CUSTOMER DATABASES FOR SMALL FIRMS: MAXIMIZING THE POWER OF YOUR MARKETING

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ABSTRACT

This article describes how and why a small business can take advantage of the benefits which will accrue from the creation and use of a customer database. What information may be useful to capture (or buy) about your customer, and how that information can be used to improve your marketing efforts and subsequent "bottom line" is presented How to create (or evaluate for purchase of) a database, and how to maintain your database to preserve its accuracy and value is explained. Information technology is transforming the business game for small firms today. The importance of database marketing as a cost-effective tool which small firms should be utilizing cannot be understated or overlooked.

INTRODUCTION

Marketing intelligence has long overlooked the greatest asset of a firm, its customers. Peter F. Drucker stated long ago that "companies are not in business to make things, but to make customers" (Drucker, 1959). Firms have always had accounting data from which they can calculate total sales by geographical area or product line, or the value of an average sale. But since the time of neighborhood mom and pop stores, when store owners knew their customers on a first name basis, they haven't known what customers are their **best** customers (let alone **who** they are). Hence, they have typically treated all customers as equal. Enter customer level databases. Knowing who your customers are, how profitable each is, and how to reach them with tailored offers has transformed the nature and efficiency of marketing power.

Information technology is transforming the business game for small firms today. In the past, most computerization efforts of both large and small companies concentrated on the automation of routine business activities, especially in areas such as accounting, payroll, inventory management, and manufacturing. The problem with these traditional databases is that they are usually not useful for marketing purposes. For example, most bank databases are set up on a product basis. As a result of not being set up on a customer basis, for many banks it would be difficult to determine the other services their checking account customers may also be purchasing from them.

Today, however, much of the focus of information technology is centered around the creation and use of customer level databases for business and marketing purposes. These computerized databases allow companies to gather, store, and analyze customer information, such as demographics and purchase information. This information can enable a better understanding of an organization's customers and then be used for future marketing purposes.

Marketing has long suffered from a dearth of sophisticated tools, especially when compared to most other management functions, despite the rapid increase in the sheer volume of marketing data available (Loewe & Hanssens, 1994). In the past, most marketing data was only obtained from sophisticated and often expensive marketing research (primarily survey) activities. Today, this data comes from a variety of sources. In fact, many firms are centering their marketing efforts around information collected for and analyzed in their database. Many marketing decisions are being based on what customers actually do (their actual buying behavior), not on predictions about their behavior which are garnered from traditional marketing research activities. Actual past customer buyer behavior is then used to predict future behavior and tailor marketing efforts. The value of a database marketing is paramount, and the uses of a database are virtually endless. However, you must first create a database before you can begin to utilize and reap its benefits. The following guidelines will provide you with the information you need in order to create, maintain and utilize your database for business and marketing purposes.

WHAT IS DATABASE MARKETING
AND WHY SHOULD SMALL FIRMS USE IT?

Database marketing has been defined as the gathering, storage, enhancement, manipulation and analysis of customer files in order to provide additional intelligence to the marketing organization beyond simply response to promotional offers (Schultz & Wang, 1993). Based on previous research, small firms are often not employing marketing activities due to concern about cost effectiveness (Stevens, McConkey, Loudon & Dunn, 1994). Database marketing can be used to improve customer loyalty and to reduce long-term marketing expenses through greater precision (Francese & Renagban, 1991). Consumer markets have become fragmented with each consumer segment needing a marketing plan tailored to each specific group of consumers. While the development of multiple marketing plans may be far too costly for small firms to undertake, these firms can still analyze potential market niches and determine which one(s) to target, and how, using database marketing.

A survey of small businesses' use of marketing tools found that yellow page ads, direct mail, newspaper ads/inserts and brochures or catalogs were the four most frequently used marketing tools (Stevens, McConkey, Loudon & Dunn, 1994). Each of these marketing tools can be used more effectively in combination with database marketing activities. It is easy and relatively inexpensive to target specific audiences with highly targeted messages using targeted media and relatively unsophisticated market research. Combining a database--a list of names and addresses with information attached--with direct marketing media, measurable direct response advertising, and direct marketing strategies have proven to be extremely powerful and profitable for achieving sales and profits (Cross, 1991).

With database marketing, a company zeros in on various narrowly targeted groups of buyers and finds ways to craft offers that will appeal very strongly to their needs (Hendricks, 1993). Small firms are in unique positions to target consumers and micro-consumer segments with database marketing. In fact, the concept of database marketing actually originated with small firms and their philosophy of knowing and staying close to customers, understanding their needs, and treating them well after the sale to cultivate repeat business (Stone & Shaw, 1987). Dent (1991) contends that the goal of this kind of "individualized marketing" is to treat every customer as a separate market segment, matching products and services precisely to individual needs. To accomplish this, products and services, as well as marketing and communication efforts must be customized.

The key to be able to execute this customization lies in your customer database. Table 1 provides a list of ways you can interact with your customers through database marketing efforts.

Table 1
Ways You Can Interact With Your Customers Via Database Marketing

Send Customized Offers
(Creating offers that will elicit the greatest response from your customers.)

Send Personalized Letters
(Personalizing each customer contact will demonstrate the value you place on each individual customer.)

Cross Sell Products
(Offering new or related products, or even unrelated products to existing customers.)

Up Sell Products
(Offering additional items that compliment the
current products being offered to existing customers.)

Announce A Sale

Mail A Survey

Report On Changes

Introduce New Products/Services

Introduce New Employees

Mail A Newsletter

Solicit Complaints

Mail A Free Gift

Send A "Thank You" Note

Finally, small firms are in a prime position to be utilizing database marketing activities because it gives them a competitive parity with or perhaps even a competitive advantage over their larger competitors. Small firms need not have big budgets in order to compete effectively with these larger firms. Many large firms attempt to market to all segments of a market. As such, their total marketing budgets, expertise, and commitment to a specific market segment are fragmented. While a small firm may still be "out-budgeted" by an larger firm in a particular market, it can segment the market segment into an even smaller, more sharply defined segment. It can become known as the expert providing the best product(s) in that subsegment. At some point, because the subsegment becomes too small for the larger company to devote more investment and/or expertise to it, the smaller company becomes the primary provider of that/those product(s) in that subsegment. Such a strategy is greatly enhanced with the use of a customer level database.

WHY SHOULD YOU FOCUS ON CUSTOMERS AND WHICH CUSTOMERS SHOULD YOU FOCUS ON?

Everyone knows that the era of mass marketing is over. Businesses are now scrambling to focus more narrowly on their customers (one-on-one) like never before. Peppers & Rogers (1995) contend that genuine one-on-one marketing is founded not just on mail, phone, and fax, but also on an increasingly powerful array of much more efficient, individually interactive vehicles. These marketing tools include on-site interactivity, on-line connections, E-mail, and (coming soon) interactive television. Focussing on your customers is a cost-efficient strategy. In fact, those firms who believe in "creating a customer" (as opposed to just "making a sale") will be wildly successful as we approach the 21st Century.

One of the fundamental principles upon which direct marketing is based is that current customers (and knowing who they are and how to reach them) are the most valuable "asset" of a firm. The "principle of success" is to find out what the customer wants and give it to them. Unfortunately, most businesses are so busy looking for new customers that they forget the customers they already have. A few more marketing axioms include:

- ◆ It costs only one-fifth as much to keep your current customers as it does to replace them. Many businesses in the U.S. spend five times as much money for new customers as they do to keep the customers they presently have! Thus, your firm should place emphasis and importance on a customer retention strategy as opposed to a customer acquisition strategy (Raphael, 1991).

- ◆ A happy customer will tell 5-7 people, while an unhappy customer will tell 7-15 people.

- ◆ The most important customer information is that which comes after the first sale.

- ◆ Your future customers will resemble your current customers.

In summary, not focussing on your customers can be a fatal mistake in business today...one that database marketing will not permit you to make. In fact, the foundation of database marketing stems from that "principle of success". However, even if you begin to focus on your customers, the fact is that all customers are not created equal. A well-known axiom in marketing is the 80/20 rule, whereas, 80 percent of your business comes from 20 percent of your customers (Zikmund & D'Amico, 1994). This narrow group (the 20 percent) of your customers have become more valuable to you over time. These are the customers to which you should target your marketing efforts and relationship building. One of the best measures to evaluate the value of your customers lies the following "RFM" rating:

(R) Recency = the date of last purchase
(F) Frequency = the total number of purchases
(M) Monetary = net sales to date

In its simplest form, the R-F-M formula calls for the establishment of a point system with purchases broken down by quarter-years. Stone (1994 p. 41) presents the following typical formula:

- ♦ <u>Recency points</u>:
  24 points - current quarter
  12 points - last 6 months
  6 points - last 9 months
  3 points - last 12 months

- ♦ <u>Frequency points</u>: Number of purchase x 4 points.

- ♦ <u>Monetary points</u>:   10 percent of dollar purchase with a ceiling of 9 points. (The ceiling avoids distortion by an unusually large purchase.)

The number of points allotted by each firm using the R-F-M formula may vary, but the principle is the same. Once the R-F-M point system is programed for your database, a monthly or quarterly update is used for tracking the value of your customers and for enhancing relationships with your most valuable ones. Brierley (1994) contends that making customers feel special, needed, wanted--not just as "consumers" or "prospects", but as individuals is the key to relationship marketing. This can be achieved by database marketing efforts.

HOW DO YOU START A DATABASE MARKETING SYSTEM?

Creating a customer database can be easy and very inexpensive. A database doesn't have to be computerized, just organized. A small firm with very limited resources could begin database marketing by using a simple index card file. Each index card should contain customer name, address and telephone number. Additional information, type of product purchased, amount of purchase and dates of purchases, and other information helpful to refresh the salespersons memory of the customers needs, can be collected.

If your active customer base is less than 250 and your products are low markup consumables sold to individuals and households, then a customer level database would most likely be difficult to cost justify. Companies selling customized products or products requiring personal selling to close a sale that have fewer than 250 active customers would probably be better served by starting with a customer contact information system to grow its profitability to levels that could better cost justify a customer level database (Newberg and Marcus, 1996). A customer contact information system is a systematic process which reminds the firm **when** to contact **which** customers for **what** purpose. This system requires the firm to maintain a data file which includes the names of all customers to be contacted on specific dates. Then, each day the firm knows which customers to contact and by cross-referencing each customers card file, knows the objective of that contact.

The following four steps provide an overview of the process of starting a database marketing system.

Step 1: Determine What Data to Collect. The first decision is to determine what data to collect and store in your database. Data included in a database record should depend on how the firm plans to use and analyze the data for specific purposes. If you do not plan to specifically use the data, then do not collect, input, and store it as a part of your customer database. It will only increase the cost of maintaining your database and will not yield any benefits. Listed in Table 2 are some of the types of data collected, inputed, stored, and used by many customer database managers.

Table 2
Data That Can Be Included in a Database Record

A. **Transactions Capturable Data**
   1. Customer account number
   2. Customer name
      a. Position/title, decision maker status
   3. Customer address
      a. Street and number
      b. City, state, Zip code
   4. Area code and telephone number
      a. Time zone/time availability
      b. Extension
   5. Individual order information
      a. Response media code
      b. Response order placement code
      c. Order product code (sku #)
      d. Order date
      e. Order entry keyer
      f. Order dollar amount
      g. Order payment method
         1. Cash
         2. Charge account (number, expiration date)

B.   Customer Evaluation Data
1.   Recency score (periodically updated)
2.   Frequency score (periodically updated)
3.   Monetary score (periodically updated)
4.   RFM score (periodically updated)
5.   Customer status (Active/Inactive/Other)
   a.   Regular customer/purchaser
   b.   Gift sender
   c.   Gift receiver
   d.   Inquirer
   e.   Sweepstakes only

C.   Personal Customer Data
1.   Customer age/age range
2.   Head of household - name and gender
3.   Second individual - name, gender, & relation
4.   Number of adults in household
5.   Marital status
6.   Presence of children
7.   Children in age ranges
8.   Occupation of head of household
9.   Occupation of spouse
10. Working woman (number present in household)
11. Estimated income code (9 increments from less than $15,000 to $125,000)
12. Known number of vehicles owned
13. Dominant vehicle lifestyle indicator (classification includes luxury car, truck/passenger utility vehicle, station wagon, import, specialty, etc.)
14. Home owner or renter
15. Length of residence (in one year increments)
16. Dwelling size (single or multi-family)
17. Birthday

D.   Customer Research Data
1.   Match code (for Merge-Purge)
2.   Primary research data
   a.   Customer surveys
   b.   Customer interviews
   c.   Customer focus groups
   d.   Other interactions with customers
3.   Secondary research data (database enhancement data)

NOTE: Adapted from M. Baier (1996), *How to Find and Cultivate Customers Through Direct Marketing,* Lincolnwood, IL: NTC Business Books, p. 48; H. Katzenstein & Sachs (1992), *Direct Marketing* (2nd ed.), New York, NY: MacMillian Publishing Company, pp. 157-161; and B. Stone (1994), *Successful Direct Marketing Methods* (5th ed.), Lincolnwood, IL: NTC Business Books, pp. 38-39, 48.

This set of potential data does not define the optimal customer database. It is only given to indicate the types of data a business may consider for inclusion in the creation of its database. A smaller firm must be careful to collect only that information which will be of use and importance in future marketing efforts with their customers.

Step 2: Determine what Database Software to Use. If you have decided to computerize your database, then next decision is what software you will utilize to help organize your database. The cost and configuration of database software can range from less than one-hundred dollars for off-the-shelf software to over a million dollars for customized database software. A small business (small with respect to the number of customers it has) is probably better off starting with database software which can be purchased off-the-shelf and is completely self-contained. Some examples of these less expensive list management software packages are presented in Table 3.

Table 3
Database Software Available for List Management

Software Package:	Developer:	List Price:
ArcList	Group 1 Software	$ 635.00
FastMail	Vertical Solutions	49.95
List & Mail	Avery Label	49.95
MagicMailer	Artsci, Inc.	69.95
Mail It	Caddylak Systems, Inc.	59.00
Mail It!!!	Computer Service Micro Applications	N/A
Mail List 4.0	Dynacomp, Inc.	34.95
MailBase	ProMark Software, Inc.	299.00
Mailing List 1	Alphanetics	49.95
MailList	Artworx Software, Inc.	24.95
MailMiser	Kestrel Enterprises	139.00
Mailtrak	TCI Software	100.00
Mass Mailer	Alternative Software, Inc.	199.95
Maximizer Lite	Richmond Technologies & Software, Inc.	N/A
OmniMailer3	Janac Enterprises	84.95
PACE Mailing List	PACE Software & Systems System	50.00\
PC Customer Call Back	Columbia Systems	95.00
PostMark	ProMark Software, Inc.	N/A
PostSave	Accurate Software, Inc.	499.00
PostSAVE III	Accurate Software, Inc.	499.00
Professional Mail	Arc Tangent, Inc.	695.00
Professional Post	Promark Software, Inc.	N/A
SBDML Mailing List	SBD Software Systems Manager	N/A

NOTE: 1994 Software Guide: A New Look. *Direct Marketing*, June, (1994), 52-63.

It is important to evaluate the software based on what your business needs are and how you intend to use your database. In addition, be sure to consider what amount of customization (if any) will be required to make the off-the-shelf software meet your business needs. If some customization is required, does your firm have the manpower and expertise necessary to complete this task? If not, you may have to factor the additional costs of hiring a vendor into the price of the off-the-shelf software package.

In determining whether or not you need to build a customized database, the following considerations should be weighed carefully:

(a) **Functions of a Database.** What will the system be used for? What reports will be standardized, who/how many persons will have on-line access? Will the system be used to track sales and media responses, to calculate RFM, for customer services uses, for shipping or tracking shipments, for financial accounting purposes, for inventory control, for inbound or outbound telemarketing, for customer profiling, etc.

(b) **Data Requirements.** The functions will dictate the data that must be captured or purchased to provide for the above functions.

(c) **Statistics/modeling Requirements.** While the functions will also dictate the types of analytical software required, it does not define the specific analytical package that should be included with the package or needs to be purchased separately.

(d) **Timeliness of the Data.** What is the need and frequency of data updates--which will differ for different analyses. What data will require immediate/on-line entry, and what data may be batch entered? How frequently?

(e) **Turnaround Times/Usage Priorities.** What will be the capacity required to provide adequate turnaround times to maintain department efficiency? What is adequate turnaround?

(f) **Outside Vendors.** Outside vendors may be needed to fulfill all the requirements that in-house personnel would need. Of utmost importance is not only an understanding of hardware and software, but also an understanding of database marketing and statistics. Most important for the evaluation of an outside vendor is a list of previous clients for whom they built or customized customer database systems. Obtain these clients' names and contact them.

Finally, whether you purchase an off-the-shelf software package or have a customized software system designed for your firm, don't forget to plan for business growth in your software selection decisions. At some point in the future you may want to expand your database to include not only your current customers, but qualified prospects, as well. Make sure your software will support your database growth.

Step 3: Inputing Data into your Database. If list information (name, address, and telephone number) is not captured, the marketer has lost the bridge to communicate future

targeted advertisements to his best prospects (current customers and second, qualified prospects). Inputing data into your database is relatively simple, once you have determined what information to collect and store. However don't be mislead into thinking that your database is complete once the information has been entered. Databases must be continually updated to be kept accurate. This is true even if your database in contained in a simple index card file.

Step 4: Database Maintenance. Seventeen to twenty percent of U.S. households change addresses (move) each year. Thus, without updating addresses frequently, correcting them and removing "nixies" (bad, undeliverable addresses), a list, its value to your firm, and its usefulness can deteriorate rapidly. The United States Postal Service (USPS) contracts with over twenty National Change of Address Companies (NCOA) who keep and maintain the address changes of individuals and households, against which business and customer lists can be merge-purged to keep customer addresses current.

In summary, beginning list building doesn't have to be complicated. The most important aspect is obtaining and maintaining customer lists with accurate information. Wheaton (1990) believes that there are four important non- technical skills needed when creating a database: communication, common sense, creativity, and attention to detail.

WHAT CAN YOU DO WITH A CUSTOMER DATABASE?

The uses of your database are virtually endless! Some of the primary uses mentioned by experts in the field (Baier, 1996, 33-34, 57-72; Katzenstein & Sachs, 1992, 149-156, 161; Stone, 1994, 43-46, 50-57) include the following:

♦ **Profiling Current Customers.** Demographic and lifestyle profiles can be collected by survey or purchased from many NCOA companies to describe current customers. "Enhancement data" can be added to customer records to provide a more detailed profile of your current customers. There are several "national household database" companies that collect data which describes individuals and their households demographically, psychographically, and on the basis of lifestyles (Morris & Pharr, 1992). Those include, among others, Axion, Behavior Bank, Claritis, Donnelly, InfoBase, Metromail, MRI, National Demographics, R.L. Polk, Simmons, and Vals. The type of customer information that can be purchased and appended to your customer list has been previously identified in Table 1 (under "Personal Customer Data"). For example, InfoBase charges a minimum of $2,000 for appending a certain set of this data to small databases. For larger databases (5 million customer records, for example), it charges $21.25 per 1000 input files plus $3.50 per 1000 processing, or a total of $123,750. There are also a variety of other variables available for an additional $3.00-20.00 cost per thousand per additional data item (InfoBase, 1995).

♦ **Identifying "Best" Customers.** This is accomplished by calculating the length of the average customer's life and customer lifetime value. By analyzing the total contribution margin generated by the "average" customer over time, a company

can calculate how much it can afford to spend (promotional costs) to acquire new customers and still meet long run profit objectives. Direct marketers consider promotional expenditures as investments in customers, not as expenses which must be immediately recovered.

♦ **Segmenting Current Customers**. With finite advertising budgets, small firms should spend their dollars efficiently. RFM analysis can be helpful in this regard. A customer list can be deciled, by dividing it into ten groups of customers based on RFM. Average customer values can then be calculated for each decile. The advertising budget for current customers can then be allocated across deciles on the basis of decile customer value. A firm should be willing to spend more to maintain and cultivate relationships with its more valuable customers, and less for its less valuable customers.

♦ **Developing a Customer Communication Program**. Communicating with your customers to send them customized offers; announce a sale; report on changes in your firm; solicit customer suggestions and/or complaints can easily be executed with your customer database. In fact, you can tailor your communications program to communicate with sub- segments of your customers or on an individual customer by customer basis.

♦ **Conducting Marketing Research**. In the past small companies did not make significant use of market research. However, now with the use of computers and databases, the usefulness of market research for small firms has increased. Much of the market research that is carried out by smaller companies is comprised of customer information obtained from purchase histories and interests which can be stored and easily retrieved using a customer database (Frigstad, 1995).

♦ **List Rental Income**. Customer lists are valuable not only to the firms that develop, maintain, and own them, but to other companies who have an interest in renting them for their own business uses. See Baier (1983) for a review of list rental procedures.

♦ **Continuity Selling/Increasing Repeat Business**. Continuity selling involves the selling of more of the same or very similar products over time (e.g., book and music clubs, magazines and insurance renewals, updated versions of computer software, additional purchases from future catalogues, etc.). Without knowing who your customers are, and without maintaining list and transactional data about them, a company cannot effectively cultivate customer relationships by selling them more of what they want/need (based on known, stored purchase data).

♦ **Cross-Selling** With a knowledge of product interest areas which customers have expressed through past purchases, complementary or other logically inferred product offers may be targeted to select groups of current customers...music club buyers could be offered CD storage racks, camera film processing customers

could be offered camera cases, scroll saw buyers could be offered project patters, etc.

In summary, while the uses of your database may be endless, they will be limited by your budget and creativity. Don't lose track of your database marketing objectives: to maximize customer purchases and satisfaction, while minimizing your marketing costs.

HOW TO EVALUATE THE EFFECTIVENESS OF YOUR DATABASE MARKETING ACTIVITIES

Evaluating the effectiveness of a database is simply the comparison of pre-database versus database contribution margins to promotional cost ratios. The difference between total contribution margin less promotional costs is the money which pays for the cost of the database. If that difference does not increase at a rate fast enough to cover the costs of acquiring, building and maintaining the database--then either the capabilities of the database exceed your business needs, or the database is not being utilized to its fullest capabilities. This is why the proper planning, designing, acquiring and building of a database is so important.

DON'T OVERLOOK THE ETHICAL ISSUES

While it may be universally agreed upon that databases are wonderful tools for marketers, how wonderful are they for customers? Schultz (1994) believes that databases should improve each consumers' personal life by eliminating unwanted offerings and ridiculous solicitations. But is this actually the case? There is a growing public concern about the information stored in databases. With the rapid growth of on-line databases, concerns about privacy invasion are on the rise. The number of on-line databases has grown from about 400 in 1980 to 4,465 in 1990, of which nearly 70 percent are U.S. based (Morris & Pharr, 1992).

Dowling (1993) contends that although it is generally acceptable to keep past purchase data in your database and use it to market to your own customers, some consumers may not appreciate you sharing this information with another company. Therefore, in regard to privacy, the database itself is typically not the real threat--it is the use of this database that worries customers. Dentino (1994) believes that people feel annoyed because they believe they get too much direct mail and/or too many telemarketing solicitations. In addition, people feel violated because they believe too much information about their lives and personal preferences is being exchanged without their knowledge. Dentino (1994) presents a nine step privacy action plan that all marketers should undertake. In summary, database technology will continue to improve and at each stage there will be new social and ethical dimensions to explore (Morris & Pharr, 1992). While there is no easy solution to the invasion of privacy issue, solutions will be generated through compromises that both the marketer and the customer must make.

CONCLUSION

As summarized by Cross (1991), database marketing is really nothing more than using information about buyers and prospects to interact with them. It takes advantage of computer

technology to do old-fashioned marketing in new- fashioned ways. There is no blueprint for creating a database. The main objective is to meet the needs of your customers and your business in a way that is most cost- effective for you. Information technology is only getting better--so don't wait to start marketing more effectively and efficiently with your database. The pennies that you save today will become dollars tomorrow!

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