second stage: targeted marketing

Chapter Synopsis

- **Moving to targeted marketing initiatives achieves dual objectives: gaining marketing and promotional efficiency and initiating the deep customer understanding necessary to achieve customer bonding**
- **Targeted marketing initiatives should be implemented progressively: retailers should start with simple applications requiring minimal data. A good compromise in the short-term between simplicity and comprehensiveness is to analyse baskets at the product category level. This level of detail makes applications attractive to both retailers and suppliers**
- **The retailer's organisation must be aligned with these new objectives. Dedicated teams, upgraded analytical skills, new measures, and new processes to foster application design and implementation are required**
- **Retailers must carefully manage commercial risks arising from the use of personal data by respecting the customer's privacy. They must also respect the loyalty ladder when differentiating between customers, avoid discrimination at the point of sale, and go beyond the basic legal requirements**
- **Results of targeted initiatives are still incomplete, since many are still at the pilot stage. Nevertheless, experiments often show double-digit sales increases. Retailers also claim higher margins**



7.0 Description of applications and information used

The objective of the second stage is to identify and target best customers for the current value proposition

We have called the second stage “targeted marketing” where retailers have established a customer database, usually populated with information from their loyalty programme as well as other sources (questionnaires, overlay data, etc.). Instead of targeting a generic consumer, as in the first stage, they can target groups of customers or even individuals with a set of (usually pre-existing) value propositions.

The major applications of the second stage include sophisticated customer acquisition, retention, and penetration initiatives (see chart below).



Many targeted marketing initiatives are being tested by pioneering retailers, although most retailers are still in the very early phases. A few interesting examples are the following:

- Since 1994 Ukrop's has offered its best customers two to six customised coupons per mailing (up to 60 to 80 customer segments), in addition to the monthly booklet of 60 to 80 vouchers. Ukrop's analyses baskets at the category level and develops initiatives to increase the customers' spending. Ukrop's issues relatively few “educational” coupons to cross-sell other categories;
- Tesco has developed a two-tier customer targeting programme. Firstly, using a customer segmentation that distinguishes five customer groups, it sends customers a differentiated version of the Clubcard magazine with specific

money-off coupons fitting the consumption pattern of their segment. Secondly, a basket analysis at the department level associated with additional customer information, such as dietary preferences, enables Tesco to add personalised vouchers to its quarterly mailings (100 different letters per quarter). Meanwhile, identification of high-spending customers and their spending pattern helps Tesco successfully target them for its themed shopping evenings (50 to 70% response rates);

- Delhaize has conducted different tests to prevent customer defections with targeted mailings and promotions. The results of these pilots are quite encouraging as the customer retention rate after a 15-week period is above 15%.

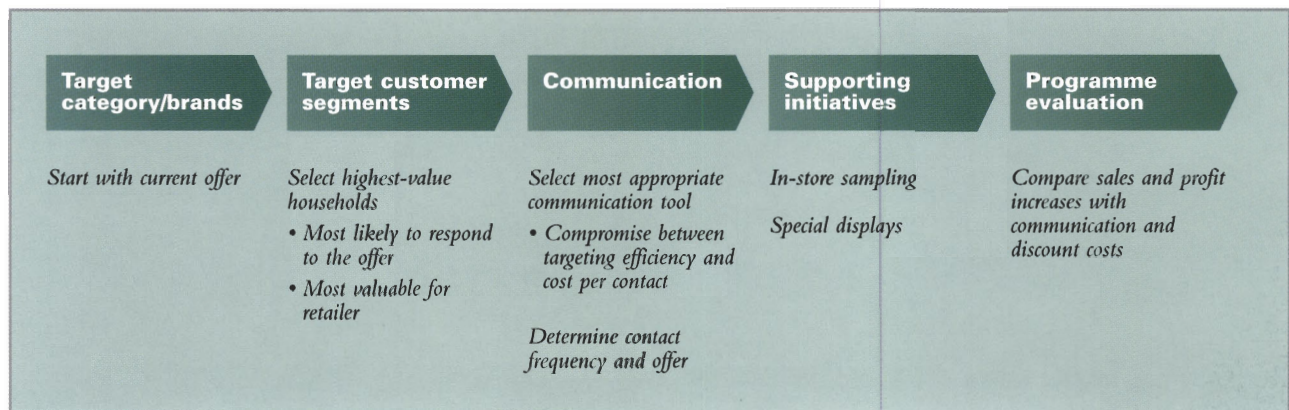
7.1 “Do’s and don’ts”

Some basic rules to follow when implementing targeted marketing initiatives
“Do’s and Don’ts”

Application design	<ul style="list-style-type: none"> • Select highest value customers • Tailor communication tool, timing and value proposition to maximise response at the lowest cost
Implementation process	<ul style="list-style-type: none"> • Start with applications requiring the least data analysis <ul style="list-style-type: none"> – Basket analysis at the total spending level • Target continuous basket analysis at the category level <ul style="list-style-type: none"> – Get additional information from overlay data and periodic data mining to the SKU level • Run pilots to fine-tune application design and test customer acceptance
Data requirements	<ul style="list-style-type: none"> • Expand and integrate the various information sources <ul style="list-style-type: none"> – Fix operational prerequisites
Organisational requirements	<ul style="list-style-type: none"> • Get or upgrade skills <ul style="list-style-type: none"> – Dedicate team of marketing analysts – Develop in-house skills even if relying on external experts • Set measures to assess application performance • Do not overwhelm operations with excessive data <ul style="list-style-type: none"> – Centralise data treatment
Legal and moral requirements	<ul style="list-style-type: none"> • Properly manage commercial risks <ul style="list-style-type: none"> – Do not be intrusive, do not manipulate – Respect the loyalty ladder when differentiating – Avoid discrimination at the point of sale – Do not eliminate all mass marketing promotion: less frequent shoppers should not be hurt – Establish a code of conduct
IT requirements	<ul style="list-style-type: none"> • Grow IT infrastructure progressively <ul style="list-style-type: none"> – Increase customer database – Acquire/build software to support new application
Relationship with suppliers	<ul style="list-style-type: none"> • Invoice suppliers in application design <ul style="list-style-type: none"> – Product launch – Promotions

7.2 Application design

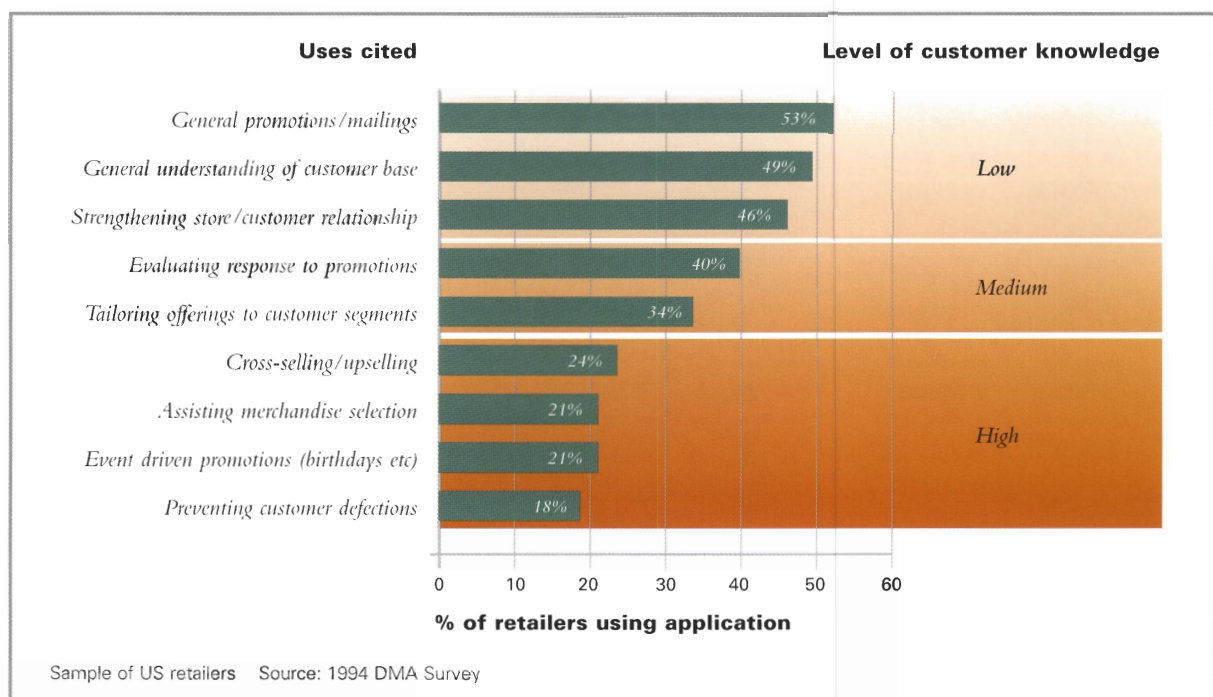
Designing a targeted promotion follows a similar process, however detailed the basket analysis



7.3 Implementation process

Building targeted applications is a progressive process. Availability of information, computer systems, and marketing skills all develop over time.

Applications requiring the least customer knowledge are implemented first



Retailers should start with simple applications requiring minimal data, such as Recency Frequency Spending (RFS) analyses.

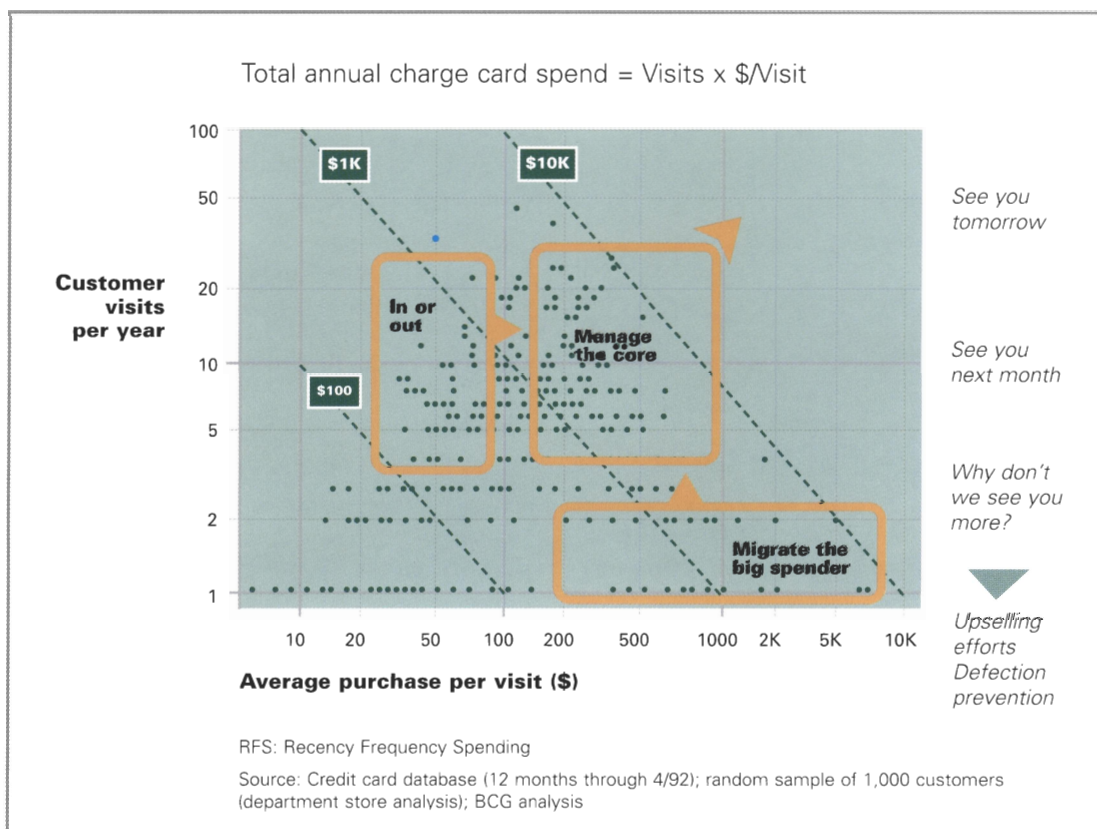
The simplest analyses can be conducted with basic total spending data by customer. These analyses do not require detailed basket data.

These analyses enable retailers to:

- Better understand the behaviour of their customer base (de-averaged purchasing frequency, defection rates, etc.);
- Launch simple initiatives to prevent defections (Delhaize) or increase penetration. Superquinn has conducted pilots since 1996 encouraging shoppers to spend above their current spending decile (premium-point coupons sent with newsletter);
- Select customers for differentiated services. Delhaize, for example, limits the mailing of its newsletter to its highest-spending customers.

The graph below highlights the purchasing behaviour of individual customers (frequency of visits and average purchase per visit). Clusters of customers with similar behaviour can be designed and the retailer can launch targeted initiatives for each cluster.

RFS analysis on total customer spending enables the launch of targeted initiatives



The detail of the basket analysis should be increased rapidly so that retailers can develop a less replicable, proprietary customer understanding.

Mining basket data at the department level and preferably at the category level is a prerequisite for exploiting the value of most applications and for starting to build in-house customer insight. Retailers can actually start archiving and analysing customer basket data at the category level, a good compromise between simplicity and richness of analysis. Targeting and understanding capabilities based on basket analysis at the category level becomes attractive for the whole value chain: retailers can seize opportunities to develop underexploited categories by customer and suppliers can significantly improve the return on their promotional and marketing budgets (e.g., differentiated product launch).

Since the beginning of the Clubcard programme, Tesco has issued more than £121 million worth of product coupons partially targeted on the basis of a basket analysis at the department level.

Basket data at the SKU level may be tracked and analysed once retailers are familiar with category data. This information is much richer than at the category level. Detailed customer basket analysis increases the level of customer understanding: individual responses to promotions and targeted offers, share of private-labels, etc. The data is increasingly attractive to suppliers, even if it is not directly shared.

Reaching the SKU level, however, dramatically increases the volume of data that needs to be processed and the complexity of cleaning and analysing it. Periodic analyses are preferable to continuous analyses here.

In addition to market-basket and basic personal data (name and address), overlay data helps retailers better understand customer behaviour and preferences and more effectively segment customers.

Most retailers are likely to leverage information at the category level in the short term. The best short-term compromise for most may be to start with continuous analyses at the category level and periodic SKU information samples, and gradually to make the transition to full basket analysis.

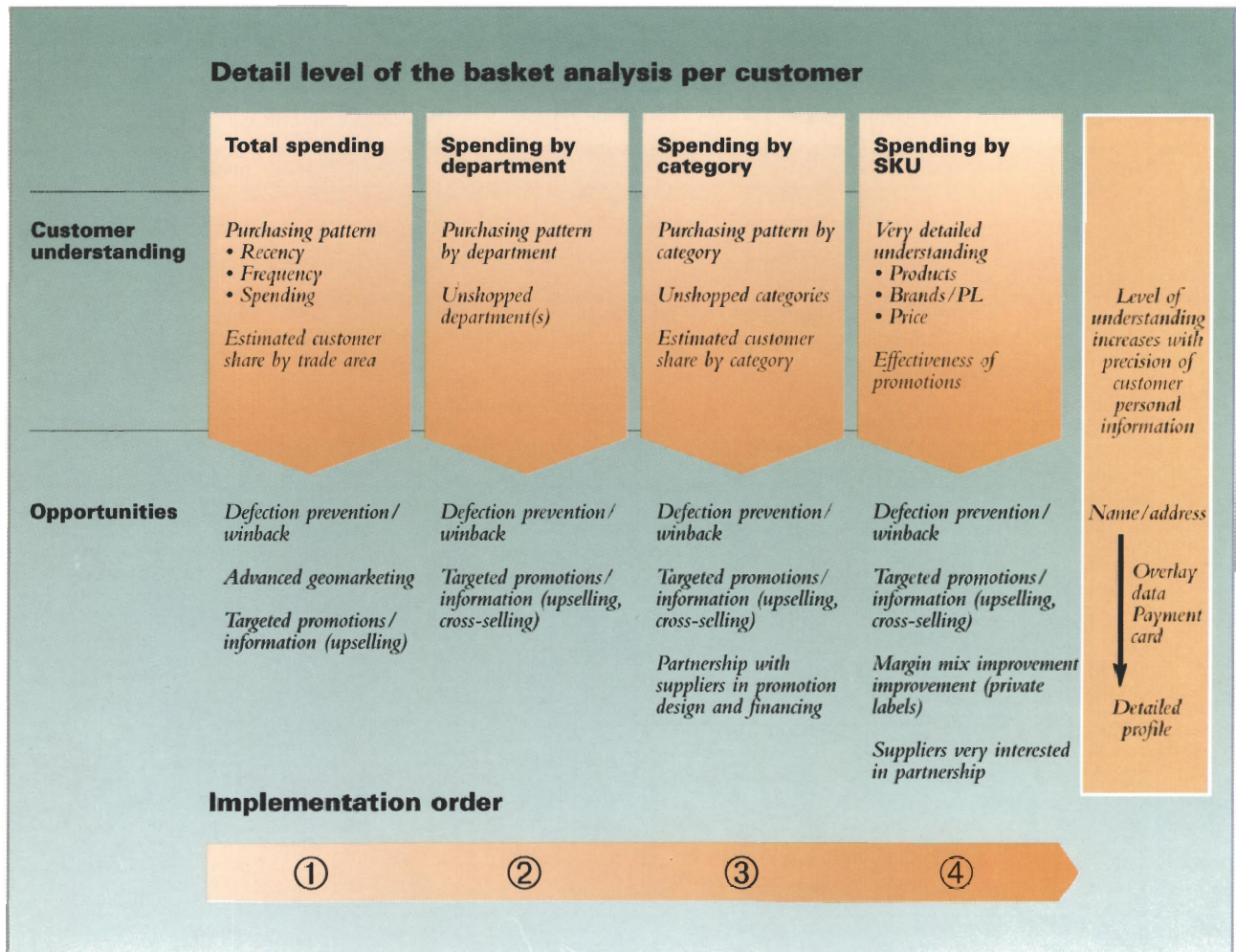
Very few retailers use full basket data. Vons is leveraging its ability to analyse customer data at the SKU level to design targeted promotions with suppliers.

- *“Vons’ programme enables me to target an offer specifically at a consumer on the basis of the type and quantity of a product they buy, how often they buy it, and whether they buy my product or a competitor’s.”* SUPPLIER

In any case, retailers should run pilots to fine-tune application design.

- *“The first time you run a database-driven promotion, there is going to be a little trial and error, no matter what you are doing.”* US RETAILER

Retailers should progressively increase the level of detail of information



7.4 Data requirements

Retailers need to expand and integrate the various information sources.

Supplementary data allows targeted marketing. Illustration: US retailer

Application	Data required	Methodology
Analyse share of each household's total grocery spending	<i>Predictors of grocery spending</i> <ul style="list-style-type: none"> • Income • Household size • Presence of children • Pet ownership • Marital status 	<i>Build a regression model that predicts grocery spending by local area or by household</i> <i>Use model outputs to estimate each household's total grocery spending</i> <i>Compare estimated total grocery spending with actual spending</i>
Increase the productivity of mailings <ul style="list-style-type: none"> • Number of consumers responding • Types of consumer responding 	<i>Demographic data</i> <ul style="list-style-type: none"> • Age • Income • Education • Presence of children • ... <i>Lifestyle data</i> <ul style="list-style-type: none"> • Response to direct mail • Interest in healthy foods • Purchasing of gourmet items • Leisure activities 	<i>Conduct a mailing or pretest with response tracking by household</i> <i>Compare respondents with nonrespondents and develop a response profile</i> <i>Use profile as a scoring model</i> <ul style="list-style-type: none"> • Select consumers for mailings • Select mailings for consumers
Target consumer segments with manufacturers	<i>Demographic data</i> <ul style="list-style-type: none"> • Household income • Age of household members • Pet ownership • ... <i>Lifestyle data</i> <ul style="list-style-type: none"> • Interest in gourmet foods • Interest in healthy foods • Cooking skills and interest 	<i>Select consumers with characteristics indicating high propensity to purchase manufacturer's brands</i> <ul style="list-style-type: none"> • Life style • Demographics <i>Conduct targeted mailings to those consumers</i>
Prospect for new customers	<i>Mailing list appended with demographic or lifestyle data</i> <ul style="list-style-type: none"> • Total grocery spending • High income • Large families • Gourmets 	<i>Rent a mailing list with high-potential households</i> <ul style="list-style-type: none"> • High income • Large families <i>Compare list with existing customer base to determine which names represent noncardholders</i> <i>Conduct mailing to noncardholders</i>

Syndicated data is often available as a complement to customer data, but using proprietary data is preferable. Syndicated data is particularly useful in targeting potential new customers, however, since no internal data on them is available. Retailers can purchase very specific data from specialised databases. These databases are widely available in the US and are now being developed in Europe (Consodata in France, for example).

Operational prerequisites need to be fixed before the information base is used. Systematic data cleaning and co-ordination are required.

Gathering data directly from consumers is preferable to purchasing syndicated data

	Consumer surveys	Syndicated data
Data from consumers is more recent	Frequency of collection determined by the retailer	Gathered as available from primary sources – Voter-registration files – Drivers-licence files – Car-registration files Frequency of updating database determined by data supplier
Data from consumers is less expensive	The retailer often has the opportunity to gather data with little incremental cost – At card sign-up – Via newsletter mailings	Syndicated data must be purchased from suppliers and merged with retailer's database
Data from consumers is more reliable	Consumers directly provide all data fields	Some fields inferred or predicted – By data syndicator – By the retailer on the basis of syndicated data
Data from consumers is more complete	Response rates from consumer surveys typically higher – 50-75% on survey – 60-90% on individual data elements	Match rates from syndicated data typically lower – 45-65% on individual records – 10-60% on each data element
Use syndicated data to fill in gaps from supplemental applications		
Source: Metromail; May & Speh; Donnelley Marketing; BCG analysis		

Multiple operational issues need to be fixed before the information base is built and used

Data gathering	Data consolidation	Data access
Scanning Coding of unscanned items (bulky or fresh products) Accurate collection and coding of specific situations: <ul style="list-style-type: none"> • Displays • Featurettes and • Coupons • TPR • Event in store • Customer complaint • Product return 	Same codes used throughout the organisation <ul style="list-style-type: none"> • Products • Promotions Compatibility of information sources <ul style="list-style-type: none"> • Check-out systems • Store data • HQ • Overlay data • Product data 	Fast, on-line access to stored data Differentiated data access by user
Systematic data cleaning and co-ordination are required		

7.5 Organisational requirements

The organisation needs to adapt to leverage customer information. Dedicated teams with upgraded skills are required. Switching from mass marketing to targeted marketing requires the building of advanced analytical skills to develop a deep customer understanding. Retailers have a strong mass marketing culture. Training is critical.

A dedicated team should pilot the programme. The team members will serve as advocates for the programme during its implementation. For example, one CCRRE member has appointed three marketing managers in charge of special activities, such as customer understanding, customer feedback analysis, and home delivery.

Success depends more on capabilities and motivation than on an absolute number of people. Ukrop's runs its programme with two people for approximately 300,000 cardholders. Vons' card programme manager has a staff of eight handling more than three million cardholders.

New measures must be developed to align the organisation with the new objectives. For example, a US retailer is using the following:

- By consumer groups
 - sales by consumer decile
 - share by geography and by consumer group
 - conversion rate of high-potential noncardholders
 - sales by household by category
 - sales by promotional event by consumer group
 - etc.
- By store
 - top 50 households
 - share of spending by household
 - etc.

Processes should be established to foster application design and implementation:

- Systematically leverage all available sources. Retailers should organise customer feedback channels and reward customer feedback. Superquinn is offering "goof points" to customers reporting any mistake made by the store. Retailers also should track competitors' initiatives.
- Empower Operations to encourage new application design. Employees in contact with customers should be empowered to handle complaints. Many initiatives should be decentralised to foster innovation.

- Initiate knowledge-sharing. The customer database should be systematically updated with all relevant information. Initiative forums could report tests and results and draw conclusions from stores with superior performance.
- Encourage fast rollout of pilot initiatives across stores.

Outsourcing options can be considered: they can bring fast and reliable new competencies and provide retailers with the economies of scale. Catalina Marketing, for example, offers the opportunity to launch targeted marketing initiatives rapidly at limited cost. This limits initial infrastructure investments and most incentive costs are supported by manufacturers. Retailers do not need to negotiate marketing budgets with suppliers and can be provided with customer information analysis. They can also use low-cost checkout printers to issue their store specific messages. In the same way, software providers are currently developing standard applications which allow simple datamining analysis.

Of course the objective for retailers in the medium-term is to internally develop competencies identified as new sources of differentiation. Retailers considering outsourcing should clearly define their long-term objective beyond targeted marketing initiatives. If their strategy is to develop a unique customer understanding to adapt products and services, they should make sure that, whether they use a third party or not, they retain control over the use of information and should ultimately develop their own internal analytical capabilities.

7.6 Legal and moral requirements

We described in Chapter 6.5 why retailers should be extremely cautious about protecting the confidentiality of customer data.

They should also set basic guidelines to minimise commercial risks when they exploit the data:

- Avoid any customer manipulation;
- Avoid intrusive campaigns;
- Respect the loyalty ladder. Here, loyalty should be considered broadly and in relative terms. A very loyal single pensioner may spend less overall than a family of five shopping occasionally at the store. Therefore retailers need to consider personal information other than point of sale data;
- Avoid discrimination at the point of sale;
- Generally, go beyond the basic legal requirements.

Guidelines need to be carefully followed to minimise commercial risks

Do not manipulate customers

- **Manipulation does not work**

“ If a customer does not visit one of your existing departments, he probably has a good reason for that ” CCRRG,E MEMBER

- **Manipulation is badly perceived**

“ Retailers want to force me to buy a specific brand name ” FOCUS GROUP

- **Provide them with relevant educational information instead**

- **Carefully select partners and potential applications if selling customer information**

Do not be too intrusive

“ I do not want everyone to know about my private life ” FOCUS GROUP

“ We should not call customers at home to sell them coffee ” CCRRG,E MEMBER

Differentiation must respect the loyalty ladder

- **Positive differentiation is well accepted**

“ Customers understand that offers are based on their purchases ” UKROP'S

“ Do not hurt your frequent shopper by giving too much attention to your occasional shopper ” CCRRG,E MEMBER

- **Positive differentiation should consider demographic data, such as family size:**

Tesco's Clubcard programme offers higher total value of coupons to a high spender only if he or she spends more

Avoid discrimination at the point of sale

“ All customers are good customers in your stores ... reward the best customers with cash instead of special treatment at the POS ” CCRRG,E MEMBER

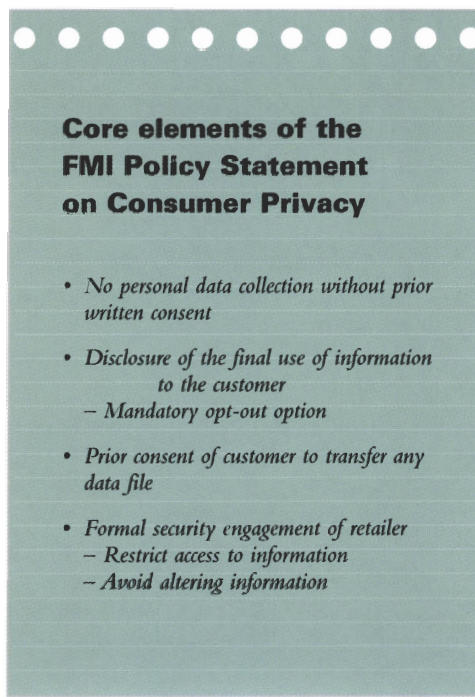
“ Do not replicate social injustice in-store ” FOCUS GROUPS

Go beyond the basic legal requirements

- **Be clear and open: communicate information treatment purposes to customers and opinion leaders**

- **Public opinion is usually more demanding than the legal framework**

US retailers have adopted an ethical code for personal data treatment to reinforce consumer trust.



US retailers have adopted an ethical code on personal data treatment to reinforce consumer trust

7.7 IT requirements

As mentioned in Chapter 6, retailers should develop the information technology infrastructure progressively.

Building a data warehouse is not a goal in itself. Retailers should analyse and define their needs precisely, and enlarge their information base progressively, while realising the value of their investments.

Implementing a customer information system is an iterative process. Applications should be identified first, then tested. If tests demonstrate the value of applications, database or software capabilities can be enhanced.

Building a comprehensive data warehouse with advanced capabilities from the start may end up overwhelming the organisation with data that it will not be able to handle effectively.

- *“The more data you have, the better the picture you get ... but it can become self-defeating if the database is so huge that you cannot manage it”* UK RETAILER

Oracle reports that only 5% of data in data warehouses is actually analysed.

7.8 Relationships with suppliers

The potential value of using customer information is spread across the whole value chain. Considering only the retailer's piece would clearly limit benefits for the whole chain, including retailers, especially since margins are often skewed toward the supplier side.

Suppliers also have a strong interest in developing targeted marketing so they can better target their promotional efforts (increased cost effectiveness of marketing investments) and better understand the consumers' needs so they can adapt their products.

Suppliers do not usually have access to customer purchasing data. Establishing a direct relationship with customers would be extremely costly, especially since annual purchases are fairly low. Few suppliers can afford to do it economically.

Retailers can use their direct access to customer information to partner suppliers in designing new applications, particularly targeted promotions. This does not mean that retailers should give the customer data to suppliers. They can design the promotion and define their customer target jointly, on the basis of their understanding of the category and the customers. The retailer can then send direct mail (or use any other communication tool) to actually reach the targeted customers.

- *"We will not give mailing lists to anyone but we are trying to do more comarketing with manufacturers, and in that case we do the mailing and the list never leaves our hands"* US RETAILER

Retailers and suppliers can share the costs and benefits of such operations. In many cases the costs could be largely supported by suppliers, who could switch a large part of their promotions from across-the-board discounts to targeted and more cost-effective promotions.

The value of involving suppliers varies by retailer. Those with no private-label or low penetration are more likely to be interested in developing a partnership than the ones with a very high private-label share of sales.

7.9 Expected impact

Expected results of targeted marketing are much more attractive than basic loyalty programmes

	FMI Survey	Specific examples
Sales increase	15-25%	<i>Roundy's: More than 10%</i> <i>Ukrop's: More than 10%</i> <i>Gregerson's Foods: 4 to 12%, depending on store</i>
Customer retention increase	8-11%	<i>Delhaize: 15% winback rate after 15 weeks</i>
Grocery gross profit increase	1-2%	<i>Gregerson's Foods:</i> - Gross margin: +1% - Advertising costs: -10% to 20% <i>Vons: Share of private label</i> - from 13% of sales in 1993 to 20% in 1995
Customer spending increase	Up to 14%	<i>Tesco: Number of visits increased by 16%</i>

Source: FMI Survey, Press search, interviews

8

Third stage: organisation around customer segments

Chapter Synopsis

- **Reorganising the whole company around customer segments will enable the retailer to design new products and services meeting the specific needs of key customer segments. Partnering with suppliers may be an attractive opportunity**
- **Retailers will identify these needs by considering the whole shopping experience of each customer segment and by tracking customers at each stage of their life cycle**
- **The major challenge for retailers is to redesign their organisation to seize these opportunities: customer segment manager positions must be created when the segmentation has reached a sufficient level of sophistication**

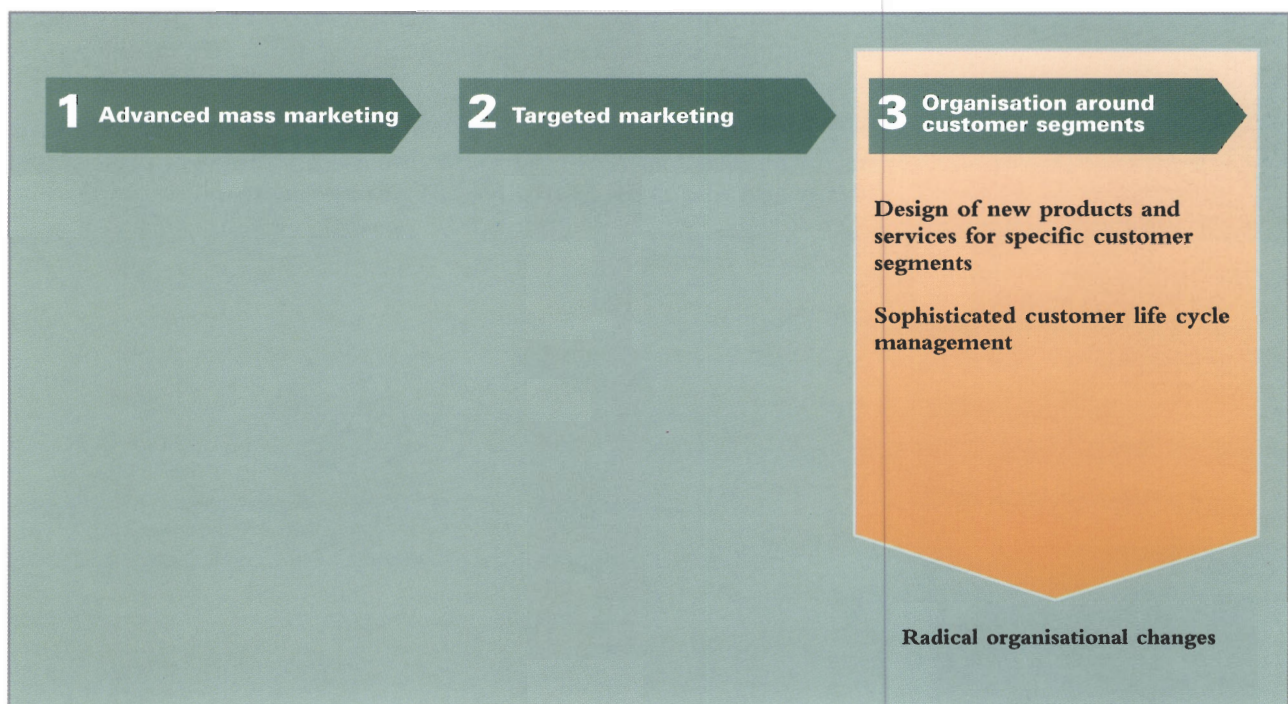


8.0 Description of applications and information used

We have called the third stage “organisation around customer segments”.

The objective of the third stage is to organise around key customer segments to understand and better serve their needs

Going through a complete change of the organisation could be, as in other industries, a key prerequisite to achieving the full benefits of using information. At this stage, retailers have not only established their customer database and begun targeting customers with sophisticated initiatives, but they have also reorganised themselves around customer segments. This will allow quantum-leap improvements in customer understanding, assortment building, service design, and customer relationships.



8.1 “Do’s and don’ts”

Some basic rules to follow when organising around customer segments “Do’s and don’ts”

Segmentation design	<ul style="list-style-type: none"> • Initiate segmentation in stage 2 (long and detailed process) • Periodically reassess segmentation
Application design	<ul style="list-style-type: none"> • Design applications for key customer segments • Consider the whole shopping experience of specific segments • Manage the life cycle of individually tracked customers
Implementation process	<ul style="list-style-type: none"> • Progressive implementation <ul style="list-style-type: none"> – Start by focusing on high-value segments – Run pilots to fine-tune segmentation and test initiatives
Data requirements	<ul style="list-style-type: none"> • Leverage all information sources <ul style="list-style-type: none"> – Feedback channels – Information-sharing within the company
Organisational requirements	<ul style="list-style-type: none"> • Create and empower customer-focused positions <ul style="list-style-type: none"> – At different levels: chain, store – With new customer marketing skills • Move to matrix organisation <ul style="list-style-type: none"> – Manage product/store/customer dimensions • Align measures with objectives for the whole organisation
Legal requirements	<ul style="list-style-type: none"> • Maintain very high ethical standards to manage commercial risks
IT requirements	<ul style="list-style-type: none"> • Continue to build IT infrastructure progressively
Relationships with suppliers	<ul style="list-style-type: none"> • Involve suppliers to develop customer segment and category understanding and design new products and services for key customer segments

8.2 Segmentation design

Segmenting the customer base is a long and complex process. Many dimensions need to be considered: behavioural, demographic and individual.

The segmentation needs to build on the customer understanding developed in Stage 2. Segments should be progressively designed and validated with supporting analysis during that phase.

After the company has reorganised around these segments, it should periodically reassess the segmentation.

Segments can be tracked with the customer information database and individually targeted

Illustration: US Retailer

8.3 Application design

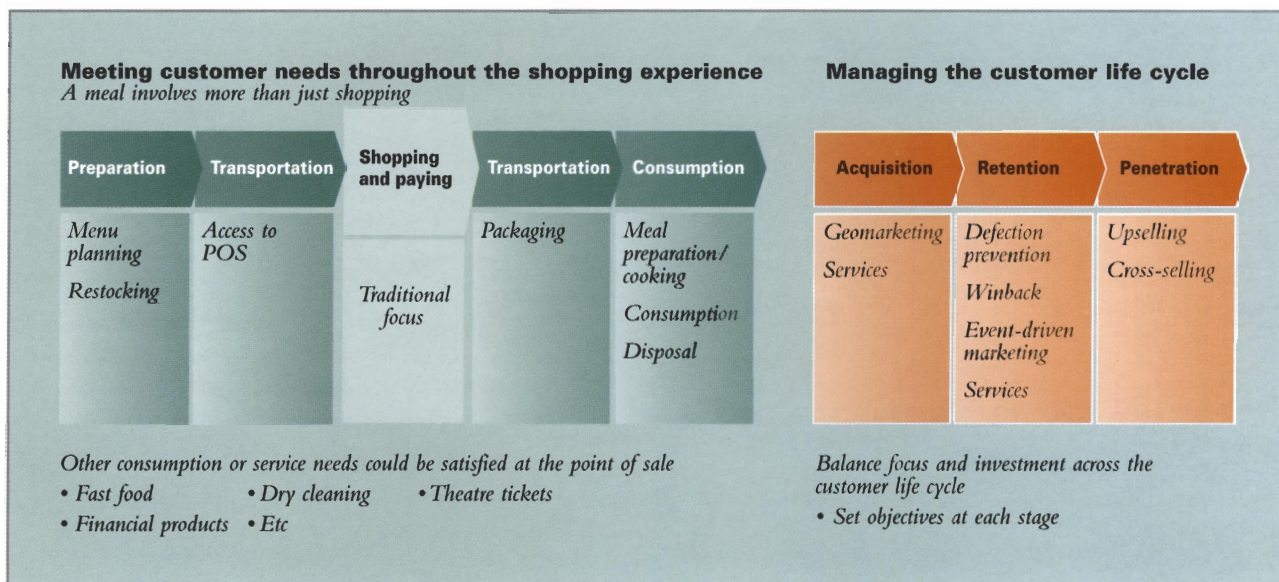
At this stage, applications, as well as product and service offers, should be individually designed for each customer segment. The example below illustrates some initiatives identified by a US retailer for some of its customer segments.

Segment	Segment definition	Identify through			Potential programmes
		Purchase history	Application data	Syndicated or 3rd party data	
Gourmets	Desire high quality and variety of food items Value speciality departments and high-quality prepared foods	✓	–	✓	<ul style="list-style-type: none"> • Newsletter content highlighting gourmet merchandise • Guest-chef cooking seminar for high-value customers • Gourmet recipes and meal ideas in newsletter • Points-based or tiered-reward programmes for purchasing speciality merchandise
Diet-conscious	High interest in healthy foods <ul style="list-style-type: none"> • High fibre • Low fat • Low-salt foods 	✓	–	✓	<ul style="list-style-type: none"> • Tie-ins with manufacturers • Targeted coupons for healthy foods • Low-fat or low-salt recipes in newsletter
Private-label enthusiast	High interest in private-label products	✓	✓	✓	<ul style="list-style-type: none"> • Newsletter content highlighting private-label products • Targeted mailings with product samples
Private-label potential user	High potential for private-label foods <ul style="list-style-type: none"> • Big household • Moderate income • Little private-label use 	✓	✓	✓	<ul style="list-style-type: none"> • Reward programmes for purchase of private-label products • Private-label challenge
Organic shoppers	Interested in fresh and organic foods	✓	–	✓	<ul style="list-style-type: none"> • Nutrition information in newsletter • Nutrition seminars for high-volume customers

When designing applications, retailers should consider the whole shopping experience for each customer segment. Opportunities to tailor products and services at each stage of the experience should be explored. By recognising that different customer segments have different needs and dissatisfactions, retailers will build a product and service offering better adapted to the key segments' needs and therefore create a sustainable competitive advantage. They will progressively reinforce this advantage by deepening their understanding of the segments.

Managing the customer life cycle by segment is another major opportunity for retailers to differentiate themselves. Acquiring customers, retaining them, and increasing the share of their purchases is a more concrete challenge when

Retailers will need to consider the whole shopping experience and the customer life cycle for each customer segment



these customers belong to well understood segments and share commonly identified needs. Since the customer database allows retailers to monitor the results right away, initiatives can be continuously fine-tuned, making them very difficult for competitors to match.

8.4 Implementation process

As emphasised in the previous two chapters, launching targeted initiatives is a progressive process. Retailers should start focusing on high-value segments before extending initiatives to other segments. Pilots and actual applications should be used to fine-tune the segmentation and better adapt the offer to the customer segments' needs.

8.5 Data requirements

Types of data similar to those gathered in the second stage will be monitored, this time at the customer segment level. In-depth analyses (including SKU-level data) can be run at the customer segment level (lower volume of data than on the total customer base).

Data should be available at all levels of the organisation, at a level of detail that facilitates decision making. The following charts illustrate the types of decisions the chain manager and the store managers can make with the information in their possession.

Information is used at different levels within the organisation

The Chain Manager can

Determine the chain's overall market share over time

Identify share shifts within the chain's trade area to or from competitors for different customer segments

Quickly pinpoint the causes of share loss by demographic and behavioural customer segments

- "The what"
- "The where"
- "The why"

Determine which competitor is serving the retailer's gaps and estimate the potential revenue and contribution available from serving these gaps

Prioritise categories and segments for share winback initiatives

Promote or reposition underutilised or weak categories and departments

Rebalance broadcast advertising message, frequency and media to optimise impact on targeted segments

Manage the chain on the basis of quick access to critical facts

- Satisfaction and repurchase intent, overall and by major demographic segments
- Number and type of customers vulnerable to defection
- Customer share and sources of share loss by department or category
- Detailed dissatisfactions
- Competitive losses
- Best-in-market performance
- Evaluate cluster and store manager performance on the basis of satisfaction and repurchase-intent ratings

The Store Manager can

Manage satisfaction and repurchase intent and measure number of customers vulnerable to defection

Identify customers' specific areas of dissatisfaction

Obtain direct feedback from customers

Determine micromerchandising opportunities based on store's demographic makeup

Alter merchandising to appeal to dissatisfied demographic segments

- Production selection
- Presentation
- Promotion strategy

Highlight departments with low penetration

Isolate specific subcategories for improved merchandising and communication

Compare store performance with that of other stores with similar demographics

- Percentage of primary shopping departments
- Ratings of department-specific performance
- Ratings of store and service attributes

Send direct-mail advertisements to underpenetrated demographic segments

8.6 Organisational requirements

Retailers face the same organisational issues as other industries. Some US retailers are considering reorganisation, without having initiated anything yet.

To our knowledge, no retailer has yet entered the third stage, organising around sophisticated customer segments, other than via limited experiments.

A few retailers, however, are moving in that direction:

- By reorganising around the customer.

For example, Sonae in Portugal has appointed a customer segment manager to design and implement applications in the future to enhance customer care for the highest-value customers. This initiative is still at the pilot stage. A UK retailer is also testing an organisation around high-, medium- and low-spending customer segments. In both cases, however, the segmentation is based on spending levels. It may not be sophisticated enough to get insights into customer needs.

Retailers face same organisational issues as other industries. Ultimate challenge: Segmenting and thinking around the customer

“ We are a purchasing-driven organisation, organised around categories. Nobody thinks about customer segments and how we could better serve them ” US RETAILER

“ When we want to do a special offer for a specific customer profile, the purchasing department answers: ‘I have better things to do than buy 20,000 units for your special offer, my job is about buying 200,000 units for our average customer’ ” VP MARKETING, MAIL-ORDER COMPANY

“ If I want to serve my customer better, I will have to put in place people thinking about them, then designing assortment, services and pricing ” US RETAILER

“ I have budget problems. The procurement department doesn’t want to finance my ‘Turkey for Christmas’ operation for heavy spenders. The CEO will make the decision ” US RETAILER

- By targeting specific customer segments, though without reorganising around them.

Ukrop’s targets young parents with its Baby Club. Superquinn organises singles evenings.

As in other industries, retailers will need to create and empower customer-focused positions. Matrix organisations will combine the customer, product, and store dimensions. Retailers will also need to align their measures across the organisation with their objectives.

8.7 Legal and moral requirements

Retailers will have an increasingly sophisticated understanding of their customers. They will need to be very careful to maintain high ethical standards to manage commercial risks.

8.8 IT requirements

Retailers should continue to build the information systems’ infrastructure and capabilities progressively.

8.9 Relationships with suppliers

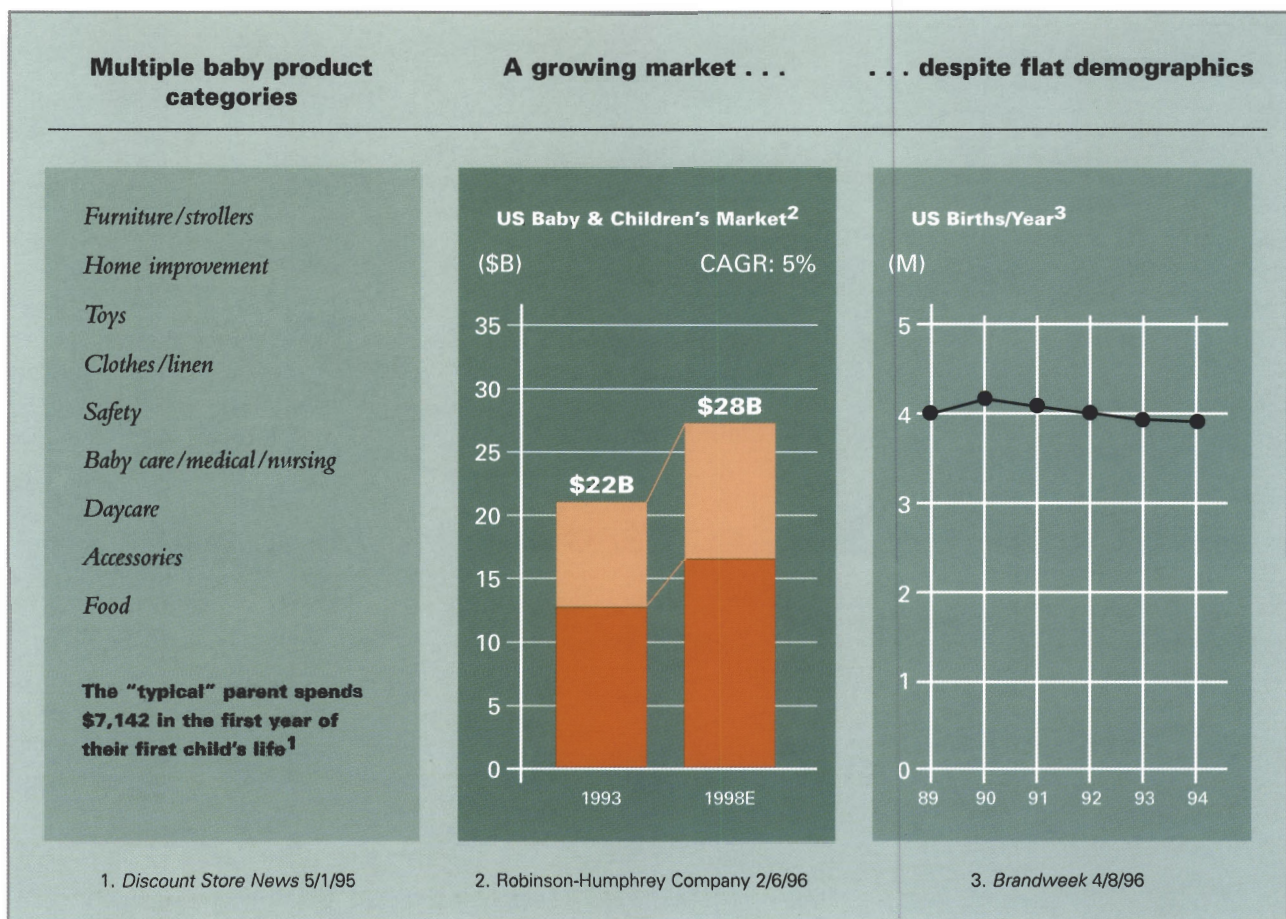
One of the objectives of the third stage is to design new products and services according to the needs of specific customer segments. Therefore retailers will need to involve suppliers

- To develop jointly a deeper customer segment and category understanding;
- To design products and services accordingly.

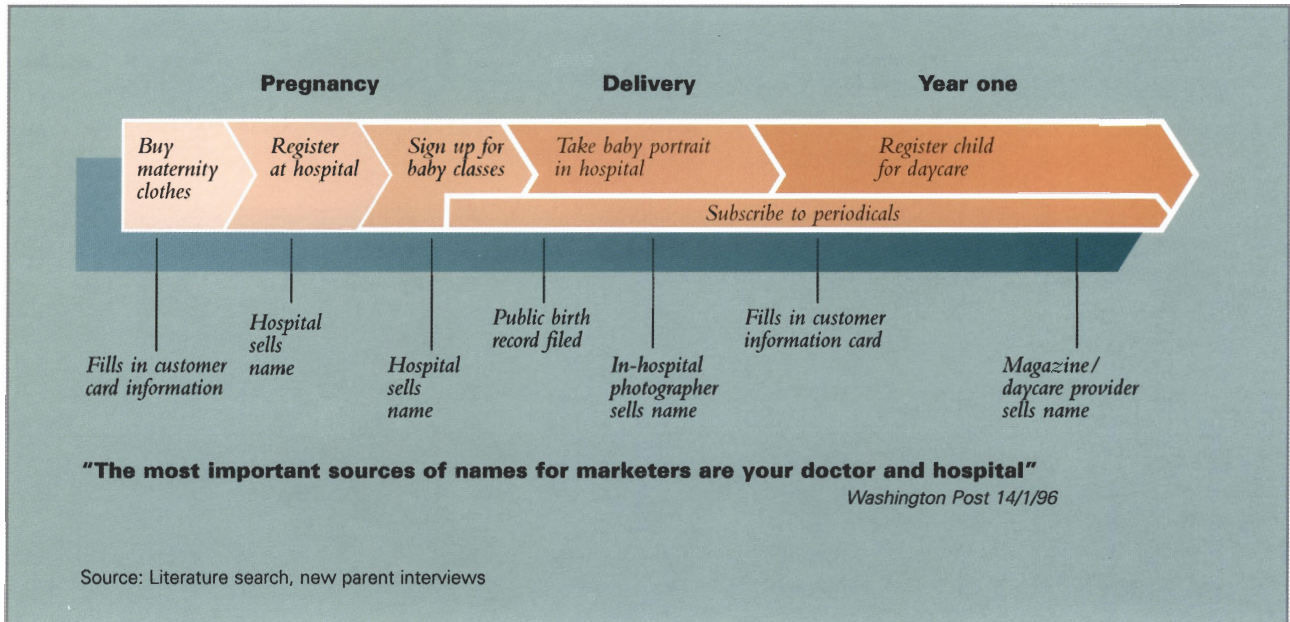
As we mentioned in Chapter 7, suppliers usually do not have access to customer purchasing data and few can afford to establish a direct relationship with their customers. Baby food manufacturers are an exception. They have demonstrated that targeting specific customer segments by using customer information can create very substantial value.

Targeting specific customer segments can be very attractive

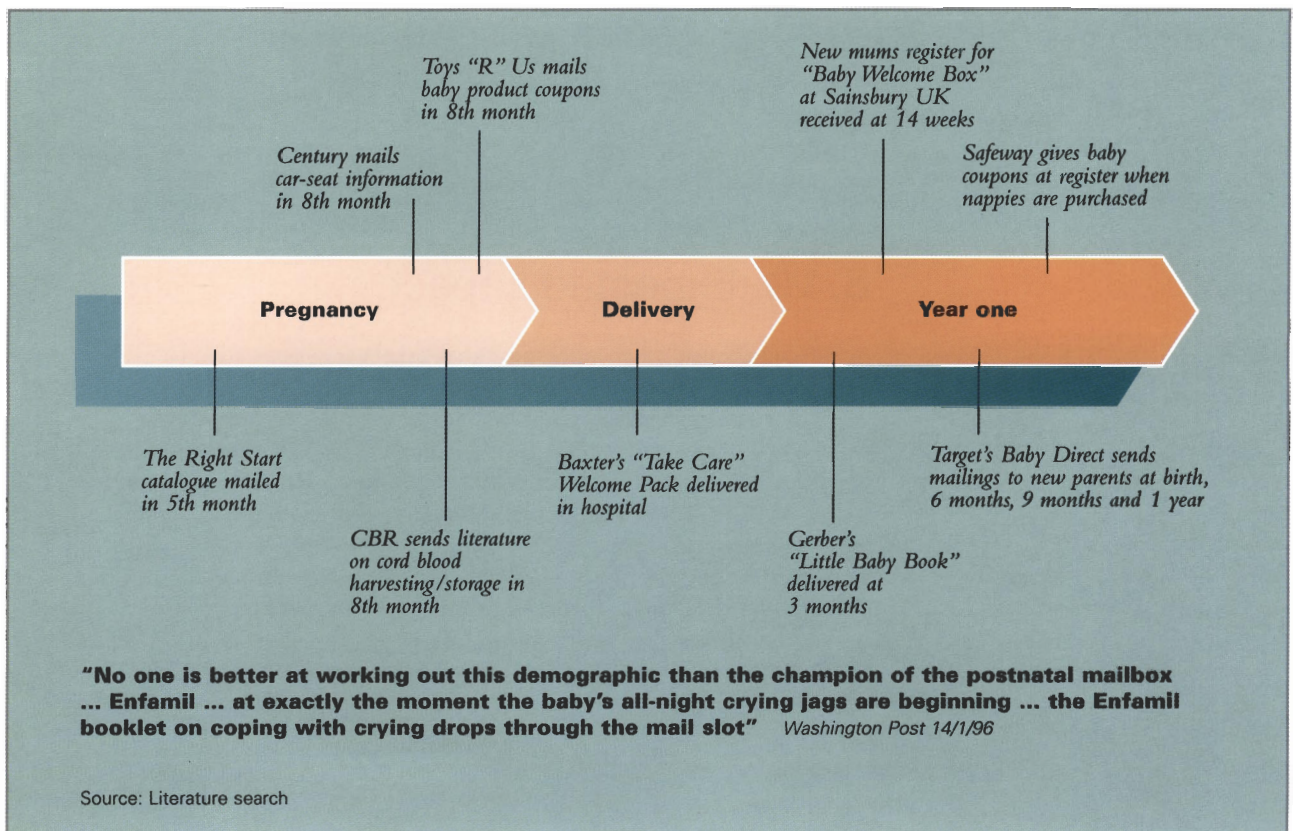
Illustration: First-year parents



Valuable information is available to identify, track and serve new families uniquely



Many baby product companies are using this information to target customers at strategic times



Baby products manufacturers can afford to target individual families since category spending by household is very high (over \$7,000 per year), and valuable customer information is available. First year parents should also be targeted by retailers: they spend large amounts not only on baby products but also in other categories, and they have specific identified needs. Ukrop's and Safeway have started to target them with their Baby Club and in-store nursery respectively.

In most categories, however, manufacturers cannot afford to target individuals directly (low spending by customer, anonymous purchase). Retailers therefore have a major role to play in targeting individuals.

- Total spending per customer is much higher for supermarkets than for manufacturers (lifetime spending per customer in supermarkets can exceed \$20,000 (based on a five-year long relationship) vs. \$2,000 – \$2,500 for a beer or a diapers manufacturer for example);
- Retailers have a direct and frequent contact with the customer and therefore the opportunity to identify him or her;
- Retailers can build a deeper customer understanding spread over many categories.

Sharing information with suppliers can benefit the whole value chain:

- Sharing of category expertise;
- Deeper understanding of customer behaviour and needs;
- Joint design of specific products, services, and promotions;
- Image-building for both partners.

Retailers with a high share of private-label sales can exploit information with the same principles and objectives across their own value chain.

8.10 Expected impact

Achieving the full value of Stage 3 may take a few years (five to ten, depending on the retailer's starting point). Therefore it is extremely difficult to quantify the investments and benefits of such a transformation.

Retailers will go through a long and continuous cultural and organisational transformation. They will need to manage potential conflicts with alternative segmentation criteria, like store formats or store size. They will progressively work more closely with suppliers to create value for both of them and potentially revisit the breakdown of profits across the value chain.

We believe that the retailers who successfully manage the transformation will:

- Increase their customer share by responding better to customer segments' needs;
- Increase customer retention through tailored customer life cycle management, reaching the highest levels of the loyalty ladder;
- Develop innovative high-value-added products and services through a superior understanding of their customers;
- Create a sustainable competitive advantage, continuously reinforced by their learning capabilities and the exceptional permanent dialogue established with customers.

9

End note

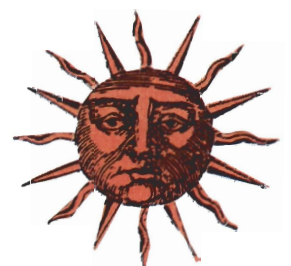
The information revolution has started in retailing and is here to stay.

Experiments are under way and insights have become available. Retailers seem to be following the same path as other industries.

Because the economics and complexity are different, the revolution will take more time. Value creation opportunities are numerous, however, for customers, retailers, and suppliers.

We believe that through the use of customer information, retailers will deepen their customer understanding, improve their joint product and service offering with suppliers, reinforce the relationship with their key customer segments, and build a sustainable competitive advantage.

In brief, using customer information appropriately will be the most important challenge for retailers in the next five to ten years.



APPENDIX A

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APPENDIX B

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