

Customer attrition

Improve the efficiency of your
customer retention management

Foreword

It costs as much as six times more to get a new customer than to keep an old one. Yet too often companies take their customers for granted or don't look for opportunities to increase revenue from perfectly satisfied customers.

And in a slow economic environment when access to new markets and customers is more difficult and expensive, 36% of businesses in a recent survey* say they have found this to be a key issue that they need to address. In these conditions it is even more critical for companies to develop and retain their current customers, focusing on those who are of higher value and profitability. Of all business issues, customer attrition is near the top in its effect on profit and loss, and 19% of companies have already identified that the economic crisis has caused them to lose customers.

To help our clients achieve a detailed view of customer attrition and other customer-facing strategies and processes, Ernst & Young has developed a customer practice within the Global Advisory practice, focused on assisting our clients with their customer management and revenue-generation performance improvement efforts.

Our Customer Advisory professionals work in multidisciplinary teams to take an integrated approach to each step of the customer lifecycle, from acquisition to attrition management. Through Ernst & Young's global network, we can select from experienced resources all around the world to assemble a team with the right competencies to serve you.

To find out how we can help, please contact our Customer Advisory professionals. We look forward to working with you.

*About our survey

At Ernst & Young we have an interest in understanding how companies are reacting to the current crisis and seeing if there are opportunities to learn from their experience and best practice. To that end, we worked with the Economist Intelligence Unit in June 2009 to interview over 300 senior executives from major companies around the world to see how they are being impacted by the economic crisis and what they are doing about it across their business.



Some initial thoughts

Retaining the best customers is becoming a top priority for all companies in all sectors.

This new world is competitive in ways that it's never been before. Ask any company's customers how many times they've been approached and aggressively pursued by their competitors. And then ask that company if it can be optimistic about keeping its customers happy on a day-to-day basis.

The number of competitors has increased and, due to globalization, competition is no longer limited to local companies – global companies are competing as well. This increased competition has been triggered by the fading of physical as well as sector barriers. Little differentiation between products and services has allowed competitors to copy from each other, driving the customer to perceive price as the only determining factor between one brand and another. In our survey, 58% of companies say that competition on price has increased as a result of the downturn and generally this has caused many companies to lower their margins in order to stay competitive.

All of this has prompted customers to become more educated in order to understand the slight differences among

the large range of products and services they are offered. And with all the readily available information customers have access to today, they see their choices, they are very aware of the protections they are provided by laws and regulations and they have become more demanding and expect much more from companies. Moreover, customers don't feel obligated to be loyal to any particular company, and therefore look for the best price, experience or service they can get. In times of economic downturn, it is not surprising that price becomes even more important to the customer.

Organizations with high rates of attrition often point to commercial reasons, such as strongest competition in the marketplace, price or downturn, for losing customers. However, customers leave due to commercial reasons only in a low percentage of the time. The main reasons are a bad experience or perceived indifference from the company. But before seeking to identify why customers leave your company, and determine the actions you may take to change this trend, first take the following three steps:

- 1 Identify and measure all types of attrition and recognize their impact.

Take the concept of "inactivity" into account to define, measure and fight attrition.

- 2 Determine and prioritize who your high-value customer (and therefore the ones you want to retain) are through:

- ▶ Customer value models
- ▶ Customer segmentation

- 3 Define a proactive customer retention strategy, personalized and adapted to the same profiles and segments.

Put loyalty programs to work for you.



Attrition... so what's attrition?

Beyond “traditional” attrition, there are other types of attrition that need to be identified and prevented.

Companies have most often focused their time and resources on customer acquisition and development, and have not paid as much attention to retaining the customers they already have – not even their highest value and most profitable customers.

When most companies talk about attrition, they are referring to those customers who have completely left the company by closing all accounts or ceasing all interactions.

However, **this is just the tip of the iceberg;** companies must also consider those customers who maintain their accounts or fidelity cards but are simply no longer active. Companies must measure and manage all dimensions of attrition, not just what many define as “traditional” attrition.

There are three types of customer attrition:

- 1 Total or complete:** the customer ceases all interactions with the company in two ways:
 - ▶ Nonvoluntary: the customer is deceased, has moved to a place where the company has no representation, etc. This type cannot be avoided.
 - ▶ Voluntary: the customer explicitly cancels all accounts, contracts or relationships with the company. This can be difficult to anticipate, as it is most often a direct consequence of a perception of bad service, in which the customer decides to change companies almost literally overnight.

- 2 Partial:** the customer changes (reduces) the product mix.

Some of this is normal – for example, cancelling a child’s account when he or she has grown up.

For some, a change in a customer’s product mix means attrition, but for others it is considered a new customer acquisition. For example, if a customer transfers all his or her money from one bank branch to another within the same bank, this might be attrition for one branch and customer acquisition for the other.

- 3 Hidden or silent:** the customer doesn’t “officially” leave but decreases or ends his or her activities with the company.

All types of attrition must be identified and managed, and different strategies and actions must be defined and implemented in order to reduce the attrition rate within organizations. Hidden or silent attrition, the most frequent and yet the least identified and managed type, makes it necessary to add a new concept in managing customer attrition: **customer inactivity.**



Add the word “inactivity” to your usual language

The concept of “inactive customer” enriches and helps define strategies to retain customers, especially in some sectors.

The concept of active versus nonactive customers can help companies determine – and even predict – attrition, giving them a more realistic picture of their customer portfolio. **Inactivity can be thought of as an early stage of attrition.** Indeed, especially in some sectors, attrition is something that does not always happen abruptly one day. Rather, it is a path, a progressive detachment that can be detected and even reversed if appropriate and personalized actions are taken.

Think of a bank customer. Perhaps the customer does not take the time to cancel a current account, but simply leaves the account open with the minimum amount required, and instead uses a different bank for daily transactions and savings. He or she then cancels a debit card and opens a term deposit at a different bank that offers better conditions. Little by little, the customer reduces the relationship with the first bank. This bank may not identify the problem since this customer did not deliberately express the determination to switch banks. For this bank, this customer is still “its” customer, though the fact is, he or she no longer “belongs” to them. The concept of inactivity is crucial here to identify and even anticipate attrition. Experience shows that in the financial sector, for example, hidden attrition represents up to 80% of total attrition.

The same is true in the retail sector, where there can be silent as well as partial attrition. For example, a customer could purchase fresh food in a local market and go to a supermarket to buy canned foods and household articles. A customer may change his or her behavior pattern and progressively reduce his or her “share of wallet” or the purchasing frequency with a retailer, without the company realizing that this customer is leaving for the competition.

Take now the utilities sector, where in some countries customers normally switch from one company to another. They are one day your customers, and the next one they have left your company; they do not hire a company for their heating and another one for their hot water. Inactivity, as opposed to the previous examples, is not a word that is that relevant in this sector.

Different customers take different attrition paths

Customers behave differently, have different needs and expectations and ... they leave differently. Sophisticated companies have begun to define differentiation strategies and processes to ensure they adapt their products and services, pricing strategies, commercial messages and promotions to different groups of customers. In addition, the differences in the way customers behave and react when their needs and expectations are not fulfilled need to be identified and incorporated into the right retention strategy. When developing customer retention strategies, most companies do not differentiate nor classify their existing customers through segmentation in order to adapt the strategy to each type of customer and their attrition pattern.

- 1** The techniques used for customer **segmentation** have evolved and now cover a complete range of variables allowing the identification of homogenous groups not limited to purely socio-demographic criteria. The integration and management of all this information should take place with statistical models and databases prepared and structured to respond to business needs.
- 2** Once all profiles have been identified, their main characteristics should generate **an offer for each segment and lifecycle phase** so the organization has products and services available to meet customer needs throughout the entire customer lifecycle. This customer focus allows you to study their evolution and therefore their potential needs, giving them a more personalized and solid service. It also helps point out the different ways customers may leave the company and different ways of reacting when a need or expectation is not fulfilled by the product or service the company is offering.
- 3** **Retention actions must be defined for each group in much the same way.** The key factors that influence customer fidelity vary depending on the perspective, sector, products and customer type. For this reason, you must first make an analysis of the causes of fidelity or value points in each of these segments. Then, you must define and implement retention actions which are adapted to different customer profiles, to ensure their efficiency and effectiveness.



Proactive, not just reactive

Reactive strategies are not enough when it comes to dealing with customer attrition within organizations.

At the moment, most companies only measure total or complete attrition and adjust their strategies accordingly as a reaction to changes in their customers' behavior. In many cases, it's too late – the customer has already made up his or her mind. However, the possibility of anticipating and preventing attrition with proactive strategies depends on the sector or product/service, and it's more difficult in those sectors where total or complete attrition is less common. As previously discussed, if you take the banking or retail sectors you will find there is a much higher impact of silent attrition, thus making proactive and preventive strategies easier to define and implement.

Companies need to focus on a more proactive approach:

- 1 First, **detect** when a customer has a high probability of attrition.
- 2 Be ready to **act** before this takes place. However, it is not efficient – and not even realistic – to try to retain all existing customers.
- 3 Therefore, **identify** high value or more profitable customers and focus on them. These are the customers companies should spend all their available resources on to retain them and make them as loyal as possible.

Defining and implementing predictive models to calculate the probability a customer might leave a company are the first steps in this global retention strategy. There are different algorithms and techniques that can be used to calculate a score, but these techniques alone are not enough. A solid and robust methodology must also be applied to ensure the results are accurate and applicable to the company.

An individual score, which measures the attrition probability for a customer, can be calculated. But if this information is not used the right way – proactively – then, it may provide little or no value.

And finally, companies must decide which customers they want to retain. It is not realistic to think a “zero attrition rate” can be achieved. In fact, there may be customers an organization may not want to keep. **Prioritization** is the right action here. Profitability, lifetime value or customer potential may be some of the criteria used to determine which customers to actively retain.

High fidelity, low attrition

Congratulations! You have now identified, typified and measured different types of attrition within your customer base, incorporating the concept of inactivity so that at risk of leaving the company have been covered. Moreover, after identifying different attrition patterns, you have decided, according to customer value and/or profitability, which customers are worth retaining. You are almost there, but you still need to design and implement successful retention strategies to achieve your main goal of **reducing the attrition rate, making certain you are retaining the best and most profitable customers.**

The next step might sound obvious, though it is not that easy to develop and implement. You must strengthen the customer's relationship with the organization to facilitate the subsistence and growth of the company.

In order to increase customers' fidelity as a means to reduce attrition, it is essential to manage the duration, intensity and profitability of the relationship. But

market conditions and customer particulars can dilute fidelity.

► **Duration** refers to the techniques used to maintain the continuity of the customer within the company. The offer generated should meet the customer's needs, which should have been previously identified depending on the segment. The fulfillment of expectations through products and services is a key aspect. Critical to this success is the requirement to reduce the gap between customer expectations and actual delivery.

► **Intensity** refers to the frequency of the relationship as a purchase or simple interaction. In order to achieve customer affinity, the company has to build strong value ties that are hard to break. Constant and two-way communication may be the best way to confirm the company is following the right path and creating a feeling of personal involvement. This is in stark contrast to mass marketing. Individualized actions through products and services must be focused on making the customer feel a personal connection with the company.

► **Profitability** is the last objective. Its achievement should be defined for each of the profiles identified by the organization - remember not all customers are equal. Companies should concentrate on designing different policies to foster long-term profitability, while at the same time being careful not to over-saturate these profitable customers and risk driving them away.

Although it is not an innovative concept, customer fidelity is currently reinventing itself as a new marketing branch and a way of understanding customer relationships with companies.

Customer fidelity has become an unavoidable mission for any organization, but very few companies have done it successfully. Too many programs rely on price or gift giving as their focus. The prevailing mind set, focused on simply retaining market share, breaks all the fundamental ideas of fidelity as a behavioral philosophy that should infuse the entire company.

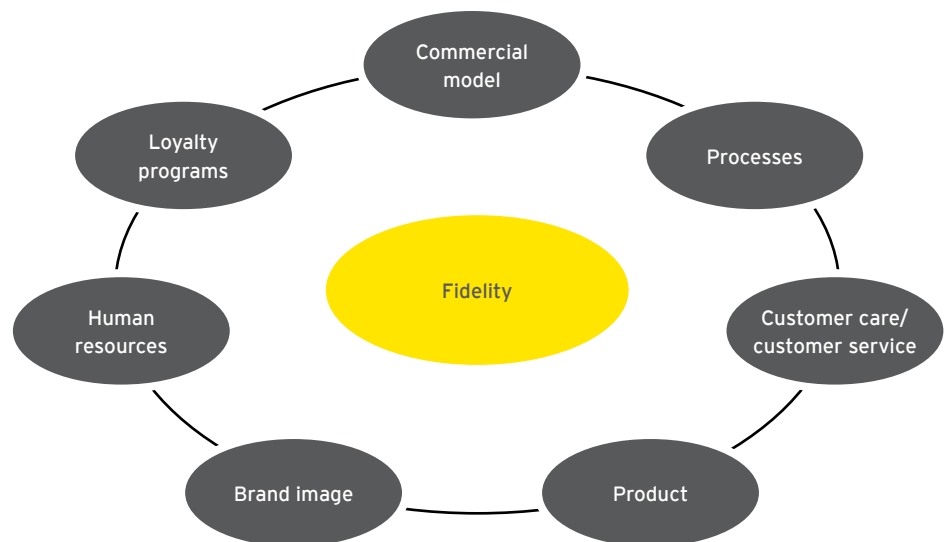
Customers fidelity aims to create a long-lasting, intense, and profitable relationship.



A change of such magnitude requires an important technological display - more and newer technology to deal with more detailed and complex data - and reorganization of structures and hierarchical systems toward a market orientation. Therefore the implementation of fidelity strategies has certain costs, which can seem relatively high depending on the variety of field techniques, tools and final benefits obtained. For this reason the first step is to identify high-value customers on which to apply these strategies, taking into account both present and potential/future value.

The organizations that already apply this have an advantage over their competitors since they have information about their customers' historical transactions. They also have channels to increase contact with their customers and establish a communication path that allows them to identify new value points. Once this information is gathered, the organization should create strong ties, attending to the customers' requirements and providing a personalized quality service.

Knowledge is best structured in seven global strategies, which define the main value points of the customers, facilitating understanding, evaluation and prioritization as depicted on the following graphic.



Let's take a closer look at each of these seven elements.



Assigning fidelity objectives and planning sales actions, in time, can help establish a fluid contact with the customer.

1. Commercial model

The commercial model allows you to get to know customers in great detail through business intelligence in order to adapt fidelity plans to their particular needs, wants and expectations. It also helps you plan and systemize all contacts, and encourages a constant relationship through commercial actions instead of launching random and mass campaigns.

Business intelligence allows the organization to transform information about its customers into knowledge for better decision-making.

A better understanding of customers, behaviors, preferences and trends allows you to adapt the marketing mix in order to increase the efficiency of fidelity strategies, adding to their chances for success.

For this reason, it is important to draw a value proposition according to segments. This "adapted-to-segment" value proposition defines the need, product satisfaction, message to be delivered and the channel that must be used to do so. Also, intensity must be specified to be able to maintain the relationship for a period of time, avoiding commercial saturation. And you must be able to generate an indicator that allows the identification of higher-attrition rate customers, to better prioritize sales actions, focusing on those customers at higher risk, with the highest value for your organization.



2. Processes

“Processes” are internal functions and customer service. The integration and coordination of all customer-related processes under a customer focus increases the ease of transactions as well as the flexibility of the organization toward market changes.

Take Zara, a global fashion boutique chain, as a good example of how to adapt processes to increase customer fidelity. The company has modified its design, manufacturing and logistics processes to dramatically raise the expectations of its customers, and therefore the way they behave. Zara updates its clothing and fashion accessories almost every week, so the shopping experience is always fresh. Not many customers are willing to return every few days to a fashion boutique to check if a garment is in stock or to see if the new fashion trend has already reached the shop, but Zara’s customers do. Zara has adapted its processes to make it easier for its boutiques to keep customers better informed and therefore satisfied. This, in turn, has increased satisfaction among Zara’s customers.

Multichannel is very important when it comes to customer processes. Companies need to ensure that their customers are well served when they cross channels. The exponential growth of alternative channels has monopolized organizations’ efforts to be in all of them with the highest possible level of presence.

Multichannel processes allow:

- ▶ A more direct approach to the customer, thereby solving geographical and time-zone limitations and offering constant availability
- ▶ Personalized communication, adapting the message to the channel and the target segment

However, presence alone is not reason enough for fidelity. To be effective, the transactions generated by each channel must be monitored and researched correctly. To do this, the organization must:

- ▶ Make sure it is capable of internally responding to all of its channels
- ▶ Create a two-way communication that is a source of information regarding customer characteristics
- ▶ Integrate all channels as a source of knowledge and contact with the customer

To successfully exploit a multichannel strategy and the transactions it produces, a company must coordinate and focus alternative channels as a means of complimentary and structured customer contact under a unified marketing strategy.

Multichanneling allows you to respond to the customer in a coordinated way and through the channel they choose.



3. Customer care/customer service

Customer service is the most powerful leverage to customer fidelity – it helps create and develop an emotional attachment with customers.

As it can be difficult to differentiate yourself in a market where products have become commoditized and largely similar, customer service has become a differentiating factor and a central axis for customer fidelity. Our survey showed that 52% of companies are currently scrutinizing their customer relationships more closely and seeking ways to strengthen these relationships, no doubt through improved customer services. Customer services can add the value that differentiates your company's products from those of other organizations.

The main efforts in this field are focused on achieving a high level of quality and personalized treatment in products/ services offered. You must not forget that the planning of proactive contacts before, during and after a purchase or contract of a product/service allows you to identify areas of improvement and value aspects that increase customer satisfaction.

The complexity resides in identifying those aspects that provide value for each of the segments or customer profiles so they can be linked back to the offer created for each group.

Personalization, at any level, requires a broad understanding of the customer in order for it to be interpreted as a differential value. This can be complicated if we take into consideration the speed of market change and the fact that this obligates the organization to establish continuous contact with the customer.

Fortunately, software developers have created a variety of complaint management systems that allow customers to manage claims via video conference. The customer simply connects to the web using the software and then can meet face-to-face with the manager that has been assigned to solve his or her problem.



Differentiation in a customer-oriented offer should include services as the differential element, not just the product itself.

4. Product

In a mature and very saturated market in which innovation is quickly copied and even improved, differentiation through product attributes is not sustainable over time. Therefore, customer attention and all other added services become the main value elements. If executed properly, services can increase fidelity, and even entice customers to pay a higher price for the same product.

These services can be related to the products, or be independent, associating values to the organization's image, increasing the cost for a customer to switch. Apple found the best way to fight its competitors was to innovate and – at the same time– to identify and target a customer segment that would become real fans willing to pay almost any price to get its latest gadgets. In this example, Apple has added value by creating products that have become part of its customers' lifestyle, making this the main differentiator and creating a stronger link with segments of customers less sensitive to price.

Therefore, differentiation begins in the **creation of a complete offering (products and services) that is adapted to the particulars of each segment**, identifying the customer lifecycle. The development of this portfolio should be done with a customer focus:

- 1 Segment the customer portfolio.
- 2 Identify the needs of each segment.
- 3 Design products and services that fit best with each segment and give higher value. Establish a price strategy which is adapted to customer segments - pricing should be established for each customer profile according to the customer's value, which can be used as a reference to apply discounts and advantages. 40% of our survey responders say that they have launched new products and services in the last 6 months, and 55% say that their pricing strategy is under greater scrutiny as a result of the downturn.
- 4 Develop a communication plan that standardizes and plans the messages and channels used to contact the customer.



5. Brand image

Brand image can also contribute to fidelity by creating stronger links with customers.

Brand image includes all actions geared to reach a predetermined position and level of notoriety within the market and minds of customers. In sectors where products are intangible and many transactions take place from a distance, confidence is a crucial factor and 38% of our survey responders are watching their brand and reputation even more closely than usual during the downturn.

The success of a brand resides in its positioning and differentiation from the rest of the competitors in order to **reach a strong emotional attachment with the customer**. When this is achieved, fidelity is reinforced.

Why do millions of customers across the world pay more for their coffee if it's Starbucks? Another example: a plain small door, only large enough for kids, has been the differentiating element for Imaginarium, a toy chain that has managed to have kids asking their parents to go to the shop with a special entry for them!

Sponsorship, reinforcement of traditional values and charity work are some examples of strategies to create a brand image that inspires confidence and respect, and makes customers want to become part of a family.



6. Human resources

The direct influence human resources strategy has over customer fidelity, especially over customer service, can be undeniable. For this reason, we will look at it individually, as a separate strategy. The objective is to involve and motivate employees to make a positive effect on satisfaction by improving customer care, service and attention, and therefore consolidate customer fidelity.

Training and employee involvement can help to detect customers that are unhappy with the organization. Proper training can teach employees how to act on customer dissatisfaction, and is an important element to proper care and retention of a company's most valuable customers. And never forget that it is extremely difficult to increase customer fidelity with unhappy employees. The first step to achieve customer satisfaction is to have satisfied employees.

Think about this the other way around. The fact that you are chosen by customers as their preferred supplier may have something to do with the fact that the best people in the world want to work for you. Customer satisfaction and employee satisfaction go hand in hand.



Loyalty programs do not attach customers by themselves, but they allow the company to know and retain customers long enough to work on the other levers.

7. Loyalty programs

Loyalty programs are tools used to better know, acquire and retain customers.

This practice has spread quickly in a number of sectors, especially in distribution and finance, making the loyalty card the most used product. The main challenge lies in designing an efficient loyalty program, identifying the segments that are targeted, their values and the actions to which they are most sensible.

Almost all the loyalty programs fall under one of the following categories:

- ▶ **Financial cards:** the objective is to increase consumption, which serves as a key to all advantages that fidelity provides. Example: American Express Membership Rewards™.
- ▶ **Non-financial cards:** mostly used in the retail sector, the objective is to gather personal and purchasing information from your customers and at the same time gratify them with benefits and rewards. Example: Europcar - Privilege Card.
- ▶ **Multifunction cards:** they are called "smart cards", thanks to their large memory capacity and the wide range of possibilities to apply them. But the expense required for implementation prevents smartcards from becoming common in the mass market.

Regardless of which loyalty model your company chooses, it is always necessary to both have customer segmentation and keep in mind the following:

- ▶ Customers value direct rewards obtained by points, and the treatment and services received from the organization.
- ▶ The program should serve as a source of personal and behavioral information from the customer to provide a more personalized and satisfying treatment and service to the customer.
- ▶ The market trend is to define and implement programs that have more than three types of advantages.
- ▶ It has to be dynamic in order to be adapted to the segments' changing habits, which the strategy is targeting.
- ▶ A criteria or metric has to be defined through which the success of the campaign will be tracked and measured in order to identify improvements that should be made. Developing programs according to segments and applying them to control groups allows you to evaluate the response customers had towards a given action.

The success of these programs has an important communication component: making the customer feel a status improvement through the program. In many cases, what is really important is not the reward itself, but the fact that the customer feels he or she is important enough to the organization to receive such a reward.



Final words

This paper has described and guided you through different concepts and components of retention strategies, helping you understand how to better identify and manage customer attrition.

New words and concepts may have been raised for you, and by now you may be in the position to think of attrition in a way you have never done before. New words and phrases like “inactivity,” “hidden attrition,” “proactive strategy,” “attrition path,” “predictive score” and “segmented value proposition” should now sound familiar to you.

After reading this article, you should now be aware that though customer attrition is becoming increasingly severe for organizations, it is not irreversible, and it is possible - though sometimes not easy - to retain and attach your best customers if you face and approach this issue the right way.

To find out more on how to define and implement strategies and processes that can be put to work for you to help reduce the attrition rate of your company and assist in building long-lasting relationships with your highest-value customers, do not hesitate to contact us. At Ernst & Young, we have the people, methods and tools to accompany you on this exciting and challenging trip to improve customer management processes.

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