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Customer Churn

Stop it before it starts

By Martin Kon

For subscription-based businesses, even a small reduction in churn can have a huge impact on enterprise value. But traditional satisfaction data and attempts to rescue departing customers don't get to the root causes that make customers want to leave. Instead, companies should invest in understanding which aspects of the customer experience drive consumer behavior, so that they can act to reduce churn cost-effectively.

Let's consider a typical consumer, Alex. Her monthly outlays include a $40 mobile phone bill; $40 each on cable TV, home phone, and flat-rate Internet access; $70 for gym membership; $70 for water, gas and electricity; and $30 in fees to her credit-card provider. That's $330 per month for services, a few of which barely existed 20 years ago. Furthermore, she has choices in every one of these categories, where 20 years ago there were a few local monopolies.

Today, a customer lost is a customer gained for a competitor. With so many competitors, companies need to focus as much energy on retaining customers as they do on acquiring them. Businesses that understand churn and invest accordingly will need to invest less in placating dissatisfied customers and less in winning new ones to grow. Businesses that do not will find rivals with better retention machines rapidly overtaking them.

Understanding how and why the churn occasion comes about will be critical. Alex pays her subscriptions via direct debit or credit card and typically questions her choice of provider only when a better-value alternative manages to catch her attention, or when a service fails to meet her expectations. The churn occasion occurs when the quality of her experience falls below a certain threshold either relative to competition (comparison churn) or relative to her own expectations (frustration churn). But what is it about her experience that is to blame?

Customer satisfaction surveys and palliative rescue initiatives do not provide an accurate guide to what Alex values and which deficiencies could lead her to leave. Mobile phone customers, for example, do not say, "Ten dropped calls in a week is unacceptable, so I'd better make a note in my diary to cancel in three months' time … now where was that customer satisfaction questionnaire?" They say, "That's enough, I'm out of here right now!" Churn events are sudden moments of clarity when customers' perceptions of their service change. Customer satisfaction surveys don't catch enough customers who have had these epiphanies, because they have already left.

For one Internet service provider in Europe, Mercer Management Consulting found that almost 80% of ex-customers had described themselves as "satisfied" or "very satisfied" in the survey they filled out within the 12 months before they left (Exhibit 1), indicating that at that

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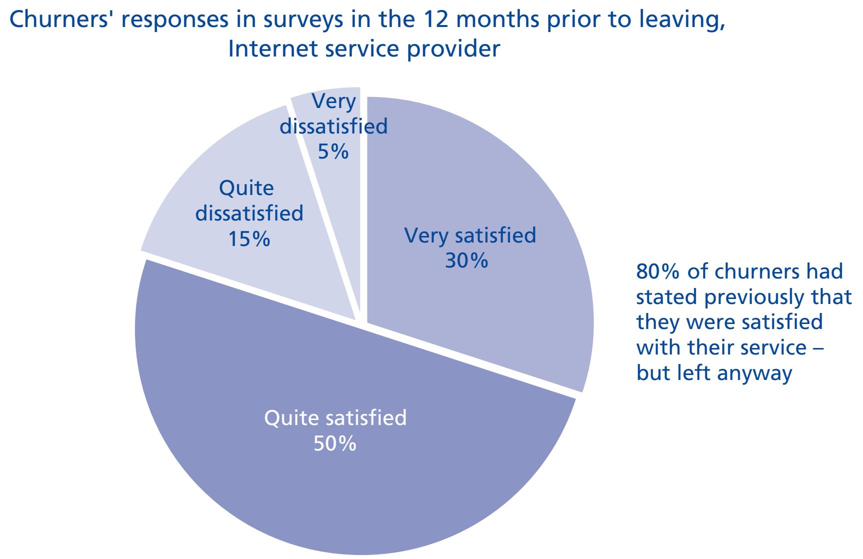
Exhibit 1 **Customer satisfaction surveys can be misleading as an indicator of what drives churn**



Source: Mercer Management Consulting client analysis

time they were not aware of why they would end up churning in the future. In this case, focusing on self-stated customer satisfaction was therefore likely to lead to costly errors.

Another common approach, the exit survey at or after the point of cancellation, offers notoriously generic and unhelpful insights into reasons for churn: responses such as “too expensive” or “poor quality” do not help to focus management’s efforts on the most impactful areas. Often, a disgruntled customer is in no mood to answer questions, or is unclear about his or her motivations, or is eager to end the debate or even to avoid causing offense. Attempts to save the customer at this stage are almost certainly too late; most customers call to cancel after they have established a relationship with a competing provider.

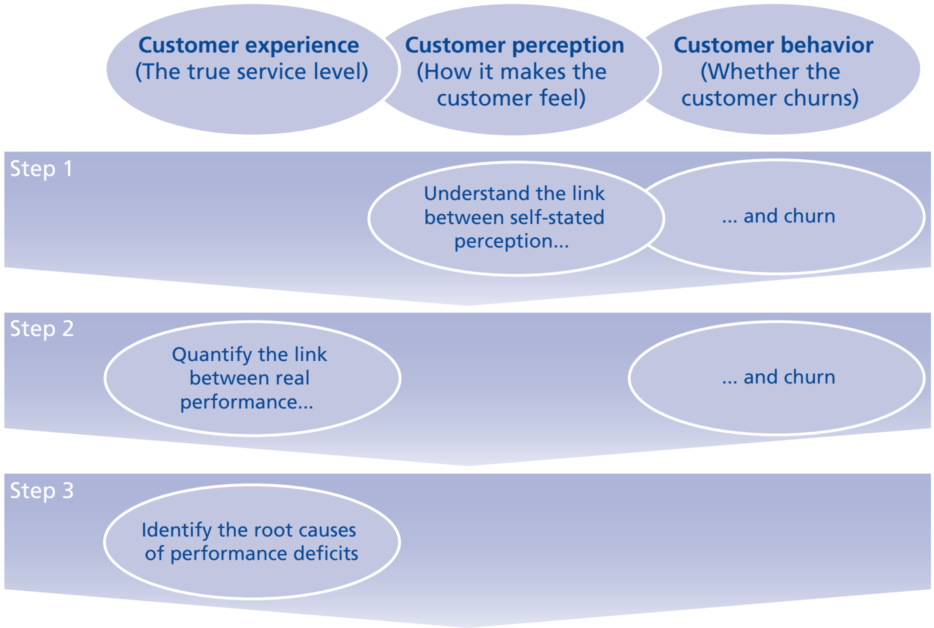
Although it is imperative for subscription businesses to understand the root causes of churn, traditional methods are ineffective. Businesses need to decide whether to invest in developing a superior and differentiated ability to understand customer churn. When implemented effectively, such a capability allows churn to be reduced cost-effectively and will fuel growth even in mature markets.

There are three important elements to consider and understand in a customer’s interaction with a subscription business:

- *Customer experience:* What measurable service experience is the customer exposed to?
- *Customer perception:* How does the customer claim to value the experience?
- *Customer behavior:* How does the customer actually behave after the experience?

Understanding these areas in depth and how they relate to each other is essential to improving those elements of a customer’s experience that will translate into satisfaction and loyalty. Fortunately, the answers are within reach of most large companies for the first time. IT systems capture large operational datasets at the customer level, and businesses can learn to

Exhibit 2 **Three steps to understanding how customer experience impacts customer perception and behavior**



Source: Mercer Management Consulting

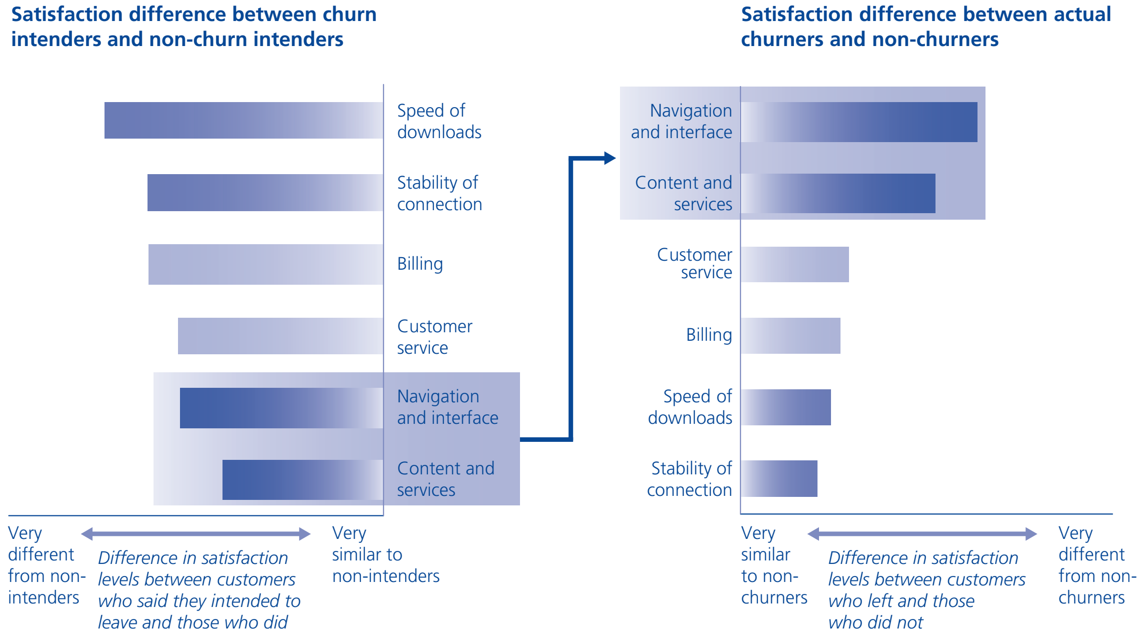
condense critical business information about churn from this data. The analysis is not always simple but it can reveal startling insights, allowing management to trade off costs and benefits with new precision and make maximum-impact investments in their service.

Starting with a fresh look at customer satisfaction data, an effective three-step approach helps companies to understand the relationship between customer experience, customer perception, and customer behavior (Exhibit 2).

1. Understand the link between self-stated perception and churn.
The main challenges of self-stated satisfaction are, first, that frustrated customers are under-represented in the sample because they leave so quickly and, second, that typical ratings and rankings research gives rather bland results (e.g., everyone agrees that reliability is important, and no one is satisfied with the price).

For example, one Internet service provider in continental Europe had focused on chronically low satisfaction scores relating to both reliability and price and it concluded that a cheaper offer and massive investment in infrastructure was the only solution. However, by linking data from a regular customer satisfaction tracker with the firm's customer cancellation data-base, Mercer determined how satisfaction responses actually converted to churn behavior on an individual, de-averaged basis. In this case, self-stated dissatisfaction with the basic service (speed and reliability) turned out to be a poor predictor of subsequent churn. Dissatisfaction with two more advanced features of the service, navigation interface and content, clearly did lead to churn (Exhibit 3).

Exhibit 3 **From perception to action: The service factors driving customers' stated intentions to leave were different from those felt by customers who actually left**



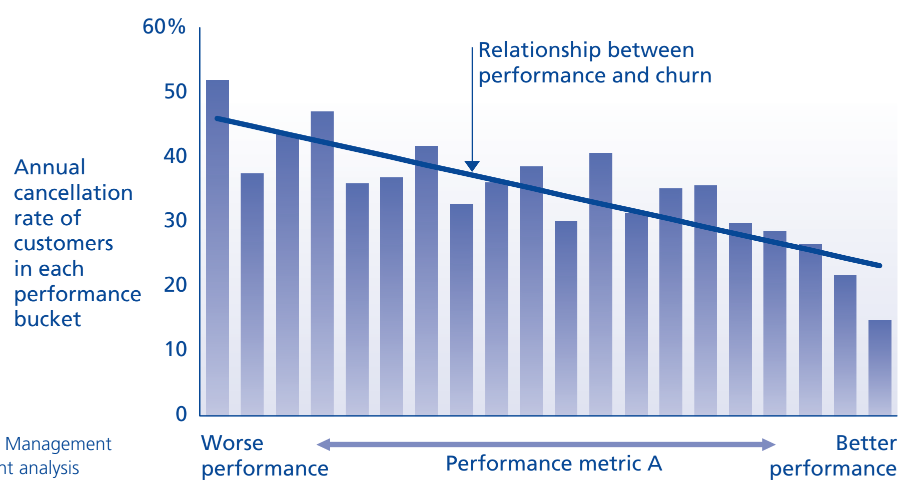
Source: Mercer Management Consulting client analysis

2. Quantify the link between real performance and churn.

In the previous example, did we conclude that speed and reliability were irrelevant? No, we already suspected that frustrated customers at the point of leaving are under-represented in customer satisfaction surveys because most of them leave before filling out a survey form.

However, the real impact of all the various elements of performance relative to other components of the customer experience was unknown. So the next step is to see how different elements of real service performance directly drive churn behavior. By linking customer-level data and cancellation data, we are able to establish a direct relationship between performance and churn, identify those elements that are most important, and quantify their impact on churn. The answers can be striking (Exhibit 4).

Exhibit 4 **The worse the performance that customers receive, the more likely they are to cancel**

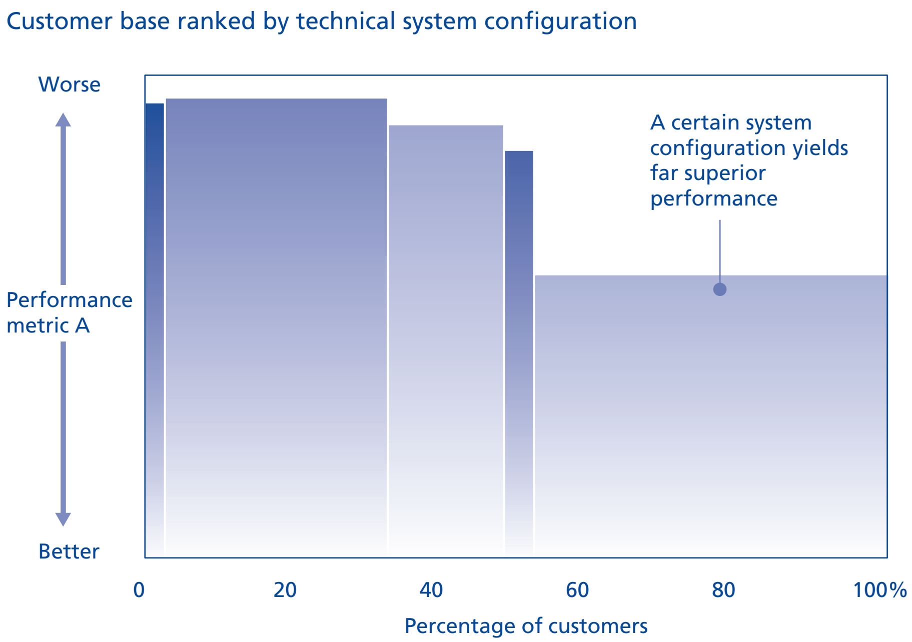


Source: Mercer Management Consulting client analysis

3. Identify the root causes of performance deficits.
Identifying and quantifying those elements with the greatest impact on churn is only valuable if the root causes of these performance deficits can be identified and dealt with. Again, a de-averaged, customer-level analysis of potential performance drivers allows companies to isolate the underlying causes and quantify the impact that realistic improvements would have on the key performance drivers and, based on the relationship determined before, on churn.

There are often many potential avenues to address performance issues, and this allows management to focus quickly on those with maximum impact. At one French service company, our analysis showed clearly that customers on a certain type of technical configuration experienced much better performance in one critical aspect (Exhibit 5). The company was able to proactively replicate this configuration for all other users, directly tackling one important aspect of churn as a result.

Exhibit 5 **A de-averaged view of customers clearly identifies the root causes of performance deficit**

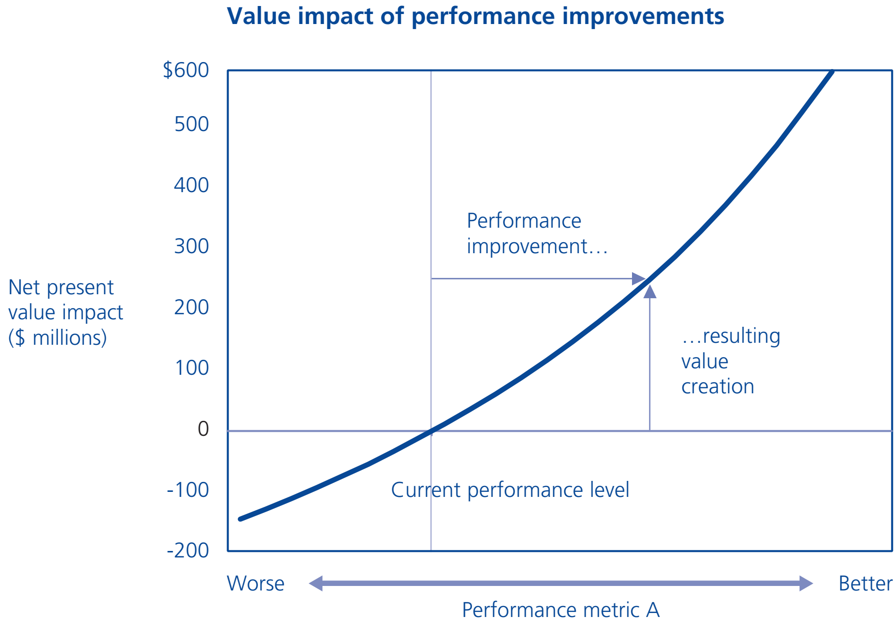


Source: Mercer Management Consulting client analysis

By combining these three approaches, managers can peel back the layers to look progressively deeper into the drivers of churn. Often, some glaring deficiencies become apparent quickly, and these can be addressed before any further analysis. The goal is to evaluate the service improvement investments and retention initiatives that will result in quick churn reduction or cost savings.

In the case of one subscription business in the U.K., management was able to see the direct economic benefit of improving specific elements of product performance. This allowed the firm to shift technical resources to focus on the critical areas. Achieving reasonable improvements in this area should result in roughly $15 million in annual EBITDA improvement and $250 million in net present value. Allocating additional resources to the issue becomes a much easier decision after that kind of benefit becomes clear (Exhibit 6).

Exhibit 6 **Linking performance metrics to churn at one company allowed accurate financial models to be developed in order to justify major investments**



Source: Mercer Management Consulting client analysis

Strategic implications

Several principles can guide managers embarking on a program to reduce churn.

Retention initiatives must focus on reducing the root causes of churn, rather than on saving customers who are already at the point of departure. Virtually all subscription businesses have a "customer save" policy that sets out how to handle customers calling to cancel their service. Much less effort and investment generally goes into retention initiatives for those customers who are not yet at the point of churn. One Internet service provider operating in several countries spent roughly $300 million on acquisition marketing to get people through the door, more than $150 million on call centers to keep people from going out the door, but little explicit budget for identifying, improving, and tracking the elements that keep regular customers happy and loyal. Expending more energy and funds on this could result in the need to spend less on saving irate customers and on acquiring new ones to replace them.

Unless designed and interpreted properly, customer satisfaction surveys can be highly misleading in identifying and prioritizing key areas on which to focus retention investments. Companies spend a lot of money on capturing and evaluating customer satisfaction, and they put a great deal of credence in the results. One large telecom firm in North America goes so far as to tie executive compensation to customer satisfaction levels.

However, stated customer satisfaction is only relevant if it indicates how customers will alter their behavior in the future. Satisfaction in absolute terms means little; for example, almost all frequent travelers would say they were dissatisfied with the punctuality of their regular airline, but most recognize that the problem is endemic to modern air travel, and they would be unlikely to choose a different airline for their next trip. On the other hand, those same travelers might state on the same survey that they are very satisfied with the quality of the in-flight meal. Yet a competitor's offer of pre-flight dining on overnight flights could still prompt many to switch carriers.

For subscription services, low stated customer satisfaction with reliability and quality must be viewed in the context of customers' expectations and experience with competitors' services. It's important to properly interpret stated satisfaction with the various elements of the experience and devise a satisfaction index that considers the relative significance of individual components.

Subscription businesses should identify and evaluate retention priorities by understanding the direct link between customer experience and customer behavior. The only accurate and relevant measure of customer satisfaction in subscription businesses is churn itself. Companies that grasp the direct relationship between various measurable elements of the customer experience and customer behavior at an individual customer level will have a significant competitive advantage in identifying and treating the drivers of loyalty and churn. At one German subscription-based business, worse performance on one key metric resulted in a high intent to leave. However, a different metric was by far the biggest driver of actual churn. Not making this direct link would have resulted in the company spending significant amounts of money on the wrong area without having a positive impact on customer loyalty.

A better understanding of churn drivers is only valuable if followed by a better plan to act upon it. Many companies often fall victim to paralysis by analysis. What matters is analysis that results in changing the company's investment or product design behavior. Among the solutions that some leading subscription companies have implemented to act on their new insights are the redesign of "customer save" scripts and actions, targeted product performance investments and service design improvements, and outbound customer communications programs.

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Understanding and addressing the root causes of churn not only leads to a more cost-efficient and effective churn-management capability, but also shows customers that their service provider is looking out for their best interests. Spending less money for more impact and getting kudos from your customers has to be considered a success.❖