Not All Customers Are Created Equal

Back in the good old days (that is what we always call 30 years ago), customers were by and large a very similar group. As retailers we segmented them by age, occupation, education and sex and found that our offerings generally appealed to the group that we were targeting. These were the days of the mass market.

Do you remember Levi Jeans, Cabbage Patch dolls, or the Beatles? In those days, large groups of customers behaved in the same way and purchased the same products. Over time both the world and retail changed. We discovered "life styles" and learned that although customers may look alike, they could behave (shop) in very different ways. Also, over this 30 year time frame, as a society we began to change in very significant ways. A new form of morality often called situational ethics began to emerge. As Baby Boomers came of age they found many ways to rationalize their wants and needs outside the existing definitions of right and wrong. For many, the color gray replaced black and white.

While all these changes in the mores of North Americans were taking place, retailers, faced with pressure from discount concepts, discovered that a way to keep their customers happy was to expand and promote their customer services. A large group of retailers expanded on the concept that the customer was always right by promoting "goods satisfactory or money refunded" or similar policies and bending over backwards to impress the public that this was an important differentiator. Consultants proudly told stories of Nordstrom and other famous customer service stores who bent over backwards for their customers.

Return Rates Rise

For some time, all was good, customers responded to the liberal return policies and most did not abuse them. In the mid and late 70's the average return rate in most department and specialty stores was less than 1%. During the 80's this inched up to 2% and in the 90's some retailers were experiencing up to 5% returns. Today, in some stores it is reaching close to double digits. This is unprecedented in retail store operations. What happened? It is becoming clear that many customers are taking advantage of the liberal return policies by "renting" product and not even bothering to pay the rent. Stories of customers buying chain saws and cutting down a tree and then returning the chain saw are all too common place, as well as people who purchase clothing and wear it to a special occasion and then return it the next day or week.
What smart retailers are learning today is that not all customers are created

300 w grand ave | ste 408 | 350 w hubbard st | ste 240 | chicago, il 60610
312.673.0187 tel | 312.835.5552 cell | 312.670.2250 fax | email: jimdion@dionco.com | www.dionco.com

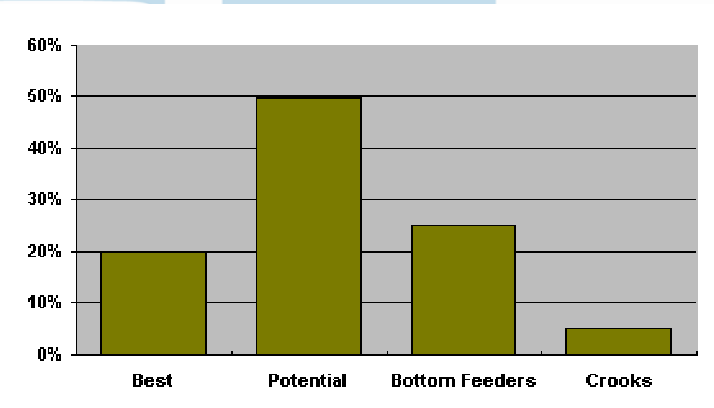
equal. They are going back and re-examining the old adage that "the customer is always right" and changing it to: "Most of the time, the customer is right, but when they are not, we will not give in and give away profit that penalizes our good customers, staff and shareholders." This is a dramatic change from the old way of treating customers and one that we need to adopt if you want to survive and thrive today.

Customer Relationship Management

The science of CRM (Customer Relationship Management) has had not only the benefit of helping us build long term relationships with our best (most profitable) customers but has also had a side benefit of helping us identify the profit robbing customers. Profit robbers are those customers who have a very relaxed conscience and only buy at low price and or have a very high incidence of product rental/returns.

If you are able to track each transaction with a customer, you can then relate the profitability of each transaction back to individual customers and then know which customers are contributing to the profitability of your store. Most retailers who do this find that the 80/20 rule (often applied to inventory productivity) applies with customers as well. It is almost universally true that 20% of customers contribute over 80% of the profit of most department and specialty stores and conversely, the other 80% of the customers contribute less than 20% of the profit of those stores.

New Segmentation Strategies



You must segment your customers into four different groups; the first group, are your top ten to twenty percent that contribute the most profit. The second group is the next 40 to 50% that have the potential to move up in profitability. The third group (called the "bottom feeders"), which for many stores represent up to 20% of their customer base, have no potential to move up and their only purpose is to come in and help clean out your stores in January and July. The last group is the real problem/opportunity group. These are the customers who cost you money each time they come into the store, often they "rent" your merchandise and don't even pay the rent. You should even stop calling them customers, as calling them that can confuse you and make it more difficult to do what you need to do. Maybe, you should call them "crooks" or "loss-tomers" which is a better description of what they are.

300 w grand ave | ste 408 | 350 w hubbard st | ste 240 | chicago, il 60610
312.673.0187 tel | 312.835.5552 cell | 312.670.2250 fax | email: jimdion@dionco.com | www.dionco.com

These customers must be actively encouraged to shop somewhere else. It is difficult for most retailers to turn away customers, but you must be able to identify and then turn away the crooks or loss-tomers.

Making Up For A Return

Think of it this way. A shoe store has a customer who brings back a pair of shoes that have been worn, they are not defective, the customer claims that they do not fit and demands a refund or another pair. The selling price of the shoes was $85.00, the cost of the shoes was $46.75, the gross margin was $38.25, and the net profit was $8.50. If the store has to write off this pair of shoes, how many additional pairs does it have to sell to make up for the loss? The answer is ten pairs! The profit on ten pairs would be $85.00 which would cover the cost portion of writing off the first pair ($46.75) plus the lost margin of $38.25 which was needed to pay all the expenses of the store and yield the original 10% net profit. It is hard to believe that one return like this can put us this far in the hole, but it can. This is why it is so critical that you identify these "crooks" and simply stop doing business with them. The way that you would do this, is to track the return behavior of your customers and once a customer has more than two "less than righteous" returns, you flag that customer and inform them that "all sales are final" or you tell them that they are not being properly served by your store, based on their unhappiness with their last purchases, and that they would be better served by another retailer. Stop playing their game!

Find The Key

For your best customers, the most profitable ones, you can reward them for their good behavior by sending them thank you letters, giving them first notice of new arrivals, sending them gifts, anything which will increase the likelihood of them repeating that behavior (spending profitable dollars in your store). We do not advise giving them discounts as this will decrease their profitability. Think of why these customers shop in your store in the first place, and often it is for reasons beyond low price and you have to reinforce those reasons. Find out what they like about your store and give them more of that. It could be convenience, personal shopping, product knowledge, brands, personal relationships, etc. To find this out, you have to conduct research and this can be with focus groups or even a mailed questionnaire. Your best customers like being asked what they think of your store and will respond with good information that you can use to serve them better.

In the middle are often thousands of customers who have the potential to become good if not great customers and your job is to get them up to the top 20%. This can be achieved by also asking them what is important and then determining what strategies can most profitably be deployed to increase the spending of this group. Often it will require better selling skills in the store along with better assortments, presentation or additional brands. The key for this group is to find what makes them happy and make sure that providing that does not alienate your best customers.

Remember, you can put your business in peril by blindly believing that the customer is always right. Learn who is really paying the bills in your store, listen to them and build your business around them and not the crooks and bottom feeders.

300 w grand ave | ste 408 | 350 w hubbard st | ste 240 | chicago, il 60610
312.673.0187 tel | 312.835.5552 cell | 312.670.2250 fax | email: jimdion@dionco.com | www.dionco.com