How Our Choices Influence The Future

Kevin Hillstrom

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1995

O.J. Simpson Trial

Best Picture = Forrest Gump

Record of the Year = “All I Wanna Do”, Sheryl Crow

Oklahoma City Federal Building is Bombed.

We lost Howard Cosell, Jerry Garcia, Mickey Mantle, and Selena Quintanilla.

And catalogs, yes, CATALOGS, were the king of the marketing world. Want proof?

Seinfeld: The J. Peterman Catalog

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Evolution Through 1995

Big Books (600 Pages) were pummeled by targeted catalogs. The Spiegel / JCP / Sears direct marketing model had been eroded by smaller, targeted catalogs (L.L. Bean, Lands' End, most New England catalogers). In fact, a few years earlier, Sears discontinued their big book. In just seven years, Spiegel would be bankrupt. JCP has never recovered.

I worked at Lands' End, 1990 – 1995 … full priced merchandise, $12.95 shipping, up to 50 catalog contacts per year, 10% pre-tax profit. Quite a business model.

Information was transmitted by a small number of gate keepers:

- **The USPS, Magazines, Newspapers, Books, Catalogs, Land-Line Telephones, Over The Air + Cable Television.**

E-Commerce At Eddie Bauer: 1996

1996: Eddie Bauer

Billion Dollar Business

Thriving Stores

Thriving Catalog

$1,000,000 Annual E-Commerce Volume

Derision from Marketing Leadership … "*Did you get six or seven orders today? Six? You missed forecast by 14%, let's try to do better*."

E-Commerce Growth At Eddie Bauer

1996 = $1,000,000.

1997 = $5,000,000.

1998 = $15,000,000.

1999 = $60,000,000.

2000 = $100,000,000.

By the end of 1999, there were two camps. The first camp felt that e-commerce was the future. The second camp felt that the catalog, and our stores, were responsible for all e-commerce volume. This camp felt that without catalogs and stores, e-commerce would not exist.

A Presentation In February 2000

I presented a forecast to Eddie Bauer Sr. Management and Spiegel Sr. Management in February 2000.

The topic: E-commerce demand would surpass Phone demand by 2003.

The reaction: Highly, highly negative. Laughter. Severe criticism.

The reality: New channels raise interesting questions about the future. New channels are fun (social) as long as they don't fundamentally change how customers transact. When new channels fundamentally change how customers transact, jobs change. When jobs change, those who hold the existing jobs get very, very feisty!

Summary

1980 – 1995 = Dismantling of the Big Book Business Model by Targeted Catalog Mailings.

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2000 – 2005 =

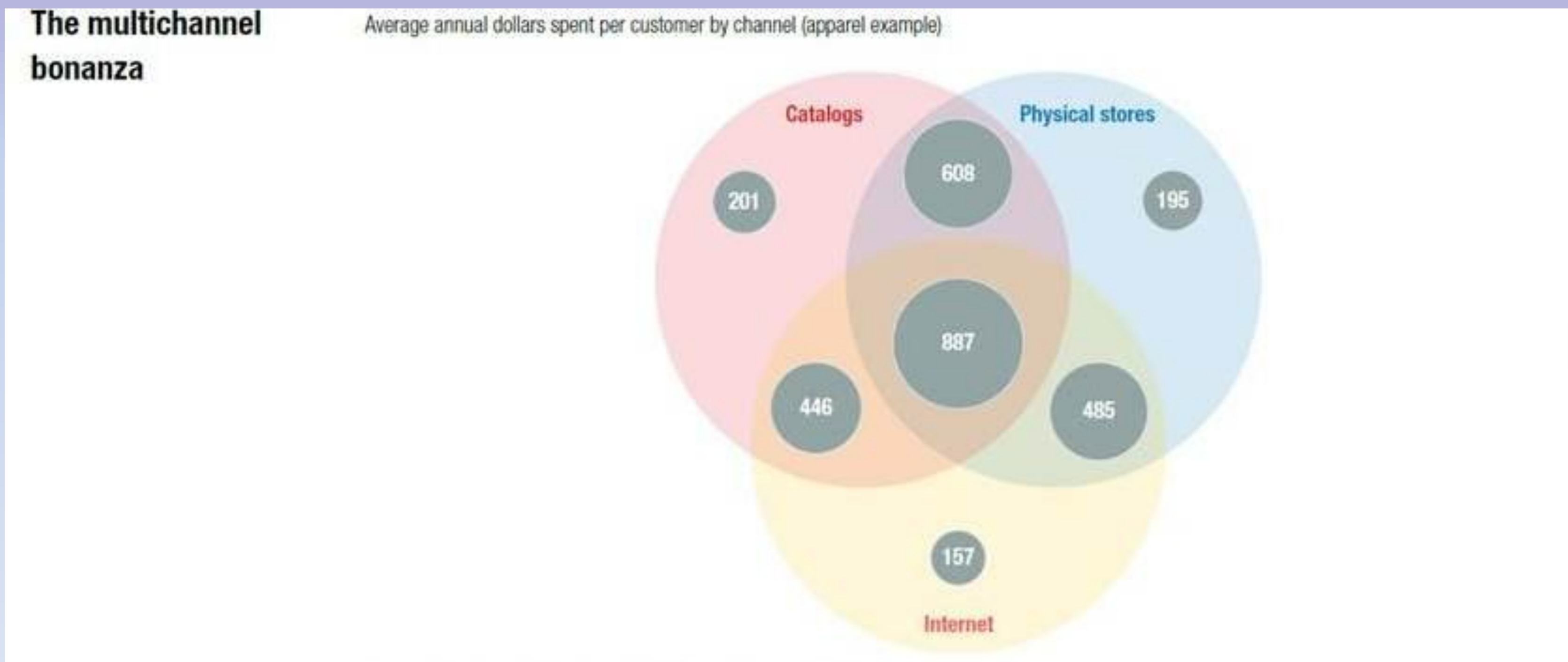
2005 – 2010 =

2010 – 2015 =

2015 – 2020 =

2000 – 2005: The Response = Multi-Channel

The most misleading slide in the history of marketing (yes, I am exaggerating) was released by McKinsey Consulting in 2002. Called the "Multichannel Bonanza", the graph suggested unfettered riches from customers if customers shopped in all channels.



The Query Format Guarantees The Outcome

Customers who buy from two merchandise categories are more valuable than customers who buy from one category.

Customers who buy using two payment types are more valuable than customers who buy using one payment type.

Customers who buy during two seasons are more valuable than customers buying from just one season.

Customers who buy from two stores are more valuable than customers buying from just one store.

Customers who buy from multiple price point ranges are more valuable than customers buying from one price point range.

Matchback Algorithm Mistakes

The multi-channel query led catalogers and vendors to create matchbacks … matchbacks grossly overstated catalog effectiveness.

Mail / Holdout Test Results				
	Mail	Phone	Online	Total
Mailed Segment	$0.25	$1.50	$1.50	$3.25
Holdout Segment	$0.00	$0.30	$0.75	$1.05
Lift	$0.25	$1.20	$0.75	$2.20
Matchback Demand per Book =			$3.25	
True Lift / Demand per Book =			$2.20	
Overstatement Factor			47.7%	

Overstated Demand = Overmailing Customers

Overstated matchback results yielded a dramatic over-circulation of names, and considerably less profit. By not recognizing this problem in 2000 – 2005, catalogers stayed married to catalogs for too long, and did not develop online marketing prowess.

Mailing Decisions				
	Matchback Results		Mail/Holdout Results	
Demand	$2.50	$2.00	$1.69	$1.35
Net Sales	$2.18	$1.74	$1.47	$1.18
Gross Margin	$1.31	$1.04	$0.88	$0.71
Less Ad Cost	$0.75	$0.75	$0.75	$0.75
Less Ship Exp.	$0.22	$0.17	$0.15	$0.12
Variable Profit	$0.34	$0.12	($0.01)	($0.16)

A Feedback Loop Begins Between 2000 - 2005

Online businesses were learning how to sell. Think Amazon. Think Zappos. Think Overstock.com. Think Newegg.

Catalogers were learning how to make sure that the website and the catalog were fully integrated, so that the core customer had a consistent shopping experience. By focusing on the core customer and an integrated channel experience, catalogers did not learn how to sell online, and consequently, began losing Gen-X to online brands (Amazon) in the process. The loss of younger customers initiated a feedback loop where the merchandise assortment began to disproportionately toward Baby Boomers.

Retailers were learning what role e-commerce could play in a store-centric world.

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2005 – 2010 =

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2015 – 2020 =

2005 – 2010: The End Of Lists, Rise Of Co-Ops

Catalog Age Becomes Multichannel Merchant.

Walter Karl, Edith Roman, Rubin Response, Millard, Mokrynski-Direct, American Church Lists, Jami, Direct Media all folded into infoGroup / InfoUSA – the utter collapse of an industry – and the beginning of a dramatic brain drain in what was left of the catalog industry.

The final Catalog Conference was held in New Orleans in 2009.

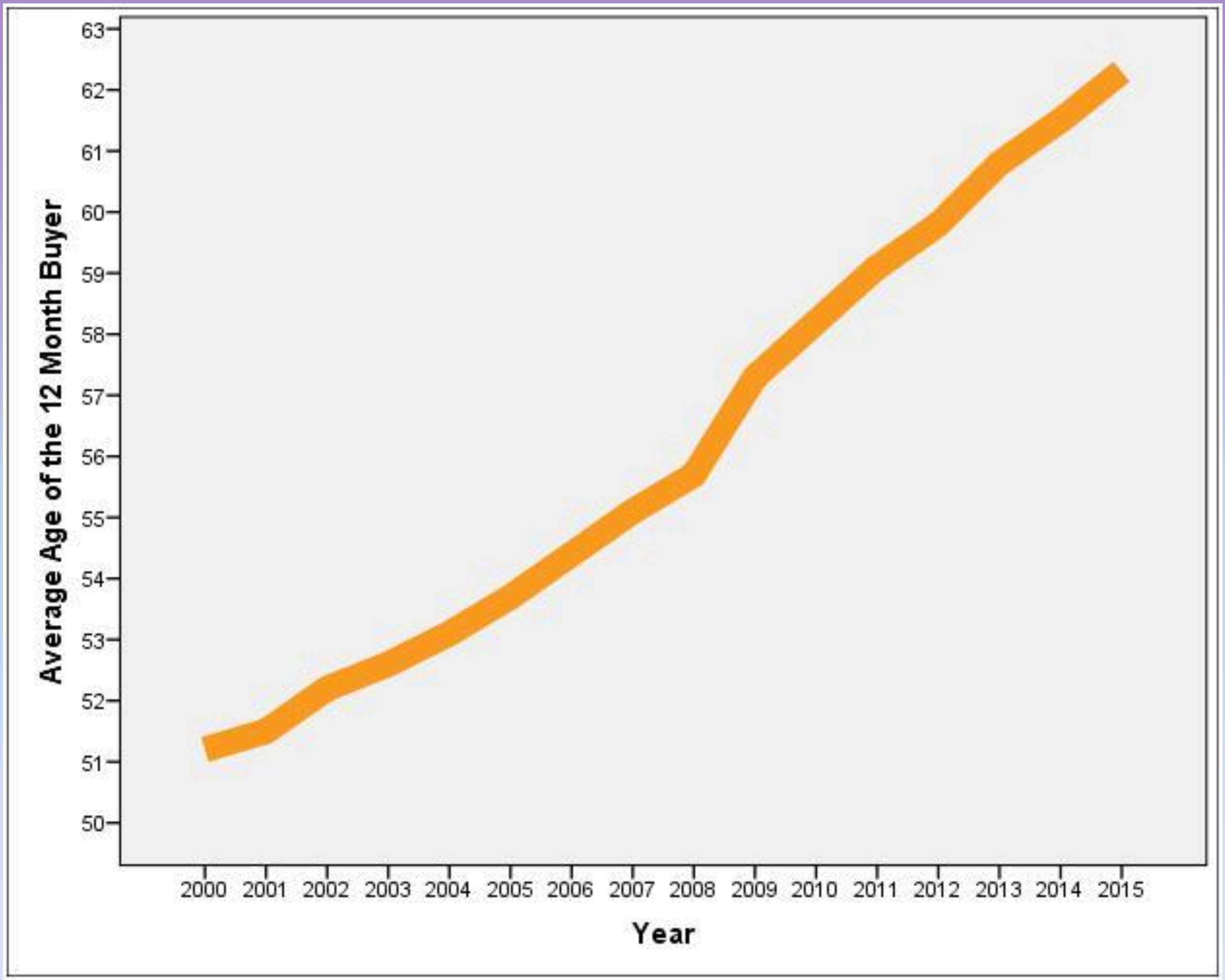
Co-Ops dominate prospecting efforts for catalogers, at a time when online marketers learned how to use online marketing to acquire customers. The reliance on co-ops results in an acceleration of a customer demographic feedback look, a feedback loop that greatly spills over into customer merchandise preferences.

Co-Ops + Multichannel = Aging Customer Base

Multi-Channel led to an intense focus on the “core customer”.

Co-Op algorithms picked up on this trend, and gradually, began to recycle approximately 10,000,000 customers who love catalog shopping.

This rapidly aged the catalog shopper.



2005 – 2010: Changes In Customer Behavior

Catalog: A 55 year old customer receives a catalog, thumbs through the catalog, then shops online, using the website as an advanced version of an order form. It's an integrated experience that the Baby Boomer generation enjoys.

Online: A 39 year old customer has a need, and uses Google as a research tool. After comparing brands for comparable items at the lowest price, the customer abandons a shopping cart for a deeper discount. Finally, the customer leverages a discount via the brand, via an affiliate, or gets a low price via Amazon, and purchases.

Retail: Retailers learn that customers use the website to perform research, and immediately begin integrating the website with the physical store (following the cataloger blueprint of 5 years prior).

2005 – 2010: Recession = Price Deflation

Catalog: Catalogers are forced to start making the move to free shipping, putting significant pressure on the profit and loss statement. This is in response to competition from online brands (Amazon).

Online: Online businesses do not have 20% to 40% of net sales tied-up in paper, so they can easily discount and offer free shipping. This does not impact the online brand profit and loss statement, but creates significant pressure on cataloger profit, due to the enormous ad-to-sales ratio catalogers manage, damaging catalogers.

Retail: Serious promotional activity – all based on price. Pricing pressure hurts weak retailers, and because of multi-channel models, moves price deflation into the online realm, further pressuring catalogers, making catalogers appear to be "expensive".

Catalogers Were Under Pressure

The list industry had been eradicated by the co-ops.

Co-ops algorithmically (and correctly) determine that a Baby Boomer customer is the catalog customer, and as a result, overwhelmingly sent catalogs to Baby Boomer prospects.

Baby Boomer customers prefer merchandise aligned with Baby Boomers! This ages the merchandise assortment, and ultimately, ages the average age of the customer shopping with catalog brands, causing the co-ops to further accelerate the selection of Baby Boomers.

20% to 40% ad-to-sales ratios are put under pressure by online free shipping and retail discounting. Catalogers suddenly seem “expensive” to an economy-rattled customer.

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2015 – 2020 =

2010 – 2015: The Story Comes Together

Mail / Holdout results further deviated from matchback outcomes.

Here's what happened: The "lift" by channel remained at the same percentage. However, demand continued to shift from mail to phone, and from phone to online. Online, at least half the demand will happen anyway, if no catalogs are mailed.

In other words, we used to overstate results by 47%. Now, we overstate results by 80%. #OhBoy!

Mail / Holdout Test Results: 2008

2008 Results	Mail	Phone	Online	Total
Mailed Segment	$0.25	$1.50	$1.50	$3.25
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Lift	$0.25	$1.20	$0.75	$2.20
Matchback Demand per Book =			$3.25	
True Lift / Demand per Book =			$2.20	
Overstatement Factor			47.7%	

Mail / Holdout Test Results: 2015

2015 Results	Mail	Phone	Online	Total
Mailed Segment	$0.05	$0.50	$2.70	$3.25
Holdout Segment	$0.00	$0.10	$1.35	$1.45
Lift	$0.05	$0.40	$1.35	$1.80
Matchback Demand per Book =			$3.25	
True Lift / Demand per Book =			$1.80	
Overstatement Factor			80.6%	

2010 – 2015: Three Demographic Personas

Judy:

Current Age = 62 Years Old.

Classic Baby Boomer, Raised On Catalogs.

Loves to thumb through the catalog, then is equally likely to shop via phone, or online.

75% of demand is catalog driven.

Classic Co-Op prospect sent to catalogers.

2010 – 2015: Three Demographic Personas

Jennifer:

Current Age = 46 Years Old.

Gen-X / Amazon shopper.

Presented her persona at NEMOA 2012, heard audible groan from the audience (i.e. the audience did not like this shopper). < 35% of catalog customer file.

45% to 50% of demand is catalog driven, measured via mail/holdout tests. Online attribution nightmare.

2010 – 2015: Three Demographic Personas

Jasmine:

Current Age = 30 Years Old.

Millenial / Mobile / Social shopper.

< 5% of catalog customer file, usually < 1%. Customer has no interest in catalog merchandise designed for Mom/Dad.

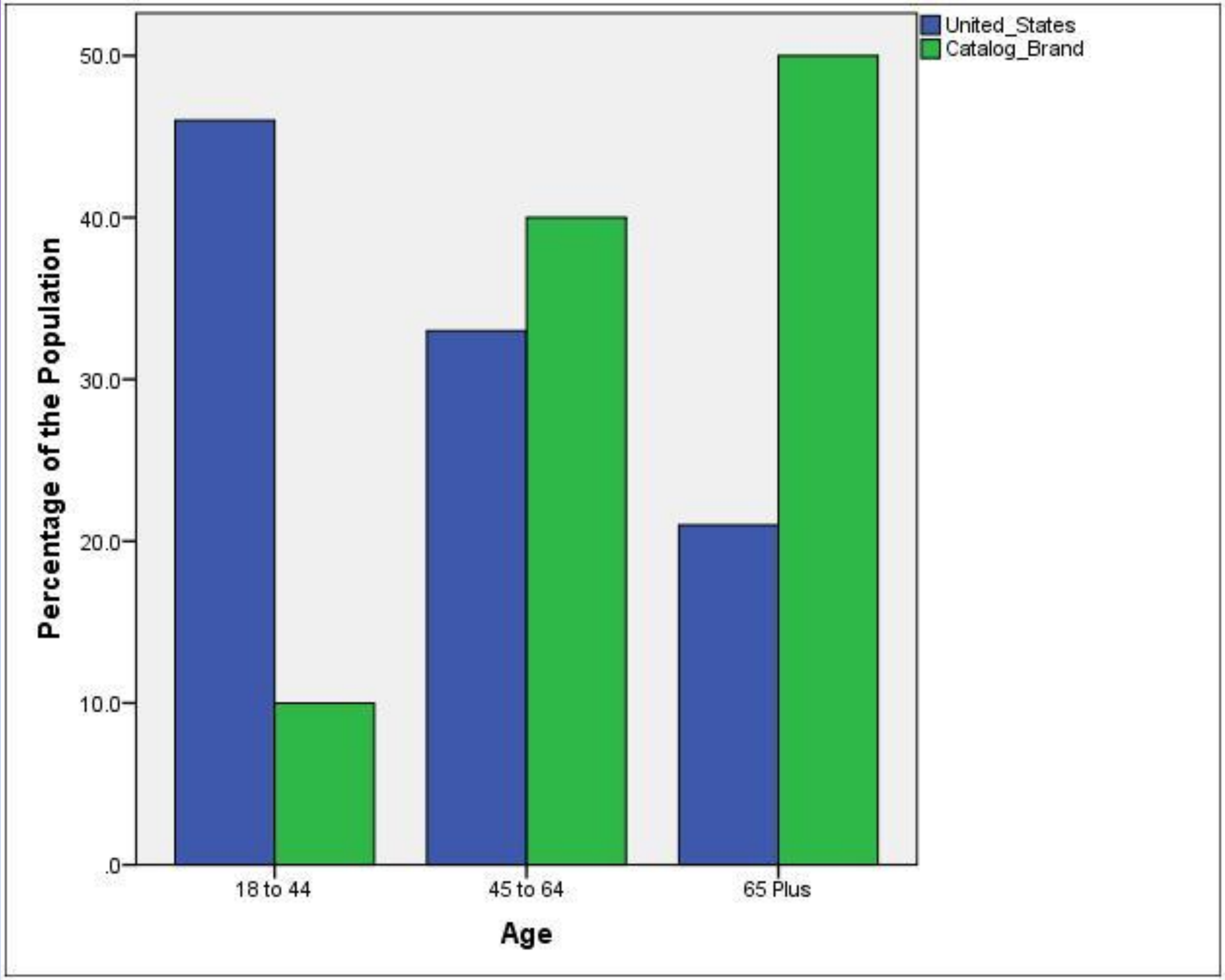
20% to 25% of demand is catalog driven, when measured via mail / holdout tests.

2010 – 2015: Catalog Demographics

This is the outcome of Multi-Channel alignment and co-op infused new names.

Catalog brands are not remotely representative, from a demographic standpoint, of the rest of the United States.

Please think ahead, ten years from now.



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Demographics Explain An Awful Lot, Folks

When a catalog shopper is 62 years old …

- **The customer is not a "social shopper". This is why social media cannot and will not generate more than 1% to 2% of total volume.**
- **The customer is not a "mobile first shopper". This is why mobile cannot and will not cause catalog sales to skyrocket.**
- **The customer has been trained, for 10-15 years, to wait to receive a catalog, receive email messages aligned with the catalog, see a website home page aligned with the catalog, and then use the website as a glorified order form. This means that the websites of catalog brands evolved much, much differently than the websites of pure online brands.**
- **The merchandise assortment dramatically skewed to the 62 year old (especially last 5-10 years), further distancing younger customers from catalogs.**

The Feedback Loop Is Accelerating

"Multichannel" led to sameness across channels, which appealed only to the core customer, the 62 year old Baby Boomer.

The 62 year old Baby Boomer buys merchandise that 62 year old Baby Boomers like.

Co-ops feed catalogers 62 year old Baby Boomer customers, who like merchandise preferred by 62 year old customers, causing merchandise preferred by 62 year old customers to perform well in square inch analyses, causing merchants to source more of this merchandise.

Customers 18-44 see the merchandise, hate it, don't buy it, leaving mostly Baby Boomer customers that now populate the top of the co-op file, trapping catalogers in the feedback loop.

Don't Believe Me? Here's Footsmart

Don't Believe Me? Here's Zappos

Merchandise / Creative / Demographics

Key FootSmart Themes:

- **Foot Health, Body Health, Ailments, Bunion Relief.**
- **Free Shipping on Orders > $59.**

Key Zappos Themes:

- **Fashion, Brands, Gender/Kids**
- **Free Two Day Business Shipping, All Orders.**
- **Free Returns.**

Pretend you are Jennifer (age = 46) or Jasmine (age = 30). Which message resonates?

FootSmart is not doing anything wrong. At all. Their merchandising / creative multi-channel approach, however, determine their audience.

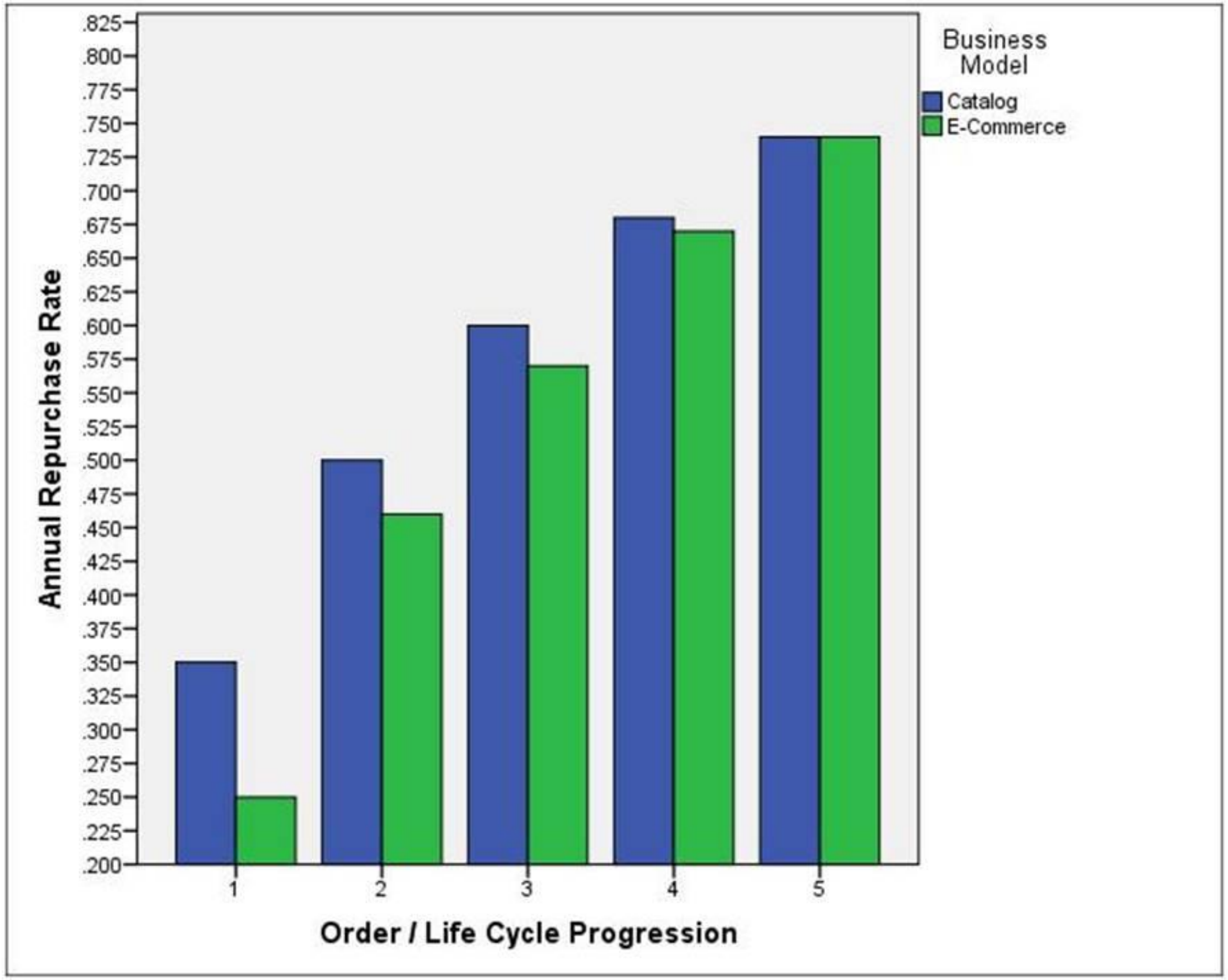
2010 – 2015 = Catalogs Shift To Rural Areas

Catalog performance is strongest where retail buying opportunities are minimal, and where broadband speeds are lower than average (yellow in this map).

2010 – 2015 = Catalog Advertising Advantage

E-commerce businesses really struggle to convert 1x buyers to 2x … too few "outreach" tools that are meaningful.

A monthly catalog, while expensive, is very good at converting 1x buyers to 2x status.



2010 – 2015 = Catalog Buyers Buy w/o Catalogs

In 2000, most transactions happened via mail/phone, and as a result, a catalog was needed to cause the transaction to happen.

In 2015, with most transactions happening online, you do not need a catalog to generate volume – ½ of the demand (or more) will happen anyway.

In 2015 (measured via mail/holdout tests), matchbacks are horribly inaccurate.

- **Mail = 100% Catalog Driven, 0% "Organic".**
- **Phone = 70% to 85% Catalog Driven, 15% to 30% Organic.**
- **Online = 10% to 50% Catalog Driven, 50% to 90% Organic.**

Catalogers can save catalog ad dollars, and reinvest those dollars in free shipping, growing both sales and profit.

2010 – 2015 = Tough To Find New Buyers

In 2014, a multi-year trend began to accelerate and spill across many business models … retail, e-commerce, and catalogs.

The Trend?

- **It is getting harder and harder to find new customers at a reasonable cost, and it is getting harder and harder to reactivate lapsed buyers at a reasonable cost. Look at your own metrics.**

Reasons?

- **Age cutoff in catalog. Challenge scaling newbies online. Trained retail prospects to not visit the store, to sit at home and click.**

Implications?

- **Growth is going to stall w/o prospecting investments.**

I Observe This Problem All The Time

The problem is exaggerated in cataloging and retailing … consistent drops in reactivated buyers and new buyers (with static active buyer repurchase rates) make growth extremely difficult.

New buyer trends are slowing in e-commerce, limiting growth.

Customer File Trajectory - Same Reactivation / Newbie Trends						
	End of 2012	End of 2013	End of 2014	End of 2015	End of 2016	End of 2017
12 Month Buyers, Start of Year	106,583	110,454	109,050	104,916	100,229	95,488
Repurchase Rate	38.3%	38.8%	38.5%	38.5%	38.5%	38.5%
Active Buyers	40,821	42,856	41,984	40,393	38,588	36,763
Reactivated Buyers	32,695	30,733	28,889	27,156	25,527	23,995
New Buyers	36,938	35,460	34,042	32,680	31,373	30,118
12 Month Buyers, End of Year	110,454	109,050	104,916	100,229	95,488	90,876

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Plugging The Holes = Tepid Or No Growth

The problem is exaggerated in cataloging and retailing … consistent drops in reactivated buyers and new buyers (with static active buyer repurchase rates) make growth extremely difficult.

New buyer trends are slowing in e-commerce, limiting growth.

Customer File Trajectory - Stop The Losses						
	End of	End of	End of	End of	End of	End of
	2012	2013	2014	2015	2016	2017
12 Month Buyers, Start of Year	106,583	110,454	109,050	104,916	103,324	102,711
Repurchase Rate	38.3%	38.8%	38.5%	38.5%	38.5%	38.5%
Active Buyers	40,821	42,856	41,984	40,393	39,780	39,544
Reactivated Buyers	32,695	30,733	28,889	28,889	28,889	28,889
New Buyers	36,938	35,460	34,042	34,042	34,042	34,042
12 Month Buyers, End of Year	110,454	109,050	104,916	103,324	102,711	102,475

2010 – 2015 = Tough To Find New Buyers

Catalogers:

- **Demographic issues (Judy-centric businesses) are making it terribly hard to grow via new customers.**

Retailers:

- **We spent 2000 – 2015 teaching customers to not visit stores. It worked! Customers now sit at home and click. This is terrible for in-store traffic, which by some studies, is down as much as 50%. Retail is losing the infrequent mall visitor – replaced by clicks.**

E-Commerce:

- **All of the "easy" customers (those from catalog marketing or retail) are gone. From here on out, it's hard work.**

2010 – 2015 = Retail Shift To E-Commerce

We spent 15 years teaching retail shoppers TO NOT VISIT RETAIL STORES – asking them to instead sit at home and click. It's working. Run the query yourself. This is one of the factors that is causing retail comp store sales to struggle – why drive to a store when you can sit and click? Omnichannel!!

Share Of Sales Via In-Store Retail		
Five Year Trend		
	2010	2015
0 to 5 Miles From a Store	94.8%	94.8%
6 to 10 Miles From a Store	91.6%	85.9%
11 to 25 Miles From a Store	88.3%	82.4%
26 to 50 Miles From a Store	72.7%	64.3%
51 to 99 Miles From a Store	49.3%	38.7%
100+ Miles From a Store	15.9%	11.4%

2010 – 2015 = Post Recession Merchandise

We all know the importance of a healthy customer file. Similarly, it is very, very important to have a healthy merchandise assortment.

After the Great Recession, to many of us created self-inflicted wounds by cutting back on the number of new items, starving the customer file of good merchandise.

Common Issue:

- **2010 = $9.4 million from new items, $15.4 million from existing.**
- **2011 = $8.7 million from new items, $16.6 million from existing.**
- **2012 = $8.5 million from new items, $15.9 million from existing.**
- **2013 = $7.7 million from new items, $16.3 million from existing.**
- **2014 = $6.9 million from new items, $16.6 million from existing.**

2010 – 2015 = Omnichannel

The multichannel movement did not help catalogers grow. At all.

Now the buzzword is "omnichannel". With mobile/social being the way that customers < 35 years old interact with businesses, there is a theory that companies must do several things to be successful.

1. **Be the same across all channels – same merch, same creative, same customer service, same prices.**
2. **Digitize Retail – allow customer to buy from any device and interact with store like one might with a digital warehouse.**
3. **Full Incorporate Mobile/Social – pull the customer into the store when the customer is not at home.**
4. **Data – Use "big data" to personalize and target as appropriate.**

2010 – 2015 = Omnichannel

The poster child for omnichannel is "Macy's".

Macy's calls themselves "America's Omnichannel Store".

Macy's is struggling.

The theory of omnichannel meets the reality of the customer file. Omnichannel theory demands that all customers like operational inventory strategies (buy online, pickup in store). Omnichannel theory demands that all customers love all channels (not supported by data). Omnichannel theory requires merchandising and promotional sameness, which, again, is not supported by actual customer transactional data.

2000 – 2015 Summary: Catalogs

“Multichannel” resulted in a strong focus on the “core customer”. By focusing on the core customer, online became a glorified order form. Catalogers did not develop online marketing chops.

This caused the customer file to age rapidly. As the customer file aged, merchandise aligned with an aging customer file, cutting off the desire of folks < age 45 to purchase from catalogers. These trends were detected by co-ops, who now self-select 60+ year old customers who have specific product preferences. A feedback loop formed. Catalogers are now cut off from those < age 45.

Too many ad dollars in catalogs due to faulty matchbacks – they need to be reallocated to free shipping.

2000 – 2015 Summary: E-Commerce

When catalogers shifted to "multichannel", they left the door open for e-commerce businesses. E-commerce businesses blew straight through the door, capturing Gen-X.

Catalogers turned e-commerce into a glorified order form.

Retailers finally figured out e-commerce in the past five years, and are in the process of shifting commoditized demand out of stores, into e-commerce.

Pure E-commerce businesses are facing two challenges … new merchandise … and new customers. All the easy new customers have been acquired. It's hard work, going forward.

2000 – 2015 Summary: Retail

It took 2000 – 2005 for retailers to figure out e-commerce. They figured it out.

Since 2005, retailers have repeatedly told customers to not visit stores, and to instead sit at home and click. Customers listened. Foot traffic in stores is down by as much as 50%, depending upon the study you read.

New+Reactivated customer counts are floundering, largely because of the reduction in foot traffic. Existing customers are slooooooowwwwly shifting demand online.

The answer, “omnichannel”, is quite honestly an unproven theory that, to date, has not saved the retail industry.

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2010 – 2015 = Hard to reactivate / find new buyers, merchandise staleness, omnichannel, demographic feedback loop.

2015 – 2020 =

2015 - 2020

The second half of the presentation will focus on what these trends mean to the future of catalog brands, retail brands, and e-commerce brands.