

# Framework for Calculating Customer Churn and Customer Value

*Leverage science and data to maximize customer lifetime value*

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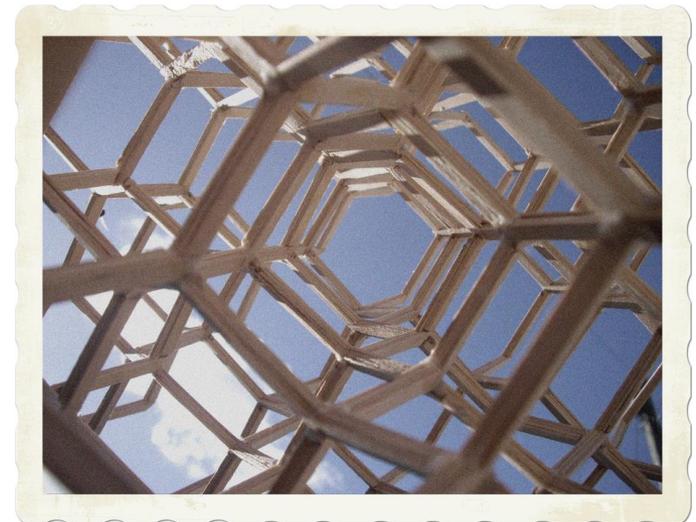
# The basic issues



## Churn: Where we need to start

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- Strategies and tactics to stem customer churn must start with a conceptual understanding of the problem, specifically—
  - Why does it typically happen?
  - What negative impacts does it have on a company's market position?
    - Brand positioning, negative word-of-mouth, and
    - Financials (e.g., decreased revenue, loss of profit)?



*The underlying framework  
shapes everything going forward*

## Reasons for churn are numerous

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- It is well understood that customers leave for a number of basic reasons—

### Voluntary

- Bought away
- Allowed to slip away
- Pulled away

### Involuntary

- Intentionally pushed away
- Supply problems
- Out of business

## Customer loss is costly

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- Stemming churn can greatly improve profits
  - One often-cited estimate—
    - A 5% reduction on churn can boost profits up to 20% <sup>1</sup>
- Costs of regaining lost customers can be higher than the cost of gaining new prospects
  - Likelihood of selling services to former customers has been estimated as being 10% to 33% of likelihood of selling to current customers<sup>2</sup>
- Customers who leave on bad terms can cost twice as much, in negative effects on potential customers, as those who are lured away or pulled away <sup>3</sup>

*Don't let  
them leave feeling  
like this*



<sup>1</sup> Reichheld, *The Loyalty Effect: The Hidden Force Behind Growth, Profits, and Lasting Value*

<sup>2</sup> Griffin and Lowenstein, *Customer Winback: How to Recapture Lost Customers*

<sup>3</sup> Hogan, Lemon and Libai, "What is the True Value of a Lost Customer?"

## Acting on customer feedback is critical

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- Gathering customer feedback on problems and reasons for defecting is important
  - But not acting on this insight is a waste of money
    - An estimated 98% of companies gather customer feedback
    - But only 15% ever make any process changes as a result
    - And only half of these ever bother to close the loop with their customers
- Change in direction is difficult—but less so if guided by strong research to increase gains and reduce risks



## Steps and methods: Needed data inputs

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- With this as our conceptual starting point, these are the steps and methods to address customer churn

### Key data inputs

- Identify reasons for churn
- Assess opportunities to save and likelihood to return
- Identify competitive providers to whom customers switched/may switch to along with the share of churners acquired by each competitor
- Evaluate perceived performance of your brand relative to the new provider

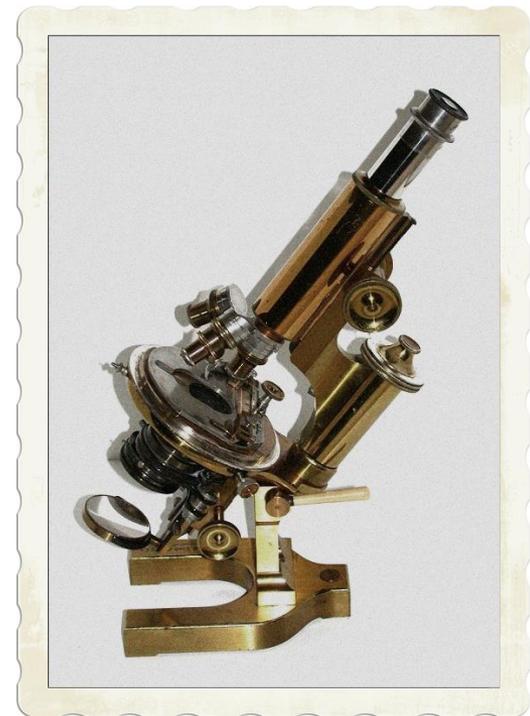


# Steps and methods: Analytics

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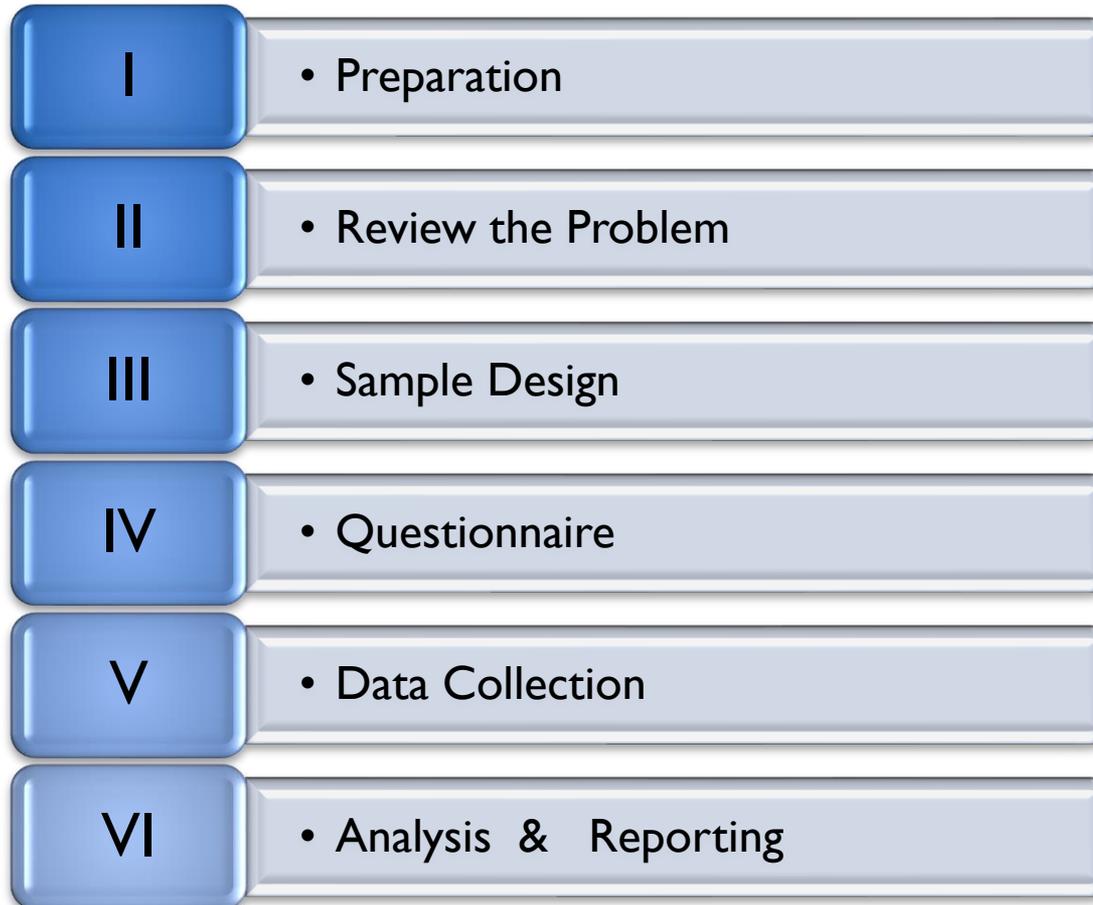
## Key Analytics

- Factors in churn and key drivers
- Model to explain combinations of factors leading to churn
- Model to identify existing customers who are at risk for defection or reduced spending
- Model of likelihood to spread positive/negative word-of-mouth



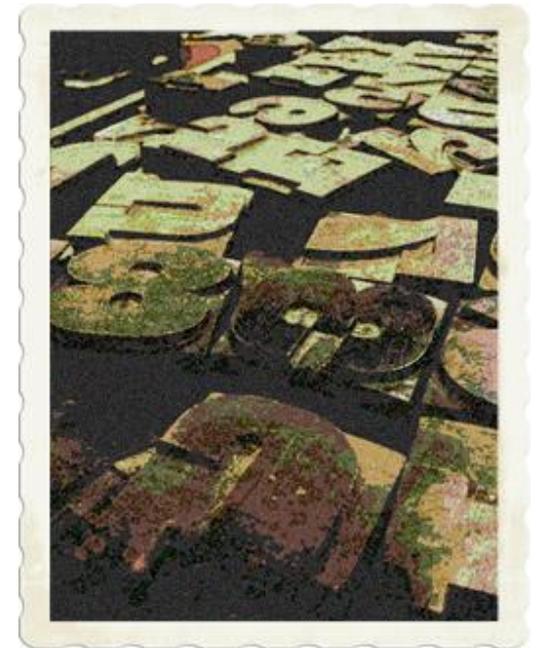
## Six steps to take to address the problem

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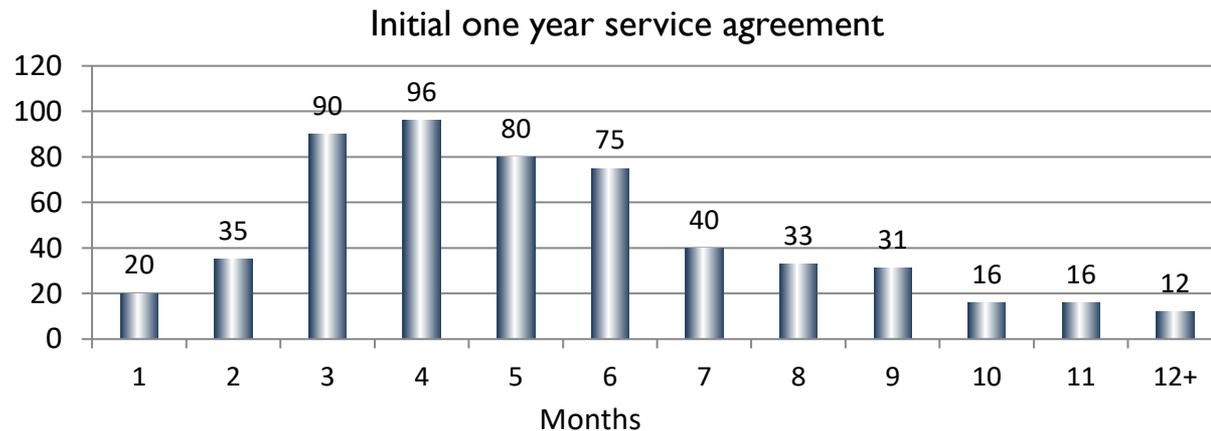


## Preparation

- Meeting with stakeholders is a critical first step
- Goals for this step—
  - Ensure agreement on the purpose and application of the research
  - Identify and discuss expectations
  - Get commitment to action
  - Get agreement with the proposed research approach, deliverables, timelines and obligations of each party
  - Begin an effective ongoing communications process



- Understanding customer churn should start with a review of the business customer database
- This can reveal patterns, such as when in the customer lifecycle churn tends to take place



- This chart—a real example—shows numbers of business customers churning in the first year of their telecommunication service agreement
  - It shows a period of extreme churn early in the customer life cycle—clearly a situation that should be addressed

Preparation

Review the  
Problem

**Sample  
Design**

- Sampling needs to take into account any important customer segments
- In addition, to capture reasons for churn and customers behaviorally likely to churn, it is best to stratify the sample in terms of three types of behaviors—
  1. Current customers who have not altered their service
  2. Have left your brand entirely for a competitor
  3. Are now spending less with your brand



*Deciding to spend less  
and love it*

- Supposing 3 segments, a reasonable sample would be 200 interviews each
  - i.e., a total of **600** interviews
  - Readings would be robust at the column-total and row-total levels
    - However, individual cells would be too small to read with confidence
  - A total sample of **900** would allow reading of each cell

| Customer type | Segment   |           |           | Total |
|---------------|-----------|-----------|-----------|-------|
|               | Segment 1 | Segment 2 | Segment 3 |       |
| Left          | 66        | 66        | 67        | 200   |
| Reduced       | 66        | 67        | 66        | 200   |
| Unchanged     | 67        | 66        | 66        | 200   |
| <b>Total</b>  | 200       | 200       | 200       | 600   |

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A 20-minute survey that can cover these areas—

- Type of churn
- Stated reasons for dropping service(s)
- Likelihood of canceling other services (if haven't defected entirely)
- Ratings of client's brand and competitors to whom switched on key performance attributes
- Importances of these attributes
- Likelihood of returning
- What, if anything, client's brand could do to win their business back
- Level of satisfaction with new provider
- Word-of-mouth behaviors



- All interviewing should be done at one point in time
- Means of interviewing most likely will be phone, due to—
  - Difficulty in getting lapsed customer to participate via Web
  - High likelihood that current customers will take a phone interview



*Fortunately, things are  
more automated now*

- Analysis focuses on answering the basic business questions and providing useful insights
- Four key multivariate analyses—
  1. Forced trade-offs via MaxDiff
    - Precisely measures what groups consider most important
    - Findings will drive analysis of—
      - How respondent groups differ
      - How client compares to competitors on factors leading to churn



## MaxDiff forces people to choose and so reveals importances

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- Similar to conjoint, MaxDiff forces individuals to make decisions about what truly is important to them
  - Respondents consider ~3 performance attributes at a time, and are asked to pick the most important the least important in each group.
- Analysis shows relative importances at the ratio level
  - As in, “Attribute B is 2.3 times as important as Attribute C”



*Choices required*

Preparation

Review the Problem

Sample Design

Questionnaire

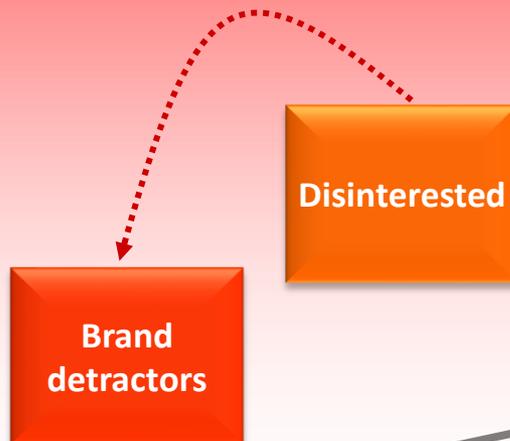
Data Collection

Analysis & Reporting

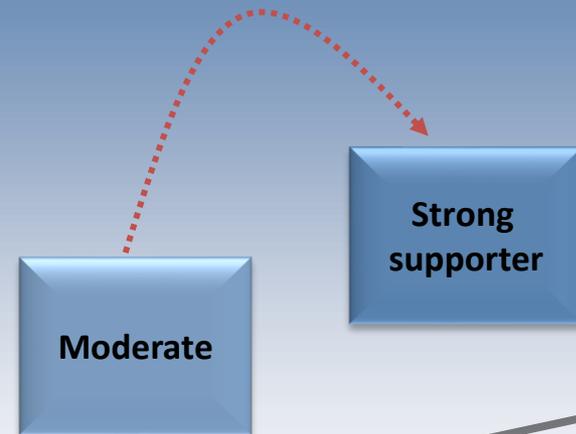
## 2. Discriminant analysis

- Will find critical differences that cause customers to move up to strong positives and down to brand detraction

What turns disinterested customers into brand detractors?

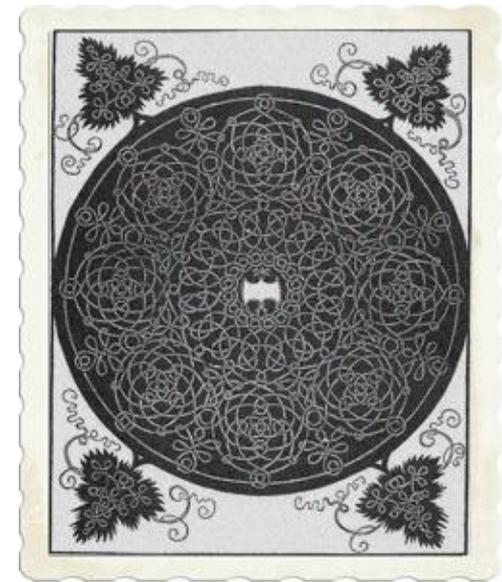


What turns moderates into strong supporters?



## 2. Classification trees or CHAID

- Will find—
  - Critical combinations of performance factors that drive customers away or to drop services, and
    - Which combinations do the most damage
  - Key differences among customers
    - Contrasting those who stay vs. those who have dropped some services, vs. those who have defected entirely
  - This creates profiles of at-risk customers for churn pre-emption



*Though it seems appropriate  
not really about CHAID*

## How CHAID works

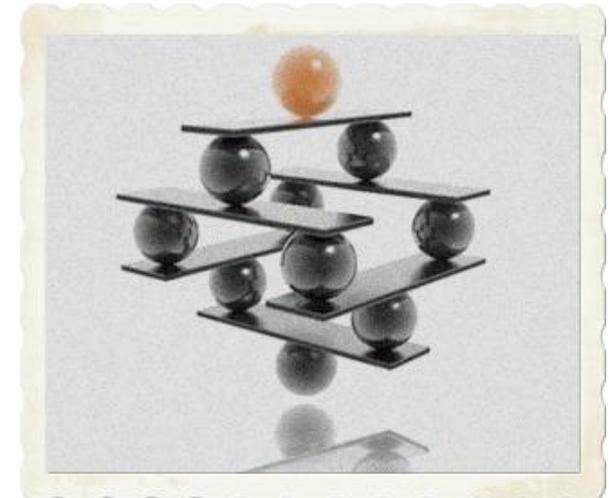
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- It first searches through all variables (or questions) to find the one most strongly differentiating groups, in terms of churn levels
- It repeats the process among high churn groups, finding subgroups with still stronger contrasts
- It repeats this and runs until no significantly different sub-groups can be found
- It creates a tree-like structure with increasingly contrasted groups, as we will see shortly



*Treelike but not quite CHAID*

3. Analysis of **word-of-mouth** identifies the spectrum of those exhibiting positive to negative word-of-mouth
  - Can be supported by **discriminant analyses**
    - Identifies performance factors that impact this word-of-mouth behavior
    - Analysis focuses on the critical junctures, where a customer either becomes more likely to defect or more likely to stay



*Will it fall or stand?*

Preparation

Review the  
Problem

Sample  
Design

Question-  
naire

Data  
Collection

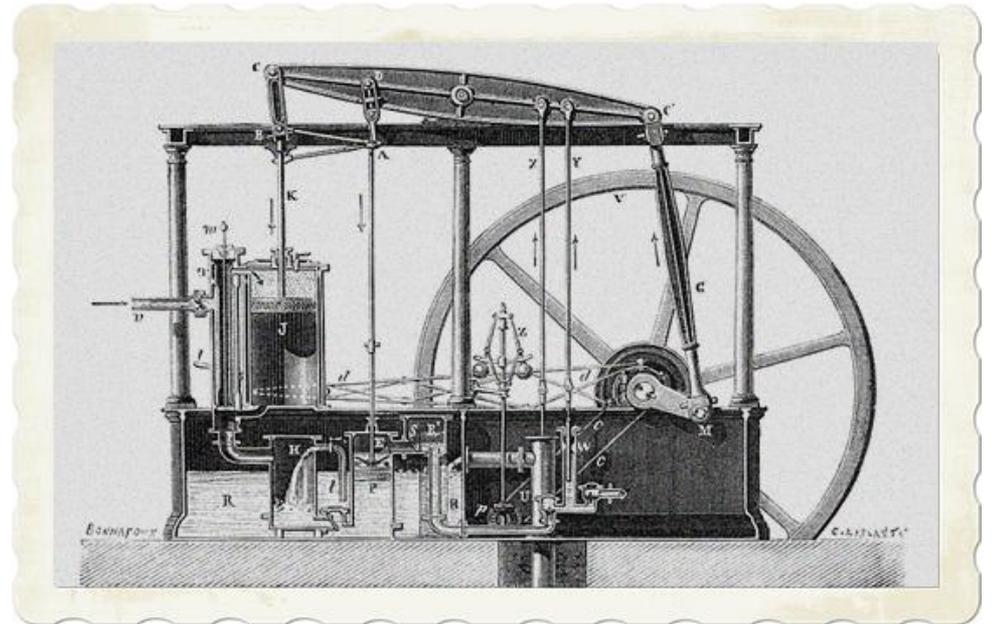
Analysis &  
Reporting

- Analyses focuses on answering each of the 3 key business questions:
  - Why are some customers leaving the company for a competitor?
  - Why are other customers reducing their spending?
  - What can your brand do to minimize this churn?



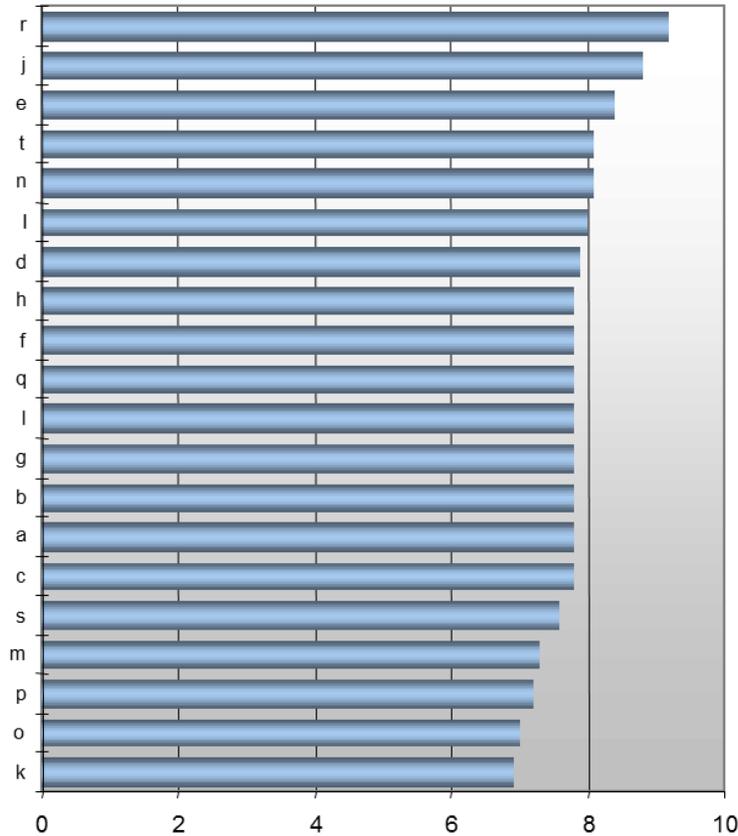
*Word of mouth  
can be powerful*

# Sample output

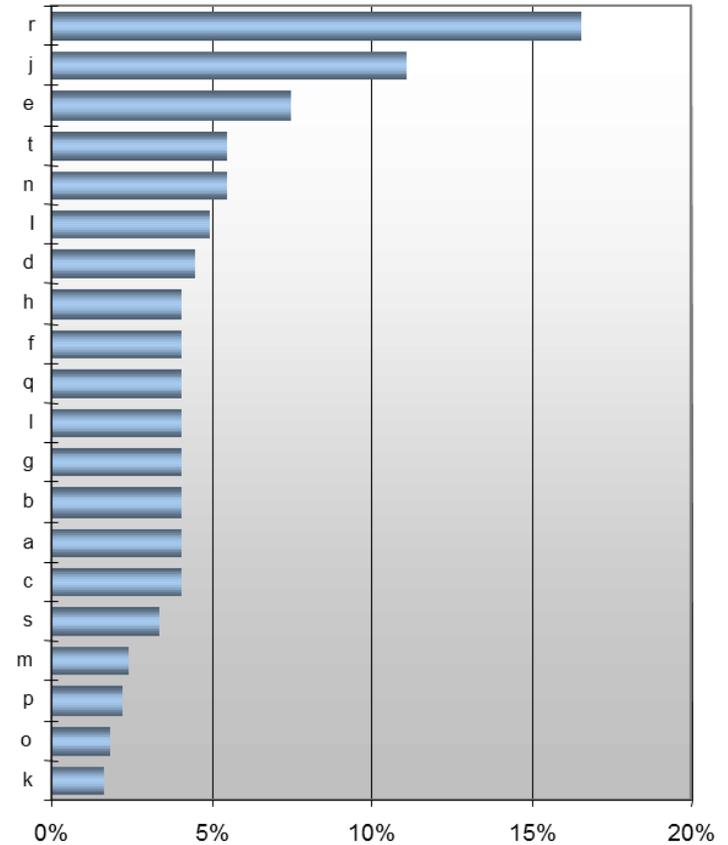


# 1. MaxDiff reveals importances much more clearly than ratings

Experiment done with split sample, same attributes: MaxDiff shows differences much more clearly



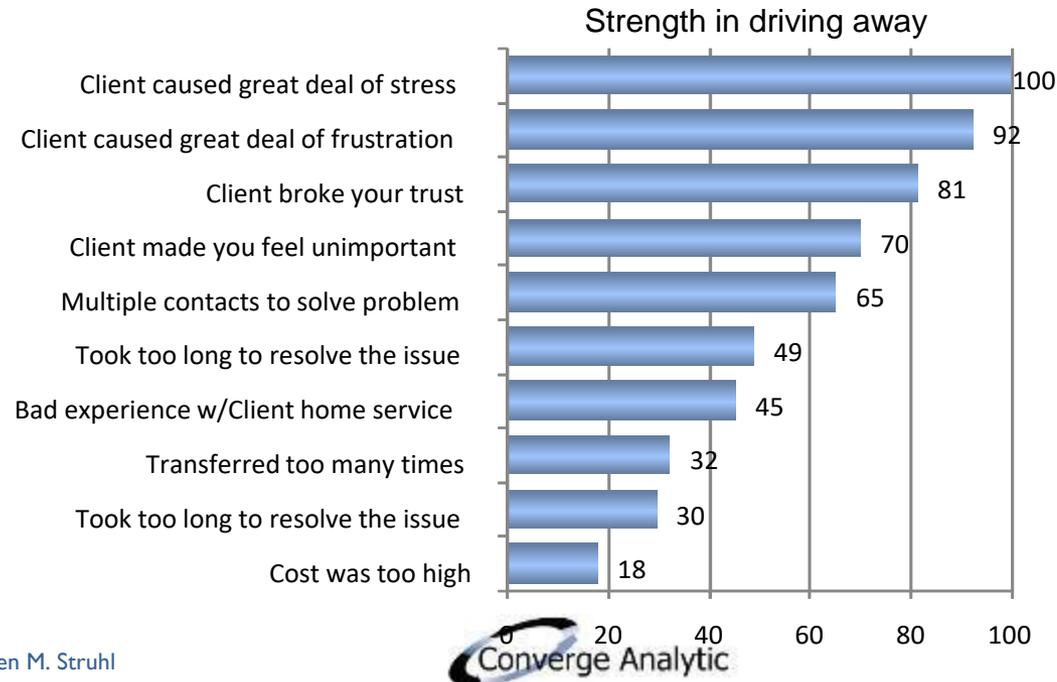
0 to 10 rating scale



MaxDiff forced trade-off

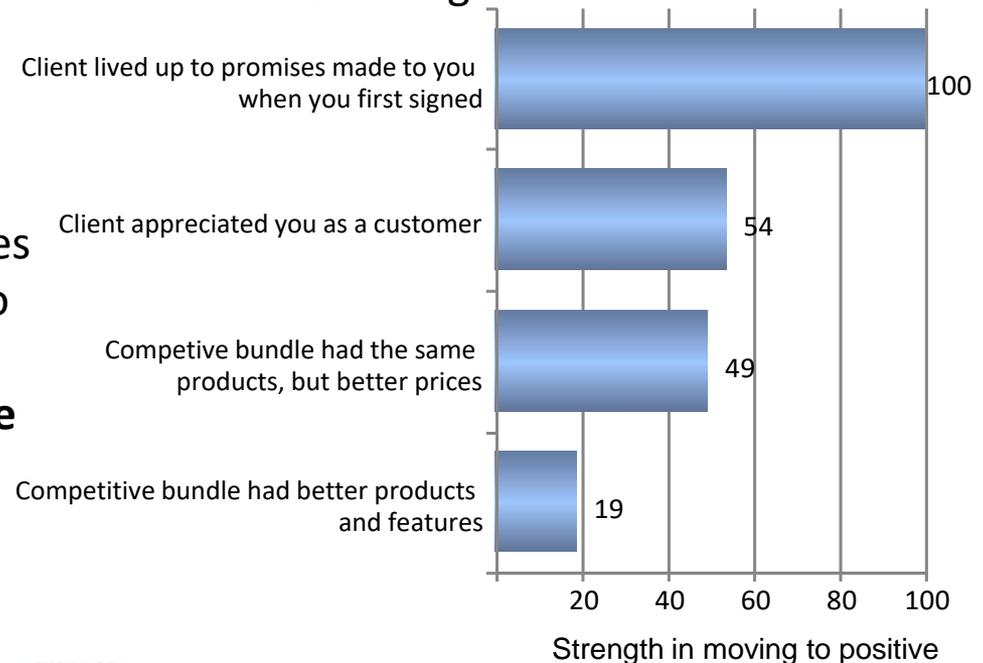
## 2. Discriminant analysis: Factors causing users to move negative

- Client causing stress and frustration and breaking trust were the strongest factors differentiating neutral lapsed customers from those who said they never would come back
  - Various forms of delays, including multiple contacts, too much time to resolve, and too many transfers also were important factors
  - Cost entered only moderately
- Knowing just these differences in responses, we can distinguish the most negative lapsed customers from neutral ones **76% of the time**

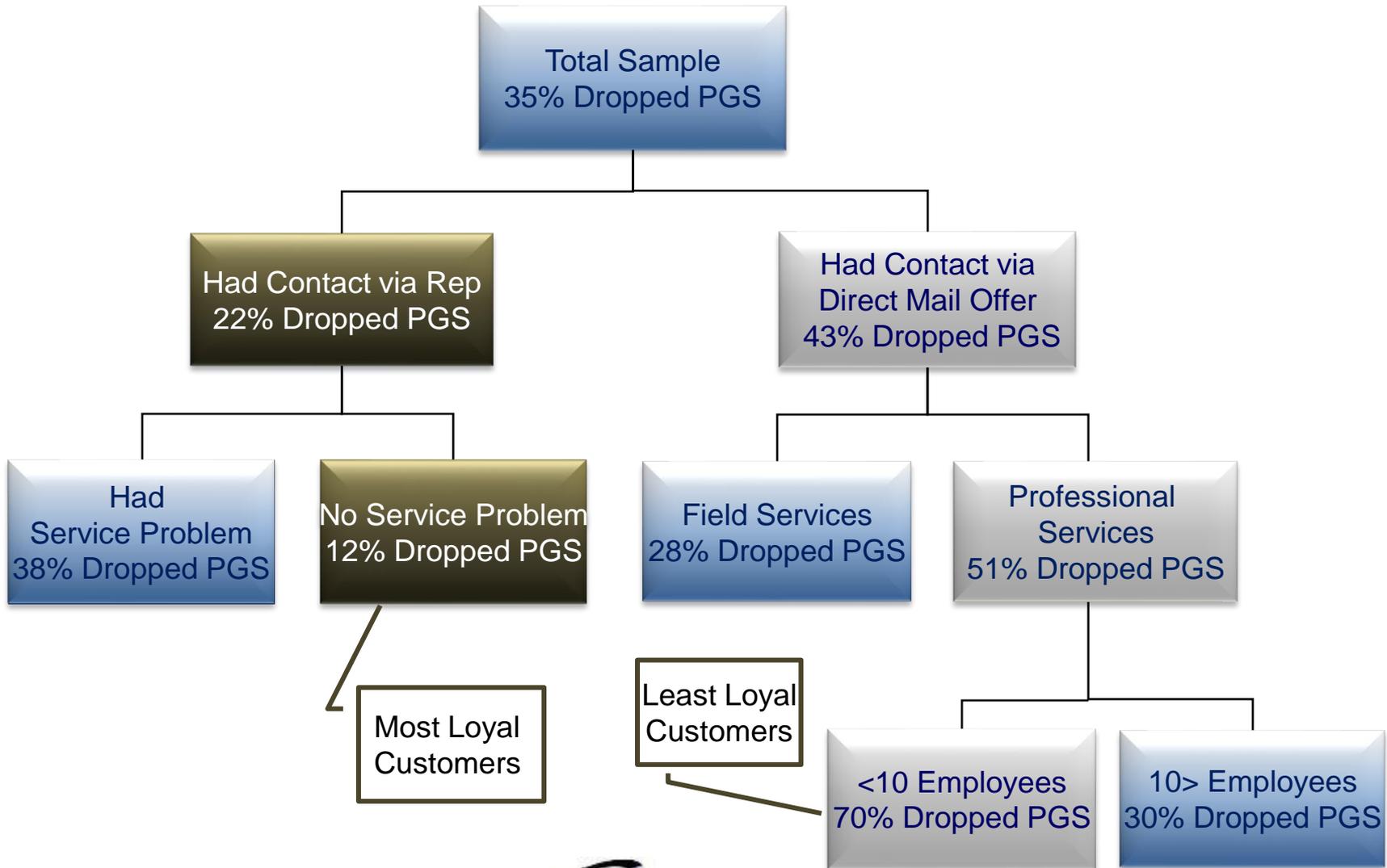


## Factors differentiating those who definitely would return from the neutral

- The leading factor differentiating lapsed customers who **definitely** would consider returning from more neutral lapsed customers was the Client living up to promises
  - This was twice as powerful an incentive to return as any other factor
- Client appreciating them as customers was another important factor
- Competitive bundles being better also were mentioned more often by customers who “definitely” would consider returning
- They did not leave because of something the client did
- Knowing just these differences we can correctly identify who is neutral and who definitely would return **73% of the time**

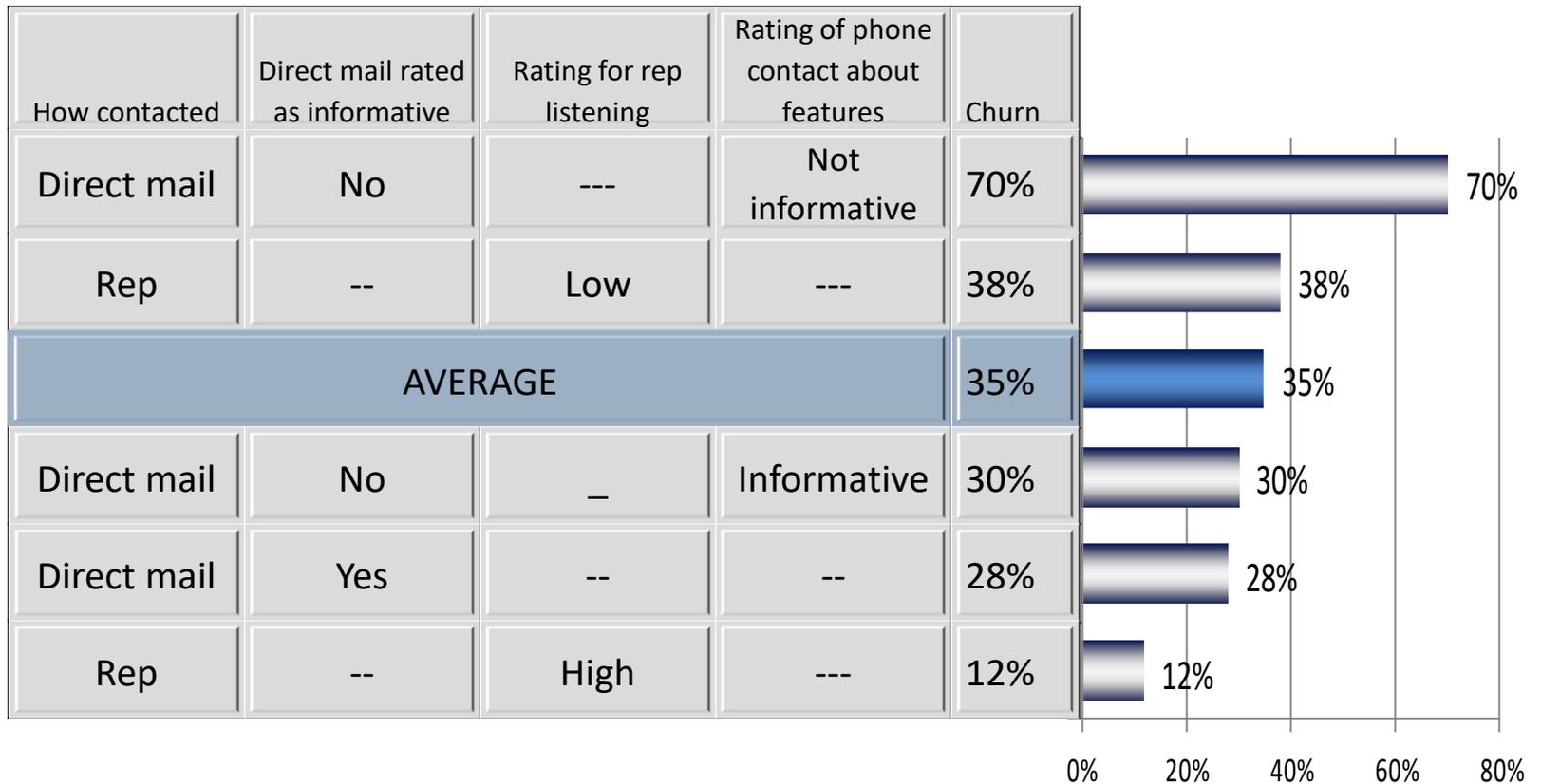


### 3. CHAID: Combinations of characteristics lead to vastly different churn rates



# CHAID tree translated into a simple table

- Showing how customer characteristics and experiences work together to lead to greater risk of churn



## 4. Word of mouth: Surprising negatives among current customers

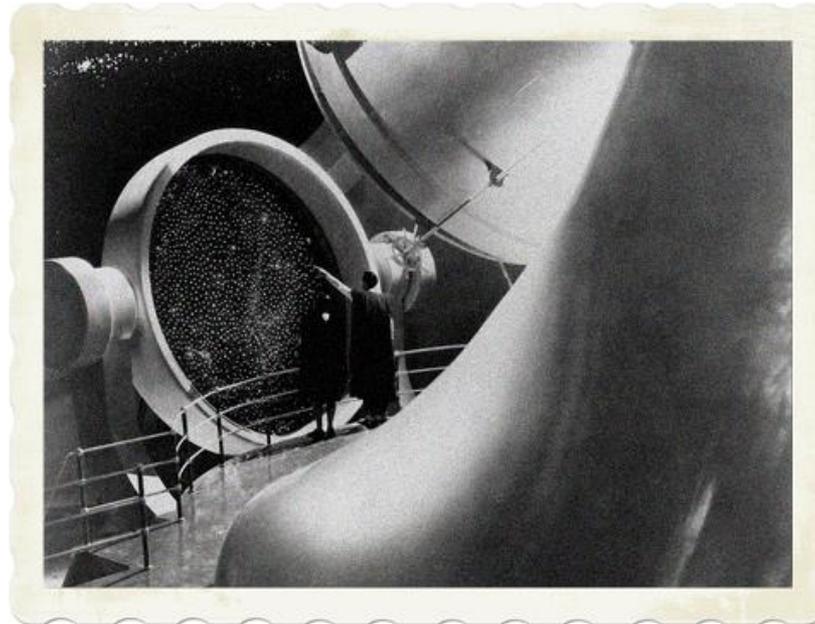
- Unexpectedly high levels of negatives among current and reduced customers suggests vulnerability and possible erosion by adverse commentary
  - Cancelled customers are only slightly more likely (23%) to say only negative things than current or reduced customers (both 15%)
- The majority of cancelled customers are neutral or mixed
- The sharpest difference is in voicing only positive opinions

| How often say positive or negative comments | Current customer | Reduced customer | Cancelled customer | Total |
|---|------------------|------------------|--------------------|-------|
| Negative, few/no positives                  | 15%              | 15%              | 23%                | 19%   |
| Neutral, few/no positives                   | 40%              | 41%              | 54%                | 46%   |
| Mixed, both positive and negative           | 10%              | 5%               | 11%                | 10%   |
| Positive, few/no negatives                  | 39%              | 35%              | 13%                | 25%   |
| Totals                                      | 314              | 41               | 284                | 639   |

## Questions? Comments?

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Call or write any time



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