Libey-Concordia Economic Outlook

and

Secrets of the Catalog Master

MeritDirect Co-Op Edition: August 2005

Donald R. Libey, Editor

Published Exclusively For Clients Of

Libey-Concordia

Advisors and Investment Bankers to the Direct Marketing Industry

Philadelphia, Pennsylvania
Cherry Hill, New Jersey
Des Moines, Iowa
www.libey.com

MeritDirect Press to Release First Book

Libey and Pickering on RFM and Beyond

MeritDirect Press, the book publishing endeavor of MeritDirect, will release its first book at the September 2005 DMA Conference in Atlanta. Written by Don Libey and Christopher Pickering, the book is titled **Libey and Pickering on RFM and Beyond.** ***It explores optimized RFM plus product, channel, position and market. The 360 page, hardbound book will be distributed in the U.S. through Amazon.com, in Europe through Synergy Partnership Ltd., and in Canada through Lloydmedia, Inc. MeritDirect Press publishes books that assist multi-channel direct marketers to become more successful and profitable. Established by the partners of MeritDirect, the mission of MeritDirect Press is to bring knowledge and wisdom of multi-channel direct marketing to clients and the professional direct marketing community. Here are a number of advance excerpts from selected chapters of the book.***

Chapter One: Recency

Recency and the Customer Database: Libey

Database technology is neither mystical nor arcane. There are those who would have the database seem mystical and arcane because they have a vested interest in keeping it that way. Actually, databases are nothing more than shoeboxes.

Years ago, peddlers scribbled customer information notes on 3 x 5 cards and filed them alphabetically by customer name in a shoebox. Every purchase was recorded, including the date, the product, the price, personal details to trigger future sales, gossip picked up from neighbors, and other details supporting future sales and recency. Every time a sale was made, the card was pulled and updated and re-filed in the box. Before a sales call was made, the card was consulted and the intuitive knowledge brought top of mind for the crafty peddler. Children's names, color preferences, sizes, birthdays, returns, income and all manner of useful information was recorded to assist the peddler in making another sale now, or on future trips. The hearts and souls of the customers were contained in those shoeboxes.

Now, it should be recognized that not every peddler used the shoebox method; only a few mastered this technology. The rest proceeded from place to place guided by the seat of their pants, relying on serendipity or luck. But the shoebox peddlers were successful where others failed. They employed knowledge rather than charm, and knowledge always wins. They were actually the first true merchandisers because they knew what the customer wanted before the customer knew and they knew where, when, why and how to present those products to each customer to assure a sale.

Today's advanced database technologies are basically file cards in a shoebox. For all of our sophistication and technological advancement we still scribble notations on the customer cards whenever we make a sales call and whenever someone buys from us. And, we are interested in the same information that the 19th century peddler captured. It is interesting that the peddlers experienced the same technology demands we experience today. At some point, they found they needed more memory for their shoebox databases. Their solution: they doubled the memory by moving up to 5 x 6 cards. Does anyone remember the early Remington Rand Cardex systems used for customer files?

The method of organizing the customer database is, essentially, alphabetically by name. We use phone numbers, customer numbers and other identification notations, but we find a single customer by sorting in one way or another. The end result is still the same: We get the information we need to make another sale. One component of that information is recency.

Where the peddler had one shoebox, we have multiple shoeboxes. We may have one for catalog customers, one for retail customers, one for web customers, one for e-mail customers, one for infomercial customers, and so on. Where the peddler made notes on one card, we may be making notes on five cards, as well as cross-notes on all cards. When we get a catalog order, we note it on the customer's card in the catalog shoebox. We also note it on the customer's card in the web shoebox, because last time that customer bought through the web site. And we note it on the card in the infomercial shoebox and the one in the retail shoebox, because the customer has bought in those channels also. It's important. We need to know everything. It just might come in handy. After all, we're obsessed with this stuff.

The peddler, preparing the wagon for a swing through the territory, would go through the customer cards and redistribute them into a logical route format–the *circulation plan*–that ordered the trip and the information about the customers to be contacted on that trip–or the *contact strategy*. Perhaps only those customers who had purchased every year for the past five years would be called on during that year's trip. Perhaps only those customers who purchased something two years ago but had not purchased anything during last year's trip would be called on. If the peddler was trying to expand the business, perhaps people who had never bought, living close to customers who had bought regularly, would be squeezed in between customer calls. A number of

choices were available to the peddler depending on the business strategy and the accurate knowledge of customer history found in the shoebox.

Once the peddler had selected the customers to be visited, the cards were put in traveling order. Villages and settlements would be scheduled and allocated against the available number of days for the trip. Customers and prospects would be added or dropped to make the route efficient, particularly with regard to expected sales and profits. No successful peddler ever traveled a random route trusting to serendipity or luck; successful peddlers built marketing plans, predicted product purchases, calculated predictable sales and earnings, and managed inventory, just as we do today.

The peddler made a relationship between customer purchases and trips. Over time, patterns emerged that could be relied upon to repeat. One customer might buy every trip regardless of the trip timing. Another customer bought only on the fall trip after harvest when cash was in hand. A third customer bought only every other trip, sometimes in the fall and sometimes in the spring; and a fourth bought only every other trip in the spring. Thus, the peddler understood *seasonality.* The intuitive knowledge of these patterns was built into the customer cards and ordered in the mind of the peddler through the intimate and tactile understanding of the shoebox database.

The peddler's objective was no different from the objective of the database marketer of today: To optimize sales and to generate the greatest possible profit with the least possible expenditure of resources. The shoebox system worked then, and the database system works today.

Key to the success of the shoebox and the database, however, is the recognition that the primary purpose was and is *marketing;* that is, selling more stuff to more people. The prospecting and customer databases exist first and foremost to create additional sales and to keep customers buying. They do not exist for the convenience of accountants, for generating invoices, for managing inventory, or other purposes, although these are secondary by-products of the database. Too often, too many diversions interfere when data becomes organized into information; too many parasites attach themselves to the database and obstruct the primary purpose: Selling. CEOs who embrace a formulaic approach to marketing, supported by sophisticated and accurate database practices, must first swear an unwavering allegiance to marketing to their customers and reject all other unessential, non-selling noise interfering with that one dominant purpose.

The Master Marketer having control of multiple channels also has control of multiple sub-databases that accurately portray the individual channels. It must be possible to fully understand database information for the catalog channel separately from the on-line channel and separate from any other channel. It must also be possible to fully understand the database information for the combined databases of all channels and to be able to see changes and trends intra- and extra-channel; otherwise, how do you know where to put your money?

Recency and the Customer Database: Pickering

Database technology is neither mystical nor arcane. So says my writing partner. I would make one small modification: Database technology *should be* neither mystical nor arcane. In the everyday business world, however, your database workings are sometimes mystical or arcane.

To be certain, there are more choices out there for affordable and powerful database technologies than ever before. A new cataloger can get a reasonably powerful software package for a few thousand dollars. The disconnect generally comes in the use of the systems.

We are marketers, so we think that the systems should primarily support marketing. Unfortunately, our peers in order fulfillment and accounting think that the systems should work for them. Middle ground can be found.

Looking at recency, it seems obvious that it applies to the date of most recent purchase by an individual (or a site). What happens, though, when an existing customer calls to place another order and the customer service representative (CSR) cannot quickly find the existing customer record? Often it is easier for the CSR to create a *new* record.

This duplicate record creates several problems. First, it overstates the number of customers. Secondly, it misstates the recency of buyers on your file. It also creates additional work in setting up a new account, slows down the ordering process by making the customer give data that is already resident elsewhere in the ether of the database. The duplicate record problem is frequently exacerbated by the compensation structure for CSRs. It is typical for CSR compensation to be based on volume of calls handled. If their perception is that it is faster to set-up a new account, then that is what they will do. To address this problem, many marketers work with their CSR group to develop ways to improve the ordering system. Using customer numbers and finder numbers are effective ways of addressing order input issues.

You likely assign your customers a customer number of some sort. This allows look-ups, enables your relational database to access their item loop (history of products purchased), and endless other useful things. And most enlightened direct marketers print their customer number on their catalogs, frequently in a colored box.

On the prospecting side a similar process can occur. A non-permanent number can be assigned to a prospect mailing piece, much like a customer number, that will allow the database to populate name and address information into the order screen when a call is received. The problem is that all too frequently the CSRs have not been trained to ask every time for the customer or finder number. Once trained, or incentivized, CSRs can capture these numbers, which yield many benefits:

1. Faster, more accurate order entry.
2. Fewer duplicate records added to the database.
3. Higher key code capture rates, particularly on new customers.

In addition to trying to ensure the accuracy of recency, marketers today have more channels to track, analyze, and follow. In some systems (generally newer) it is easy to add fields to track recency by channel and in legacy systems this is sometimes quite difficult.

If you have a system that can keep a recency by channel, by all means, do so. Also contemplate what other similar data you should keep:

1. Database recency–the recency associated with the most recent purchase irrespective of channel.
2. Channel of first purchase and channel of most recent purchase.
3. Date of first purchase.

The database recency will be the easiest to use recency and will drive much of the segmentation. Database recency should be the recency used when measuring overall database performance, such as house file counts by recency.

The channel of first purchase and last purchase will be critical to see how your customers like to purchase from you. Many catalogers with web presence find that they are most effective acquiring new customers via the mail, but once the initial purchase is

made repeat buyers prefer to buy via the web. To confirm that theory simply look at recent two time plus buyers whose first and most recent purchases were through the same channel versus those that migrated from one channel to another. You cannot asses this, though, unless you have your database set up to capture and report on this vital information.

Date of first purchase is a little used nugget of information that can be unbelievably useful in determining house file circulation strategies. Drilling into customers by the year of first purchase allows you to do 'vintage analysis' to see if, for example, customers acquired in a given year perform differently than those acquired in another year.

Consider 1998 buyers versus 1999 buyers. There was no large scale change or shock to the system in 1998, so we can treat that as a 'normal' year. In 1999 we were on the cusp of a change, the New Millennium. As discussed, this led to some accelerated buying. It also led to some different buying habits. In 1999, those catalogers who sold goods like camping equipment, freeze dried foods, water purification and survival equipment, fuel storage, first aid, and power generation products had a better than average year. Some had their best year ever. As these customers progress and attrite through the life-cycle, they cause anomalies. Many of the purchasers were making a one-time purchase: they aren't campers by nature, but they bought a few lanterns and sleeping bags. You won't see them again. In 2000 and 2001, as these buyers progressed down through the Recency cells, it looked as though the company was doing a poor job of retention. In 2002 and 2003 it looked like there were large pools of re-activation candidates. The problem was there was the 'glut' of event driven buyers.

By using date of first purchase and creating recency reports for each year, the Master Marketer can see these anomalies. Taking this information they then begin to develop house file circulation plans that treat those buyers differently, perhaps adding additional selection criteria or redeploying circulation from these segments to more productive ones.

These examples, I am hopeful, show that a big key to understanding your database technology is getting familiar with how the data is entered, rolled-up and updated, and extracted. The Master Marketer has an understanding of all of these.

Chapter Four: Optimized RFM

Optimized RFM Plus North American Industrial Classification System (NAICS): Pickering

The NAICS codes feel like the metric system: it is simply easier to use than the incumbent SIC (Standard Industrial Classification) system and there is tremendous resistance to it.

The fact is that most major providers of business-to-business information offer SIC codes—not necessarily because they feel that it is a better system (it certainly is not), but in response to demands of the market. Most business-to-business marketers have SIC codes embedded in their systems and it is easier to keep in a BAU (Business As Usual) mode. That being said, using either NAICS or SIC is the most logical place for business-to-business marketers to look for the *X* factor to add to their RFM segmentation. The power is strong, perhaps only equaled by employee size.

Both codes, NAICS and SIC, go to at least four digits (NAICS actually goes to six and there are proprietary SIC classifications that go to eight digits). For all but the very, largest business-to-business marketers this is not practical because it creates too many

segments of too small a size. Paralysis by analysis will inevitably set in. To avoid this, use the codes at their two-digit level or even at a super-two digit level—there are some industry standard groupings that collapse eighty plus two-digit groups to about twenty groups.

When you have the level of segmentation you can easily use, pockets of much higher than average and much lower than average value (defined by lifetime value, lifetime dollars, monetary momentum, etc.) will appear. Rather than allowing this simply to become 'gee whiz' information, ask the following questions:

> 1. If my best segments defined by RFM + NAICS accounts for forty percent of my value and twenty percent of my customers, am I targeting an appropriate and corresponding percentage of my house file circulation to these segments?
>
> 2. Am I looking at these high value RFM + NAICS segments and targeting them in my new customer acquisition, even suffering a lower response rate because of the higher payoff?
>
> 3. Am I looking at these low value RFM + NAICS segments and avoiding them in my new customer acquisition, even foregoing a higher response rate because of the lower payoff?

The Master Marketer has asked and answered these questions and continually re-visits the question to see how the customer base has changed. It is all about making a closed loop system: use the intelligence gained through analysis to drive better decisions.

Chapter Five: Product

Mechanics of RFM plus Product Segmentation: Pickering

Product is powerful, not only in the intangible ability to create excitement and stimulate demand, but also in the qualitative sense. Segmenting by product can give enormous power to your RFM segmentation.

The question becomes, *how* do you segment by product? The answer, the standard answer taught at business colleges across the land is this: it depends.

Most direct marketing companies have between a few hundred and a few thousand products or SKUs. Using hundreds or thousands of variables to create different RFM segments would generate a set of data impossible to work with effectively. Additionally, the cells would be too small to produce meaningful, repeatable results.

At the highest product level, usually referred to as product category, there are generally a reasonable number of categories, a dozen or two. Initial analysis should be done on all available product categories, though with some analyses these can be collapsed further into ad-hoc groups that have similar predictive abilities.

There are nuances to using product categories for RFM segmentation. Some very powerful historical analysis can be done using the *first* product category purchased. Alternatively, on-going RFMP segmentation frequently develops from the first product category purchased to *if ever purchased* from a given product category.

As an example, computer peripherals manufacturers and retailers frequently sell printers at or near cost. The paradigm is set-up to make money from the ink cartridge sales, not the printer. If you would fill the average automobile gas tank with printer ink, it

would take nearly $100,000 worth of ink to fill it up! As you can see, that is a lot of margin.

Thus, a customer who consistently buys a printer but not ink will not be a very valuable customer. This may not show when looking at RFM only, unless monetary value also includes some gross margin or profitability measure. Looking at the RFM + product category and being able to use an average margin can help separate the truly profitable customers (printer and ink buyers) from the pretenders (printer only buyers). The printer and ink example provides a good reason to assign margin or profitability on as micro a level as possible, at the product category at least and preferably at the individual product level.

The quickest way to include product in the RFM segmentation is to simply set-up a counter of how many different product categories have been purchased. Although not perfect, segmenting RFM cells by one product category purchased versus two, three or more product categories purchased will rank-order profitability in almost every instance.

Chapter 6: Channel

Catalog: Libey

Any discussion of multi-channel direct marketing must begin with the catalog channel. Any discussion that focuses on the size of the catalog channel and other macro estimates of growth will be outdated in a matter of months. It is wiser to find current statistical data on the catalog channel as it is required. Here, it is wiser to focus on the philosophical and conceptual elements of the catalog as a viable channel within direct marketing.

Catalogs have been around for a very long time. One of the first recorded references to a printed catalog was in the 12th Century. Monks working in scriptoriums produced illuminated copies of the catalog on vellum and they were carried by priests in the summer and fall of the year to abbeys throughout Europe. The catalogs contained drawings and descriptions of religious relics, which could be obtained by the abbeys as items of veneration for the faithful, for a price. The finger bone of a saint, the heart of a martyr, scraps of holy shrouds, chalices, splinters of the cross and other religious antiquities were offered along with add-on handcrafted reliquaries to house the treasures. Purchases were paid for in advance and the priest returned to headquarters with the orders and the cash, loaded up the products and delivered them on the return trip, along with a new catalog and the 'spring' offers. The cardinal elements of this earliest of catalogs remain the same today: 1) a good list; 2) good products; 3) a good offer; 4) circulation; 5) fulfillment; and 6) the first known bounce-back and package insert.

Almost eight hundred years later, catalogs have become a very big part of the global commerce. In the United States alone, we estimate there are over 20,000 catalogs of all types: business-to-business, consumer and manufacturing. The catalog is an established, respected and effective method of selling. The reason for its success is, I believe, because of its contemplative nature. Looking at a catalog of products is, largely, a personal and relaxing endeavor. The catalog shopper is engaged by photography, descriptive or specification copy, attainment of a dream or successful achievement of an application, all contemplative and pleasant intellectual activities, whether personal or business-related. That just doesn't happen in a Wal-Mart.

While the contemplative nature of the catalog has endured, the call to action has shifted progressively from mail to telephone and now to online response. Online ordering, in response to contemplative catalog shopping, accounts for half of the orders,

yet eighty percent of those online orders are driven by a paper catalog. At the same time, the total number of catalogs produced is increasing. Online ordering will continue to gain over mail and telephone, but the catalog will remain a primary driver of those online orders. Eventually, online catalogs will edge up in popularity, partly because of generational acceptance and familiarity, but also because of irresistible catalog economics. Suffice it to say, the online world will grow in importance, but the paper catalog world will retain its relevance and importance for many more years. It is not the catalog channel *or* the online channel; it is the symbiotic blending of both—as well as other channels—that drives the future of direct marketing.

Were I to venture a guess as to the mix in twenty years, I would think physical catalog response would be at the ten to fifteen percent level with online response at the eighty-five to ninety percent level. This means, of the eighty-five to ninety percent online orders, probably fifteen percent will be driven by a paper catalog and the remainder driven by search and online catalogs. Worst case, paper catalogs will still drive about twenty to twenty-five percent of orders. However, the direct industry will be magnitudes larger and the total number of orders will have increased dramatically. The larger number of orders will be obtained across numerous channels, one of which will be the enduring and ever-viable catalog channel.

With a positive long-range outlook for catalogs, common sense demands that, at the minimum, optimized RFM analyses be accomplished for catalog channel customers to derive the greatest possible understanding of the trends in their historical purchasing behavior. The added benefit of being better able to allocate resources to the catalog channel on a basis proportionate to earnings is a plus. If the catalog channel is twenty-five percent of your business in the future, and if industry growth produces a business that is four times your present size over twenty years, then the catalog channel alone could equal the same or more than your entire business today. *The point: Catalogs are important to your future and knowing as much as you can possibly know about your catalog customers is like having life insurance.*

Catalog: Pickering

We have lived through the Orwellian coming of 1984, the end of the world as we know it in 2000, and we have lived through the projected complete demise of the catalog in favor of the web and e-mail. The catalog is a tough old bird and has survived all these events.

Nonetheless, there are changes as well as constants with catalogs. For one thing, a stand-alone catalog, as we knew it in the 1960s or 1970s, with all responses coming via mailed in order form, is dead. There was debate in the late 1970s and early 1980s about the appropriate use of 800 numbers: do we include them and pay large phone bills or do we have regular numbers and reduce, but 'qualify' the inbound callers? History has shown that investing in making things easier for the customer to give you their money pays off.

Order forms today look much different. They used to be in the middle of the catalog (always) easily ripped out and usually included some sort of envelope. Today they are usually, but not always, in the middle but aren't really intended to be detached. The order form has morphed into a vehicle to communicate shipping charges, delivery information, and sizing charts. In the 1980s, there was a story, perhaps apocryphal, about a new circulation manager who ordered an entire season's worth of catalogs without an order form. It was the most elementary of mistakes. Today, it would scarcely be noticed.

The move toward using catalogs to drive order placement via toll-free calls was a great boon for catalogers. It became a built-in opportunity to cross-sell or up-sell and, at the minimum, the ability to provide 'high-touch.' The newer channels of outbound telemarketing, web, and outbound e-mail have similar opportunities inherent in them.

The cliché that says that the only constant is change is certainly true. Direct marketing has always been attractive to entrepreneurs because of the low barriers to entry. You don't necessarily need to set-up distributors or retailers; all you need is product (not even inventory) and a catalog, website or telephone. That is true now more than ever.

With the increasing clutter that comes along, more and more offerings make knowing and putting into practice the basic lessons of direct marketing all that more important. We have had less than ten years to find our way through the new channels of web and e-mail. There will likely be five or ten more years before integrated multi-channel campaigns are the norm. By that time, we will likely have new channels of communication, payment, and delivery.

As Harry Truman said, "There is nothing new in the world except the history you do not know." Knowing the history and principles of direct marketing as applied to catalogs will allow you apply tried and true principles and have a reliable guide to the new channels.

Chapter Seven: Position

Price: Libey

Positioning is the perception the marketplace has of your company based on at least six elements: price, quality, service, speed, selection and access. Other positioning elements exist, but these six are most often central to a multi-channel direct marketing position. Looked at another way, position is a vantage point from which prospects and customers determine whether they want to do business with you. As an example, what do you think of when you see a Wal-Mart ad? Now, what do you think of when you see a Williams-Sonoma catalog? Those two *very* different perceptions are the sum of your beliefs and vantage points of each company based on price, quality, service, selection, access and, in this comparison, image. Position tends to be either in-your-face or elusive. Some companies are masters of defining and presenting a clear position; some are tentative and fuzzy about what and who they are.

In an ideal world, position determines almost everything. If a company opts to be known only for low prices, as does Wal-Mart, that choice of a single position determines the flimsy, cheap plastic bags, the eyesore-blue color of the stores, the littering of the surrounding neighborhood, the rare cleaning of the carpets in the entryways, the purely utilitarian shelving and lack of attractive displays, uninformed, part-time, minimum-wage employees, the absence of meaningful customer service, and the overarching aura of lowest-common-denominator-mediocrity that so typifies the Wal-Mart experience. In contrast, the multi-position choices of Williams-Sonoma determine taste, style, elegance, informed and friendly staff, high-design, spotlessness, extreme customer services, and the overarching aura of highest quality and exclusivity. Decisions about creative, logos, training, website design, packaging, products, wages, location—literally, everything—begin and end with the corporate position. That's in an ideal world. In reality, position is partially ignored and the elements get confused.

When doing the preliminary interview work with CEOs to begin the process for long range strategic planning, I always ask two questions:

1. What is your exit strategy? Until the objective of the end is known, we cannot create a strategy to get there. You operate businesses very differently depending on whether they will be sold to a competitor, sold to an investment group, given to the children, structured as an employee buy-out, or liquidated for cash. For each end game, there is a different strategy for almost every interim business decision and direction.

2. What is your position? Once the exit strategy and the end game are known and described, the position necessary to get there with the greatest amount of business valuation can be determined and all tactical and strategic decisions flow from there. If it's all about price, certain things become important. If it's all about service, certain other things become important. The integration of channels is determined by the position. The design of catalogs is determined by position. The product selection is determined by position. Position is the elephant we ride on to get to the Taj Mahal.

One of the positioning points is price. Three price positions are found: 1) high price leader; 2) mid-price player; and 3) low price leader. The first sets the price standard for the market or product group; the second hides in the weeds and adjusts; the third battles for share on price. None of the three is the best position and none is the worst position; each is a viable position provided all other positioning elements are in synch and integrated properly.

If all of direct marketing were organized as a circus, then the companies that position themselves on price would be the high flyers, the aerialists, the trapeze artists operating without a net. Price always performs in the center ring and is not very forgiving. With a price position, you are always holding your breath. Have you ever noticed that the businesses that operate on pure price, such as commodity traders buying and selling corn, wheat, pork bellies, foreign currencies, crude oil (or any other classic 'good'), buy and sell on fractions of a cent? A transaction on the Chicago Board of Trade for 20 contracts of wheat (100,000 bushels) may be done for as little as one-quarter of a cent gain per bushel. The profit per trade is only $250, but if you do that over and over 100 times a day, you make $25,000 a day. Of course, the floor trader standing next to you is probably willing to do the business for one-quarter of a cent less. When you are the high price or the low price leader, there is always someone who will do the business for a fraction of a cent less. That is the problem with the price position.

The mid-price player position takes you out of the center ring. Unfortunately, that means you are just another act and are relegated to the side rings. As the price leaders parry and dodge, the mid-price player works the spread and makes a little more or a little less depending on the price extremes. Most business-to-business direct marketers like to be mid-price players, never appearing on the radar screen at either the highest or the lowest price. There is a nice bit of business to be done just working 'the middles.' After all, that's where most of the buyers will be found. At least until the unholy Wal-Martization of America is complete.

The Turn of the Century will be remembered as the time when price became primary in the mind of the American consumer. Prior to the advent of online technology, price comparison was a *physical* and *intellectual* effort involving on-site or telephone research. With Internet access, price comparison has become an *automated* and *technological* process involving search engines and shopping aggregators. What previously took perhaps weeks, now takes only nanoseconds. The effect of this is, of course, that most purchases going forward will involve price comparison, thereby forever

establishing price as the primary driver of commerce, an evolution of the buying process that remains to be evaluated for its future positive or negative effects.

Chapter Eight: Market

Adjacent Market: Libey

Adjacent markets exist side-by-side with core markets. If the core market is antique Studebaker restoration shops, an adjacent market is antique Corvette restoration shops. If the core market is larger, say, auto body shops, an adjacent market is brake shops or transmission shops. If the core market is broad, auto repair, an adjacent market could be airplane maintenance or boat repair.

Adjacent markets tend to be horizontal with some overlap. If the core market is health care, for example, an adjacent market may be health care record keeping. Since all health care professionals have to keep records, the adjacent market overlaps concentric markets such as physicians, veterinarians, dentists, and chiropractors. Another adjacent market might be health care uniforms, also an overlapping market. A third adjacent market might be health care practice furniture. Each of these adjacent markets have a logical basis for expansion: universe. When we look at the giants of direct marketing, such as Patterson Dental Supply, we find an adjacent market strategy serving the dental, the companion pet veterinary and the rehabilitation markets. Similarly, NEBS, the venerable business forms direct marketing company, serves tilers, plumbers, electricians, HVAC, landscapers and other adjacent markets within the broad contractor market.

Consumer adjacent markets are often less horizontal and logical, more circular. The popcorn and flower markets, as an example, are both served by 1-800-FLOWERS and would seem to be an illogical fit until you understand that the core market is actually gifting. In that context, their brand line-up makes sense: Popcorn Factory, Plow & Hearth, HearthSong, Magic Cabin Dolls, Cheryl & Co. cookies and 1-800-FLOWERS.

Another perspective on adjacent markets can be obtained with Amazon.com. Since beginning with books, the online marketer has expanded to 29 adjacent markets, not all logical. Books and music are clearly logical, as are DVD/VHS. But books and tools is illogical, as are pet supplies, apparel and kitchenware. Amazon's definition of adjacent markets is broad, almost 'general department store' in nature. Yet, all of the adjacent markets are home related and all can be serviced online.

In contrast, multi-channel direct marketer Barnes & Noble views adjacent markets quite differently. The core book market is supported by used, out of print and textbook markets. Music is a major retail department as well as an online market. Considerable retail space is devoted to the coffee bar and specialty baked goods, soup and sandwiches. The adjacent market strategy is much more horizontal and overlapping than we find with Amazon. Barnes & Noble is retaining its core market while adding adjacent markets that are quite logical.

When adjacent markets and RFM segmentation and optimization are examined, Amazon is far more advanced than Barnes & Noble. After more than twenty years of shopping at Barnes & Noble, they have no idea who I am and what my interests are, nor do they have any way of contacting me as a customer. Why? Because I have never signed up for their membership program. I spend between $2,000 and $3,000 almost every year in the retail stores, but am still a nameless customer they know absolutely nothing about. Compare that to Amazon, which knows more about me and my interests than any company or person on the face of the Earth. Amazon does everything we talk about in this book and more. Amazon actively manipulates my RFM behavior, my affinities, my

linear purchases, literally everything I do in my relationship with the company, and optimizes my lifetime purchases and my lifetime net profitability. As a result, I spend more with Amazon than I care to think about. But, I only buy books and the odd CD. I'm a core market guy and probably will never be an adjacent market customer. Yet, I buy cappuccino, music, new books and used books from Barnes & Noble. *The point: If you want to expand to adjacent markets, first decide whether you really mean adjacent markets or adjacent products.*

Adjacent Market: Pickering

Adjacent markets can occur or they can be developed. With more channels and more advertising vehicles being deployed by direct marketers today, there is more opportunity for adjacent markets to develop unintended and unaided.

There is nothing whatsoever wrong with adjacent markets that naturally occur, think of it as marketing Darwinism (my grandfather used to call these occurrences 'volunteers'). Adjacent markets can develop from the most unlikely of places.

WD-40 was developed as a degreaser and penetrating solvent intended for use on engines and other machinery. As such, the core market was defined as people who service machinery. However, many anglers swear that WD-40 is a great bait for bass fishing. The bass fishing market is probably not the audience that WD-40 started out to serve, nor was attracting bass the problem they hoped to solve. Yet WD-40 is extensively used in that way.

What does WD-40 do with this unusual opportunity? It could do nothing. Or it could start to package the product differently, perhaps in smaller containers that are more easily taken with the angler. It could also start to look for advertising opportunities reaching those who both work on machinery and enjoy fishing as a hobby,

Among direct marketers, government agencies and educational institutions often occur as an adjacent market. And it only makes sense. What building has more office space than any other in the world? The Pentagon. What do you think its budget is for things like cellular phones, office supplies, floor mats, computers, light bulbs, and the plethora of things used and consumed in an office?

An adjacent market, by definition, is not, or was not, the core market or the intended market. Therefore, to move effectively into a adjacent market, the tactics must be reviewed to see if they are as applicable in the adjacent market as in the core. April may be a great month to mail the core market, but it is probably a poor time to try to send a mail piece or an e-mail to anyone at the I.R.S.

Adjacent markets are usually defined using the same variables and descriptors used for core markets. For business-to-business marketers, the language generally includes variables like SIC, employee size, and job title. Consumer marketers may look at age, income, special interest, ethnicity, gender, USDA growing zone, and the like. It is important to develop definitions that are executable in the real world. If you want to define a market by SIC, but that variable only has coverage on twenty percent of your file, is that really a useful definition? It probably makes sense to investigate how to increase the coverage of that variable and see if the market definition still works.

Ù

The Third-Fourth Quarter 2005 Regional Economic Outlook

Once again, the regions have performed consistently and continue to ride the economic boom of the housing market. Spending and manufacturing activity continues to improve and job generation appears to have some momentum. The nation, by and large, is doing reasonably well and better than predicted.

There are signs in the leading indicators that slowing is approaching. If these are accurate (and they usually are), we could see a downturn in economic strength in the late months of 2005 or early 2006. These signs have been consistent in the last three months and seem to be heralding some degree of economic change. However, the long term interest rates continue to act opposite conventional wisdom, especially with the ten increases to interest rates made by the Fed in 2005. This is unusual and seems to point to the strong housing market as its rationale. As always, oil prices are scary. At writing, the rate was around $64 a barrel. The oil situation could go totally out of control, but so far Americans are not reacting to the high prices. Behavior, in almost all economic areas, is opposite of what would normally be expected, and that is a warning sign.

However, we continue to strongly encourage multi-channel direct marketers in pursuing prospecting and customer contacts reasonably aggressively, through the fall months and into the coming holiday season. We remain positive for the third quarter 2005 outcome and the balance 2005. All regions continue to remain positive.

Signs of Improvement

Region One (CT, ME, MA, NH, RI, VT)
Region Two (NY, NJ, CT, PR, VI)
Region Three (PA, NJ, DE)
Region Four (OH, KY, PA, WV)
Region Five (KY, MD, TN, VA, NC, SC)
Region Six (GA, AL, FL, LA, MS, TN)
Region Seven (IL, IN, MI, WI, IA)
Region Eight (MO, IL, IN, KY, TN, LA, AR)
Region Nine (MN, WI, ND, SD, MT, MI)
Region Ten (KS, CO, MO, NE, NM, OK, WY)
Region Eleven (TX, LA, NM)
Region Twelve (CA, UT, AZ, NM, OR, WA)

Mixed to Slower

None

The Third-Fourth Quarter 2005 Circulation Outlook and Recommendation

Synopsis

The short-term economic outlook for the catalog industry continues to be positive through the third and fourth quarters of 2005. There continue to be signs of slowing emerging in the leading indicators, which may indicate moderation in the late fourth quarter and early 2006. The intermediate-term outlook, however, remains positive for the balance of 2005 and into 2006, and the long-term outlook through 2007 remains positive.

Keep Prospecting

For the fifth time this year, I repeat my prospecting recommendation:

Once again, perspective is essential. If you will think back over the years and recognize how many companies have regretted their short-term decisions to pull back in either economic downturns or periods of uncertainty, you will reflect again on the reality that reducing prospecting and house mailings *at any time* is always a strategy for slowing the growth and profitability of the business longer-term. The savings of a few thousand dollars in times of uncertainty or cloudy economics can result in the loss of many more thousands of dollars in future profits and business valuations. Multi-channel marketers are having solid results through the end of July. They have invested in advanced online marketing *and* have wisely continued to support, grow and invest in their catalog businesses because they understand, know and believe that those catalogs are driving substantial number of online orders. Our strategy should be about focus and consistency. Those are the qualities that deliver increased corporate valuation. *The point: Prospecting in all channels isn't an optional strategy; it is a constant strategy that produces profits.*

Nation at a Glance

The detailed economic conditions for each state have been integrated into the following recommendations. **Changes to circulation recommendations through the Third-Fourth Quarter 2005 and are highlighted in bold italics.** A few moderating changes are recommended through the third and fourth quarters, from Increased to Normal mailing, but no decreases are found anywhere.

State	Mailings
Alabama	Normal
Alaska	Normal
Arizona	Increase
Arkansas	Normal
California	Normal
Colorado	Increase
Connecticut	Normal
Connecticut-Fairfield	Increase
Delaware	Increase
District of Columbia	Increase
Florida	***Normal***
Georgia	***Normal***
Hawaii	Normal
Idaho	Normal
Illinois—North	Normal
Illinois—South	Normal
Indiana—North	Normal
Indiana—South	Normal
Iowa	Increase
Kansas	***Normal***
Kentucky—East	Normal
Kentucky—West	Normal
Louisiana—North	Normal
Louisiana—South	Normal
Maine	Normal
Maryland	Normal
Massachusetts	Normal
Michigan	Normal
Michigan—Up. Pen.	Normal
Minnesota	Increase
Mississippi—North	Normal
Mississippi—South	Normal
Missouri—North	Normal
Missouri—South	Normal
Montana	Normal
Nebraska	Normal
Nevada	Normal
New Hampshire	Normal
New Jersey—North	Increase
New Jersey-South	Increase

New Mexico—East	Normal
New Mexico—West	Normal
New York	Increase
North Carolina	Normal
North Dakota	Increase
Ohio	Increase
Oklahoma	Normal
Oregon	Increase
Pennsylvania—East	Increase
Pennsylvania—West	Increase
Puerto Rico	Normal
Rhode Island	Normal
South Carolina	Normal
South Dakota	Increase
Tennessee—East	Normal
Tennessee—West	Normal
Texas	Increase
Utah	Normal
Vermont	Normal
Virgin Islands	Normal
Virginia	Increase
Washington	Increase
West Virginia—East	Normal
West Virginia—West	Normal
Wisconsin—North	Normal
Wisconsin—South	Normal
Wyoming	Increase

Ù

The *Libey-Concordia Economic Outlook and Secrets of the Catalog Master* is published seven times annually by MeritDirect. The information provided is published for information purposes only and does not constitute recommendations for investment or other financial activities. No guarantee of business performance is made or implied and readers are encouraged to seek adequate professional advice prior to making strategic and financial decisions or investments, or altering planned business activities.

Copyright 2005 by Donald R. Libey. No reproduction or dissemination of this material by any means whatsoever, electronic or printed, is permitted without written consent of the author and publisher. Copyright infringements will be pursued to the full extent allowed by law.

The *Libey-Concordia Economic Outlook and Secrets of the Catalog Master* is provided to clients of Libey-Concordia and its strategic partners, MeritDirect, Libey Incorporated, Concordia Financial Group, Inc., and Amtower & Company.

Libey-Concordia

Advisors and Investment Bankers to the Direct Marketing Industry

Philadelphia, Pennsylvania Offices
(Offices of Kenneth W. Evans, Jr., Geoffrey C. Walker)

1601 Market Street 16th Floor
Philadelphia Pennsylvania 19103
Tel: 215-561-4454 Fax: 215-561-4455

Cherry Hill, New Jersey
(Office of Donald R. Libey)

811 Church Road Suite 105
Cherry Hill, New Jersey 08002
Tel: 877-903-9448 Fax: 866-221-8346

E-mail: libey@libey.com
www.libey.com