

# Libey Economic Outlook

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## The Force of the New Metrics

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*It is clear that successful companies today are measuring everything possible. It is equally clear that direct multichannel marketing has entered a New Age of Advanced Metric Analysis. It is also absolutely clear that those companies who do not or cannot adopt the New Metrics will not survive.*

### The Contrast

During the month of January, it was instructive for me to spend a day with each of four CEO/owners of multichannel direct marketing companies with sales of \$100 million and above. All four of these companies are successful by almost any measure. Sales are increasing at ten percent or more year over year in each case. Earnings are keeping up with sales and are greater than 10 percent. The customer files are growing. Two of the companies are business-to-consumer; two are business-to-business. All four use the catalog, online, email and telephone channels to drive sales. One has a substantial field sales force, as well. Two have centralized distribution; two have decentralized distribution locations. All four have some of the best metric analyses I have ever seen. The CEOs actually know *exactly* what is going on in their businesses and why. There is no guesswork. Even more impressive, none of the four CEOs asked me for benchmarks or 'norms' for performance factors. They already knew what the norms are.

Contrast my January experience with my experience last July when I spent a day with each of four CEO/owners of multichannel direct marketing companies with sales of

\$30 million or less. All four of these companies are marginal by almost any measure. Sales are flat or barely increasing and have been for several years. Earnings are less than five percent of sales. The customer files are stagnant or shrinking. Two were business-to-business; one was business-to-consumer; and one was a hybrid. All four use the catalog and online channels to drive sales; two do not use email effectively; three do not use outbound telemarketing. All four have centralized distribution. All four are essentially in the dark when it comes to metrics. The CEOs haven't got a clue what is going on in their businesses. Everything—in every department—is guesswork. All four CEOs asked me what performance benchmarks they should expect and what 'normal' should be for their businesses. They cannot answer the fundamental performance questions about their companies. They have no idea what they are doing.

The four successful CEOs are engaged in maximizing the present and future value of their companies in order to structure a successful sale within three years or so. They are strategic.

The four struggling CEOs are discovering the values of their companies are minimal because they have minimal earnings. They would like to sell now, but there is nothing of value to sell. They are stuck.

What is the difference between these two groups (aside from business talent and skill)? The successful CEOs all had companies under \$30 million at one time but consistently grew their businesses to over \$100 million. The struggling CEOs have all spent decades at below \$30 million; never able to squeeze through the knotholes of successful growth.

The successful CEOs *measure*—accurately, universally, constantly, and everything. In each case, sometime around 1985, they all became obsessed with measurements and analysis. The struggling CEOs became obsessed with other things like products, creative, manufacturing, fulfillment—all good things—but not the things that make the successful, financial difference in direct marketing.

## **The Holes**

When I think about these differences in various companies, my mind conjures up a vision of an after dinner cheese platter [What would you expect?]. Some of the companies are hard and solid, much like a good pecorino Romano. Some are soft and loose, like brie. Others are laced with spreading mold and have a ripe odor, like Roquefort. And then there are the Swiss cheeses, full of holes, all porous with great tunnels leading nowhere. The Swiss cheese companies allow their scarce earnings to pour out of the holes. The holes are formed because there are no measurements taking place. These Swiss cheese businesses are riddled with leaks.

The first thing I look for in an underperforming business is holes. I want to know where the earnings—if any—are going. Reading a financial statement is a pretty simple exercise. You look at sales, gross profit and EBIT. If EBIT is less than ten percent and it is a normal gross profit business, there are leaks. Then, it is simply a matter of looking for them and plugging the holes.

High performance companies have very few holes. Because measuring everything is an obsession, and because knowing exactly what the measurements mean, holes are not allowed to develop in the cheese. These pecorino Romano companies, all solid and hard with lots of butterfat, hold up well and increase their value as they age. The value of the cheese is in the entire wheel, not just a small wedge.

Low performance companies have an over-abundance of holes, an *abbundanza*. Because little is measured—and most of that not consistently or accurately—holes are a gassy by-product of sour fermentation. These Swiss cheese companies, all full of air, tend to spoil and lose their value. They produce a small wedge of value, never the elusive whole-wheel promise of abundance.

Imagine the lost opportunity of holes. If \$1 million of leaking EBIT slips through the holes and runs off the financial statement onto the floor every year for eight years, it is a compounded \$10-\$12 million of lost earnings. Oddly, most of the companies that are leaking EBIT are, at the same time, cash-strapped and looking for a bigger line of credit. What could they have done with \$10-\$12 million over the last eight years?

### **The Clash of Allocation**

2007 was a year of likely permanent change in direct marketing. The costs of catalogs have nullified much of our previous economic advantage. The alternative is seen to be the online channel. The popular concept of “multichannel” is likely a popular fiction. There have always been a variety of “channels” that produce sales. We have had field sales and telemarketing, catalog and direct mail, retail and wholesale. Those are not new channels. In 1991, however, we came up with something that was truly new: ecommerce. That new sales method has captured about fifty percent of the “direct marketing” universe in less than twenty years. It has captured about fifteen percent of all other sales in the same time. It will likely alter the commercial landscape over the next ten years to claim nearly fifty percent of all consumption in the U.S. Think what that means for physical retail stores, large and small, and the massively overbuilt U.S. retail landscape.

As the beast grows and gets stronger, its masters are learning how to measure and control it; those who are not learning how to measure and control it are relegated to forever laboring as the indentured servants of the beast, never the masters.

The care and feeding of the beast is, essentially, allocation. How much do you give the beast every day? How much do you give other, aging beasts in comparison? The answer to that all-important issue of proportion is revealed and known to those who accurately measure; however, it remains a costly mystery to those who do not measure.

This describes the clash of allocation that is top-of-mind in so many evolving direct marketing companies today. In fact, it is the most important issue for other symbiotic companies, such as data processors, software vendors, list brokers, printers, creative shops, and others who service the direct industry.

Taken to its logical extremes, ecommerce requires web sites, search, products, merchandising, warehousing and fulfillment, and third-party delivery. Gone are paper

advertising, postage, retail stores, and a lot of employees. And, atop it all, are the exquisite suites of metrics that drive the new model of consumption.

### **The Knowledge Factor**

Waxing philosophically for a bit, there is a truism of the human experience that is worth reflecting on at this point of our commercial evolution: Knowledge is power.

From the earliest formations of the means of controlling others, knowledge has been reserved for those who take and hold power over those who are ignorant. Knowledge assures a ruling class of the powerful; ignorance assures a working class of the powerless. Nature abhors uniformity. There are leaders and followers; alphas and omegas; powerful and powerless. This is the nature of Nature; it is the norm of existence.

The same philosophical construct is found in commerce. There are leaders of commerce and followers; alpha businesses and omega businesses; powerful companies and powerless companies. In fact, one can classify almost all management teams in these natural terms. Some are powerful teams; some are powerless teams. What sets them apart is knowledge. The powerful have it and the weak do not.

Unlike 1980, when I could successfully compete in the catalog world on product innovation alone, or in 1985 when I could successfully compete in the catalog world on list selection and circulation prowess, today I must compete from a position of almost pure superior knowledge about *all* aspects of *all* elements in *all* channels. The amount of knowledge required to gain and control commercial power is far greater than my brain can process. I must have sophisticated cyber heuristics to process the data and give me interpretive knowledge to allow me to make informed, low-risk strategic and tactical decisions.

The New Metrics, for the first time, are integrating interpretive knowledge from multiple platforms, modules and specialty software programs to come together in controlled, defined and accurate analytics that present knowledge to powerful leaders as *truth*. In a perfect analytic world, statistical knowledge approaches pure *truth*. The guesswork is removed; unknowns are anathema; allocations of everything are *precise*. Everything is *known*. That is power.

### **The Future of Competition**

Competition in the past was determined by the Four M's: Money, Markets, Marketing, and Merchandising. It was a time for entrepreneurs.

Competition in the future will be determined by Access and Knowledge. Access will be a highly advanced two-way search process allowing buyers to find sellers and sellers to find buyers, at Google-speeds. Knowledge will encompass truth-based metrical analyses of everything related to markets, customers, products, distribution, and financial and operational optimization. It is a time for precision measurers.

Yes, we will lose much of the fun; lose much of the art; lose much of the independent, maverick nature of the Golden Age of Direct Marketing. What will emerge, however gray it may appear, will be the efficiencies that have been missing from direct

marketing throughout its history. If you take the entire body of knowledge about catalog response, it can be housed in a fairly small box when compared to the enormous, skyscraper library of knowledge that has already been assembled for ecommerce. The Masters of the future are already measuring—precisely—thousands upon thousands of minute, relational, online details. In the coming years, the Masters will amass these billions of knowledge bits into predictive heuristics that instantly, precisely, alter and integrate the minute-by-minute evolving DNA of their alpha-competitive and successful ecommerce companies.

### **The Exciting Part**

We are witnessing a Darwinian event. Our world of direct marketing is undergoing a rapid, biological, evolutionary change, and we get to observe it and, in some cases, form it. That is a very exciting experience.

We also are witnessing the unfolding of a rare opportunity. Those who recognize what is occurring have the opportunity to powerfully participate in the future and to successfully adapt to the evolutionary forces that are now underway. The opportunity, however, is dependent on the acquisition of knowledge. Most of our companies are rich in data; some have transformed that data to information; a few have further transformed that information to knowledge; and a handful—the powerful companies—have transformed that knowledge to wisdom.

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### **Talent: Local and Regional**

Almost overnight the job market has dried up. Multichannel direct marketing companies are slowing or postponing their hiring plans. Even the demand for the elusive ‘hybrid’ with both catalog and online expertise—a person who was commanding anywhere from \$150,000 to \$200,000 in early 2007—has softened noticeably in 2008.

The experienced, senior talent that is available is often in their 40s and they are very reluctant to move, disrupt their children’s schooling, leave their friends and their well-established lives and sell their homes (maybe) for an opportunity that may not be worth the risk.

As a result, I have two talented people who will only consider employment opportunities in New York City or the boroughs; at least four who won’t leave Chicago; two who are looking to remain in northern Ohio; and three or four absolutely staying in Wisconsin.

The direct marketing job market has shifted to a regional or local talent pool. In many instances, senior managers are commuting long distances instead of moving; some are working remotely with monthly trips to the company. Both the employees and the companies are exploring new ways of work and relationships. One talented online/search expert is working for three companies from home, actually giving each of the three an equivalent of half-time. Everybody is happy; it works.

## China Experiences Growing Pains

While reading through an interview in *Catalog Success* with Mike Stopka, the CEO of Design Toscano, the Chicago-based home décor catalog, I was intrigued by his comments regarding events in China.

He says that he and numerous other CEOs he talks with are experiencing disruptions in the Chinese manufacturing supply chain. Apparently, market conditions are forcing prices in China up by at least fifteen percent.

He reports that labor shortages have occurred and that inflation is rising quickly. Recent changes in labor law have resulted in new overtime work rules and significantly increased overtime pay. Employees in factories will now be paid 200 percent of their hourly rate for overtime and 300 percent for weekend work. Each employee is given a contract and a guaranteed severance package, as well. As a result, costs for Chinese made products are going up across China.

Many manufacturers and aggregators are having difficulties meeting their delivery schedules. A significant number of factories are closing and others are working only with their largest customers who can place large volume orders. Apparently, the small company who only wants to purchase a portion of a container and consolidate it with other orders from other factories is having problems getting factory time and commitments.

What this indicates is the classic growing pains experienced in the Industrial Revolution during the early and mid-1800s in England. The same changes were seen in New England here in the U.S. at the turn of the Nineteenth Century, and again in Chicago in the early 1900s. Low cost labor only continues when there is no social progress; success breeds higher labor costs.

And so, over time the low-cost circus folds its tent and moves to some other labor center, such as Indonesia or Viet Nam, which is exactly what is happening. Wal-Mart will, again, transfer a couple of trillion dollars to the economy of these two countries, things there will improve and their labor rates will go up. Perhaps one day Wal-Mart—and all other low-cost leaders—will be buying cheap labor goods made here in the U.S.

It is ironic how the western world (The Americas and Europe) has given its treasure to produce improvements to the lives of the Chinese people. Now, the Chinese are using that treasure to purchase large parts of the U.S. economy.

What this raises is the question of where do you go when the China market for some of your products is no longer viable? Are you looking at sourcing alternatives in other parts of the world? And the biggest question is what happens when there is no discernable cost benefit anywhere in the world? What happens when the cost of goods is universally fifteen points higher and the economy precludes price increases? Can you live with lower margins?



## The Second Quarter 2008 Economic Outlook

As of early February, the economic outlook continues to slow. The evidence that consumer spending has slowed is significant. With seventy percent of the U.S. economy driven by personal consumption, a meaningful retraction of spending by consumers would have an almost instant negative economic effect. The reporting has included nationwide instances of families deciding to pay cash instead of buying on credit, and only for things that are essential.

Multiple sectors—industrial, services, financial, housing, automobiles, and others—are all slowing to recessionary levels. At this point, it is reasonable to conclude that we are, indeed, in a recession. Receiving the official designation by the economic board is little more than a formality.

Decreased spending will continue to lower demand for goods. Lowered demand will create fewer jobs and additional layoffs. Continued tightening in disposable income will result leading to ever-decreasing demand. At some point, the spiral comes to a halt, and that is when equilibrium is restored and a new economic base is formed, generally signaling the start of another economic cycle upward. It has occurred countless times before and will be repeated in the future. This event is normal. These are the economic periods that justify having cash reserves.

Of continuing and growing concern to the multichannel direct marketing industry, are the previously described issues of Do Not Mail, Do Not Track, Postage Costs, Privacy, Database Proliferation, “Black-Box” Prospect Mailing Selects, Environmental Activism, Carbon Footprints, Supply Chain Economics and Globalization. These problems are beginning to exert noticeable pressure on our micro-economy of direct marketing.

### *Signs of Regional Stability or Status Quo*

None

### *Flat or Slower*

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)

# **The Second Quarter 2008**

## **Circulation and Prospecting Outlook and Recommendations**

### **Synopsis**

The short-term economic outlook for the catalog industry in the second quarter of 2008 is moderately positive. The intermediate-term outlook is moderately positive for the first half of 2008 and the long-term outlook for the last half of 2008 is more positive.

While essentially positive, the outlook continues to show weaker growth than that seen over the last three years. I would continue to estimate economic growth at less than 3 percent for 2008, likely down to 1.5 percent. Within the multichannel direct marketing industry, I expect no more than 4 to 5 percent growth overall for 2008, perhaps only 3 percent. Within the channels, I see overall catalog and mailing growth at the 3 percent level and overall online marketing growth at the 7 percent level.

### **Investment Prospecting**

For the normally weak second quarter, we continue to recommend a careful review and study of your investment prospecting plan and an attempt to remain in the market for new customers. The comments from January pertaining to the importance of an active investment prospecting strategy are repeated below.

If history is any teacher, many direct marketers will experience economic and credit pressure during 2008. Most will decrease their marketing efforts or shift allocations to less expensive media, particularly online. This will result in a two- to three-year diminishment of the new customer files and a longer-term deterioration on profitability and growth.

Adopt a contrarian approach and find as much investment resources as possible to put into new customer acquisition in 2008. When your competitors are slowing, that is the time to increase market share through two primary strategic initiatives: 1) new product offerings; and 2) increased investment in new customer acquisition (investment prospecting).

Many of you have been my readers since my first newsletter in 1988. Over those 20 years, we have had four periods of economic slowing. In every one of those cycles, I have pleaded with you to expand product offerings and investment prospecting leading to greater new customer acquisition and market share during the downturn and after the coming recovery. Those who have followed that advice have done well; those who pulled back have not had comparable success and growth.

These are the normal cyclical periods of necessary contrary strategy. If you can take the pressure and operate as a forward-looking contrarian, capitalizing on opportunity, you will grow and prosper consistently over the long haul. If you cannot take the pressure, you will first expand during good times, then contract during difficult times; you will go ahead 2 and back 1.5, over and over. Meanwhile, your contrarian competitor who follows my advice will go ahead 2, then 1.5, then 1, then 2 again as the cycles continue to rotate. It is a *cyclical* economy and you must use a contra-cyclical strategy to maximize growth and market share.

And so, January, February and March are the months for an intense scrutiny of circulation planning, new customer budget allocation, database modeling, and product development research. Call in your Trusted Advisors; obtain opinions and advice; share your position with those who can find ways to optimize your performance. Look at these strategic issues closer and with more intensity than you have done so in the past several years. It is on this effort that a great deal of your 2008-2011 growth, profitability and success will be determined.

### Nation at a Glance

We have revised our mailing volume recommendations to Normal for the first half of 2008. We caution against decreasing prospecting or customer mailings except for normal hygiene and mailing frequency improvements. Do not fall into the trap of reducing mailings; the end result is always diminished customer acquisition performance. Changes are in **bold**.

State	Mailings		
		Mississippi—North	Evaluate locally
		Mississippi—South	Evaluate locally
Alabama	Normal	Missouri—North	Normal
Alaska	Normal	Missouri—South	Normal
Arizona	Normal	Montana	Normal
Arkansas	Normal	Nebraska	Normal
California	Normal	Nevada	Increase
<b>Colorado</b>	<b>Normal</b>	New Hampshire	Normal
Connecticut	Normal	<b>New Jersey—North</b>	<b>Normal</b>
Connecticut-Fairfld	Normal	<b>New Jersey-South</b>	<b>Normal</b>
Delaware	Normal	New Mexico—East	Normal
District of Columbia	Normal	New Mexico—West	Normal
Florida	Normal	New York	Normal
Georgia	Normal	North Carolina	Normal
Hawaii	Normal	North Dakota	Normal
Idaho	Normal	Ohio	Normal
<b>Illinois—North</b>	<b>Normal</b>	Oklahoma	Normal
Illinois—South	Normal	Oregon	Normal
Indiana—North	Normal	Pennsylvania—East	Normal
Indiana—South	Normal	Pennsylvania—West	Normal
<b>Iowa</b>	<b>Normal</b>	Puerto Rico	Normal
Kansas	Normal	Rhode Island	Normal
Kentucky—East	Normal	South Carolina	Normal
Kentucky—West	Normal	South Dakota	Normal
Louisiana—North	Evaluate locally	Tennessee—East	Normal
Louisiana—South	Evaluate locally	Tennessee—West	Normal
Maine	Normal	Texas	Normal
Maryland	Normal	Utah	Normal
Massachusetts	Normal	Vermont	Normal
Michigan	Normal	Virgin Islands	Normal
Michigan—Up. Pen.	Normal	Virginia	Normal
Minnesota	Normal	Washington	Normal

West Virginia—East Normal  
West Virginia—West Normal  
**Wisconsin—North Normal**

**Wisconsin—South Normal**  
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