

# A DYNAMIC SEGMENTATION APPROACH FOR TARGETING AND CUSTOMIZING DIRECT MARKETING CAMPAIGNS

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An important aspect of customer relationship management is the targeting of customer segments with tailored promotional activities. While most contributions focus on the selection of promising customers for targeting, only few authors address the question of which specific differential offers to direct to the selected target groups. We focus on both issues and propose a flexible, two-stage approach for dynamically deriving behaviorally persistent segments and subsequent target marketing selection using retail-purchase histories from loyalty-program members. The underlying concept of behavioral persistence entails an in-depth analysis of complementary cross-category purchase interdependencies at a segment level. The effectiveness and efficiency of the proposed procedure are demonstrated in a controlled field experiment involving the targeting of several thousands of customers enrolled in the loyalty program of a “do-it-yourself” retailer. Our empirical findings provide evidence of significant positive impacts on both profitability and sales for segment-specific tailored direct marketing campaigns.

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## INTRODUCTION

The retail industry is characterized by fierce price competition among companies that offer rather similar product assortments and pursue aggressive promotional policies within given retail formats (Corstens & Corstens, 1995; Kahn & McAlister, 1997). Retailers are collecting huge amounts of personally identifiable point-of-sale (POS) transaction data dissembling rich information about customers' purchasing habits (e.g., sizes, spending values, or compositions of shopping baskets). The individual purchase histories collected from the customers enrolled in the program can be linked back to store and marketing data, sociodemographic background characteristics, and additional survey or feedback information (if available). Within advanced concepts of customer relationship management (CRM), this database of consolidated data sources plays a central role in analyzing and planning targeted direct marketing actions (Winer, 2001).

As our brief review in the next section will show, considerable advances have been achieved in the field of target segment selection for direct marketing purposes; however, the authors could not detect any contributions to the academic marketing literature that convincingly address the question of which specific differential offers (in terms of merchandise types or product categories to be featured or subjected to rewards) to direct to the customer segments that turn out to be worth targeting.

This article attempts to utilize the multicategory nature of choice decisions made by individual shoppers throughout their shopping trip histories to assist direct marketers in selecting *who* to target with *what specific offer(s)*. In doing so, both the process of segment formation and the customization of targeted cross- and upselling campaigns are based on a measure that quantifies a customer's "interest" in particular (combinations of) product categories. As in the case of the Tesco *Clubcard* program (Humby & Hunt, 2003) or the indications provided by Pearson and Gessner (1999), resolution of this issue is sometimes claimed by practitioners, but there is a lack of a more thorough treatment in the academic literature. Furthermore, specification of such "interest measures" and especially consideration of cross-category effects are mostly accomplished on a rather ad hoc basis or guided by pure managerial intuition.

In contrast, we advocate a more general and data-driven approach for quantifying a specific customer's tendency to symptomatically (re)purchase distinctive combinations of product categories included in a retail assortment. The latter is denoted as "behavioral persistence," which will be evaluated based on an in-depth exploratory analysis of shopping basket histories. The remainder of this article proceeds as follows: Following a brief discussion of current practices in target market selection within loyalty programs and their specific deficiencies, an overview of previous research on analyzing cross-category purchase interdependencies based on shopping basket data is provided. Next, we propose a flexible and dynamic approach to derive segments of customers who are behaviorally persistent in the aforementioned sense. The proposed two-stage modeling framework includes a data-compression step of the observed shopping basket data and resolves the subsequent target group selection. In an empirical application study, targeting effectiveness and efficiency of the proposed procedure are evaluated in a controlled field experiment involving segment-specific adapted direct mailings to a large customer sample of a "do-it-yourself" (DIY) retailer. Finally, we discuss conclusions and outline some suggestions for future research.

## CONCEPTUAL BACKGROUND AND RELATED LITERATURE

### *Current Issues and Practices in Target Marketing Selection*

Due to the typically noncontractual loyalty-program settings in retailing, shoppers are free to enroll in any competing programs within the same retail industry and experience much lower (if any) switching costs as compared to financial institutions or telecommunication providers (Reinartz & Kumar, 2000; Rust, Zeithaml, & Lemon, 2000). This has led to an increasingly competitive environment with different companies vying for retention of the same customer base. Furthermore, many programs appear to be launched as a defensive marketing strategy rather than as a sophisticated CRM initiative (Kumar & Shah, 2004; Reinartz & Kumar, 2002).

Traditionally, loyalty programs have spent too much focus on purchase frequency or spending without

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