'An essential survival guide for retailers'
PETER PRITCHARD, CEO, Pets at Home

REINVENTING RETAIL

THE NEW RULES THAT DRIVE SALES AND GROW PROFITS

IAN SHEPHERD

Praise for *Reinventing Retail*

*'*Reinventing Retail *is THE wake-up call that the industry needs. The message is clear – if companies do not grasp that they have to design every part of their organisation with the customer in mind, they will die. However, it does not need to be that way – Ian offers a definitive set of practical actions and insight that can help retailers thrive and grow in these turbulent times.'*

**Dr Geraint Evans, award-winning CMO,
academic researcher and writer**

'Ian Shepherd combines a far-sighted analysis of the changing commercial landscape with a practical set of options for today's retailers. Not just an essential read, but an invigorating toolbox of solutions.'

**Philip Downer, Managing Director,
Calliope Gifts; former CEO, Borders UK**

'Ian brings decades of experience in customer strategy to this book.'

**Clare Iles, Independent CRM and
Customer Engagement expert**

'Don't want to end up as a footnote in retail history? Then you have to understand how to operate in the "new normal". Ian Shepherd's solution is to cut through changes in technology, consumption, markets and customers to build agile and responsive organisations that do not just survive, but thrive. An easy-to-read blueprint that helps retailers capitalise on strengths and avoid being trapped by weaknesses - it helps you think through strategy and then supports you in execution. A must-have for anyone in retail who wants to do more than just survive in today's volatile market - use this and you should be able to work out how to thrive.'

**Professor Christopher Bones, Dean Emeritus,
Henley Business School; Professor Emeritus,
Alliance Manchester Business School;
Chairman, Good Growth**

The economics of doing the right thing

We have already discussed the fact that channel profitability is, for a modern retailer, the answer to the wrong question. In a world where customers shop through multiple channels, often for an individual purchase, it makes no sense to think about 'the internet channel' as being in some way less profitable than 'the retail channel', since neither can exist without the other. The right question for us to be asking is about the profitability of different customers, not of different sale channels.

We will take that thinking one step further. We need to move beyond thinking about the profitability of a customer for a specific transaction and instead think about the value of our relationship with our customers over the longer term.

On a particular day, I might buy a product from a retailer but then, getting it home, realise it isn't quite right for me and take it back later in the afternoon. Measured on that day, I'm not a particularly profitable customer. Indeed, the business might have lost money on me over the day if the product can't be easily resold or needs repackaging. A business can protect itself from my inconvenient behaviour with tougher returns policies, or cancellation charges if I've bought a subscription for something.

It's easy to see though, that the real value of my custom for that retailer isn't just measured on that one day. I might be a regular and valuable customer and indeed might have been for many years. The right way to deal with me in our thought experiment must be related somehow to the existence of that longer-term relationship.

A trainer I once knew used to illustrate this fact with the apocryphal story of the £9 pizza. A new employee in a pizza parlour gets into an argument with a customer who thinks that he has the wrong toppings on his pizza and refuses to refund him. The owner takes the new employee to one side and points out that that customer has been coming to the parlour every week since he was a little boy, and that the customer relationship that has just been sacrificed for the sake of £9 was actually worth tens of thousands.

Any good retailer knows this, which is why most would look after me when I tried to return my product even without knowing the long-term value of my business. Instinctively, they will take a hit on the day simply because of the chance that I will come back again and end up being a valuable customer. They will do the right thing for the long term at the expense of the short term.

Economically, we call this 'maximising customer lifetime value'. CLV is a simple concept. It measures the value of the business we do with a customer from the first sale we make with them to the last and recognises that a customer who makes small purchases but comes very frequently might be worth more than someone who makes a big purchase but only once. It also tells us that taking an action which encourages a customer to stay for longer can be just as profitable as taking an action that gets them to spend more on a particular day.

CLV is such a simple concept that every consumer business executive has heard it and used it a million times in meetings.

We might be familiar with the term, but have we really thought it through? Because the principle of CLV contains within it the solution to our dilemma – what to do when, in the New Normal, customers can unpack our costs and margins, object to our uneven pricing policies and reject our hidden charges. Consider how we might break down the constituent parts of the CLV equation.

If your objective is to maximise the long-term value of your relationship with each customer, then the right action to take at any

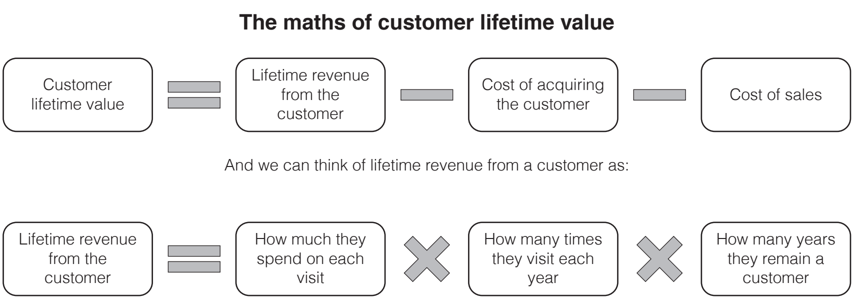

Figure 2.1 The maths of customer lifetime value

given point in time is self-evidently the one which supports that objective. If that means removing a hidden charge or reducing the price of a high-margin product then so be it. The long-term benefits will outweigh the short-term costs.

Won't they?

Well, only if we make the right decisions at the right time. Maximising CLV is not a blanket excuse to reduce every price or wipe out every source of short-term profit. If we make no profit in the short term, after all, then the long term will simply be the sum of a series of very small numbers.

As the economist John Maynard Keynes memorably said, in the long run we're all dead.

Indeed, a weakness of the CLV approach to customer relationships is that the future is inherently unknown and therefore involves some risk. If I asked you to give me £10 today on the basis that I'd pay you back £15 in a month, your decision about whether to make the loan would certainly be impacted by whether or not you were worried that I'd skip town in the meantime.

Inevitably, therefore, there is an allure to profit today versus profit at some point in the future. Economists call this the discount rate – the time value of money – and it represents a sensible reason why we might not always chase future profits at the expense of today's.

Too many boardroom discussions about changing prices and policies that customers dislike but which drive current profit founder on this point. Those advocating change end up sounding like flowery do-gooders who just want to make the change because it is the right thing to do and any financial analysis supporting the change looks like it is promising jam tomorrow instead of jam today.

But there is a gritty reality to the concept of customer lifetime value. If you continue to charge that innocent-looking booking fee, penal cancellation charge or ridiculous warranty premium and the result is simply that customers choose to shop elsewhere, then it won't just be in the long term that your business is dead.

The resolution to those challenging boardroom discussions is to develop a viewpoint on what the consequences will be of not changing. Observing customer reaction to particular price points or commercial policies and spotting competitors or new entrants gearing up to change the industry norms are key to building this case.

And it is here that our analysis of the New Normal is so powerful. This rule of the New Normal is important not just because it is true but also because it is relatively new. Once upon a time, when consumers had less information at their fingertips, or when those transaction costs of sharing information were higher, our current commercial policies might have made sense, and might indeed have represented the strategy which maximised customer lifetime value. Certainly, the subscription business I described earlier could prove that rewarding customers who threatened to leave and penalising those who didn't was the most valuable strategy – not just in the short term, but over the long term too.

But the world has changed. And with it, so must our commercial policies. As we'll explore next, consumers have never had more ability to band together and campaign or complain about things they regard as unfair. And as technology changes have reduced the cost of entering many industries, it has never been easier for a new entrant to pounce on those complaints and position themselves as the champion of the consumer, stealing your business along the way.

The power of listening

If the first part of our response to a new empowered and informed customer base is to consider the lifetime value of each customer, the second is to listen to them actively and intelligently.

The warning sign that a historical commercial policy or source of profit is becoming an issue is of course best seen in the attitudes and behaviours of your current customers and those of your competitors. We'll talk later about some of the common techniques you can use to make sure that you and your team are genuinely immersed in customer feedback. An excellent starting point, however, in the New Normal, is to make sure you are properly listening online.

I had a conversation once with a casual dining brand. Before going to meet them, I spent a few weeks filtering Twitter and Facebook discussions that mentioned their brand and those of their most obvious competitors. What struck me more than anything else when we met was that their carefully crafted brand and market research packs bore no resemblance at all to what customers were saying about them when they spoke to each other online. There really is no substitute for immersing yourself in the raw chaos of social media discussions if you want to find out what people really think of you.

That is particularly true when a board is being asked to make decisions about commercial and pricing policies. With the best will in the world, the people sitting around most board tables do not live in the same world as their customers, least of all when it comes to money. I gave a presentation to the board of one brand I worked with, demonstrating the maths of what it is like to live on the average household income in the UK. What seemed like an academic debate about how much we should increase our monthly price was, for real people, a matter of whether they bought our product or gave their kids a summer holiday.

Actively listening to customers (and those who choose to be customers of your competitors) is therefore a critical tool to enable us to spot aspects of our products or pricing that we should think about changing. Our CLV-based business case is dramatically more powerful if we have evidence with which to support an analysis of how much we might lose in the long term if we try to support the short term despite what our customers want.

Action planning

How do you listen to customers? I've never met anyone in retailing who said they didn't care what customers thought, but the process of gathering customer feedback varies widely from business to business, as shown below:

- Do you spend enough time working in your own stores to actually chat to customers or deal with complaints (rather than the much more common royal visit where you do a shift and spend the rest of the year talking about that one visit to a store)?

- Do you engage in focus groups or more interactive customer discussion sessions where issues can be vented and discussed in-depth?
- Do you do the same thing with customers of competitor brands to avoid the error of only listening to people who have chosen to do business with you?
- Do you read the comments on comment cards or customer feedback? Most executives I know will spend time reading the feedback summary report which gives the scores on the various questions that have been asked, but few will read the raw text of the 'any other comments' box, which is usually where all the useful data is.
- Do you listen in or take calls in your call centre?
- Do you respond personally to emails or social media-generated complaints?

A business where senior executives really know what's going on in the minds of customers, and those who choose to go to competitors, is self-evidently a much stronger one. How organised is your 'customer closeness' programme and how widely does it stretch across your management team?

Don't be like the CEO of one business who boasted that he knew what his customers were thinking because he talked to his chauffeur!

There is an additional benefit to getting to know what is in our customers' minds, and that is in understanding what pricing and commercial actions we might take that they might not like, but would regard as at least fair. Here lies the reconciliation between this rule and the last one.

For Rule 1, we discussed the importance of finding opportunities to price at a premium (or at least earn a margin) where we can in order to avoid being picked off by low-price competitors. However, we have now recognised that some of the historical margin