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Customer Retention in On-line Retail

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Let's step back in time for a moment and look at what retail was like half a decade ago. The owner of the little corner shop had known you since you were a child. When you walked in the door he greeted you by name, asked you about your family and wanted to know how much you liked the blue shirt you bought last week. Because he knew how you loved them, he told you that fresh oranges had just come in. When you asked him about a new vacuum cleaner, he explained the product to you and also let you know that your neighbor had just bought one the week before and was very happy with it. When you bought five oranges, he stuck another one in your bag for free and told you that diapers would be on sale next week because he knew you had been watching your budget ever since the baby arrived.

Coming back to the world of today, we realize that for the most part, this kind of very personal shopping experience and customer service has been lost in these days of anonymous hyper-markets. Personal relationships with retailers are exceptions. Retailers cannot tailor offers to specific customers and their needs anymore. To make up for this lack of focus and personalization, retailers undertake huge amounts of advertising.

However, information about customer's needs and preferences *does* exist. If someone buys diapers in a supermarket one week, it's highly likely that the same person will be interested in a special offer for baby food the next. Unfortunately, this information is not available in a usable, digitized format; therefore, it's very difficult for the retailer to make use of it. Because the retailer cannot attribute diaper purchases to any specific shopper, he advertises the baby food offer in the regional newspaper—even though at least ninety percent of the people who read the ad won't buy baby food, regardless of the price or the amount of advertising. Why not? Because they don't have a baby!

On-line retail can be a retailer's dream come true: because of the wealth of information available in a digitized format about that customer, online retail enables the retailer to tailor the offered products or services to a specific customer's needs. As the Internet provides new and different opportunities to do business and to service customers, the rules of the retail game are changing dramatically.

This article focuses on the success factors for on-line retail and on the possible website features that can support these success factors.

Success factors in on-line retail

When you get ready to open a virtual store, you have to think about creating an interesting user interface, getting traffic to your site and converting the people who visit your site into paying customers. But to ensure profitability in the long-run, *customer retention* becomes more and more important. Building on-line customer retention comprises three basic elements:

> ***Customer Loyalty:*** A loyal customer is a customer who keeps coming back to your website to buy your product or service. You might think it doesn't really matter if the same customer comes back or if a new customer visits the site and makes a purchase. However, there *are* considerable differences: loyal customers require no additional marketing or set-up costs, generally provide a higher revenue per purchase, are less sensitive to price and refer new customers (F. Reichheld, *Harvard Business Review*, March-April 1996). Customer loyalty is especially important in electronic commerce, where the switching costs between different websites are low but the marketing costs to win a new customer are relatively high. Due to the "law of increasing returns" in networked communities, each additional customer represents exponentially increasing value and therefore losing a customer hurts twice as much.
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> ***Share of Wallet:*** Once the retailer has convinced the customer to come back and buy again, the next step is to increase the share of wallet. This concept entails selling more and more products to the same customer and reducing the customer's purchases from traditional brick-and-mortar retailers, thus increasing revenue without increasing the number of customers. The challenge here lies in estimating the size of the overall "wallet" before understanding your share of that wallet.
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> ***Product Margin:*** When a retailer offers many different products, some products are almost always more profitable than others. Therefore, to increase profitability, it is important to monitor the margin of the products a customer is buying and to actively push products with high margins; naturally website features that point customers to high-margin products are particularly valuable.

It is crucial to consider these factors before designing a virtual store; clearly, when a retailer sets out a goal of customer retention, specific website features must be included. As described below, the design of the user interface, the underlying database, the content of the website and the kinds of alliances with business partners may be completely different when designing a website focused on customer retention.

Customer Retention Website Features

There are five basic principles that can be used to increase customer retention in on-line retail. Some are unique to the on-line environment; others could also be put to use by traditional retailers. Table 1 gives an overview of different features and the elements of customer retention each supports.

Table 1: Range of website features supporting customer retention

Value-added information

A powerful tool to ensure that the customer comes back to the website involves offering the value-added information that the customer wants to have before making a purchase. For example, if the customer's objective is to prepare a special dinner for guests, he'll usually decide on a recipe first and then buy the necessary ingredients. When an on-line supermarket offers recipes and the customer finds a recipe he likes, the chances increase that he will also buy the ingredients from that website. The retailer caters to the customer's desire for convenience by anticipating and satisfying that customer's information needs. The value-added information not only makes sure that the customer comes back to the website, but also it provides opportunities for the retailer to increase share of wallet and profitability. By offering mouthwatering recipes and providing the convenience of putting the right amount of every ingredient into the shopping basket with one mouse-click, the retailer has a strong tool to increase his share of wallet with this customer. It also allows the retailer to push higher-margin products by promoting recipes that call for those ingredients.

In order to be able to provide the value-added information necessary to support the customer's buying decisions, the retailer might have to invest heavily. The other option is to form a strategic alliance with another company to provide the information. However, in order to obtain the full benefit from the alliance, the value-added information must be fully incorporated into the retailer's website and interact with the retailer's offerings. For example, simple links from a website with recipes to a website for groceries—where the customer has to key in all the recipe's ingredients again—is neither likely to impress the user nor to enforce customer retention; what seems like such a surefire alliance may very likely turn customers off. Examples like this emphasize the importance of analyzing customer-retention tools before developing even the first concept for a website.

Personalization

Personalizing product or service offerings to a customer's individual needs is another effective method for increasing customer retention. The more a customer buys from a certain retailer, the more information the retailer has about that customer—and the better the retailer can tailor the product offering to individual needs. This long-heralded segment-of-one—where product offerings and marketing are adapted to the needs of individual customers—has become reality! The customer is unlikely to switch to another retailer, because a different retailer—with no access to the detailed, historical information on the customer's preferences and buying behavior—will not be able to address his particular needs nearly as well.

A word of caution: It's important to let the customer know that your site is personalized, especially when word-of-mouth is an important avenue for obtaining new customers. If the customer does not know that your offer is tailored to his specific interests and needs, he may like the site but may not advocate it to friends or colleagues who have different interests.

Obviously, in order to tailor offers to an individual, the retailer first must learn about that person's needs, interests and preferences. There are two different ways to obtain this information: By observing the customer's actions or asking the customer questions.

> ***Point of entry:*** Without asking the customer any direct questions, the retailer can learn a great deal about her by looking at the Internet link she used to enter the retailer's website. This can be especially valuable if the point of entry is a very targeted website. For example, if a customer enters a travel agent's website through the website of a scuba diver community, this specific insight points the travel agent toward focusing offerings on scuba-diving destinations. If the analysis of the Internet entry point shows that the customer lives in a wealthy area, this, too, could serve as a first indication for possible interests and needs.
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> ***Buying patterns:*** The website can also obtain a wealth of information by analyzing the customer's buying patterns. A customer might buy a high percentage of luxury goods or always select the cheapest offering; he might buy diapers frequently, thus indicating that he has a baby; perhaps he booked a golf hotel through the retailer's website last year. If the database allows analysis of such data, recent buying patterns can offer invaluable information. In addition to actual buying patterns, the retailer can analyze what products the customer has looked at without buying and at what level of detail he reviewed these products.
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> ***Questions to the customer:*** Of course, the easiest way to obtain information about the customer is simply to ask. However, unless there is some immediate benefit, the customer might be reluctant to answer. Even if the retailer asks only one question, there should be an obvious benefit for the customer. For example, if an on-line grocer asks a customer if she is a vegetarian, there is an immediate benefit for the customer if—in the future—the website will display only vegetarian foods and offer vegetarian recipes. Similarly, if a travel agent asks a customer about the sports he likes, there would be an immediate benefit for the customer if the website only shows him hotels featuring that offer the desired sport from now on. The same kinds of information could also be obtained—with a lot more work—if the retailer tracks the customer's selections while surfing on the website.

If the retailer can't deliver immediate customer benefits through tailored product offerings, he can always offer tangible benefits in return for answering questions. Probably one of the most important pieces of information a retailer can get about a customer is his e-mail address. If the e-mail address is not required to deliver the product itself, there are other ways to get in. The retailer could ask for the e-mail address in order to confirm an order or to inform the customer about order status and expected delivery time; the retailer could ask the customer for his e-mail address and, in return, offer free first-time delivery, a six-month warranty extension on ordered products, or bonus points in the retailer's customer loyalty program. To make sure that customers are not put off, questions should be asked very selectively; each time, it should be clear how the customer would benefit from answering.

Taking another tack, the retailer could let the customer herself consciously tailor the site to her own personal needs and preferences. The customer could de-select the areas of the product range she does not want to buy. For example, if a customer is a health-conscious vegetarian, she might ask not to see meat or sweets in an on-line grocery store. Going further, the customer could select areas or products about which she would like to receive e-mails. For instance, a customer might want to be informed via e-mail about every flight special from Frankfurt to Venice. If the retailer gives the customer the ability to tailor the website to her needs—and the customer takes advantage of this feature—there is a high probability that the customer will be loyal to that website. She most likely will not want to go through the whole profile-building exercise again with another retailer.

Customers are increasingly concerned about on-line privacy and question the value of voluntarily abdicating their right to privacy. Furthermore, in many countries, legislation limits companies' ability to gather information without the customer's knowledge and permission. Therefore, customers must be informed about what information is collected and what it is used for—in particular when it is sold or given to third parties. Being entirely open about this and offering benefits for participating—including the ability to see and modify personal information—is key for successful "permission marketing."

Intelligent communication

Once the retailer has obtained information about a customer, he can begin communicating intelligently with that person. The difference between intelligent communication and advertising lies in the relevance for the customer. If 19 out of 20 e-mail messages the customer receives from the retailer are totally irrelevant, he will remove himself from the retailer's mailing list as quickly as possible. If 15 out of 20 messages are of interest to the customer—because they actually address *his* needs—he will probably look forward to the next message. Therefore, intelligent communication should be rooted in information about the customer's needs, interests and preferences. Be sure that the customer considers both on-line and off-line communications useful. Otherwise, the website loses credibility—and in the end, loses the customer.

> ***Off-line communication****:* Off-line communication refers to communication with the customer when he is not on the website. The objective of off-line communication is to bring the customer back to the retailer's website. The easiest and least expensive way to communicate with the customer off-line is to send him an e-mail; that's why it's so vital to obtain the customer's correct e-mail address as quickly as possible. If the customer does not come back to the website on his own and the retailer doesn't have his e-mail address, it becomes much more expensive—and in many cases virtually unfeasible—to contact him again. From the knowledge that the retailer has collected about the customer, he should be able to craft a message that will induce the customer to re-visit the website. The more accurate and detailed the information the retailer has about the customer, the greater the opportunity to create an interesting offer.
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> One way to make sure the customer comes to the website soon after receiving the retailer's e-mail is to offer a low-price product (loss leader) for a limited amount of time. This also ensures that the retailer does not have to sell too many of the loss leaders to customers who happen to be on the website anyway. Think about offering a product below-cost or at zero-margin, as a way to pay the customer for visiting the website. Of course, this will be profitable only if the customer also buys other products once he is on the website. If the analysis of customer buying patterns shows that certain customers only come to the site to buy the advertised product and nothing else, consider excluding these people from future off-line communication campaigns because—although they are increasing revenue—they are actually decreasing profit.
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> Another efficient method of off-line communication is to remind the customer of something important. For example, if the customer used a car dealer's website to book an appointment to get his car serviced, the dealer can remind the customer via e-mail the next time the car needs an inspection and propose possible appointment dates. The customer only has to select one and press <reply>, and the dealer has secured customer loyalty. Depending on the kind of business, there are various ways to induce customers to come back to websites. Remember, however, that customers always must think e-mails from retailers are valuable.
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> ***On-line communication****:* On-line communication refers to communication with the customer when he is on the website. The objective of on-line communication is to increase sales volume and push high-margin products. However, pushing high-margin products should not translate into the customer thinking that the retailer is pushing *expensive* products. For example, travel agents do not make a lot of money on trans-Atlantic flights; in fact, the margins on hotel bookings and car rentals are considerably higher. When a customer who books a flight from London to Miami is also offered a hotel and a rental car for a reasonable price, he will probably consider this a convenient one-stop service instead of suspecting that the travel agent only wants to push high-margin products. Similarly, when the customer buys coffee (a typical loss leader), the system could then ask if he needs coffee filters (a high-margin product). Again, the customer who is thus reminded will probably think of this as a helpful hint—not as a crafty way to cross-sell a high-margin product. In this way, cross-selling, if it is used properly, not only can increase share of wallet, but also boost profitability. Conversely, if the customer comes to a website to buy coffee filters, the retailer would be wise not to ruin his margin by reminding the customer that he might also need coffee.

User-generated content

User-generated content can take two forms: customer feedback or on-line communication directly between users. Both can serve to build a community. The web gives the retailer the unique opportunity to make individual customer comments accessible to all customers. Think about it: have you ever been in a restaurant all by yourself with no other guests? How did you feel? You probably wondered what was wrong with the restaurant—was the food that bad or was there something going on that you didn't know about? It's not surprising that a customer on a website might feel the same way. He might wonder if this is really a trustworthy company he is buying from; having to key in a credit card number gives most people pause. He might wonder about the quality of the products and if they are actually as good as promised. So when he sees a lot of comments from other customers displayed, he feels better knowing that others frequently buy on this site.

Displaying honest—both good *and* bad— customer feedback on the website also gives the retailer credibility, which is extremely important in the impersonal Internet environment. For example, Amazon.com is not afraid of displaying negative comments about its books; every comment is always couched as a reader's personal opinion. The more customer feedback there is, the easier it is for a new customer to make an informed decision; this in turn, increases customer satisfaction and—ultimately—customer retention. If a travel agent's website displays a "negative" customer comment because a hotel has no discotheque, someone else may choose the same hotel for that very reason. User-generated content provides competitive advantage that cannot easily be duplicated; furthermore, it increases switching costs and makes it extremely difficult for competitors to draw customers away from the site. Last but not least, most people who have taken the time to comment will come back to the site just to see if their comments are actually displayed and accessible. Who doesn't like to see his personal opinion published?

Apart from publicizing customer comments and opinions for the benefit of the customer such feedback is also invaluable for the on-line retailer himself. It gives the retailer a chance to improve his products and service. Through customer feedback, the retailer can easily identify those products that sound good on the website (otherwise, customers would not have bought them in the first place), but fail to satisfy customers. Such products should be improved or eliminated because they lead to customer defection and negative word-of-mouth. Customer feedback also gives the retailer a chance to obtain immediate information about the efficiency of his distribution and payment systems. A word to the wise: this type of customer feedback should be looked at as an early warning system only. The retailer should take it quite seriously, but not publicize it on the website.

In addition to facilitating communication between customers and retailer, on-line retailers should consider fostering communication between customers themselves. New technology can allow customers to see who else is on-line and to communicate instantly with them. Many people find this valuable. Imagine a customer who is trying to select a hotel for an upcoming Caribbean holiday. The customer is very keen on in-line skating; therefore, she would like to know if the roads around the hotel are suitable. The information is not available in the travel agent's hotel description; nor have other customers commented on the roads. But this customer finds out that another customer who has just been to that hotel is currently on-line, and she is able to ask the newly-returned customer all sorts of relevant questions. In addition to the direct benefit of being able to make an informed decision about the hotel, the customer also feels part of the larger community. Even better, customer loyalty actually is increased, as that customer can't take the website community with her if she chooses to shop at a competitor's website.

Therefore, user-generated content is one of the most powerful tools for increased customer retention. The "law of increasing returns" ensures self-reinforcing success: a linear increase in the number of customers leads to an exponential increase in the value of the website. Each additional member increases the value of the site, and in turn attracts more members (K. Kelly, *New Rules for the New Economy*, 1998). As more people frequent the website and generate content, the more valuable the website becomes for the users themselves—as well as for potential new customers. Thus, a website that accumulates a great deal of meaningful user-generated content and hosts dozens of chat groups becomes increasingly attractive for new customers. At the same time, it becomes extremely difficult for competitors to draw customers away from such sites or even to retain new customers on their sites. This principle highlights again the importance of the first-mover advantage in electronic commerce.

Loyalty incentives

A loyalty program is a way of influencing and changing a customer's buying behavior. Generally, retailers reward customers for activities that are highly desirable and lead to enhanced profitability, increased revenues, greater numbers of purchases or more new customers referred. Loyalty schemes can also offer incentives for tasks that overcome barriers to purchase. Doing something for the first time often constitutes a barrier for a customer, because he must obtain and understand new information and do things he has never done before. One way to make sure the customer is not put off by the barriers is to offer high-loyalty incentives for doing something for the first time.

For example, if the retailer introduces a new payment system, he could offer a large loyalty bonus for any first-time user. Similarly, the introduction of new telephone cards could be linked to a bonus for the first call using the new card. Once the customer has cleared the first-time user hurdle and has discovered how easy and convenient it really is, chances are that he will use the card more often, thus increasing the revenue for the retailer. When offering first-time bonuses, the retailer must be able to identify the customer correctly; otherwise, repeat customers will claim the first-time bonus every single time (e.g., using a slightly different name). This can be avoided by not giving a direct incentive, but by offering points in a loyalty program in which the customer must accumulate points before gaining rewards.

Recognize that the customer doesn't even have to know he's included in a loyalty scheme. Since the Internet provides a unique opportunity to market to segments-of-one, retailers actually can reward extremely loyal or profitable customers by offering them products at a very special price available to no one else. (Even if legal obligations must require the retailer to offer the product to everyone, this does not mean that he must actively inform everyone about it.) Thus, the retailer can favor highly desirable customers by giving them—on-line or off-line—first-hand information about specials.

On the other hand, it can be very helpful for retailers to inform customers of a loyalty scheme: knowing that he's attained a certain status with a retailer and that he may therefore be accorded valuable privileges and exclusive treatment can be a very powerful incentive for a customer to be loyal to a website. Much like frequent flier programs that guarantee an airline's best customers preferred treatment when allocating scarce resources (e.g., seats on fully booked flights), on-line retailers can offer preferred treatment for their most loyal customers. This could include anything from free shipping or more bonus points per purchase to holiday bookings without cancellation fees.

Another valuable website feature entails giving incentives to loyal customers who tell their friends or colleagues how wonderful the website is. Loyal customers could have the opportunity to send an e-mail to a friend with a personal message and a link to the website. This digitized word-of-mouth testimonial also allows the retailer to reward the most active advocates of his website within the customer loyalty scheme. If it normally costs a retailer $200 to obtain a new customer, he can easily offer a bonus of up to that amount for a successful referral, especially since referred customers tend to be more loyal than customers obtained in any other way.

Happily, loyalty programs on the Internet are much easier to administer than traditional loyalty programs—because any buying information is already available in a digitized format. Therefore, such programs require less administrative upkeep. There are no limits in imaging different kinds of rewards that could be offered in the loyalty scheme. From free purchases and free delivery to warranty extensions and other preferential treatment—anything is possible.

Incorporating A Customer Retention Focus into the Website Design

Evaluating different website features that reinforce customer retention underscores how important it is for these features to be incorporated from the very outset of website development. Of course, the price of admission for performing segment-of-one marketing is a database that allows easy access to purchase history, profitability per customer, and customer loyalty information. The database should also be designed to measure the success of marketing activities such as intelligent on-line and off-line communication; this kind of feedback will allow the retailer to fine-tune communication campaigns. Retailers might also consider measuring necessary repurchase ratio, average revenue per purchase and the percentage of effective cross-selling.

Given the time required to build these capabilities, it may make sense for retailers to consider entering alliances instead of trying to do it all by themselves. In fact, for developing some value-added features, partnerships with companies from other industries might be the only way to offer the right information for the customer. Remember that the company that secures the best website partners has an inherent first-mover advantage that will be hard to duplicate.

Obviously, such alliances will open up completely new territories for most retailers. For example, a supermarket might form an alliance with a cookbook publisher to obtain access to a large number of top-quality recipes. Partnerships and alliances like this can help retailers increase website content, reach critical mass quickly and supplement missing competencies and skills. Building a profitable website that retains customers and forges a strong community of users is a lot more complicated than designing lots of colorful web pages and waiting for the revenue to roll in. Quickly scan the retailer websites that are up and running on the Internet today; comparing them with the concepts outlined above will underscore the fact that most sites still have a very long way to go. That means *you* have a great opportunity to become the first-mover in your space. Seize it!