OLIVER WYMAN

CHURN VALUE MANAGEMENT

HOW CAN COMPANIES RETAIN CUSTOMERS IN AN INCREASINGLY VOLATILE WORLD?

CHURN VALUE MANAGEMENT

Holding on to customers is getting tougher. Most companies in mass consumer subscription industries, such as telecoms, broadband or pay TV, are seeing significant growth in their retention investments. This can involve spending well above five points of EBITDA each year just to be able to stand still. But a few of them have developed innovative ways of dealing with "churn" in a much more efficient manner. Some of these companies have been able to achieve 10% lower churn rates than their peers ... with up to 20% less invested in retention!

As many markets begin to saturate, customer acquisition teams have been developing and launching new offers or more generous promotions to convince the last laggards to adopt their services, and to lure competitors' customers.

While the war to recruit each other's customers rages on, historic "brand loyalist" or apathetic customers have been educating themselves and shopping around to find the best deal on the market. Others will try to negotiate good discounts from their current provider.

As a result, many operators are forced to invest ever-increasing amounts in subscriber retention for customers whose loyalty continues to fade. In the process, they also happen to educate them on how to negotiate a better deal! In short: Retaining customers, and their value, is not going to get any easier.

Of course, retention capabilities are high on the agenda in most, if not all, of the companies in these sectors. Most of them will have developed churn propensity models, implemented industrial churn prevention campaigns and built large dedicated retention teams. But they also continue a series of behaviors: They focus on attracting customers regardless of their intrinsic loyalty characteristics; they create "incentives to churn" with acquisition offers that are more generous than renewal offers; and they measure retention effectiveness in volume saves.

By contrast, leading operators manage the *value* of churn throughout the customer life cycle: They focus on attracting the best customers, provide incentives for customers to become (or stay) loyal, earnestly address the most important "churn triggers" and use their wealth of customer data to optimize the value of their retention and win-back efforts.

Ultimately, they achieve a much more efficient and effective use of their retention spending, which in turn increases customer value and enables more investment in the broader value proposition. In other words, a cycle of value creation is born.

Oliver Wyman has worked with operators across a broad range of mass consumer subscription industries, including communications, media and tech players. In this paper, we will share our perspective on effective churn value-management options currently in practice and in particular how these are being applied in telecom, broadband and pay TV operators to create this value engine.

PREVENTING CHURN: IT STARTS AT ACQUISITION, AND CONTINUES THROUGHOUT THE CUSTOMER LIFETIME

In many companies, churn is mostly seen as an issue for the "save team," whose job is to perform magic to convince any customers to stay. Other companies recognize that churn can be addressed before disconnection requests, and they deploy proactive anti-churn campaigns, often relying on churn propensity models. But very few companies go as far as addressing churn by leveraging all possible levers (acquire, delight, prevent and save) throughout the customer life cycle, as illustrated below. In our experience, these are the companies that perform best in terms of churn-management efficiency and effectiveness. Over the following pages, we will share our observations on how these companies operate on each of the levers.

Exhibit 1: The four stages of churn management

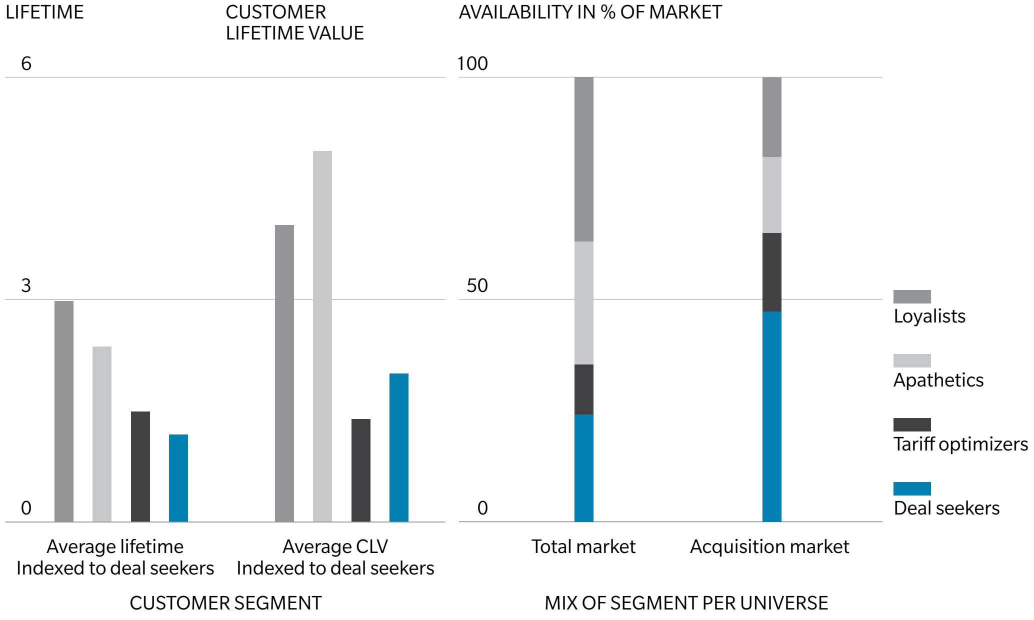
1. ACQUIRE	2. DELIGHT	3. PREVENT	4. SAVE
• Out-mix the competition on the "intrinsic loyalists" • Build in service hooks that raise thresholds and avoid churn triggers	• Build equity with customers and barriers to churn, leveraging data competitors can't access	• Identify and act on "moments of truth" that trigger churn	• Focus on saved value (and not save volumes!), managing acquisition and retention equilibrium

1. ACQUIRE

Every marketer knows: Not all customers are the same. But how many companies account for customers' differences in terms of intrinsic loyalty when building their acquisition strategy? Too few, unfortunately.

In working with many operators across the globe, the same pattern came up again and again: Some customers, referred to here as "deal seekers" or "tariff optimizers," plan from the beginning of their relationship with their provider to shop around at some point and to negotiate hard or leave. Some other segments, such as "brand loyalists" or "apathetic," will only leave if they can pay an outrageously lower price with competition later on, or if they start to have serious service issues. Their structural, intrinsic mindset differences seriously impact segments' expected lifetimes, profitability, and availability on the market. The churn rate for deal seekers is typically twice that of the apathetic segment, with monthly profitability close to half (since deal seekers know how to take advantage of the best promotions). We observed a range of one to four or five in lifetime value across these loyalty-based segments. The irony is that while representing a minority of the overall market, deal seekers and tariff optimizers constitute a majority of acquisition potentials, being recycled much faster on the market (*see Exhibit 2*). Therefore, many acquisition strategies are designed to attract the most volatile population, while educating loyal customers to become deal seekers.

Exhibit 2: Acquisition strategy: the “deal seekers” curse



Telecom, broadband and pay TV operators all face pressure to increase their number of subscribers. Acquiring fewer, but better-quality customers is almost never an enterprise value-maximizing strategy. The challenge, therefore, is to *alter the mix of acquisitions, not the volume acquired*, and to create “hooks” in the value proposition that add barriers to churn.

To do so, the best proposition-design teams work very hard to understand how different elements of the offer attract different customer segments (i.e., loyalists vs. deal seekers), yet also trigger churn or mitigate it. For example, they measure how deep, immediate short-term promotions disproportionately attract deal seekers, while price-fairness guarantees and increasing benefits over time are more appealing to loyalists. They also measure how creating hassles to churn (for example, providing free and easy-to-use access to cloud storage for their content, or simply adding a step to the disconnection process, such as having to return a box to a postal address in certain packaging) increase customers’ loyalty without impacting brand equity.

They then use these insights to design the best proposition in line with the company’s gross add targets, but one that out-mixes their competitors when it comes to intrinsic loyalists and forces deal seekers to be less volatile through their “loyalty hooks.”

This way, they have fewer and fewer customers to save and need fewer expensive acquisitions to sustain growth.

2. DELIGHT

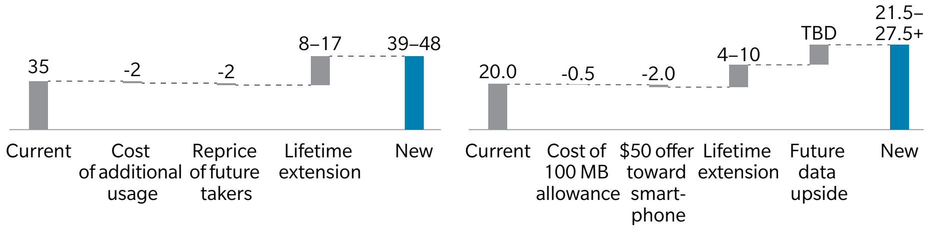
How often do companies contact their customers for something other than a service announcement, or to sell them something? In our experience, very rarely! This is one of the reasons fewer and fewer direct marketing campaigns have a measurable, positive impact, and why the percentage of customers opting for the ‘Do not solicit’ lists is increasing to alarming levels. Among the base management diagnostics we performed, we found advanced operators who had up to 80% of campaigns with negative or no ROI (when applying the right measurement lens) and had seen the rate of DNS clients increase to 50% on the “cheap channels” like emails and texts.

Best-in-class companies understood that building a relationship with customers is not only about service announcements and transactions, but also “surprise and delight” gifts that strengthen the relationship.

In low marginal cost businesses, like telecoms, broadband and pay TV, there are indeed often opportunities to drive loyalty at low actual cost through proposition upgrades.
Very few customers subscribe to all of the operator’s products and services, and almost none of the remaining ones will ever subscribe to the products they do not have. To address this, best-in-class operators have developed programs to proactively propose private offers to their existing customers that increase their customers’ loyalty, sometimes enable further product/usage adoption and largely compensate for the opportunity losses of potential self-initiated upgrades.

Exhibit 3: “Suprise and delight”: improving loyalty at little cost

	ADDRESS HIGH CHURN RISK AT END OF CONTRACT	MANAGE DATA ADOPTION AND CHURN PREVENTION OF VOICE-CENTRIC CUSTOMERS
Example target	• Hanna is using 2 GB of data each month (on a 3 GB plan) • She is 22 months into her contract and predicted to be a high risk for churn and have low propensity to migrate to higher plan	• Bill is a voice-centric customer • Despite owning a data-capable device, he does not use any data • Scoring models show Bill is unlikely to use data anytime soon and/or get a smartphone
Offer	• Automatically put Hanna on the 5 GB data plan for the price of her current 3 GB • “Your business is valued – starting today, we will give you an extra 2 GB each month for free. It’s on us, enjoy!”	• Add 100 MB of free data usage each month to Bill’s account • Make Bill eligible for smartphone upgrade at half-price
Rationale	• Create price advantage with other providers when price shopping • Perceived value of $20 is far greater than actual cost of extra 5 GB, especially given data usage profile	• Stimulate data adoption faster than would otherwise happen, and benefit from churn reduction • Once stimulated, go back to Bill with deal on upsales to regular data packages
Benefits	• Customer’s perceived benefit: $20 (rate card price of extra 2 GB) • Actual economics:	• Customer’s perceived benefits: $50 credit, $5–10 of data/month • Actual economics:



EBITDA IN $

3. PREVENT

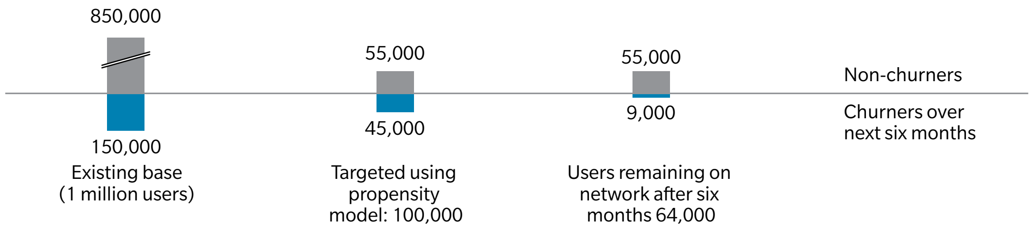
Even with the most loyal customers, operators can sometimes fall short on the experience delivered. Whether this means billing errors, bill shock, service interruption, drops in service quality or price competitiveness, many elements can dramatically increase an intrinsically loyal customer's propensity to churn: This is what we call the "accident-triggered churn." More structural issues, such as when a customer resides in a zone where competitors have a better product, or where the operator's service coverage is just not great, are obviously also a large part of the churn (if not the majority). This is what we call the "structural-triggered churn." The challenge for operators is to sort out these elements to identify how each factor truly impacts churn and then build corresponding proactive churn campaigns.

Most companies rely on a "one size fits all" churn propensity model that ends up being a black box for the marketer and only identifies the most fragile customers. These models typically combine "triggers," "structural causes," and other customer characteristics, but in most cases, are not used to inform marketers about what generated the high score. Because the time horizon on the models is fixed, they also tend to miss triggers that only generate a spike for a short duration.

Therefore, many anti-churn campaigns fail to generate positive returns on investment. Because they are designed to fight generic high-churn risk, these campaigns tend to take the form of general discounts or investments. In these situations, the false-positive phenomenon within the target group largely counterbalances the churn benefits.

Exhibit 4: Proactive anti-churn: when propensity models are not enough

THE FALSE POSITIVE PHENOMENON...
For 9,000 saves (meaning a save rate of 20% on potential churners), the action had to touch 100,000 customers!



...AND ITS IMPACTS!
Example of value-reducing proactive retention campaigns at a convergent operator

Score (0.8 – 1.0)	Accepted	Offer	NPV
5k lines ARPU = H	1k lines X % saved	15% discount on bill during y months + 1 handset[1]	-61,604 €
14k lines ARPU = M+	4k lines Y % saved		-70,214 €
12k lines ARPU = M-	2k lines Z % saved		-78,995 €
4k lines ARPU = L	0.5k lines W % saved		-15,625 €
35k lines ARPU = M+	**7.5k lines % saved**		**-226,438 €**

In this example, taken from a project delivered for a European converged operator, the quantity of real churners saved was insufficient to compensate for the amount of "false positives" – even among clients scoring at the highest level of churn propensity (0.8–1.0 range).

1 Proactive retention actions did not generate value in the "most likely to churn" and higher-value customer clusters

Best-in-class companies, on the other hand, have developed a set of different analytics to better, more proactively tackle the churn issue:

- Micro-signal models: These models aim to identify specific customer signals that could indicate his or her consideration to churn, but that are only valid for a very short period of time. This could be a review of the terms and conditions of the contract, multiple calls to call centers, a sudden change in usage or a variety of other actions. These models are used in conjunction with the following models to start specific prevention campaigns among customers.
- Churn triggers models: These models are designed to identify the root causes of why customers become more likely to churn, regardless of their intrinsic loyalty. They typically capture customers' price positioning, their network and/or service experience (compared with competition potential), and other metrics. These methods are precise enough that marketers can use them in specific campaigns:
  - When the problem is structural (for example, when a mobile operator has a customer in a poorly covered area, and the issue has become too much for the customer to accept), specific campaigns, such as offering micro-cells to improve coverage, can be very effective. Alternatively, when the reason for churn is an unfavorable "value of money" position against competition, value proposition adjustments, such as free usage, perhaps coupled with slight discounts, work very well. Only in extreme cases do proactive price adjustments generate value, though! When the problem is accidental (for example, in cases of service issues or clogged call centers that keep customers waiting), marketers can test and identify whether the best solution is to ignore the issue, attack the issue head-on and apologize, or just double down on the "delight" aspect.

In all cases, individual customer data are critical for assessing the issue's real impact on churn propensity. This requires effectively differentiating the delta due to that issue from the absolute level of churn propensity, driven by, for example, a deal seekers' lack of loyalty.

In addition, each action needs to be analytically sound to avoid negative returns on investment that stem from false positives as well as from potential "wake-up effects" (in cases where the best strategy is to acknowledge the problem in one way or the other). Only extensive test-and-learn cycles will end up with a portfolio of value-positive, anti-churn campaigns.

Exhibit 5: Agile churn: do not forget signals and triggers

CHURN SIGNALS			CHURN TRIGGERS		
	Description	**Uplift**[1]		**Description**	**Uplift**[1]
Handset unlocking	Inquiry about the possibility of unlocking their device	x13.9	**Unresolved incident (pending action)**	One incident followed by a complaint call for no action taken	x5.7
End of commitment	Inquiry about status of commitment period	x13.2	**Serious service incident**	Dropped calls percentage reaching 5% for more than one month	x4.0
Competitors' telesales incoming calls	Received calls from competitors' telesales phone numbers at least twice in the last three months	x3.0	**Complaint**	Two or more complaints over the last 90 days related to: invoice, admin., orders, handset, etc.	x3.1

1 Churn increase for unbound customers

It is worth noting, though, that within the entire anti-churn arsenal, these prevention campaigns typically matter less than the “delight” aspect: Our experience with many best-in-class operators indicates that it is really difficult to counteract the false positives and wake-up effects.

4. SAVE

Even if a lot can be achieved with “loyalty minded” acquisition strategies, and “delight” and “prevent” churn operations, some customers will always reach the disconnection-request step: This presents the ultimate chance to retain them.

Most operators have therefore built retention-specialist call centers (often denominated as save desks), with specific “save offers” only available to the customers who reach this final stage of the relationship. Their agents are trained to understand churn reasons and to convince the customers to stay, often incentivized by their save rate. The success of these strategies has, however, in part been responsible for teaching customers to “bluff” and has resulted in operators happy to give away value and call it a “win.” One of the extremes of that situation has been highlighted in an experiment that was conducted in one of the most effective retention call centers (with over 90% save rates on churn request). For a sample of disconnect requests, retention agents were directed to only thank the customers for their past loyalty and apologize for not being able to provide a counter-proposition. Among this sample of customers, who claimed to be willing to churn, the operator measured a “save rate” of 75%, compared with the 90% achieved by normal operations. In other words, 75% of callers were either bluffers looking for a better deal, “complainers” that agents classified as “saved churners” to get their commission, or customers who just needed some attention to calm down!

That’s why leading operators have developed detailed insights about customers’ individual “bluff propensity,” about different ways of negotiating with customers and about better incentives for their agents. Through rigorous test-and-learn processes, they have gained a deep understanding of the true value at stake (measured as the value of the customer multiplied by the actual probability that he or she would churn without a counter offer) and of the value of the different counter offers. In some cases, agents are then encouraged to “only acknowledge” the issue, while others are directed to propose a “more for same” offer (in fact improving the deal, at little cost for the operator) and, only in extreme cases, discounts.

Exhibit 6: Reactive retention: Be more generous, but not with discounts!

	EXISTING PACKAGE	OPTION 1: SAME FOR LESS	OPTION 2: MORE FOR SAME
Package	Premium	Premium	**Premium+**
Rack rate	$60	$60	**$80**
ARPU	$60	**$55**	$60
Cost	$5	$5	**$7**
Margin	$55	**$50**	**$53**
	Discount vs. rack rate	$5	$20
	Margin giveaway	$5	$2

These insights are brought together into sophisticated decision-support tools that instantly assess an individual customer and recommend a maximum possible giveaway offer.

Leading operators combine the science of the decision-support tools with the experience and intuition of their agents, for example by enabling and incentivizing agents to make saves below the ceiling giveaway offer. They also fine-tune their incentive schemes to make sure that agents not only stay below the ceiling giveaway, but are also encouraged to offer the optimal giveaway between a need-to-save and need-to-maintain margin.

CONCLUSION

Managing customer churn is becoming more difficult and more expensive as telecom, broadband and pay TV markets saturate and operators' gross adds increasingly come from switchers. Leading operators are developing more sophisticated capabilities, adapted from cross-industry experiences that create a virtuous "value engine" cycle of less churn volume and lower subscriber retention costs. These approaches enable acquisition teams to invest more in propositions, push deeper into sales channels and ultimately win the increasingly competitive race for net adds.

Over the past few pages, we have introduced some of the challenges of managing churn at each stage of the life cycle and some of the approaches that leading operators have developed to address these challenges. Those companies that have not developed their churn-management capabilities risk reversing the value engine. In this scenario, churn volumes increase despite increasing subscriber-retention costs, resulting in lower lifetime values and less cash to invest in the proposition and inflow. Among these operators, we see the same common mistakes:

- The majority of them focus on reacting, or win-backs
- Reaction and win-back strategies are developed for effectiveness, not efficiency
- Many proactive campaigns are based on generic scoring propensity and customer segmentations, not on concrete churn triggers
- Very little focus is placed on churn when designing propositions
- Acquisition and retention are managed in silos

In our experience, moving "upstream" can offer huge opportunities. This involves shifting from an "end of life" focus to managing activity across the four life stages described earlier and improving the specific capabilities within each stage. Not all operators need to be best-in-class across all capabilities – local market dynamics and operator specifics will determine which ones have the biggest impact. To do so, operators must assess their own situation to determine which capabilities to move to what levels.

Finally, "best-in-class" is a relative, not an absolute position to obtain – leading operators continue to develop and improve their capabilities. Because "best" is always being redefined, sustaining a positive value engine requires an operator mindset of continually assessing and improving capabilities.

ABOUT OLIVER WYMAN

Oliver Wyman is a global leader in management consulting. With offices in 50+ cities across 25 countries, Oliver Wyman combines deep industry knowledge with specialized expertise in strategy, operations, risk management, and organization transformation. The firm's 3,000 professionals help clients optimize their business, improve their operations and risk profile, and accelerate their organizational performance to seize the most attractive opportunities. Oliver Wyman is a wholly owned subsidiary of Marsh & McLennan Companies [NYSE: MMC].

For more information, visit www.oliverwyman.com.

CONTACTS

LAURENT BENSOUSSAN

Partner, New York
Laurent.Bensoussan@oliverwyman.com

LORENZO MILANS DEL BOSCH

Partner, Madrid
Lorenzo.MilansDelBosch@oliverwyman.com

FABIEN NAUD

Principal, Boston
Fabien.Naud@oliverwyman.com

PHILIPPE BENICHOU

Engagement Manager, New York
Philippe.Benichou@oliverwyman.com

CONTACT

CMT.practice@oliverwyman.com

OLIVER WYMAN