OLIVER WYMAN

# THE CUSTOMER CENTRICITY PARADOX

## WHY STARTING WITH YOUR CUSTOMERS MAY BE THE WORST WAY TO SERVE THEM

MARSH GUY CARPENTER MERCER OLIVER WYMAN MARSH & McLENNAN COMPANIES

# WHY STARTING WITH YOUR CUSTOMERS MAY BE THE WORST WAY TO SERVE THEM

Over the past decade, few concepts in retail have resonated as strongly as 'customer centricity'. Many retailers have long suspected that they could do more to enhance their appeal to customers. Now that good data on individual customers is commonplace, it's easy to understand why retailers have been eager to use this information to more systematically understand customer needs. And it's hard to disagree that doing the right thing for customers is generally good practice.

Nonetheless, the prize remains elusive. In our conversations with retail executives, no-one tells us they feel they are making the most of customer centricity. Many say they can't define exactly what customer centricity *means*, and some express scepticism about whether it's 'just another marketing fad'. Best practice for customer centricity seems to involve little more than bombarding customers with electronic coupons, the vast majority of which are ignored.

But customer centricity should be more than this. Though under-realised today, it has great potential as a sales driver. This paper summarises our view of what customer centricity really is; explains why it is so rarely achieved in practice; and provides some advice on how retailers can start to get more from it.

## THE PROMISE

Is customer centricity more than just hype? Our answer is a resounding 'yes'. Harnessing customer data can substantially improve a retailer's performance. To explain why, it's important to start by articulating what customer centricity is: in our view, it has four distinct aspects.

First, customer centricity is a way of **acknowledging that customers, markets, and stores are different from one another**. It is about bringing that realisation to life by creating a frame of reference and a language for talking about those differences, and so establishing a segmented way of talking about the business rather than an 'averaged' one. It's a basic concept, but few retailers make decisions this way at the moment.

Second, it is about **building meaningful one-to-one connections with customers**. Retailers have a wide variety of individualised channels available: Direct mail, in-store coupons at the tills or a kiosk, email, and mobile devices. Customer centricity means using these channels to deliver personalised value to customers. As well as building the brand and generating loyalty, targeting discounts in this way offers much better economics than conventional promotions or price changes – and so is much more effective for driving sales.

Third, customer centricity means **using customer data to make better day-to-day decisions**. Some decisions can only be made correctly by understanding individual customers and the choices they make – even when the decisions affect *all* customers. For example, when choosing which products to carry, a retailer needs to identify items that inspire strong loyalty. Such items may be slow sellers, but removing them from the assortment is a sure way of losing money. Similarly, when cutting prices, targeting investment in the right places requires knowing which customers will show the greatest response, and in which categories and stores.

Fourth, customer centricity means **helping store managers and associates understand their customers**. Insights about the customer base shouldn't stay at head office: they need to reach individual stores. Helping store managers understand their local customers and how they are positioned relative to nearby competitors can allow a much greater degree of devolved, local decision making. Giving store associates information about the types of customers and shopping occasions they serve can also improve face-to-face interactions – especially valuable in high-touch, assisted-sale retail sectors.

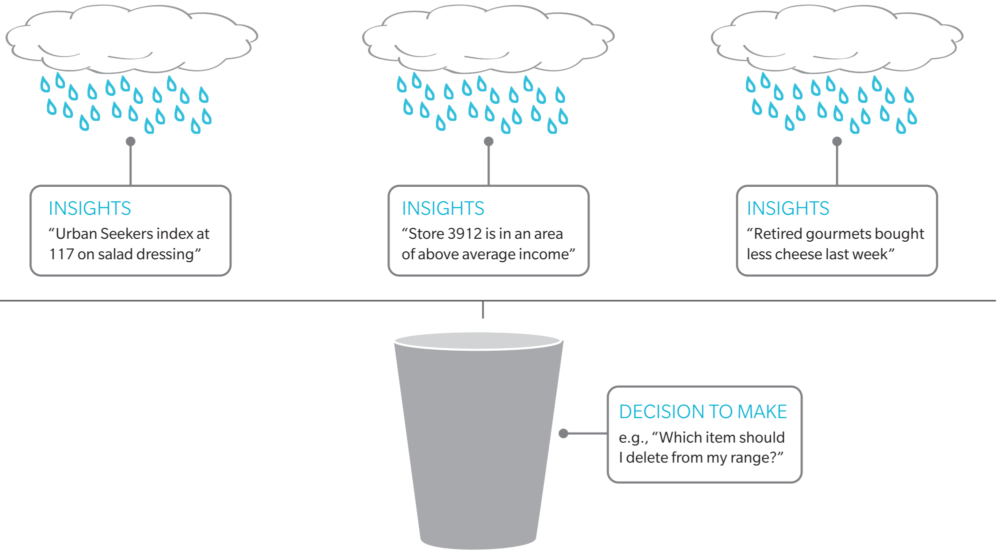
## THE REALITY

So customer centricity programmes have considerable promise – at least in theory. But in practice they have rarely lived up to their potential.

While customer segmentation has been used to good effect in strategic direction-setting discussions and in developing marketing campaigns, they are difficult to deploy in other contexts, especially within Trading. Segments may start out as a precise set of characteristics, but can quickly take on a life of their own, such as a case we saw where 60% of customers in one retailer's 'Young Families' segment had no children. Here, a useful shorthand had quickly turned into a misleading generalisation. Episodes like this are common, and undermine the credibility of segmentation efforts in general.

One-to-one marketing is the area in which customer centricity programmes have had the greatest impact so far. Retailers can drive significant sales gains by taking money out of inefficient promotions, or even by raising prices overall and redirecting investment into direct marketing programmes. For example, taking a point or two of sales from basic promotions (or from price increases) and putting it into targeted offers could deliver five or more points of like-for-like sales. The trouble for many retailers is that this is as far as they can take it. They struggle to find a sufficient number of better-than-breakeven offers to justify a spend of more than one or two points. As a result, these programmes are very limited in scale, and while the teams running these programmes often (correctly) trumpet them as their company's best sales drivers, operators simultaneously grumble that they just can't see those programmes shifting their business.

## EXHIBIT 1: CUSTOMER CENTRICITY IS OFTEN JUST A DELUGE OF INFORMATION




Retailers that pursue customer centricity may succeed in rapidly creating a deluge of individual insights. But it isn't always clear if or why an individual insight matters, and those tasked with making a specific decision are not guaranteed to get the insights they need. In such cases, decision makers may feel more 'soaked' then 'quenched' by customer centricity.

Customer centricity programmes have often had the greatest difficulty landing successfully in Trading. Traders are used to making decisions about products, not about customers. To them, customer centricity often feels like it's being forced into decision-making contexts where it doesn't belong. This can cause a lot of friction between Marketing and Trading organisations. One grocery category manager was told that the 'Urban Seekers' segment indexed at 117 on salad dressing. "What am I supposed to do with that information?" he asked. "Carry more? Lower my retails? What?" In another case, a Trading organisation systematically redesigned its category planning process to include customer segment-level data, giving the buyers seven times as much data to collect and digest, when they were already impossibly busy.

Overall, the hoped-for cultural shift away from the buy side and towards a culture of selling has happened only rarely. Too often, customer centricity has been a theoretical curiosity dreamed up by Marketing, rather than something that changes the customer experience in the store.

So what can retailers do to help bridge the gap between this reality and customer centricity's potential?

## BRIDGING THE GAP

It turns out that a single, fundamental mistake explains most difficulties with customer centricity. Most companies try to be customer centric by starting with customers: they learn everything they possibly can about them, then attempt to push the information they accumulate into every decision, see *Exhibit 1*. This order is exactly backwards. To make customer centricity work in practice, a retailer needs to *start* with the set of decisions that are important in running the business, and *then* figure out how understanding customers can help them make those decisions better.

Applying this rule, segmentation becomes a different exercise. Instead of focusing on a single description of customers that tries to meet the needs of the entire business, different segmentations are used for different decisions, and many of these won't overlap at all, see *Exhibit 2*. When setting prices, it is necessary to know how price-sensitive customers are, and that means knowing not only who they are but also who else is competing for their business. On the other hand, managing assortment requires knowing how customers choose between products, and how product-loyal they are – neither of which has anything to do with price sensitivity. The two decisions therefore require different segmentations. So beginning with your decisions, not your customers, naturally leads you to ask what segmentations you need, not just how to use the one you've got.

As far as one-to-one marketing is concerned, it's possible to enlarge a programme to a scale that will have real impact. Too often, companies spend time sourcing coupons or designing offers, then scan their databases to find customers they think may be receptive. One-to-one channels are there to build relationships with customers, not to off load coupons. The relevant question is, "How do I make *this* customer a better customer?" and that is a question that can be asked of *every* customer. Moving from big programmes that you hope will work for everyone towards personalised campaigns that nudge a person's behaviour in the right direction a little bit at a time allows far more investment in high-return offers.

### EXHIBIT 2: EFFECTIVE SEGMENTATION

| LEVER | DECISION TO BE MADE | SEGMENTATION NEEDED TO ANSWER QUESTION |
|---|---|---|
| PRICING | What should be my base price for this product? | • Demographics – Income<br>• Competitive intensity |
| PROMOTIONS | Should I promote this product this week and if so, how? | • Share of wallet<br>• Customer loyalty |
| ASSORTMENT | Which items should I put in this planogram? | • Customer lifetime value<br>• Demographics – Ethnicity/Income |

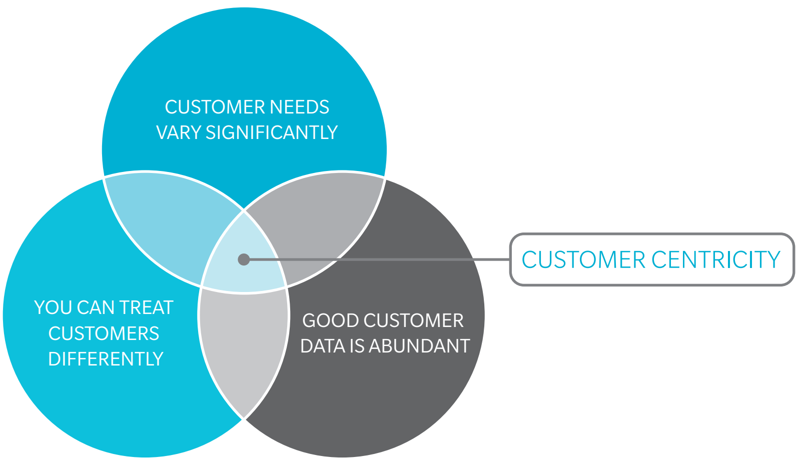
The fundamental challenge for segmentation is that the basic dimensions are different depending on which lever is being managed. No single segmentation ever meets all these needs.

When customer centricity begins with the decisions that need to be made, not just with 'interesting facts about customers', it can actually bring Marketing and Trading closer together. As described earlier, having a list of named segments and penetration levels doesn't in itself help a trader decide what products to carry. But when you ask what customer information might improve or simplify that decision, you create a completely different dynamic.

Customer data is highly relevant here. You can begin by observing how customers switch between products over time to understand each item's true substitutability. Then you can link in estimates of customers' lifetime value to better understand which items drive a halo effect across the store. You can incorporate segment data, to help you build an assortment that is relevant not just for your existing customers, but for the market as a whole. Combine all of this information, and you have a picture of which items have the highest incremental value: a very good way to build up a planogram.

The same mind-set can be productive and empowering in stores: where a store manager needs to decide which promotions to put on which endcaps, knowing which promotions generate the best customer response in that particular store will yield better results. Managers need to build schedules for associates. Knowing what sorts of shopping occasions happen when makes it easier to write schedules to provide adequate service coverage, with the right level and type of labour at the right times. Similarly, a store associate selling a mobile phone may want to know the best strategy for selling its accessories at the same time. Knowing a few key facts about the person who is shopping can help pick the strategy most likely to work: we've seen one electronics retailer put laminated cards at the cash register with selling tactics for several different types of customers. Associates learned how to quickly classify shoppers by asking a few simple questions and then to follow the right, tailored selling approach. Almost immediately, accessories sales shot up.

EXHIBIT 3: CUSTOMER CENTRICITY



# CONCLUSION

Customer centricity has been around for some time. But retailers have continually struggled to unlock its transformative potential, and many have come to doubt its value. We see a common theme in these struggles. Most retailers that try to be customer centric see it as a challenge to make sense out of their large and growing set of customer data. But this process separates insight generation from decision making, and the result is a deluge of facts that complicates decisions without improving them. There is a better way, and that, paradoxically, is to treat customers not as the starting point but as the endpoint of customer centricity. Getting customer centricity right means focusing intently on the decisions that need to be made. The right pieces for customer centricity are all already there, see *Exhibit 3*. It's just that for many retailers, they're in the wrong order.

## ABOUT OLIVER WYMAN

Oliver Wyman is a global leader in management consulting that combines deep industry knowledge with specialised expertise in strategy, operations, risk management, and organisation transformation.

In the Retail practice, we draw on unrivalled customer and strategic insight and state-of-the-art analytical techniques to deliver better results for our clients. We understand what it takes to win in retail: an obsession with serving the customer, constant dedication to better execution, and a relentless drive to improve capabilities. We believe our hands-on approach to making change happen is truly unique – and over the last 20 years, we've built our business by helping retailers build theirs.

www.oliverwyman.com

## FOR MORE INFORMATION PLEASE CONTACT


Matthew Isotta
Global Retail Practice Leader
matthew.isotta@oliverwyman.com
+971 4425 7026

James Bacos
EMEA Retail Practice Leader
james.bacos@oliverwyman.com
+49 89 939 49 441

Paul Beswick
North American Retail Practice Leader
paul.beswick@oliverwyman.com
+1 617 424 3259

Bernard Demeure
French and Iberian Retail Practice Leader
bernard.demeure@oliverwyman.com
+33 1 45023 209

Nick Harrison
UK Retail Practice Leader
nick.harrison@oliverwyman.com
+44 20 7 852 7773

Sirko Siemssen
Central European Retail Practice Leader
sirko.siemssen@oliverwyman.com
+49 89 939 49 574

Riccardo Trentini
Italian and Turkish Retail Practice Leader
riccardo.trentini@oliverwyman.com
+39 02 305 771




OLIVER WYMAN