

MODELING YOUR WAY THROUGH THE ECONOMIC MUDDLE

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Article of Interest



It is no secret that the current economic situation has hit retailers hard. Same store sales are down or just about holding steady and even high-end consumers are curtailing their spending. The difference in the purchase patterns of high-end consumers may not be because of any real change to their economic state but rather a crisis of confidence or a desire to restrain expressions of affluence while others are in distress. Aspirational buyers have moved down a rung or two on the hierarchy of brands and core buyers, less flush but still brand loyal, are purchasing at discount or through the Off Price channel.

In the face of this, retailers have a set of needs that are sometimes conflicting: **to maximize revenue; to continue to engage customers in order to stem long-term attrition**, including those pulling back on their spending; **to support channels appropriately**, especially the full price retail channel, which seems to be taking the brunt of the revenue crunch; and **to gain the greatest, accountable value from marketing budgets, which are certain to come under eagle-eye scrutiny during this challenging business cycle.**

One of the strongest weapons available to retailers is modeling, a database marketing tool that offers the ability to target and measure highly specific marketing goals and, when necessary, create a balance among them.

In addition, models can drive valuable customer insight that might not otherwise be available through simpler data mining and segmentation methodologies. Difficult economic times seem to drive greater differentiation among customer segments and modeling is ideal at uncovering them so that marketers can develop effective strategies targeted to each segment.

HERE ARE SOME WAYS THAT MODELING CAN WORK FOR RETAILERS IN TIMES OF ECONOMIC STRESS:

CHANNEL CONVERSION MODELS

Many retailers with an Off Price footprint are seeing real growth on the Off Price side while Full Price Retail falters. Clearly, many consumers, while still brand loyal, have shifted their spending to the Off Price channel. Because retailers have a need to support their established retail locations, a Channel Conversion Model can help drive some of the Off Price spending back to Full Price Retail, especially during a sales event. MBS recently implemented an Off-Price-to-Full-Price Conversion Model for a retailer that drove significant lifts in response rate (29%), sales (20.6%), and sales-per-piece (20.6%) for deciles 1 - 4, successfully identifying those customers most likely to buy in Full Price Retail if given the right incentive. The ultimate win was that MBS's client has found an efficient and productive approach to driving Full Price Retail sales, even during a difficult economy.

RESPONSE/SUPPRESSION MODELS

Response Models are tried-and-true analytical applications that have proven effective in both good times and bad. Currently, many direct marketers are experiencing falling response rates and are looking to mail deeper and deeper into their house files to make up the difference. Live testing of progressively deeper segments can be a slow, tedious, and risky process. A model can provide better, faster results.

On the flip side, for marketers already mailing deep into their house files, models can be used to identify unproductive segments from the circulation plan. These models might be considered Suppression Models but they are simply the inverse of a response model and applied in exactly the same way.

MBS recently helped our client develop such a Suppression Model, going head-to-head against their RFM segmentation with positive results. This client expects to be able to cut circulation by 10%, losing the costs associated with non-responsive customers and retaining the profit generated by the responsive segments. Because mailing costs are expected to increase even further in the near future, they have taken a highly effective step in the right direction to combat the ongoing challenge of rising costs.

RESPONSE/REVENUE MODELS

During a weak economy marketers are under a lot of pressure to drive revenue but they cannot lose sight of their mission to support the brand and keep customers across an array of segments engaged so that their loyalty is intact when good economic times return.

The modeler, therefore, must set out to optimize both response and revenue - a delicate balancing act in even the best of times. An excellent example of this particular challenge is a model that MBS recently developed for one of our clients, a department store Home Division that offers merchandise across an array of price points - from small appliances, tableware, and bedding on the lower end, to furniture and rugs on the higher end. We have aptly named this our "Rugs to Mugs" Model.

Because we had two opposing goals, we employed two types of modeling techniques - logistic regression analysis to drive response and linear regression analysis to maximize revenue. If we put too much emphasis on the logistic aspect, we would drive a higher response rates, albeit for lower ticket items ("mugs"); if we put too much emphasis on the linear aspect, we would drive much lower response rates for higher price point items ("rugs").

In addition, MBS recognized that this client fielded two very different types of promotional events - one day/short term sales, which tended to feature more moderate priced merchandise, and long term sales, which tended to offer higher end, big ticket items like leather sofas and hand-tied oriental rugs. Therefore we recommended that two different models be developed - the first for one-day sales and the second for all others.

The first model was successful in selecting customers most likely to respond to "buy now" one-day sales offers. Interestingly, customers who scored in the highest deciles of the one-day model were less affluent than those who scored in the lowest deciles. Conversely, the second model identified more affluent core buyers who would be more likely to purchase at the higher price points featured in the long term sales.

Ultimately, a 50/50 mix of the each modeling technique optimized performance for each model. The beauty of these models is that they drove the desired response and revenue while keeping an array of customer segments, including "aspirational" who otherwise might have abandoned the retailer altogether in a weak economy, appropriately engaged with the brand.