

Customer Life Time Value for Private Labels: A case of Apparel Category in India

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Introduction

Private Labels or Store brands have grown at an impressive rate since the advent of modern retailing in India. Apparel is the second largest category, after food and groceries, for Indian retailers, constituting 10% of the \$ 37 billion market in India (A T Kearny report 2011). Additionally private labels account for nearly 40% of the total private labels sale in India (Indian Retail Industry 2010). The apparel market was expected to grow to the tune of \$8 bn by 2016 with a CAGR of 8.5% (Technopak report 2011) with a wide retail presence among the modern retailers. Hence, there is ample scope for private labels in this category. The growth of private labels has been commensurate with the increase in the number of studies being conducted in India and across the globe. A comprehensive review of articles published on or with reference to store brands in various scholarly and non-scholarly journals and magazines, appearing on just one of the electronic database namely, ABI/Inform, since 1986, further strengthens the relevance and the implications of the phenomenon „Store Brands“. Number of studies published in this domain pre-1986, stood at nominal 31, but has increased exponentially to 153 in each time span of 4 years period till 2010 (Gooner & Nadler 2012). Over the past two decades there has been considerable improvement of PLBs image and quality across the globe (Au-Yeung & Lu 2009) resulting in retailers targeting upscale customers exclusively with private labels.

Grewal and Levy (2008) in their editorial remarks of Journal of Retailing had commented that more number of studies are required in the area of loyalty towards private labels. As retailers tend to earn more from their private labels programme, hence acquisition and subsequently

retention of these customers is of prime importance to the retailers. Moreover, the genesis and success of any private label programme depends on its ability to customize and customization is crucial for retention. Though majority of the studies in this domain have focused on purchase intention while acquiring the customers, very few studies have delved on retaining the customers for private labels by the modern retailers and specifically those customers who would generate high Customer life time Value (CLTV).

Research Gap and Research Problem

Retention is a reflection of the loyalty of the customers and has been considered as its proxy measure (Kumar & Reinartz 2012). Yet, there would be a variation in the degree of loyalty across categories (Pappu & Quester 2008). Retailers have experimented with various loyalty programmes and tools. For e.g. *Gap Inc.* introduced Private label Credit Card (PLCC) in 2004 as an innovative brand loyalty tool, later followed by many others, leading to its decreasing efficacy. The prime reason was the failure to analyse and interpret plethora of data captured for the spending pattern of the customers (Ferguson 2006). Moreover research has proved that customers who are loyal may not necessarily be profitable for the marketer and vice versa (Kumar & Reinartz 2012). Therefore the concept of providing the same loyalty benefits to customers exhibiting a certain level of loyalty needs a revisit.

Though the apparels considered in this study are premium priced, but being marketed on the plank of fashion, the inter purchase cycle is reduced considerably resulting in greater opportunities for customers to indulge in price comparison between purchase cycles and hence increasing their price sensitivity (Ailawadi et al. 2003). Hence customers' loyalty over a time period may have been significantly influenced by price led promotions of the retailer in response to the aggressiveness of competitors to wean away these customers from the retailer's fold or a decrease in customers' switching cost due to macro environmental forces. This aspect would cover both aspects of loyalty – behavioural and attitudinal (Kumar & Reinartz 2012). Yet, studies prove that reduced customer inertia for trying out new offers by the marketer based on a price led promotion may boomerang due to increased probability of the customer exploring similar offers by the competitors. Customer loyalty without resulting in enhanced profitability has low consequence for marketer. Hence quantifying the customer relationship makes sense. As brand

loyalty may likely (and not certainly) result in increased profit for retailers (Ailawadi 2001), it would be more fruitful to focus on those customers who would be generating high customer lifetime value (CLTV) for the retailers. Therefore it is imperative to target the right segment with the right marketing interventions rather than focusing on “suboptimal” customers to increase their profitability and avoid any adverse impact. With the variation in customers’ loyalty and their contribution to firm’s profitability how can the firm identify those customers who exhibit greater customer life time value (CLTV)?

Though most of the studies have considered the services sector for comprehending customer retention issues, this study has attempted to understand the same for Indian retailers dealing in private label apparels. Though Indian retailers are capturing customer data they are not able to leverage this information for their customer relationship management exercise. This study can guide them to increase their ROI by taking right marketing decisions for retention as well as reacquisition of defected customers through better second life time experience and enhanced profitability from second lifetime value (Kumar et al. 2015)

This exercise demands an in depth understanding of customers’ repeat purchase behavior. As the retailers are in the best position to gather customer level behavioural data, these metrics can aid them in better understanding and implementation of customer relationship management metrics. The captured metrics may not always exhibit observable heterogeneity (e.g. demographics), therefore the unobserved heterogeneity of the customers can be accounted for by developing a latent class segmentation approach (Kamakura & Russell 1989).

Objectives of the Study

The purpose of this study is to:

- a) Identify and segment the customers of private labels apparels on the basis of „degree of loyalty“ and „profitability to the retailer“. Therefore four broad segments would emerge- I) high on loyalty and profitability, II) high on loyalty but low on profitability, III) low on loyalty and high on profitability and IV) low on loyalty as well as profitability.
- b) To prioritize them on the basis of the segment’s ability to deliver various gains for the retailer. This exercise would also help in probing the customers in low loyalty quadrants to observe their status during their first life time as well as probable reasons for their defection.

c) To show the impact of price based promotions on the purchase behavior of the customers in these segments.

d) CLTV for each customer segments and the retailer's present customer equity can be predicted at the present marketing cost. Retailers can accordingly offer customized solutions to different customer segments for increased retention rate and / or enhanced profitability. The results would also aid in prioritizing the efforts of the retailer in servicing different segments. This would culminate in generating higher CLTV and hence, customer equity, in a category characterized by „fashion and fad“.

Research Methodology

Study has been conducted on the database of over 6000 customers, extracted from the POS database of a known Indian retailer exclusively dealing in premium private label apparels. They market their labels through their exclusive brand outlets (EBOs) as well as their online vertical. Therefore this study is considering sale through only two channels. The database spans over a period of 4 years and would provide an acceptable insight as the lifetime duration in this sector last on an average for 5 to 10 years (as per industry standards). Customer activity measurement would cover measuring average inter purchase time, retention rate, survival rate and lifetime duration for each segment. The tool used are -a) Sensitivity analysis on two variables- retention rate and monetary value generated over three years time period, b) *Recency, Frequency and Monetary* value (RFM) analysis, as it has proved to be a reliable time variant predictor for future purchases even in cases of non-contractual customers (Braun et al. 2015) using evolutionary algorithm (Winston 2014).

Assumptions: a) Industry benchmark of having a gross margin of minimum 30% on premium western style apparels has been considered as the bench mark for defining the level of profitability generated through that customer. Accordingly customers purchasing items having gross margin greater than 30% are considered as highly profitable customers and below it designated as those generating low profitability.

High - profitability $\geq 30\%$

Low - profitability $< 30\%$

b) Referring to Objective 2, One cycle of purchase refers to purchases at regular intervals of maximum three months. A break between two purchase incidence > 3 months to be counted in next cycle.

Data Analysis& Results

Figure 1
Profitability/ Loyalty Grid
 Profitability / Loyalty →

	↓ H	L
H	I 30%	II 32%
L	III 22%	IV 16%

Figure 1 depicts a disconnect between the profitability and loyalty status of the customers. What is interesting to observe is the generation of high profitability by 32% of the customers who are low on loyalty status. Hence customers falling in this segment require equal, if not greater attention than those falling in the first segment.

Figure 2

Revenue generated from various percentage of customers

% customers	Revenue Generated(Lakhs)	% marginal increase
5	10486	
10	13285	0.789311
15	15848	0.838276
20	17033	0.930429
25	19157	0.889127

Fig 2 reflecting the finding from the sensitivity analysis depicts a dip in the marginal increase of revenue generation when serving more than 20% of customers. Therefore following Pareto's principle, identifying and serving these 20% customers showcasing their greater customer life time value would enhance the profitability of the organization.

Implications of the Study

As this study is restricted to only one category- apparels, it would aid Indian apparel retailers to develop an adequate proactive plan(s) to retain profitable customers as well as win back (the profitable) defected customers through valuable insight about repeat purchase behavior and segmentation of customers on behavioral (loyalty) and profitability basis.

Keywords: Private Labels, RFM, Sensitivity Analysis, CLTV

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