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## Must-Have Analytics For Your Retention Tool Kit

by **Srividya Sridharan**

with Dave Frankland and Allison Smith

### EXECUTIVE SUMMARY

In an austere business environment, customer retention is enjoying its moment in the spotlight. While retention efforts such as loyalty programs, service upgrades, and incentives reinforce value to customers, firms turn to analytics to help design appropriate retention efforts at an individual level. This report highlights how analytics helps detect and control churn, helps expand the depth of products and services that customers use, and, ultimately, helps drive wallet share.

### THE NEW NORM REQUIRES FIRMS TO DO MORE WITH LESS

The impact of a conservative business environment, following the global recession of 2008 to 2009, forced many marketers to rethink an acquisition-heavy customer strategy. Firms woke up to the fact that long-term enterprise value requires not just aggressive top-line growth but an equally strong bottom-line performance — putting the attention back on customer retention efforts. For instance, during the recession, 1-800-Flowers.com boosted customer retention by 10%, which equates to an additional \$40 million in revenue.<sup>1</sup> The urgency to incorporate retention-based marketing strategies grows as:

- **Consumers tighten their purse strings.** Consumers' shopping habits changed to emphasize value for money over other purchase considerations. Discretionary spending was reduced, whether by downgrading to a basic cable service or by bargain hunting. In the current environment, we find that consumers favor free shipping offers and tend to research products extensively to get the best price, making it a lot harder to acquire customers based on product features and benefits alone.<sup>2</sup>
- **Marketers demand more bang for the buck.** In our conversations with marketers, we find an increased emphasis on ROI and measurement. That clarity makes it easy to question the logic of attempting to convert prospects with constrained budgets rather than enticing existing customers to stay longer and spend more. It also means that firms want investments in retention to work harder. For example, speaking at Forrester's Marketing Forum during the height of the recession, a senior vice president at FedEx estimated that a 1% improvement in customer retention had resulted in \$100 million in revenues.<sup>3</sup>
- **Marketers seek balanced growth.** Acquisition marketing primarily aids volume growth, with limited foresight into the downstream cost to serve newly acquired customers. This in turn erodes profitability. A Belgian-based insurance company experienced this problem when the cost to secure

new customers exceeded first-year revenues by almost 50%, forcing it to rethink its acquisition-only strategy. On the other hand, augmenting acquisition with well-crafted retention efforts promises balanced growth by boosting the bottom line.

## TACKLE RETENTION AT THE CUSTOMER LEVEL

Far too many firms — focused on winning new customers — suffer from a “leaky bucket.” Their acquisition efforts feed the customer pipeline, but, at the same time, they lose customers at a steady rate for a variety of reasons. Customer Intelligence (CI) professionals can play a vital role in plugging this leaky bucket by feeding insights about customers into the retention process. Unlike in acquisition-focused analytics, where CI teams try to acquire look-alikes of best customers, retention-focused analytics taps into an existing gold mine of customer data. To design retention-focused analytical solutions, CI pros must focus on four main areas:

- **Identify who to retain.** To determine where to focus retention efforts, firms need to understand which customers are worth retaining. As a starting point, tease out the 20% of customers with the greatest potential to generate 150% of the profits.<sup>4</sup> Existing value-based segmentation models offer clues to identify profit-based retention targets, but other factors, such as rate of repeat purchases and service history, should also be considered.
- **Calculate the cost to retain.** Once a retention target is identified, a firm must determine whether to allocate resources in attempts to retain that customer or to let the customer follow their existing path and, possibly, churn. Customer lifetime value is a key metric to understand the cost of retention and the tradeoff involved in resource allocation.
- **Estimate when to retain.** An understanding of the customer life cycle and the drivers of churn help determine when to introduce retention stimuli. A senior marketer at a leading retailer of household goods and electronics told us, “It’s all about retention, not win-back, not reactivation; it’s about intervening before someone falls way out of pattern.”
- **Design the appropriate retention offer.** Based on an understanding of who to retain, at what cost, and when to intervene, designing the appropriate next best offer through predictive analytics helps ensure that the retention loop closes. Next-best-action strategies boost customer lifetime value by appropriately presenting the most acceptable offer to a customer.<sup>5</sup>

## USE TWO ANALYTICAL APPROACHES TO BOOST RETENTION

As it relates to customer retention, analytics can serve two functions: 1) to identify and manage customer attrition, and 2) to identify opportunities to increase customer revenue and profitability. We recommend distinct analytical approaches toward each objective — churn management and cross-sell/upsell analysis (see Figure 1).

## Churn Management Ensures Revenue Protection

Subscription-based models such as telecom, TV, Internet, or any other bundled services widely use churn and attrition analysis to understand customer defection. While churn is easier to spot when the customer is in a time-bound contract or billing cycle, in cases where the tenure is not defined, other proxies of churn are used. For instance, financial services firms may look at churn as: 1) a reduction in activity; 2) a lowering of average balances; or 3) a reduction in number of accounts.<sup>6</sup> CI professionals should use churn analysis to:

- **Signal when to worry about customer attrition.** Most firms deal with customer attrition in one form or another. For instance, at least one in seven telecom and cable consumers is likely to churn over a six-month period.<sup>7</sup> Churn analysis uncovers predictors of customer attrition or defection, whether voluntary or involuntary, and assigns “likelihood to churn” scores to individual customers or segments.
- **Pinpoint timing of customer defection.** Survival and hazard modeling are time-to-event analytical techniques commonly used in churn analysis. Both are effectively used to estimate the customer tenure. Paul Laughlin, head of customer and market insight at Lloyds Banking Group, told us in *The Forrester Community For Customer Intelligence Professionals*: “An analytical technique I have seen bear fruit in this area [customer retention] is the use of survival analysis [. . .] It [survival analysis] really comes into its own in helping with the timeliness question. Identifying the likely tenure of a cohort of customers can help focus efforts on those most at risk of leaving.”<sup>8</sup>
- **Refine retention targets further.** To extend the value of churn analysis, apply the learnings to effectively design an outbound retention campaign. Uplift modeling refines churn analysis and focuses offers and communications on those customers most likely to respond positively to a retention campaign, avoiding those customers likely to respond negatively or not react at all.<sup>9</sup> A senior executive at Rogers Communications shared the following scenario with us: As heavy users of churn modeling churn rates decline over time, the challenge then is to build the right economic model of outbound offers instead of blindly offering the richest offer to a small number of customers at risk of churning.

## Cross-Sell And Upsell Analysis Expands Footprint Of Products/Services

Cross-sell and upsell tactics lure customers to buy more from the portfolio of products and services offered by a firm. Firms use cross-selling to offer a product or service that goes with an existing product that a customer has and use upselling when a higher priced but similar item is offered to the customer. CI professionals should use cross-sell/upsell analysis to:

- **Target low-hanging fruit.** On average, in the financial services industry, consumers own nine financial products but maintain just two and a half of them with a single firm, opening up the

opportunity to cross-sell and upsell to boost share of wallet.<sup>10</sup> This particularly makes sense for multibrand, multiproduct scenarios.

- **Build product clusters and bundles.** Association models and market-basket analysis techniques are typically used in cross-sell/upsell analysis to detect associations between discrete events, products, or attributes and then assemble clusters of products that are purchased together. Customers who have purchased some, but not all, products in a particular cluster are good candidates to target for cross-selling or upselling. A senior analytics executive at AAA National told us that, while its current cross-sell efforts are product-centric, it wants to move toward a more member-focused, next-best-offer approach to cross-sell.
- **Present relevant and contextual offers.** Product associations as an output of the cross-sell/upsell analytical exercise should be placed within the context of the customer's current life cycle. For example, just because diapers and baby food appear in the same shopping cart does not mean the customer is likely to buy all other types of baby products. Take into account the age of the baby, for example, as a variable that should be considered to recommend an age-appropriate baby product.

**Figure 1** Retention-Focused Analytical Techniques

Business application	Commonly used analytical techniques	Description
Churn prediction	Logistic regression	This estimates the probabilities of categorical outcomes, i.e., the probability of an event occurring or not occurring. It also gives the effect of the predictors on the categorical outcome or target field.
	Survival analysis	This gives the probability of a customer surviving up to a certain time.
	Hazard analysis	This gives the probability that a customer might stop a relationship at a particular point in time.
	Decision trees	This is a set of rules with associated probabilities represented in a tree structure, which can be used for binary or multiple outcomes.
	Neural networks	These are machine learning algorithms that use complex, nonlinear functions for estimation and classification and resemble biological neural networks in structure.
Cross-sell/upsell	Association/affinity models (market-basket analysis)	These are used to identify purchase patterns and groups of products purchased together by analyzing past co-occurrences of events, purchases, or attributes. They do not involve a single output field to be predicted.
Retention campaign planning	Uplift modeling	This models the difference in behavior between target and control groups, not just the behavior of a target group in a retention campaign.

## RECOMMENDATIONS

### DON'T NEGLECT THE VALUE OF ANALYTICS IN RETENTION

Firms blinkered by acquisition will face a challenging task ahead in investing disproportionately more to retain all the customers that were aggressively acquired. Before getting to the point of making a tough tradeoff — at the risk of customer dissatisfaction — CI professionals must intervene by showing the value that analytics brings to retention efforts:

- **Apply time-tested techniques in new ways.** How does churn analysis apply to a non-subscription-based model? Even if churn management does not directly apply to the firm's business model, experiment with the underlying concepts of determining customer relationship duration, churn predictors, probability to repurchase, etc., and then invest in a full-fledged churn analysis.
- **Look for hooks back into acquisition processes.** There is a delicate balance between retention and acquisition. Can the analytics applied to drive retention provide any information to make acquisition processes more effective? For example, uncovering churn predictors during churn analysis can help in marketing planning and investing in lead sources that are least likely to attract customers who will churn in the future. Customers acquired through the web channel may have a lower propensity to churn than those acquired through a telemarketing effort.
- **Activate learnings at customer experience touchpoints.** Ensure that the insights from retention-based analytics are available to the frontline employees handling customer interactions. For example, knowledge about a customer's churn risk and churn indicators can help "surprise and delight" the customer during a face-to-face interaction at a bank and potentially influence his or her decision to churn.

## ENDNOTES

- <sup>1</sup> Source: "SAS helps 1-800-FLOWERS.COM grow deep roots with customers," SAS (<http://www.sas.com/success/1800flowers.html>).
- <sup>2</sup> Forrester asked respondents to our North American Technographics® Affluent Online Survey, Q2 2010, whether, given the state of the US economy, they were planning to change their shopping habits. Twenty-seven percent of all US online adults said that free shipping offers will motivate them to buy more online than they have in the past, and 26% of all US online adults said they will do more research online (before purchasing) to be sure they get the best price. Source: North American Technographics Affluent Online Survey, Q2 2010 (US).
- <sup>3</sup> Source: Mark Colombo, senior vice president, digital access marketing, FedEx Services, speaking at Forrester's Marketing Forum 2008.

- <sup>4</sup> The top 20% of a company's customers generate 150% of the company's profit, while the bottom 20% of customers drain 80% of profits. Source: Larry Selden and Geoffrey Colvin, *Angel Customers & Demon Customers: Discover Which is Which and Turbo-Charge Your Stock*, Portfolio, 2003.
- <sup>5</sup> The next best offer is whatever the customer finds most acceptable; it also maximizes the yield from that customer in sales, revenues, and profits — in other words, customer lifetime value (CLV). See the April 13, 2011, "[Boost Customer Lifetime Value Through Next Best Actions In Multichannel CRM](#)" report.
- <sup>6</sup> Customer attrition — with its inherent message of failure — is a hard topic for marketers to tackle. Marketers often lack agreement on the timing of churn and the process of identifying customers with a high likelihood of churn. See the October 20, 2008, "[Optimizing Customer Retention Programs](#)" report.
- <sup>7</sup> Over the next six months, telcos and cable companies can expect nearly 50 million of their subscribers to switch to a new provider or cancel their service altogether. See the January 16, 2009, "[The Science Of Churn: When And Why Consumers Switch Service Providers](#)" report.
- <sup>8</sup> Check out our discussion on analytical techniques used in retention. Source: The Forrester Community For Customer Intelligence Professionals (<http://community.forrester.com/message/15313#15313>).
- <sup>9</sup> Uplift modeling is an analytical technique that models the difference in behavior between target and control groups, not just the behavior of a target group. See the October 20, 2008, "[Optimizing Customer Retention Programs](#)" report.
- <sup>10</sup> Forrester surveyed 4,630 US online adults to understand the breadth of their financial relationships. Overall, we found that US online adults own an average of 8.9 financial products. See the September 25, 2009, "[Solving The Cross-Sell Imperative In Financial Services](#)" report.