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PROGRAM SUMMARY

Strategic Planning and Management in Retailing Program Continues Its Run

In September 2007, the Strategic Planning and Management in Retailing Program ran for the 47th time in North America and the 22nd time at Babson College. Larry Ring and John Strong were the program faculty. Retail executives from nine countries attended the program. This program currently is offered twice in North America (at Babson and at the College of William and Mary) and once in Australia and in Singapore (both sponsored by Monash University in Australia). The program is next scheduled to be offered April 26–May 2, 2008 at William and Mary in Williamsburg. Those interested are encouraged to apply early. To register, contact Susan Hartshorn at shartshorn@babson.edu, or at 781-239-2923.

The program was kicked off with “The Eight Ways to Win in Retailing,” and featured cases on Target Stores in 2006, Best Buy and Best Buy in 2006, Zara, Seven Eleven Japan, and Meijer. In addition, the faculty deliv-

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ered lectures and exercises on financial and productivity analysis, strategic thinking and planning, category scorecards, basket analysis, and supply chain management. On Wednesday afternoon, September 19, the group participated in a store tour with visits to Wal-Mart, BJ’s Wholesale Club, Target, Walgreen’s, Whole Foods Market, Trader Joe’s, Staples, Shopper’s World Power Center (including Best Buy, DSW, Toys “R” Us, Barnes & Noble, T.J. Maxx, Sports Authority, and others), and the newly reconstructed Natick Mall, now called the Natick Collection (Nordstrom, Neiman Marcus, Macy’s, Lord and Taylor, Sears, J. C. Penney, and numerous specialty stores). The highlight of the trip was our visit and guided tour of Jordan’s Furniture, including a viewing of its “Mardi Gras” show and its IMAX Theater.

Babson’s Executive Conference Center made for an ideal learning environment and, of course, the food was excellent. Participants were treated to a lobster and clam bake upon returning from their store tour on Wednesday. Thursday’s lunch was the annual Doug Tigert Cheeseburger BBQ. Susan Hartshorn served as program manager and housemother, and looked after all members of the diverse group of participants who represented nine countries.

Strategic Profit Model Results for U.S. Retailers for 2006

The table on pages 3–4 reports the most recent Strategic Profit Model (SPM) results for the 37 largest public U.S. retail companies based on sales. As we have done in the past, Tiffany, a jeweler, has been added to the list to make a total of 38 companies.

Twenty-three of the 38 companies listed here improved their after-tax return on year-end net worth (RONW) for 2006 from 2005. This compared to 24 that improved in 2005 versus 2004.

Amazon.com was the top performer for 2006, with an after-tax RONW of 44.08 percent. This was the first year of meaningful numbers for the online retailer as it displaced longtime leader TJX at the top of the list. Amazon achieved its position primarily because of very high leverage (10 times) on a fairly pedestrian ROA of 4.35 percent.

After six straight years at the top of the list, TJX finished second in 2006 with an RONW of nearly 34 percent, down slightly from 36 percent in 2005. TJX now has been first or second in our listing for an impressive 10 consecutive years. As we have observed for several years, opportunistic merchandising seems to continue to work very well. Apparently, there is a never-ending supply of obsolesces, fashion mistakes, end-of-runs, bankruptcies, train wrecks, and the like. More important, value retailing continues to produce great results.

However, there also is room for good upscale retailers as Nordstrom was again in third position in 2006 with a 31.27 RONW as the family management team clearly has this chain humming along. Nordstrom now has improved from 7 percent in 2002 to 15 percent in 2003 to 22 percent in 2004 to 26 percent in 2005 to 31 percent now.

J. C. Penney was in fourth place at 26.45 percent, up from 24.38 percent in 2005. This promotional department store, having shed its drug business, seems much more focused, and the results are starting to show it. Perhaps, J. C. Penney also is benefiting from Sears' lack of focus.

Home Depot had sales in 2006 of nearly \$91 billion, making it the second largest retailer in the U.S. and the

third largest in the world. This company was fifth on our list with its highest-ever RONW of 23.02 percent, up from 21.7 percent in 2005 and 20.7 percent the previous year. Despite this financial performance, CEO Robert Nardelli was unceremoniously dumped after being roundly criticized for a lagging stock price and an outsized compensation package. (Apparently undaunted, he became the new CEO of Chrysler.) Home Depot's archrival, Lowe's, had a RONW in 2006 of 19.75 percent as the company continued to chase its much larger competitor.

The Limited, second in our 2005 listing with a nearly 27 percent RONW, slipped to sixth in 2006 with a 23 percent RONW. Kroger was just behind at 22.65 percent and continues to improve as the Cincinnati company passed Publix to become the No. 1 food retailer based on RONW. Publix came in 10th at 22.06 percent, down slightly from 23.52 percent in 2005.

Bed Bath & Beyond was in eighth place at 22.43 percent and down slightly from 2005. The No. 9 company in our listing was Best Buy at 22.22 percent, up slightly from 2005. Best Buy seems to have clearly left Circuit City in its dust. Family Dollar was in 11th position with 20.7 percent, much improved from the previous year.

Wal-Mart was in 12th place in the listing with RONW of 20.47 percent and has displayed remarkable consistency with its previous five years' RONW numbers at 21.73, 21.29, 20.76, 19.0, 20.1, and 20.8 percent, respectively. In addition to these outstanding returns, Wal-Mart now has pushed its sales to nearly \$350 billion in 2006, up from \$316 billion in 2005. Wal-Mart remains nearly four times larger than the next largest U.S. retailer.

Kohl's came in 13th in our ranking at 19.79 percent, up from 14.13 percent in 2005. Office Depot and Staples were close behind at 19.77 percent and 19.39 percent, respectively. This represented a major improvement for Office Depot. Druggist Walgreen's finished at 18.4 percent, up slightly from 2005, and Target was at 17.83 percent, also up slightly from 2005.

The Gap has dropped again to 15.04 percent from 23.3 percent two years ago. The chain continues to struggle with declining comps and a seeming inability to recapture consumers' imagination. It remains to be seen

if new leadership will make the difference. Dollar General dropped dramatically from 20.35 percent to 7.9 percent and shortly thereafter went private in a private equity deal.

As we scan the list, it is once again clear that the cream has clearly risen to the top of the retailing world. In order, we have the:

- Best Dot-com Retailer.....Amazon.com
- Best Off-PricerTJX
- Best Upscale Department StoreNordstrom
- Best Promotional Department Store.....J. C. Penney
- Best DIY/Home Improvement Chain....Home Depot
- Best Specialty Apparel ChainLimited
- Best Grocer.....Kroger
- Best Home RetailerBed Bath & Beyond
- Best Consumer Electronics ChainBest Buy
- Best Dollar Store.....Dollar General
- Best Discounter.....Wal-Mart
- Best Office Supplies Super Store.....Office Depot and Staples
- Best DruggistWalgreen's

As it has for several years, the traditional department stores continued to post fairly puny results as the sector continues to consolidate and struggles to find a place for itself among the discounters and the big boxes. Federated Department Stores, now renamed Macy's, was down slightly from last year to 8.06 percent. Saks Holdings continued to drop to a negative number, and, as of this date, has pretty well sold itself off. This company will drop off the list next year. Dillard's was at 9.02 percent and improved from 2005.

The traditional grocers (besides Publix and Kroger) continued to be in the bottom half of the list as Wal-Mart and Target Supercenters take their price/value customers and Whole Foods and other specialty grocers steal the cream off the top. Winn-Dixie and A&P have emerged from bankruptcy but remain near the bottom of the list. Supervalu was at 8.52 percent as it tries to digest the remains of Albertson's and others, while Safeway was at 15.36 percent and enjoying the fruits of its repositioning.

Others at the bottom of the list again were Rite Aid, Circuit City, and BJ's Wholesale Club.

2006 STRATEGIC PROFIT MODELS FOR SELECTED RETAILERS (RONW)

Retailer Name	Date	Sales '06 (in millions)	Return on Sales '06	Asset Turnover '06	Return on Assets '06	Financial Leverage '06	Return on Net Worth '06	Return on Net Worth '05	Return on Net Worth '04	Return on Net Worth '03	Return on Net Worth '02
AMAZON.COM	Dec-06	\$10,711.00	1.77%	2.45	4.35%	10.12	44.08%	nm	nm	nm	nm
TJX COMPANIES INC.	Jan-07	\$17,404.60	4.46%	2.86	12.76%	2.66	33.92%	36.48%	40.17%	42.41%	41.04%
NORDSTROM INC.	Jan-07	\$8,560.70	7.92%	1.78	14.06%	2.22	31.27%	26.34%	22.00%	14.86%	6.57%
J. C. PENNEY	Jan-07	\$19,903.00	5.70%	1.57	8.95%	2.96	26.45%	24.38%	13.74%	-17.11%	6.36%
HOME DEPOT INC.	Jan-07	\$90,837.00	6.34%	1.74	11.02%	2.09	23.02%	21.70%	20.70%	19.21%	18.50%
LIMITED INC.	Jan-07	\$10,671.00	6.33%	1.50	9.52%	2.40	22.84%	26.95%	30.19%	13.62%	10.33%
KROGER CO.	Jan-07	\$66,111.00	1.69%	3.12	5.26%	4.31	22.65%	21.82%	-2.82%	7.85%	31.30%
BED BATH & BEYOND INC.	Feb-07	\$6,617.40	8.98%	1.67	15.01%	1.49	22.43%	25.32%	22.91%	20.06%	20.80%
BEST BUY CO. INC.	Feb-07	\$35,934.00	3.83%	2.65	10.15%	2.19	22.22%	21.69%	20.99%	20.60%	0.01%
PUBLIX SUPER MARKETS INC.	Dec-06	\$21,819.73	5.03%	2.95	14.84%	1.49	22.06%	23.52%	22.85%	20.85%	21.01%
FAMILY DOLLAR STORES	Aug-07	\$6,834.00	3.56%	2.60	9.26%	2.24	20.70%	16.59%	15.25%	19.50%	20.10%
WAL-MART STORES	Jan-07	\$348,650.00	3.61%	2.31	8.34%	2.46	20.47%	21.73%	21.29%	20.76%	19.00%
KOHL'S CORP.	Jan-07	\$15,544.20	7.13%	1.72	12.26%	1.61	19.79%	14.13%	14.70%	14.11%	18.31%

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OFFICE DEPOT INC.	Dec-06	\$15,010.80	3.44%	2.28	7.86%	2.52	19.77%	10.00%	10.41%	9.89%	13.54%
LOWE'S COS.	Jan-07	\$46,927.00	6.62%	1.69	11.18%	1.77	19.75%	19.32%	18.86%	18.21%	17.72%
STAPLES INC.	Feb-07	\$18,160.80	5.36%	2.16	11.60%	1.67	19.39%	18.86%	17.21%	13.38%	16.78%
WALGREEN CO.	Aug-07	\$53,762.00	3.80%	2.78	10.57%	1.74	18.40%	17.31%	17.54%	16.53%	16.34%
TARGET CORP.	Feb-07	\$59,490.00	4.68%	1.59	7.46%	2.39	17.83%	16.95%	14.47%	16.64%	17.52%
SAFEWAY	Dec-06	\$40,185.00	2.17%	2.47	5.35%	2.87	15.36%	11.41%	13.01%	-4.66%	-22.83%
GAP INC.	Jan-07	\$15,943.00	4.88%	1.87	9.11%	1.65	15.04%	20.52%	23.30%	21.53%	13.05%
TIFFANY	Jan-07	\$2,648.30	9.59%	0.93	8.92%	1.58	14.07%	13.91%	17.89%	14.68%	15.73%
CVS CORP.	Dec-06	\$43,813.80	3.12%	2.13	6.65%	2.07	13.80%	14.70%	13.15%	14.07%	13.79%
BARNES & NOBLE	Jan-07	\$5,261.30	2.89%	1.65	4.76%	2.74	13.07%	13.30%	10.69%	12.06%	9.74%
COSTCO COMPANIES INC.	Sep-07	\$64,400.16	1.68%	3.28	5.52%	2.27	12.56%	12.09%	11.89%	11.57%	12.66%
SEARS HOLDINGS	Feb-07	\$53,012.00	2.81%	1.76	4.96%	2.36	11.72%	10.76%	6.19%	53.07%	20.38%
FOOTLOCKER	Jan-07	\$5,750.00	4.30%	1.77	7.60%	1.42	10.76%	12.97%	13.93%	15.05%	0.1378
DELHAIZE AMERICA	Dec-06	\$17,289.20	2.17%	1.93	4.19%	2.23	9.35%	8.74%	7.12%	5.46%	-1.06%
BLOCKBUSTER	Dec-06	\$5,523.50	1.23%	1.76	2.16%	4.23	9.15%	-93.11%	-117.49%	-30.12%	-39.06%
DILLARDS INC. -CL A	Jan-07	\$7,810.10	2.99%	1.44	4.31%	2.09	9.02%	5.19%	5.06%	0.42%	-17.58%
SUPERVALU INC.	Feb-07	\$37,406.00	1.21%	1.72	2.08%	4.09	8.52%	7.87%	15.37%	12.68%	12.79%
MACY'S	Jan-07	\$26,970.00	3.66%	0.91	3.34%	2.41	8.06%	10.16%	11.17%	11.67%	14.20%
DOLLAR GENERAL	Jan-07	\$9,169.80	1.50%	3.02	4.54%	1.74	7.90%	20.35%	20.43%	19.09%	20.57%
BJ'S WHOLESALE CLUB	Jan-07	\$8,303.50	0.87%	4.17	3.61%	1.95	7.06%	12.68%	12.41%	12.06%	17.68%
GREAT ATLANTIC & PAC TEA CO.	Feb-07	\$6,850.30	0.39%	3.24	1.25%	4.90	6.15%	-9.68%	-80.45%	-38.05%	-38.86%
WINN-DIXIE STORES INC.	Jun-07	\$4,524.48	0.63%	2.69	1.69%	2.08	3.53%	nm	-1,404.19%	7.85%	31.30%
RITE AID CORP.	Mar-07	\$17,507.70	0.15%	2.47	0.38%	4.26	1.61%	2.69%	na	na	na
CIRCUIT CITY STR	Feb-07	\$12,429.80	-0.08%	3.10	-0.25%	2.24	-0.57%	7.73%	2.87%	-4.02%	1.78%
SAKS HOLDINGS INC.	Feb-07	\$2,940.00	-0.25%	1.16	-0.29%	2.32	-0.67%	1.12%	2.93%	3.57%	1.07%

Strategic Profit Model Results for International Retailers for 2006

The table on the next two pages provides the Strategic Profit Model Results for 30 of the largest publicly held international retailing companies. This is our seventh year of compiling these statistics. Twelve countries are represented here; although, most of these retailers have at least continental, if not global operations. Among international retailers, the five largest are food retailers and all have European origins but are clearly global players. Carrefour (French) is the largest (by sales at \$110 billion), followed by Tesco (British, \$87 billion), Metro (German, \$85 billion), Royal Ahold (Dutch, \$59 billion), and Groupe Auchan (French, \$50 billion). Put in perspective, however, all five combined are just a bit larger than the world's No. 1 retailer, Wal-Mart at \$350 billion.

In terms of overall performance on return on net worth, 2006 saw Marks & Spencer continue as No. 1 at 56.82 percent, up from 45.06 percent last year. Woolworth's Australia, always near the top of the list, came second in 2006 at 34.04 percent, almost the same as in each of the last four years. Woolies now has distanced itself from Australian archrival Coles Group, which dropped

dramatically to 19.14 percent from 32.34 percent (and subsequently sold itself to Wesfarmers).

In third position was newly restructured Karstadt Quelle (and also newly named Arcandor AG). Arcandor leaped to a RONW 30.03 percent, up from a negative number the previous two years. Carrefour followed in fourth position at 23.14 percent, and Daiei was fifth at 22.23 percent. This Japanese retailer has undergone massive restructuring and store closings and now appears to be benefiting from those efforts—although much of its net income is still non-operating. Metro was in sixth position at 19.73 percent.

Otto Versand was eighth at 19.02 percent, up from 11.12 the previous year.

The next five in order were all food retailers, including: Jardine Matheson (Dairy Farm) at 18.50 percent (lots of leverage for this diversified trading warehouse) and up from 13.87 percent; Tesco at 17.96 percent (up slightly); Sainsbury at 15.57 percent and up dramatically from 2005; Groupe Auchan at RONW of 12.41 percent and down from 17.29 percent; and Delhaize at 10.12 percent, basically unchanged from 2005.

Among other food retailers, Coop was at 9.13 percent, Sobeys was at 8.79 percent RONW, Ahold rebounded to 7.11 percent after a negative year in 2005, and Migros was at 7.05 percent. The remaining food companies were

STRATEGIC PROFIT MODEL RESULTS FOR 2006 FOR SELECTED INTERNATIONAL RETAILERS (RONW)

Company Name	Country	Business Area	Date	Net Sales Millions US	Return on Sales '06	Asset Turnover '06	Return on Assets '06	Financial Leverage '05	Return on Net Worth '06	Return on Net Worth '05	Return on Net Worth '04	Return on Net Worth '03	Return on Net Worth '02
Marks & Spencer	UK	Broadline	Mar-07	\$17,520	10.91%	1.60	17.41%	3.26	56.82%	45.06%	23.92%	22.51%	14.50%
Woolworth's Limited	Australia	Food	Jun-07	\$38,015	4.42%	2.95	13.03%	2.61	34.04%	34.58%	35.98%	35.62%	35.70%
Karstadt Quelle (Arcandor AG)	Germany	Broadline	Dec-06	\$18,803	2.63%	1.65	4.32%	6.94	30.03%	-136.23%	-263.31%	6.29%	9.70%
Carrefour	France	Food	Dec-06	\$110,807	3.12%	1.64	5.12%	4.52	23.14%	15.31%	18.28%	22.98%	25.01%
Daiei	Japan	Broadline	Feb-07	\$11,016	3.22%	1.15	3.72%	5.98	22.23%	3.95%	nm	16.30%	nm
Metro	Germany	Food	Dec-06	\$85,224	1.99%	1.86	3.71%	5.32	19.73%	12.22%	16.72%	11.92%	11.82%
Coles Group Limited	Australia	Food	Jul-07	\$34,688	2.16%	3.57	7.69%	2.49	19.14%	32.34%	16.75%	15.10%	11.37%
Otto Versand (Otto GmbH & Co KG)	Germany	Specialty	Feb-07	\$21,779	3.32%	1.12	3.71%	5.12	19.02%	11.12%	6.04%	7.60%	13.28%

STRATEGIC PROFIT MODEL RESULTS FOR 2006 FOR SELECTED INTERNATIONAL RETAILERS (RONW)

Company Name	Country	Business Area	Date	Net Sales Millions US	Return on Sales '06	Asset Turnover '06	Return on Assets '06	Financial Leverage '05	Return on Net Worth '06	Return on Net Worth '05	Return on Net Worth '04	Return on Net Worth '03	Return on Net Worth '02
Jardine Matheson	China	Food	Dec-06	\$16,281	12.62%	0.80	10.08%	1.84	18.50%	13.87%	17.59%	6.75%	17.27%
Tesco	UK	Food	Feb-07	\$87,263	4.45%	1.72	7.66%	2.35	17.96%	16.89%	15.12%	13.85%	14.47%
J. Sainsbury	UK	Food	Mar-07	\$34,886	1.89%	1.79	3.38%	4.60	15.57%	1.45%	1.46%	12.79%	9.09%
Groupe Auchan	France	Food	Dec-06	\$49,733	2.17%	1.50	3.25%	3.82	12.41%	17.29%	9.04%	10.57%	4.97%
Delhaize	Belgium	Food	Dec-06	\$27,340	1.87%	2.07	3.88%	2.61	10.12%	10.16%	6.29%	5.14%	5.10%
El Corte Ingles	Spain	Broadline	Jan-06	\$22,667	4.12%	1.33	5.47%	1.80	9.85%	na	na	na	10.88%
Coop	Switzerland	Food	Dec-06	\$12,921	2.12%	1.40	2.98%	3.06	9.13%	5.37%	9.72%	5.21%	6.04%
Takashimaya	Japan	Broadline	Feb-07	\$8,756	2.51%	1.29	3.23%	2.73	8.83%	9.31%	7.12%	-1.97%	2.07%
Sobeys	Canada	Food	Apr-07	\$13,340	1.33%	3.20	4.27%	2.06	8.79%	10.32%	11.30%	10.63%	12.45%
PPR	France	Broadline	Dec-06	\$25,629	4.05%	0.80	3.25%	2.45	7.96%	7.06%	11.96%	9.34%	21.60%
Kingfisher	UK	Specialty	Jan-07	\$17,705	3.90%	1.01	3.93%	1.95	7.65%	5.37%	9.72%	5.21%	6.04%
Royal Ahold	Netherlands	Food	Dec-06	\$59,245	1.65%	1.90	3.13%	2.27	7.11%	-1.21%	-2.12%	-0.02%	-45.89%
Migros	Switzerland	Food	Dec-06	\$17,695	3.65%	1.17	4.28%	1.65	7.05%	7.26%	1.36%	3.60%	na
Seven and I Holdings	Japan	Food	Feb-07	\$42,065	2.76%	1.27	3.50%	2.00	7.00%	2.70%	1.11%	4.71%	5.80%
Aeon	Japan	Food	Feb-07	\$37,772	1.33%	1.23	1.63%	3.87	6.32%	4.28%	7.45%	11.55%	12.59%
Wm Morrison Supermarkets	UK	Food	Jan-07	\$25,518	1.99%	1.69	3.36%	1.88	6.31%	-7.54%	5.11%	8.91%	7.60%
Home Retail Group	UK	Broadline	Mar-07	\$11,002	3.34%	1.24	4.14%	1.47	6.09%	11.28%	na	na	na
Coop Norden	Sweden	Food	Dec-06	\$13,325	0.17%	4.22	0.73%	3.85	2.82%	-16.12%	0.77%	-5.01%	na
George Weston	Canada	Food	Dec-06	\$32,167	0.38%	1.73	0.65%	3.57	2.32%	13.66%	9.77%	17.75%	22.16%
Fonciere Euris	France	Food	Dec-06	\$33,115	0.33%	1.05	0.34%	4.51	1.55%	1.78%	15.83%	54.27%	11.99%
Dixon's (DSG International)	UK	Broadline	Apr-07	\$16,124	0.03%	1.99	0.06%	3.05	0.18%	18.68%	16.48%	19.09%	11.96%
UNY	Japan	Broadline	Feb-06	\$9,029	1.55%	0.00	0.00%	3.98	0.01%	4.44%	3.18%	4.59%	6.51%

all 7 percent RONW or less and former Canadian high flyer George Weston struggled with a disappointing 2.32 percent as Wal-Mart's presence in food in Canada increased. All told, this list is dominated by food retailers with 19 of the largest 30.

Among broadline retailers, after Marks & Spencer, Arcandor, and Daiei came El Corte Ingles at 9.85 percent, Takashimaya at 8.83 percent, PPR at 7.96 percent, Home Retail Group at 6.09 percent RONW, Dixon's at .18 per-

cent (and a huge drop from 2005 primarily due to restructuring charges), and UNY at .01 percent.

Overall, 17 of the 30 listed companies here for which data were available had a higher RONW in 2006 than 2005. It also remains the case that, in general, the largest international retailers carry significantly more leverage than do their U.S. counterparts. Despite lower levels of leverage, the U.S. retailers appear to be more profitable than their foreign counterparts. Our U.S. list shows

12 companies with a RONW of greater than 20 percent, while the international list contains just five companies with that kind of performance.

Lessons from Customer Loyalty Programs in Retailing

By John S. Strong

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The past three decades have seen fundamental changes in the role of information to manage and improve retail performance and productivity.ⁱ Today, such information helps to improve execution of retail initiatives, and indeed to define strategic opportunities (and problems). But along with unprecedented information comes the challenge of deciding how far to go with information efforts, as well as how to manage and integrate different types of information.

Product Information

The information revolution in retailing has had four major stages. Each stage was made possible in part by enabling technologies previously unavailable or too expensive. The first stage was driven by the adoption of UPC bar codes and point-of-sale scanning technology, which enabled retailers to obtain current information about item-level sales and profitability. This allowed retail buyers to undertake line reviews and category management to a degree not previously possible. Although the 80/20 rule was often asserted, retailers learned that in practice, this outcome depended on how you defined a category and the degree of oversight of buying activity. In some cases, return distributions were even more skewed, with 10 percent or less of items comprising 80 percent of sales and margin. The distribution of sales was seen to depend on category definitions and policies with respect to purchase orders and safety stocks. This led to much more powerful tools to enhance strong performing items, to identify candidates for delisting, and to classify items into category roles such as traffic drivers, profit drivers, or assortment enhancers.

The development of retail category management had implications for retail strategy and operations beyond the

buying function. One result was to accelerate the shift in power from suppliers to retailers, especially from branded, fast-moving consumer goods companies. In addition, current sales data led to greater pressure to improve supply chain performance. Major efforts were made to reduce the prevalence of out-of-stocks and so adding full-margin sales, while helping to establish min-max order and inventory policies at the item level. This enabled retailers to generate higher sales and returns (GMROI) with less inventory investment. Moreover, it became clear that the benefits of strong category management reinforced the competitive advantage of every day low price (EDLP) value retailers at the expense of promotional high/low operators.

Basket and Transaction Information

The second stage involved the development of transactional and operational data, enabling retailers to analyze transactions at the basket level. Although at this stage transactions were not associated with a specific customer, the information allowed retailers to gain better understanding of both customer experience and product relationships. In terms of customer experience, retailers were able to understand conversion rates and shopping characteristics and profitability by season, day, or hour. More recently, this information has been supplemented by “customer experience data” which attempts to observe how customers shop and what problems, bottlenecks, or frustration factors they encounter—and the consequences of these issues (lost sales, smaller baskets, less frequent store visits, etc.).ⁱⁱ Together, these efforts allow stores to develop and monitor programs designed to increase number, size, or mix of transactions.

In terms of product relationships, basket analysis allowed estimation of cross-shop relationships and their effects on basket size and value. This led to better promotional activities and understanding the effects of deletions or promotions on the total merchandise offer. For example, it was now possible to assess the effectiveness of traffic drivers—did they actually drive traffic, and if so—what else did those customers buy, and how profitable was it for the retailer?

Customer Information

The third stage was the ability to identify specific customers with their transactions, extending basket

analysis and profitability to customers. This stage was facilitated by two developments—greater personalized transaction information from payment systems such as credit cards, and the advent of customer loyalty programs.

This stage followed the widespread dissemination of research findings that keeping and enhancing relationships with existing customers held great potential for increasing value. The development of customer relationship management (CRM) software led to rapid growth. Datamonitor estimates that global CRM license revenues grew from less than \$500 million in 1999 to \$3.6 billion in 2006, and is forecast to rise to \$6.6 billion by 2012. This does not include the additional costs incurred by companies to run customer loyalty programs; according to Gartner Group, U.S. companies spent more than \$1.2 billion on such programs in 2003. Overall, current spending on global customer programs is on the order of \$5 billion–\$7 billion annually. At the company level, consulting firm Ovum estimates that for every dollar spent on constructing a data warehouse, \$4 is spent annually on its care and feeding (managing, updating, and using it).ⁱⁱⁱ

Retailers have had long experience with formal loyalty programs. Trading stamps had been in existence since the mid-1800s, originally as a means of rewarding cash customers versus those who paid on credit.^{iv} The largest such program, the Sperry and Hutchinson (S&H) Green Stamp program, was first offered in 1896, and became very popular in the 1930s. Stores purchased stamps from S&H and gave them to shoppers in proportion to sales. Shoppers could then redeem accumulated stamps for products from the S&H catalog. By the 1960s, the program had become so large that S&H actually sold three times as many stamps as the United States Postal Service! However, the rising cost of the program and frequent stamp wars with double and triple awards led supermarkets to realize that the prevalence and the general nature of rewards provided limited benefits to increased sales, margin, or market share. As a result, stores began to focus more on their own product discounts and sales. This shift transformed into more extensive coupon and promotional strategies still prevalent today.

A New Generation of Retailer Loyalty Programs

Increasing competition and the perceived success of customer loyalty programs in the airline and hotel industry

in the 1980s and 1990s pushed retailers to reconsider the development of customer loyalty programs. What was different was the effort to match a specific name or household to products and purchasing behavior. By 2003, more than 60 percent of U.S. food, drug, and mass retailers had some form of loyalty program. According to Jupiter Research, more than 75 percent of U.S. consumers had at least one loyalty card. More than one-third of the shopping population has two or more cards. The heaviest shoppers not only have multiple customer loyalty cards, but have multiple cards with the same retail segment (grocers, pharmacy, and apparel). Today, this new generation of customer programs is well-established enough to summarize experience to date and to identify lessons for retailers to improve the performance of their programs.

Lessons from Loyalty Programs

1. Loyalty program economics are much more challenging in retail than in hospitality.

Airlines and hotels have high, short-run fixed costs and low marginal costs (since the plane is going to fly anyway, the opportunity to fill an otherwise empty seat creates large incremental operating profits). In this setting, providing benefits in the form of miles or points to spur extra passengers creates the opportunity for high marginal profits. In addition, the cost of airline ticket rewards can be limited by capacity controls or blackout periods. In contrast, the short-run fixed costs are lower in retail, as the cost of goods sold is a larger percentage of selling price. Thus, driving additional volumes results in smaller incremental profits than for a hotel or an airline. This does not mean that these incremental gross margin dollars are unimportant, but rather that the comparison of incremental costs and benefits is likely to be much closer.

2. Most retailing programs break even or lose money on a stand-alone basis, so that information insights into other business decisions must be significant.

Customer loyalty programs are expensive to run. Prior to its acquisition by Wal-Mart, ASDA (UK) estimated that operating a nationwide program in Britain would cost at least £60 million annually, and decided that benefits would not approach that amount. Even the most heralded program, Tesco's Clubcard, operated only on a break-even

RETAILERS NEED TO GARNER ADDITIONAL INSIGHTS FROM THEIR CUSTOMER LOYALTY PROGRAM THAT IMPROVE PERFORMANCE IN INDIRECT WAYS.

basis for its first decade.^v A financial model of alternative loyalty initiatives developed by Rigby and Ledingham illustrates many of the tradeoffs and shows that in many cases it is very hard for a program to be cost-effective.^{vi} This is especially true if the program is designed to reduce customer defections, as it is very difficult to accurately predict such at-risk customers. Another challenge is that giving discounts to members of a program may not increase volumes, but increase more cherry-picking behavior. This is especially true if discounts are tied to specific purchases through Point of Sale couponing, rather than benefits tied to overall customer value.

As a result, retailers need to garner additional insights from their customer loyalty program that improve performance in indirect ways. For example, customer data may help to tailor store assortments or to better forecast or “guide” purchase behavior. For example, Amazon.com’s customer database enables the company to make suggestions for books and other items by suggesting other related items that have been purchased by similar customers. This application has spurred bundling and increased average transaction size.

3. The widespread adoption of loyalty programs by both retailers and customers has reduced the effectiveness of driving incremental purchases or share, especially for retail segments that involve frequent visits and commoditized purchases.

Since almost every retailer has a customer program and many consumers have multiple loyalty memberships, the existence of a program in itself has had little effect on market share. However, the absence of a program in many sectors (such as supermarkets) may have reduced share. In effect, a customer program keeps you in the game, but doesn’t differentiate you. To do that, retailers need to have a program which is demonstrably better or different from others.

4. Recency, Frequency, Value (RFV) analysis is a good place to start, but it doesn’t tell you what to do.

The recency, frequency, and value framework has been the most common analysis undertaken with customer data. Recency (when did you shop last) is intended to provide information about potential defections; frequency of shopping provides information about the strength of relationship with the store; and value provides information about individual customer profitability. However, these are just starting points—they need to be accompanied by a plan of response (e.g., what do we do if a customer’s visits are declining?).

5. Using customer data for market segmentation and targeting is a good idea, but one that is very hard to execute for many retail formats.

Getting customer clusters right is rife with challenges. Tesco has approached the problem by organizing their segmentation in terms of customer characteristics including life stage, shopping habits, brand loyalty, and promotional sensitivity.^{vii} These customer segments are then broken down further into groups based on the types of products they buy, such as organic or prepared foods. A major benefit has been much better targeting of promotions, with savings from these efforts being redirected to lower prices on those items that are central to customer price perceptions.

The large number of transactions, the high frequency of visits, relatively well-defined trade areas, the different nature of shopping trips, and the complexity of baskets (food and nonfood items) make supermarkets a good fit for defining customer segments from a wealth of data. For example, Clubcard information has allowed Tesco to identify more than 20 distinct customer segments—each of which receives specialized communication (more than 4 million versions of the quarterly mailing are sent to approximately 15 million Clubcard holders).^{viii}

In contrast, many apparel retailers have customers that visit four to six times a year, with limited purchase baskets, so there is much less data to group customers into segments. Moreover, unlike the supermarket where restocking purchases are the norm, many apparel store transactions are one-off in character, limiting the forecasting value of such data. In these cases, retailers should spend more time trying to understand each customer’s behavior and

tailoring contact on a 1:1 basis, rather than defining interactions by segment.

6. The opportunity for 1:1 targeting requires permission to be successful.

Many of the highest value shoppers belong to multiple loyalty programs. A common complaint is feeling bombarded by information, offers, and various discounts. Retailers who have been most successful at targeting individual customers have done so by keeping their communications less frequent, but more meaningful and more valuable. The best results also have tended to come from customers who were given the choice to opt in to receive these communications.

7. Best customers are more important and more unknown than you think.

One of the most important and surprising results from customer loyalty data is that a core group of shoppers represent a huge share of business. It is not uncommon for the top customers to be worth 10–15 times more than the average customer. For Tesco, the 100 best customers at a given store spent more than the bottom 4,000. For Neiman Marcus, the top 100,000 customers account for more than half of total company sales, spending an average of \$12,000 annually versus \$600 for the average customer.^{ix}

In many cases, though, even store managers don't know who many of these customers are. Surveys suggest that store associates tend to think best customers are the ones they see the most or with whom they spend the most time. But many of the very best customers like the store and just quietly go about their business. The challenge is how to recognize and enhance their support. One example is that some food and drug retailers have pushed category management to recognize which items are purchased by the best customers. They then make sure in-stock levels and targets are very high for these items.

IT IS NOT UNCOMMON FOR THE TOP CUSTOMERS TO BE WORTH 10–15 TIMES MORE THAN THE AVERAGE CUSTOMER.

8. Reward structures work best when they are simple and are tied to your own store.

There are three basic classes of reward structures. The first are discount-led programs. These discounts can be associated with current behavior (coupons that you receive at checkout for discounts on future transactions), or they can be based on past behavior (rebates based on purchase volumes in some designated prior period). Discounts have been most effective for retailers when they are received prior to a store visit, and where they can be applied to a broad range of purchases. For example, Tesco's program provides a 1 percent rebate based on purchases in the prior quarter in the form of Clubcard points, which can be used as a cash equivalent for any items. This flexibility has been shown to increase incremental spend and transaction profitability when points as currency are used.

The degree of discounting and price competition in many markets is so strong that discount programs may be perceived to be of limited value (the perspective that "even with this discount, I can buy this item cheaper somewhere else."). In fact, retailers have tended to be frugal with the value of these rebates. A customer program member who spends \$20,000 at a department store typically might receive a gift card worth \$500–\$800, meaning that such rebate rewards are on the order of 2.5 percent to 4 percent. This rebate is commonly seen as quite small given high average price points, margins, and ubiquitous off-price alternatives. The result is a preference by many of the best customers for privileges rather than rebates or discounts.

The second reward structures are points-led programs in which customers accumulate points in a multivendor program, such as FlyBuys in Australia or Nectar in the U.K. The problem with these programs is that the benefits do not tie back to the retailer. While retail purchases tend to be among the greatest drivers of points accumulation, only a trivial percentage of program rewards revert back to the retailer. Most of the rewards that are redeemed are for travel, especially by air. While consumers may see such programs as valuable, they are limited in their positive benefits for retailers.

The third class of rewards involves privilege-led programs. These structures typically offer nonprice benefits if certain purchase thresholds are achieved. For example, retailers

may offer free shipping and returns on online purchases, may open stores early for their best customers, or may offer special events such as fashion shows or invitations to store opening galas. For many retailers—especially those in segments where frequency of visits may be less frequent—these types of programs have been quite successful.

9. Qualifications for customer tiers need to be simple and seen as fair.

Consumers have come to accept and understand that retailers may offer their best customers additional perquisites or privileges. However, it needs to be clear what you need to do to achieve such special status, and how such status is retained. Trying to offer too many different levels is confusing (“Am I bronze, silver, gold, or platinum? And what does that mean?”). It is much better to have fewer tiers with significant differences in qualifications, so that large numbers of customers don’t bounce around across levels over time.

A good example of a simple and attractive loyalty program is that of Chico’s FAS, a midprice women’s casual apparel chain. Chico’s Passport Club is based on lifetime (not annual) spending. Once a customer spends \$500, she becomes a permanent Passport Club member, entitling her to a 5 percent lifetime discount on all items, advance sale notices, free shipping on catalog or online orders, and a 20 percent discount on your birthday. In 2006, there were 1.7 million permanent members representing 78 percent of sales. These members visited the stores seven times annually versus four times for the average shopper, with average transaction spending twice as high. The program with its mix of discounts and benefits has become a core part of the business.

10. Many customer loyalty programs still are ready, fire, aim.

Despite the challenges, developing a customer strategy has become as essential as product and store operations as part of retail strategy.^x Customers are increasingly being seen as assets, not sales. The best practitioners bring together product, transaction, and customer data—and have a plan what they are going to do with it. Retailers need to know why they are launching or operating a customer loyalty program. Are you trying to increase sales or margins or cross-shopping? Are you trying to increase basket size or frequency of shop? The most successful

programs have clearly identified objectives and metrics that are directly related to those goals. In other words, treat your loyalty program as a business.

ⁱ For a discussion of techniques and methodologies behind data analysis, see M. Berry and G. Linoff, *Data Mining Techniques*, Second Edition, (Indianapolis: Wiley Publishing, 2004). For discussion of managerial aspects, see M. Krafft, and M. Mantrala, editors, *Retailing in the 21st Century*, (Berlin: Springer, 2006). For a detailed case study of development, execution, and application in retailing, see C. Humby, T. Hunt, and T. Phillips, *Scoring Points: How Tesco is Winning Customer Loyalty*, (London: Kogan Page, 2004).

ⁱⁱ See R. Burke, “The Third Wave of Marketing Intelligence,” in Krafft and Mantrala, op. cit, pp. 113-125.

ⁱⁱⁱ C. Humby, T. Hunt, and T. Phillips, *Scoring Points*, op cit, p. 105.

^{iv} Trading stamp information from <http://www.shsolutions.com/history.html>.

^v C. Humby, T. Hunt, and T. Phillips, *Scoring Points*, op cit., p.5.

^{vi} D. Rigby and D. Ledingham, “CRM Done Right,” *Harvard Business Review*, November 2004, pp. 10-11.

^{vii} See Humby et al., *Scoring Points*.

^{viii} Information from company annual reports, available at www.tesco.com.

^{ix} V. O’Connell, “Posh Retailers Pile on Perks for Top Customers,” *The Wall Street Journal*, April 26, 2007, p. D1.

^x A good article on developing a customer strategy is presented in R. Winer, “A Framework for Customer Relationship Management,” *California Management Review*, Vol. 43 No. 4, Summer 2001, pp. 89-105.

2008 PROGRAM DATES

- William and Mary, April 26–May 2
- Monash, May 25–30
- Singapore, June 22–27
- Babson, September 13–19

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