

The Leaky Bucket

Four ways to fix your customer retention issues



Introduction

Imagine using a bucket of water to wash your car. But the only bucket you have has lots of holes in it. To keep it full of water you have three options:

- 1) Keep putting more water in
- 2) Fix the holes
- 3) Get a new bucket

Option 1 requires too much effort and is highly inefficient, option 3 is too expensive, so how do you go about fixing the holes?

What has this got to do with customer retention?

Well, a lot of companies go with approach number one to fix their customer retention issues. Instead of fixing the root causes of their retention problem, they simply top up their “bucket” with lots of new customers to replace the ones that churn out of their “holes”.

Many companies spend an absolute fortune on acquisition for very little profitable growth. The Leaky Bucket approach is a very expensive way to run a business. With the credit crunch, the days of high spend acquisition campaigns are over. Retaining your existing customers, and delivering profitable growth is more important than ever.

This discussion paper examines four of the most material impacts on customer retention and offers some solutions on how to tackle customer churn effectively.



1. Acquisition is the answer, what is the question?

The first and perhaps the largest cause of customer churn is actually acquisition, the first part of the customer lifecycle.

Many acquisition and business growth strategies are very aggressive, and an aggressive acquisition strategy will, without fail, create customer management problems in the future.

Most companies have embraced the use of digital channels as a way of delivering more cost-efficient acquisition, but that alone is not enough. Companies need to deliver acquisition strategies with a much more holistic value-based approach that are capable of delivering profitable customer growth.

Are bankers really to blame for the credit crunch, or does the real cause of the recession actually lie at the doorstep of those that create acquisition strategies?

Many companies are volume driven, with resultant sales strategies that heavily discount their products to customers, of whom many fundamentally can't afford the product at full price. Substantial offers are being made to customers to meet short term sales targets, without considering future implications of this strategy.

It happened in the sub-prime market, it happens in subscription businesses and it is particularly widespread in retail. If your customers cannot afford your product when they come off a discount then they will churn, a pattern becoming increasingly predominant in today's economic climate.

Customer value expectations are defined during and soon after the point of acquisition. Once these have been established (on a discounted basis if lots of acquisition offers have been used to acquire those customers) then it will be very difficult to subsequently change those value expectations.

A business intent on volume, will struggle to manage its customer retention. If they do, it will come at high cost. After all, if you are giving away goods at acquisition, then you will be expected to do the same at the

end of the cycle if you want to retain your customers. Subsequently, you end up spending more than ever on both acquisition and retention – the classic leaky bucket.

Has anyone ever read a marketing text book that says that to sell a product, you have to discount it to the point you are practically giving it away? Although theoretically absurd, this is what many businesses are doing in practice. Many marketers say they have to make aggressive offers to get people through the door, but are the people attracted with these offers really the type of customers you want?

Many subscription companies, in particular, have been creating their own self-contained credit crunch by falling into the trap of:

- Short term, aggressive sales targets
- Increasingly discounted offers as the means to achieve those targets
- Discount strategies which acquire customers who can't afford the product at full price
- Existing customers demanding the same treatment as new customers and subsequently seeking to renegotiate their existing terms
- Reducing loyalty as the customer base destabilises

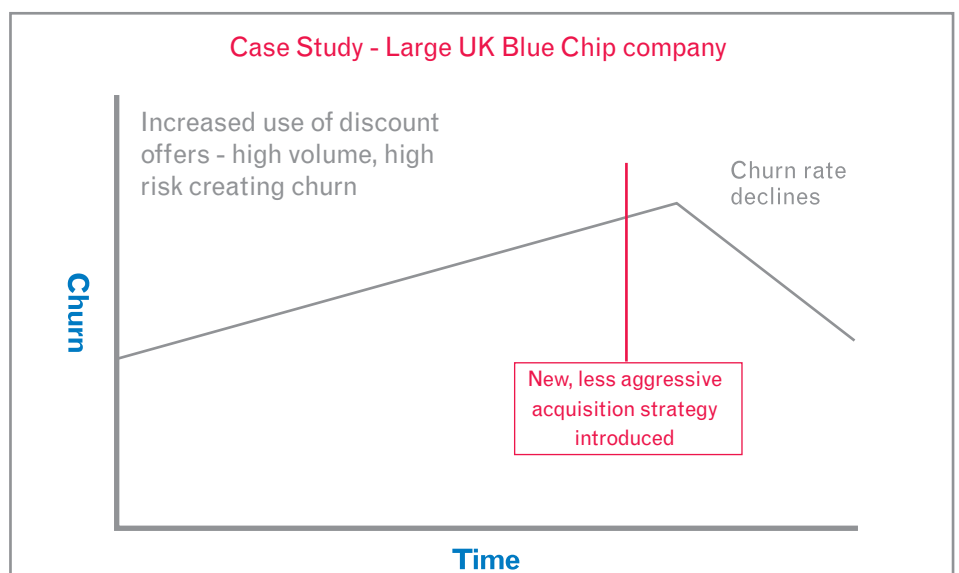
How much of an impact does aggressive acquisition have on your business? Well, one large UK company improved its P&L by millions of pounds by simply stopping heavy, short-term discounting.

The previously increasing churn rate almost immediately reversed when they softened their aggressive acquisition strategy, while the customer base continued to grow, despite less acquisition. A large amount of the existing customer base had been offer seeking simply because they could. Once the offers were removed this behaviour stopped and churn rates dramatically declined.

Organisations may think they are delivering great benefit to the business by bringing in lots of customers with great offers, but if the result means that they have to spend millions trying to retain those customers as they come off acquisition offers then the strategy is flawed.

A common misconception is that if you don't have an aggressive acquisition strategy then you risk losing sales to competitors. Maybe this is so, but lowering the barrier to entry for customers through unsustainable propositions to get them to buy a product they cannot afford at full price is one of, if not the biggest, contributors to customer churn. Do you actually want customers who cannot afford to buy from you?

Therefore, for any business it is absolutely critical to get your acquisition strategy right – growth yes, but sustainable and profitable growth.



2. It is about me the individual and what I do – not the products and services you provide me

As a consumer you shop around and carefully select a product you want to buy and the supplier you wish to purchase from. Within days, and with no concept of who you are and what you want, you are then inundated with copious amounts of marketing collateral asking you to purchase every single product and service the company has ever created.

The failure of previous incarnations of CRM has spawned a new, ultra simplistic approach to marketing. Who cares about customer behaviour when an alternative and easier way to manage the customer and stop churn is to get customers to own as many products and services as possible?

Again, we have a scenario where many companies are positioning their goods and services in such a way (e.g. bundles, one size fits all) that at full price many customers could not afford or want to purchase them. Giving away your services and therefore profit margin on an indiscriminate basis, is not a profitable way to retain your customers.

A rule of thumb for 21st Century Marketing: If something is easy to market to the whole country, then it won't be profitable.

Product or customer?

Most companies will be able to give you a lot of information on the retention performance of their products and why it is good to have a given customer on a certain product. (e.g. Product X delivers £30 of profit and customers will survive for 20 months on that product). However, that statistic may relate to 1 million customers and within this period some customers will leave, others will upgrade, and others could stay indefinitely. The range in values, risk and potential of the customers will differ so much that hardly any customers will individually deliver a £30 profit and stay for 20 months.

Product approaches to determining the value of customers are therefore flawed. Purchasing decisions are made by customers and customers only. Customer Lifetime Value and Net Present Value (NPV) approaches are far more actionable to deliver profitability and will grow a business more than any product approach.

Product NPV

Views at product and package level only

Based on insight from historical segment and cohort behaviour (not customer behaviour)

Not customer level modelling

No concept of what a customer could do on the future that will impact their value

No use of additional 3rd party unique customer data

Segmented business rules driving customer level investment decisions

Relate to Product Performance

Customer NPV

Views at individual customer level

Customer propensity, churn and value modelling driving unique value calculations for each customer

An understanding of what customers could do in the future that will impact their value

Unique and individual value scores driving customer level investment decisions

Application of additional customer level data (credit, life stage, etc) to determine most accurate likely outcomes

Relate to Customer Behaviour

Most importantly, these approaches give businesses the capability to make decisions based on what the customer does, not what their peers do. Every customer can be treated as an individual, and even have their own P&L and you won't be able to achieve a more accurate view of profitability.

To deliver genuine profitable customer growth, businesses need to respond to and predict individual customer behaviour.

Why does the marketing plan never achieve its objectives?

1. Too often it is focused on the accountant's way (i.e. come up with a number and work backwards) and as a result targets are often unrealistic and marketing plans fail.
2. Plans are usually focused on the product and not the customers.

If we want marketing plans that deliver growth and profit then it is time for a new approach – a new phase of customer interaction and a new way of thinking. We need to accept that customers do not conform to pre-determined segments like SOHO, but in fact they are totally individual and sometimes irrational. Most importantly we need to recognise customers as carbon based life forms capable of making informed purchasing decisions.

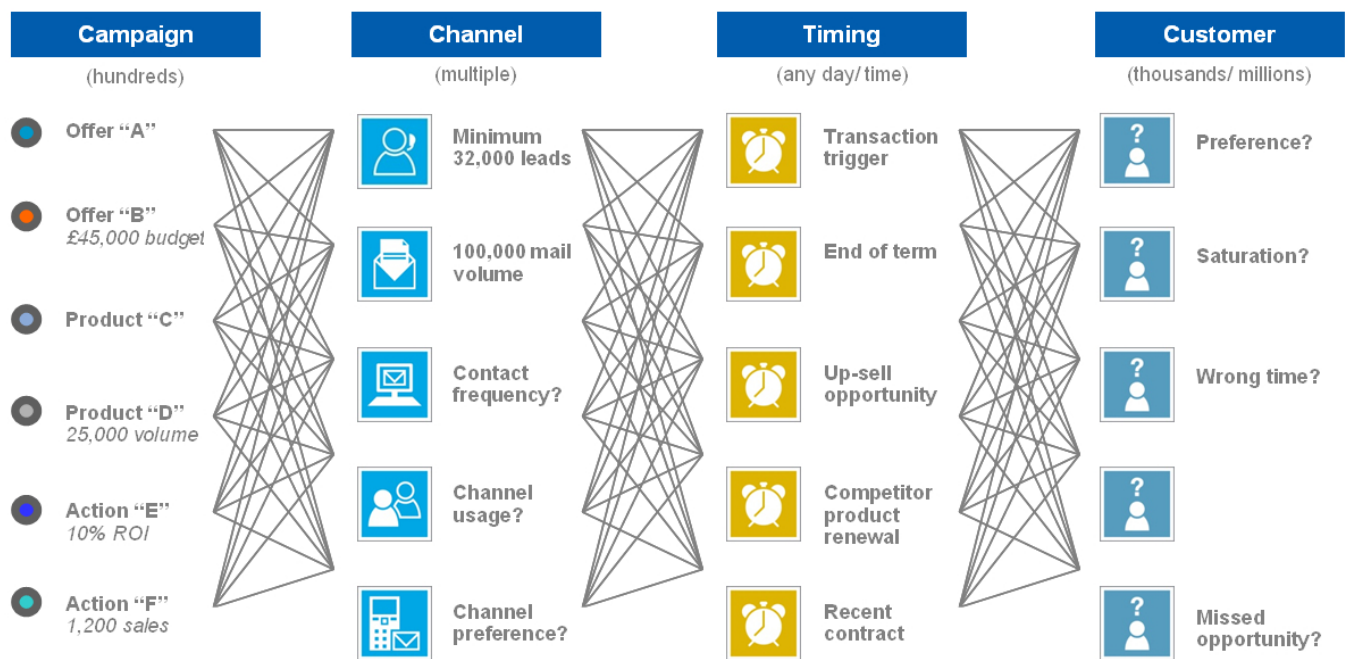
The individual customer is king

Modern marketing is not about forcing people to purchase because of segmented stereotypes or because a certain product is good at preventing churn. Instead, it is about facilitating different individual customer needs and preferences in the most profitable way. Therefore, optimisation is the single biggest new capability for the modern marketer to acquire.

Optimisation is fact based, it deals with individual customers and metrics, and is not based on the guess work and averages that underpin many of today's approaches.

Optimisation is critical as communication and targeting will have to be increasingly focused on the individual if you are to manage the customer lifecycle effectively.

Optimisation – Meeting the specific needs of the individual customer

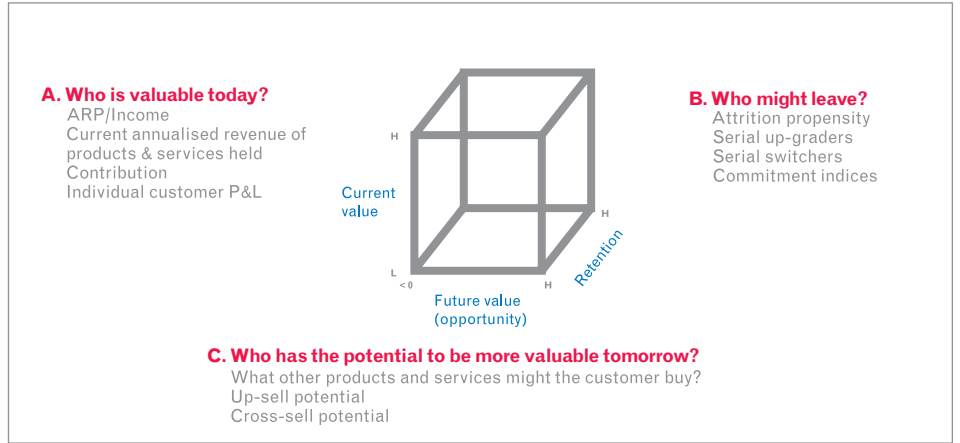


Segmentation is still a necessary requirement to define your strategies. However, this has to be focused away from products and redirected to the individual customers and the potential value they can create.

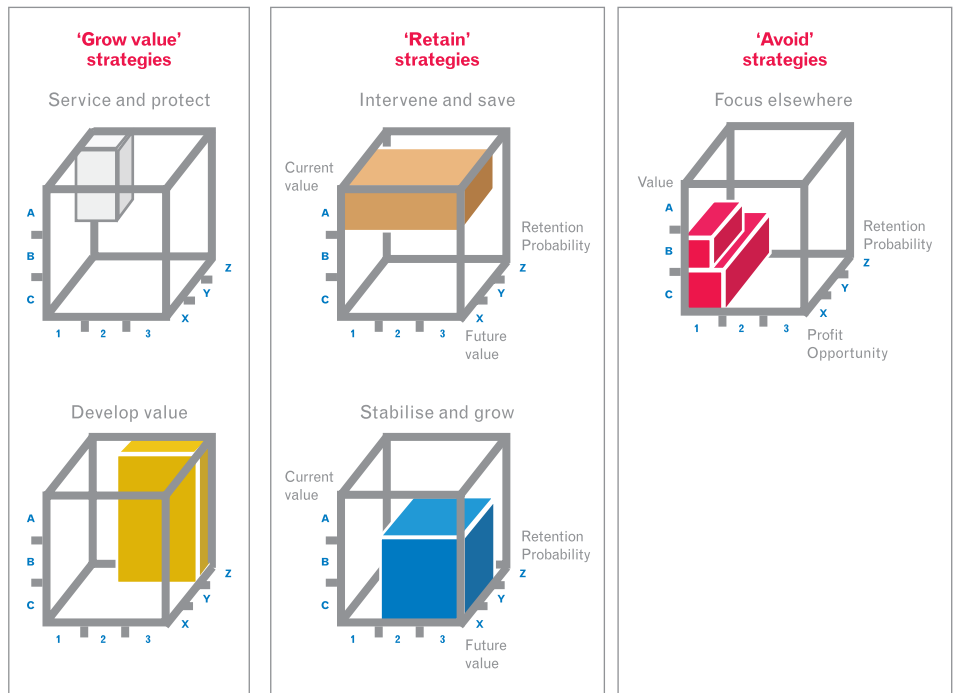
A multi-faceted customer level NPV approach that looks at current customer value, customers' churn risk, and customer potential (e.g. will they buy other products and services?) is a powerful way to look at your customer base. This will help identify who risky customers are, which are worthy of future investment and which type of investment is most appropriate.

This customer lifetime value approach enables the creation of growth, retention and aversion strategies for managing customers that fit more closely to actual customer behaviour. Using a combination of customer value segmentation and targeting at individual customer level results in a very powerful customer management strategy. Adopting such a strategy can transform your return on investment by 10-40%, even for businesses that already adopt some optimisation and segmentation techniques.

A 21st Century Approach to Customer Value and Retention



Customer Strategies



3. Customer loyalty – or bribery for signing on the dotted line...?

Why do your customers stay with you? Do they value what you do, or are they simply tied in to a contract that prevents them from leaving?

Customer behaviour works in two ways. They will do what they want most of the time, however they often behave the way they do because you, through your business rules, have encouraged them to behave that way. For example, many customers churn at the end of a contract because they are human beings with a brain, and having been told that they are on a contract, they know when they can shop around again.

Look at the impact that contracts, business rules, and terms and conditions are having on your business. Are contracts and tie-ins actually forcing your customers to churn or downgrade en masse at a particular time?

There are very few businesses that proactively try and influence when a customer will churn. Most rely on letting customers try to cancel, and then getting them to enter a new contract again to retain them for another year or so.

What can you do, as a marketer, to positively influence your customer's behaviour so they do things you actually want them to do?

If a business has a churn problem, they usually throw money at it in reactive retention – the last chance saloon. Experience suggests you are much better throwing more effort into proactive retention. The reason you need to do this is simple - to save customers reactively involves call centres, agents, offers and therefore a lot of money.

There are companies that have managed to deliver proactive customer retention that has improved the churn rate and at very low cost. By identifying the most at-risk customers, activities such as service messaging, or 'exclusive' low cost offers can significantly improve churn over time. One particular UK company ran a successful programme

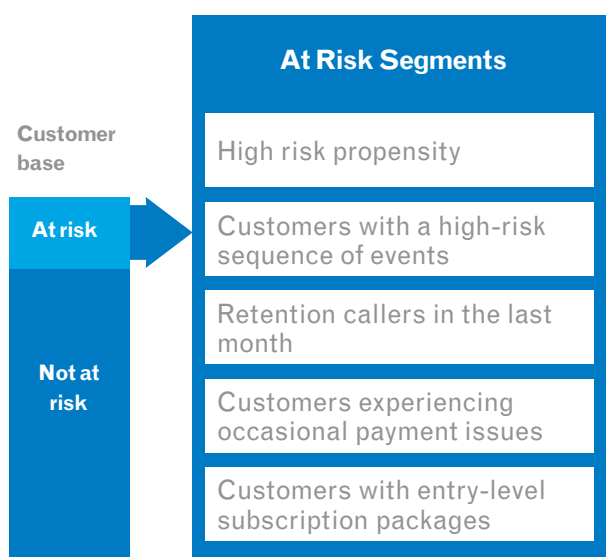
that not only saved customers, but achieved this at a cost per save of one-third of that of reactive retention for similar customer profiles.

Proactive loyalty schemes do work and make a real difference, but only if done properly and if the business accepts that the benefits deliver over time and not over night.

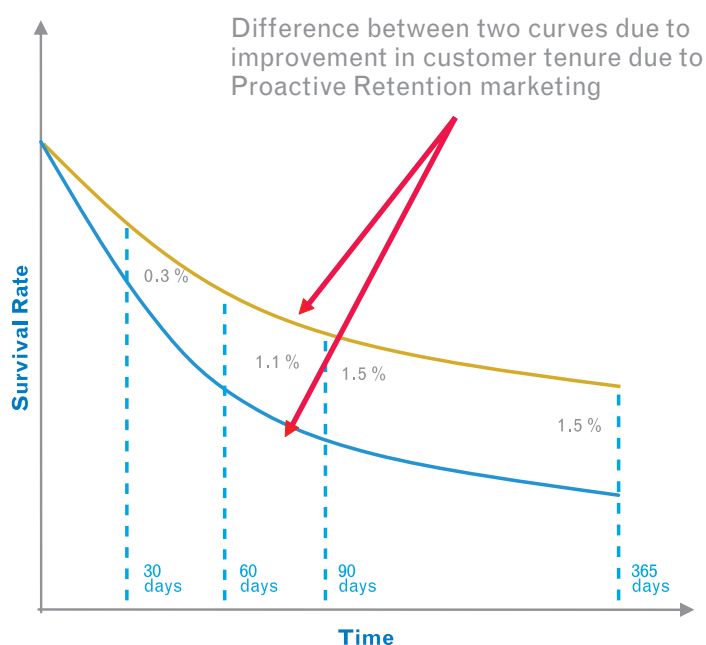
It is not a quick fix and this long-term approach is possibly why many businesses give up and rely on reactive quick wins instead. However, if businesses are serious about regaining profitability in their customer retention activities, then they will increasingly need to focus on proactive retention rather than reactive retention

Case Study – Proactive Retention Benefits Achieved by Large Blue Chip Company

Insight-driven Strategy



Successful Campaign Results



4. Meeting customer needs - the dying and misunderstood art of good customer service.



I want the cashier in the grocery store to not be miserable and surly. If I buy a carpet, I want them to fit it for me and properly. If I buy a mobile phone, I want it to work. This is all simple stuff, yet often customers' experiences will be the exact opposite.

You can be as clever as you want, or invest as much money as you want in customer retention, but if you do not do the simple things well, then you will fail the customer.

Customer service doesn't just mean call centres. Many companies spend millions of pounds on the call centres, but many fail to make life easy for their customers, which is what it is all about. Customer service is really about customer experience.

1. To quote a famous phrase, customers want it to "do what it says on the tin"
2. Customers want joined up and consistent communications through the channel of their choice; some don't want to speak to you at all and that also needs to be recognised.

3. Customers want you as a business to understand that they have ever changing needs and demands. Many businesses still treat customers in the same way they did when they joined 5 years ago – in that time they may have got married, had kids, completely changed their outlook on life— businesses need to respond to those changes.
4. Brand – Use the brand to set the customer expectations (reasonably) so that customers are clear on what to expect from your company. From personal experience of reading and listening to many customer complaints, it is amazing how many result from customers thinking they should get something or some benefit, and then find out that they aren't allowed.
5. And in today's world it is unacceptable to not have systems that can remember and record previous customer interactions!

To expand the last point further, it doesn't matter if the call centre is in the UK or India or anywhere else.

Without any relevant, individual customer information, a call centre agent will be unable to provide good service to a customer.

Ultimately, the reason why service is dying is because businesses have not kept up with the fact that the consumer has become more and more demanding. What was acceptable 10 years ago is no longer acceptable to today's consumers.

So, if the consumer is getting more and more demanding, how do you respond? Below are just a few effective marketing responses that can be used to meet the needs of the 21st century consumer.

As well as responding through marketing, it is also very important to get the customer service right. Many companies are yet to truly utilise the power of the internet or email for servicing their customers. Don't get left behind. Look at companies like Expedia, as an example, and how they have taken the core travel market from the traditional high street travel agents. By not adopting new marketing and customer service channels you risk losing market share to your competitors. You have to meet these changing consumer demands.

21st century consumer dynamics

Possible marketing response



Multiple new channels



Utilise them!!

Saturation



Proposition innovation

Propensity to shop around



Cross-sell

'What's in it for me?'



Communication

'Never satisfied'



Personalisation

Choice, but confusion



Brand values

Reduced friction



Proactive retention

Cost conscious



Proposition differentiation

Conclusion - Four ways to fix your leaky bucket.

If you want a loyal customer base remember the 4 key themes of why you have a leaky bucket in the first place, and manage them appropriately

1. Set behaviours and expectations of your customers from the day they join. Getting acquisition right pays dividends. Getting it wrong makes life difficult for everyone.
2. Conduct one to one relationships with your prospects and customers across all stages of the customer journey. Do CRM again, but this time do it properly with an increasing focus on individual customer profitability.
3. Positively influence your customer behaviour with good effective marketing. Don't rely on reactive strategies to bail you out. Be more proactive in how you interact with your customer base.
4. Deliver the services and propositions to meet your customer needs and desires. Service is about the whole customer experience, not just about call centres.

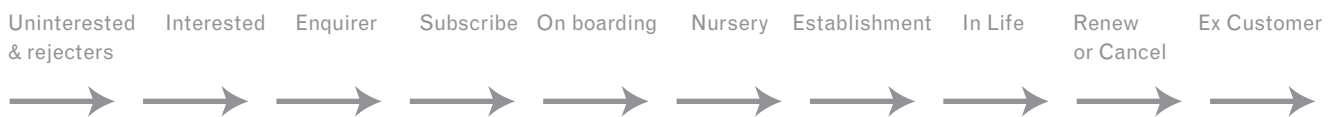
The final note of caution is that in order to properly fix customer retention, you need two further things:

- A talented and sizeable team of people focused on the customer.
- A cross business team that works together and to the same customer and business goals.

The customer lifecycle is a complicated journey, and requires management at every point. However, businesses seem reluctant to invest in people to manage it, and more intent in creating silos of Marketing teams and Customer Service that run with opposing and conflicting customer strategies.

All the causes of the leaky bucket are a result of the business not working to the same goals and people have their own objectives and deliverables. The best sports teams are those where the players have a deep understanding of each other and what they do, and play as a team and not as a set of individuals. The best businesses operate in the same way. Make it so in your business.

Managing Customer Retention Spans the Whole Customer Lifecycle



1. Get the acquisition strategy right

2. Focus on individual customers, focus on future customer value

3. Proactively, and positively impact customer behaviours

4. Service customer needs

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Russell Woodward is Lead Sector Consultant for Experian's specialist integrated marketing division. He has 10 years sector experience, predominantly in mobile telecoms and media and entertainment. Seven years were spent client side with Orange in a number of key roles across consumer and business teams.

As an experienced sector specialist, Russell has been instrumental in delivering many projects that have turned data and insight into actual profitable and innovative marketing strategies – demonstrated by his team winning the 'Data Strategy Award – Best Practice in Data' two years running for Sky's 'Olive' (see <http://www.experianim.com/trustscience>)

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