

Customer Retention: A Business Imperative

Introduction

A wide variety of business strategies vie for the attention and support of senior management as they seek ways to improve corporate profitability. Aggressive advertising and promotions, streamlining operations, cost cutting, outsourcing, acquisitions, and divestitures are all viable strategies that will enhance profitability in the short term. The problem with these strategies is that they often overlook a company's most valuable profit generating asset — its current customer. Some strategies, like cutting costs by outsourcing service centers offshore or providing discounts for services to attract new business while maintaining high prices for current customers, may actually accelerate defections of the company's most profitable customers.

To be successful and to generate the maximum benefit, any profitability enhancing strategy must include a current customer focus.

Customer Retention

Regardless of whatever strategies or tactics it uses to enhance profitability, a company must focus on maintaining its current customer base. The benefits of high customer retention levels are well documented, and include the following:

- The cost of attracting a new customer is five to twelve times greater than the cost of keeping an existing customer.
- The ROI is up to 10 times higher for investments in customer retention than for the acquisition of new customers.
- Converting new customers to loyal ones takes more time, effort and expense than is required for current customers.
- Loyal customers generally have greater usage levels, are more open to cross selling, and are less price sensitive.

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- It requires many new customers to replace the revenue stream lost by one old customer. Even more are needed to replace the profits the old customer generated.
- A 5% increase in customer retention typically results in a 75% increase in aggregate lifetime profits.
- Loyal customers refer new customers while defecting ones typically tell 8 to 16 others about the reasons for their defection.

Maintaining high levels of customer retention also indirectly affects company profitability by reducing employee turnover as a result of the increased pride and satisfaction employees experience working for a well respected company.

Unfortunately, in today's highly competitive marketplace customer turnover is commonplace. Defection rates range from 5% to 30% annually across all industries, with rates as high as 20% not uncommon. These defection rates force companies to replace a significant percentage of their customer base every few years. Clearly, unless they have a monopoly on their product or service, most companies have to work extremely hard to keep their customers over an extended period of time

CRM systems do not capture the kind of information needed for an effective customer retention program.

CRM Recognizing the problem that high customer churn rates represent, many companies have implemented CRM programs. While CRM systems are effective at capturing and sharing customer information, they generally do not capture the kind of information needed to build loyalty and assure customer retention. Rather, the typical CRM application is focused on the sales process or on gathering marketing data, and usually "pushes" offer information from the company to the customer or to company employees who provide after-sales support. For example, a typical CRM portfolio includes the following:

- Call center automation
- Sales force automation

- Shopping analysis
- Campaign planning and management

CRM rarely looks at the dynamics of the company-customer interaction and is even less frequently designed to evaluate customer propensity to defection.

Too frequently, the customer who is merely satisfied is open to the next better opportunity or lower price.

Customer Satisfaction

Many companies mistakenly assume that they can lessen the rate of customer defection by instituting customer satisfaction programs. High customer satisfaction, however, does not automatically translate into greater customer retention. The generally high correlation often seen between customer satisfaction and loyalty stems from the fact that loyal customers are satisfied. But, the assumption that satisfied customers are loyal is a risky one. Customer satisfaction is a predominantly passive and transitory state for the customer and does not reflect the entire spectrum of involvement the customer has with the company. Too frequently the customer who is merely satisfied is open to the next better opportunity or lower price.

While it is likely an error to state, as one business writer did, that “customer satisfaction is worthless,” many believe that its importance in the retention equation has been dramatically overstated and that other factors must be included in the process to differentiate loyal customers from those with the potential to defect.

It is essential that the full extent of the relationship that customers have with a company is completely understood – not just their level of satisfaction.

In order to enhance customer retention, it is essential that the full extent of the relationship that customers have with a company is completely understood, not just their satisfaction, and that a monitoring system be put in place to provide early warning of any problems before they become critical.

Customer Retention Metrics

To reap the financial rewards of customer retention, an integrated strategy needs to be developed that examines, predicts and ultimately influences customer behavior. This strategy needs to be based on solid quantitative information gleaned from internal company financial, marketing and operations statistics and coupled with external “voice of the customer” data. The following components are required for an effective customer retention program:

- Situational analysis
- Identifying the right customers
- A performance measurement system that...
 - Determines how well a company is performing on the issues most important to its key customers
 - Monitors changing customer needs and expectations
 - Provides early warning of potential defections

Customer retention strategies are based on solid quantitative information gleaned from internal company statistics and external “voice of the customer” data.

Situational Analysis Implementing a customer retention program should begin with a comprehensive situational analysis of the company and its customers. The situational analysis describes the state of retention of the company prior to the initiation of any retention efforts and assesses how current levels of customer churn impact profitability.

The situational analysis also serves to define the retention and financial benchmarks against which any programs will be judged and sets the goals of the retention program.

Customer Targeting

Successful retention strategies recognize that not all customers are equal. It is commonly believed that 20% of a company's customers account for about 80% of its profits. In fact, this commonly accepted wisdom may in some industries understate the true profitability of a company's best customers. For example, research in the banking industry has shown that the top 15% of banking customers at some banks may generate virtually all of their profits. This is possible because some banks either lose money or break even on many customers, with the profits generated by the top customers compensating for these losses.

Customer retention strategies are most profitable if directed to keeping your best customers.

Customer retention strategies are therefore most profitable if they succeed in keeping the company's best customers. Companies must identify customers who are currently most profitable, together with those that have the greatest expectations for profitability, and put their retention efforts against these key groups. The alternative, hanging on to unprofitable customers, saps a company of its earnings and potential.

Segmenting the customer database and applying customer lifetime value (CLV) methodologies is one of the best ways to identify the customers with the greatest potential. The strength of these methodologies is that they identify customers who are currently very profitable, predict which dormant customers are likely to become valuable in the future, and provide a profile of future target customers.

Performance Measurement System

Once the targets of the retention program have been identified, it is necessary to develop a performance measurement system that will provide an in-depth understanding of the relationship current customers have with the company, how they perceive the service experience, the value they place on its products and/or services, the needs that are most important, and how they are fulfilled. Additionally, in order to better understand

which needs, if unfulfilled, would lead to defection, it is often useful to interview lost customers to obtain an understanding of the motivations behind their defection. The customer retention measurement system must also benchmark the value of the company and its offerings versus that of the competition. Customers may rate you highly, but if they rate competitors as high or higher, your customer base is at risk.

Conceptually, the performance measurement instrument can be divided into two major components: an assessment of the importance of the factors that measure customer interaction and involvement with the company, and performance ratings of the company on these factors.

It is crucial to know which factors add value and increase the likelihood of retention and which merely fulfill minimum “cost of entry” requirements.

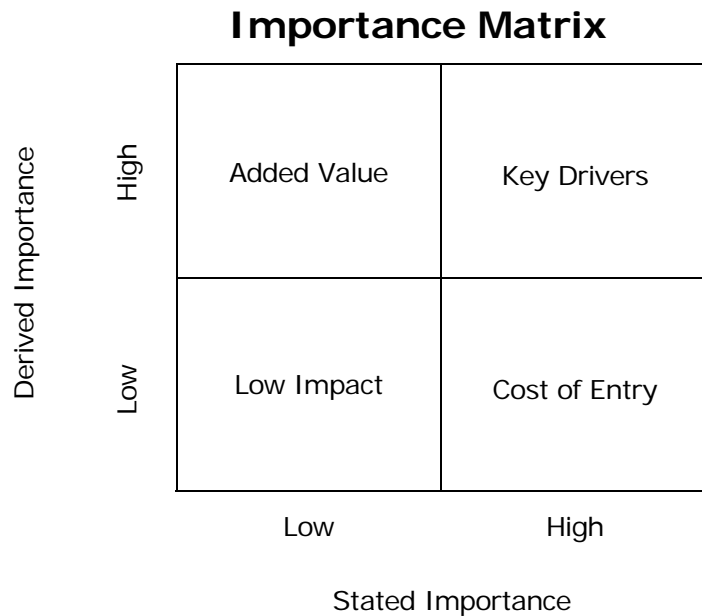
Assessing the importance of the attributes that define the customer’s interaction with the company is an essential prerequisite for managing retention. It is crucial to know which factors add value and increase the likelihood of retention and which merely fulfill minimum “cost of entry” requirements.

Two different methodologies are employed to determine attribute importance: “stated importance” and “derived importance.” Although “stated importance” is the more commonly employed methodology, it is not by itself a good reflection of customer behavior. For example, customers may say that “gets clothes clean” is most important for a laundry detergent when, in fact, their purchases are based primarily on “scent,” “stain removal” and “price.” Additionally, most consumers have great difficulty differentiating gradations of importance when assessing attributes and tend to rate almost all relevant attributes as “very important.”

Derived importance overcomes most of the shortcomings of stated importance by looking at what consumers actually do rather than what they say. Derived importance is a mathematically determined measure. Using multivariate analyses, it examines the relationship between behavioral variable ratings, such as product usage or

purchase intent, and attribute-ratings, and generates beta values of the regressions that act as proxies for importance scores.

Stated importance and derived importance measures do not always agree and the best methodologies for determining importance combine the two to yield insights that would be lost if either measure alone were used. The following importance matrix demonstrates the power of the combined measure analysis by providing not only accurate importance measurements, but also differentiating between cost of entry attributes and true harbingers of customer defection.



The quadrants of the matrix are described as follows:

Cost of Entry: Acceptable performance on these attributes is required of all companies that plan to operate in this industry or arena. Retention is not generally enhanced if performance on these attributes is better than that of the competition.

Low Impact: High performance on these variables does not yield a commensurate impact on retention.

Key Drivers: High performance on these variables increases customer loyalty and retention. Conversely, poor performance reveals vulnerability.

Added Value: High performance on these customer needs, while often unarticulated or lower rated by customers, represents a strong opportunity for differentiation and leverage over the competition.

Once the key drivers of retention have been identified, regularly tracking company performance on these drivers will provide a basis for addressing any current shortcomings, a useful tool for managing customer relationships, and an early warning system to identify developing issues before they become irreversible.

Concluding Thoughts

In today's competitive marketplace, customer retention offers increased profitability and sustainable protection against competitive inroads. Achieving this goal, however, requires considerable company effort.

To be effective over the long-term, a customer retention program must start at the top. Senior management must make a solid commitment to the process, setting the tone and focus of the organization on navigating the dynamic environment of customer needs, expectations and competitive choices.

Customer retention must also be built on a:

- pervasive, customer-focused company culture
- full understanding of key customer groups, their needs, attitudes and beliefs about the company, its products and services
- well developed process for effective internal collaboration, in which understanding the customers and their relationship

with the company becomes an integral element of corporate strategy

- system of retention metrics to accurately assess the company's performance at every step

Companies who develop and use an effective customer retention program will achieve improved performance on key top and bottom line measurements, including: brand share, revenue and profitability. More importantly, they will also insure their continued strong performance into the future.

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