

Second Lifetime Value: Customer Reincarnation

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It has been determined that most companies lose between ten and forty percent of their customers each year. The economic impact on organizations, not to mention the crushing effect on employees, including downsizing, rightsizing, plant closings, layoffs, etc., are the real consequences of this customer loss. Left unchecked, customer turnover results in a 'multiplier' effect that creates alienation among remaining customers, negative company growth, and the erosion of employee trust.

The rate of customer turnover is particularly significant on the Internet, where the opportunities for customer loss occur at warp speed. A recent McKinsey study, *ePerformance*, found that 98.7% of online visitors do not become repeat customers. Another study determined that most sites will lose 60% of their first-time customers in a six week period.

The numbers are just as dramatic in the offline world. A study by KPMG about customer defections in the United Kingdom reported that 44% of U.K. customers changed at least one of their key product or service suppliers (supermarkets, phone companies, etc.) in the past year. Cahners In-Stat Group research has found that this year, worldwide, 34 million wireless telecom customers will churn from supplier to supplier as they look for better value; and, by 2004, that number will have grown to 77 million.

Losing a valued customer is never fun. It's an unhappy event for all concerned. Companies have a choice. They can give in to the disappointment and despair and purge that lost customer from their data files, thereby ensuring that the customer is gone forever. Or, they can get focused on the necessary steps to win back that customer.

In some businesses, customers make their decision to terminate the relationship and officially communicate their intent to the company. In others, there is never a formal declaration of termination. Instead, the customer slips away, either by buying less and less over time or by terminating their purchasing all at once. Consider the 'formal' and informal ways customers terminate across varying industries.

How Customers Say Goodbye

Organization	How customers give official termination notice	How customers unofficially terminate
Doctor/dentist	requests medical records	periodic visits stop
Insurance	cancels policy	policy payments stop
Church	move membership to another church	attendance/tithing stops
Credit card	cancels credit card	credit card usage stops
Restaurant	none	patronizing stops
Magazine	notified not renewing	lets subscription lapse
Auto dealership	none	periodic servicing stops
Hairdresser	none	stops making appointments
Dry cleaner	none	stops patronizing
Web site	none	Site visits stop
Book club	cancels membership	

The end of the customer lifecycle is typically characterized by a phase of passive customer relationship in which the customer stops purchasing. In so many businesses, customers do not typically notify suppliers that they are terminating. (See Chart Above.) Instead, companies must rely on purchase behaviors and other ‘informal’ signals that defection is looming. The quicker companies realize that termination is upon them, the better positioned they are to immediately leverage the situation for future opportunities.

Not all lost customers make good win-back prospects, **nor will companies want to win back all lost customers.** It’s important that lost customers be segmented by win-back potential, with those lost customers with highest probable return given greatest priority. Without an effective segmentation strategy, lots of time and money can be wasted on re-contacting lost customers who are poor prospects for future business. One data base

strategist described the issue this way: “I have a phone line downstairs in my home that I use for occasional business purposes. Never a long distance call. And about every six months, I get an offer I can’t refuse and I switch the thing from one long distance carrier to another. I always get a call back from the carrier I just terminated trying to woo me back. Why would they even want me back? I make no long distance calls. I’m more expensive for them to process. And they call back every time, which tells me there is no profiling, no segmentation being done. It’s just reactive.”

The best segmentation plan for lost customers we’ve found thus far is a two-step process outlined by Bernd Stauss and Christian Friege, of the Catholic University of Eichstaett, Germany. First, lost customers are segmented based on lifetime value. Next, these same customers are segmented a second time, based on reason for defection. Let’s look at this segmentation process step by step.

Segment and Grade Lost Customers:

Step 1: Segmenting by Second Lifetime Value

With lost customers, the lifetime value of the terminated relationship is not as important as the value of the relationship once the customer is regained. Stauss and Friege call this Second Lifetime Value (SLTV). What if you have a file of lost customer names, but almost no additional data by which to predict SLTV? Here’s how one firm faced the same challenge and got what it needed. An optical company in the Northeast with three store locations and a database of 15,000-20,000 lapsed customers contacted us about winning back lost business. In estimating SLTV, the firm’s information about these customers was very limited. To determine future account value, we recommended these lapsed customers be contacted by phone, starting with the accounts with the most recent purchase date.

Because a customer’s reason for defection can offer valuable insight on whether or not this same customer makes a good win-back prospect for the future, Stauss and Friege have identified five distinct defector categories: (1) intentionally pushed away, (2) unintentionally pushed away, (3) pulled away, (4) bought away and (5) moved away.

1. Intentionally pushed away customers

These customers are unprofitable to serve and for that reason, the firm does little to encourage their ongoing patronage. In this case, contracts will not be prolonged or the service level will be reduced in a way that **encourages** customers **to** defect by themselves. Examples include customers who have proven to be a poor credit risk, or whose costs to serve are greater than the profits. It’s important that companies identify intentionally pushed away customers and **exclude** them **from** win-back initiatives.

The unreasonable demands of unhappy customers whose needs do not fit with the company’s capabilities can devour excessive resources and wreak havoc on employee morale. Says Southwest Airlines CEO Herb Kelleher, “The customer is sometimes wrong. We write to them and say, ‘Fly somebody else. Don’t abuse our people.’”

To manage unprofitable customers, some companies are creating sophisticated processes that match service levels to customer value. This technique can serve to 'push away' low profit customers, or at minimum, limit the costs to serve such customers. For example, when you call AT&T with a question about your long distance service, the company will route you to one of many different call centers. AT&T computers use caller ID to identify your phone number, then match it to your monthly bill. If it's high, you get what AT&T calls 'hot-towel service'---human operators who stay on the phone with you. Spend less than \$3 a month and you get no such handholding---just more automated voices. What if cut rate service drives off lower-paying customers? The company loses \$500 million a year on its 15 million to 20 million 'occasional communicators' who rarely make long distance calls yet costs plenty to acquire, bill and service. "We've gotten a lot smarter about separating the customers we do want from customers we don't" says AT&T CEO Michael Armstrong.

2. Unintentionally pushed away customers

These are customers companies want to keep, but who leave because the company's performance does not meet the customers' expectation. Some of the most commonly cited reasons by 'unintentionally pushed away' customers for why they stop buying from a supplier include the following:

- Unhappiness with product delivery, installation, service or price. A single incident is unlikely to lose a customer, but several incidents of poor quality, late delivery or inaccurate shipments may do it. A price rise may have the same effect, especially if your customer hasn't been given much advance notice.
- Improper handling of a complaint. A single incidence here can lose a customer. Someone who feels a complaint isn't taken seriously, or is dissatisfied with your resolution of it may search out another supplier.
- Disapproval of changes. Whenever companies make a change in policy, product or sales force, they risk offending some customers.
- Feeling taken for granted. Established customers, while highly valued, can be taken for granted by salespeople. This is a major error, every customer should be resold in every transaction.

Some firms have learned from the customers they unintentionally pushed away. Zane's Cycle, an independent bicycle retailer in Branford, Conn., east of New Haven had annual revenues last year of just under \$1.5 million---much higher than most bike shops. Owner Chris Zane expects that revenue will pass \$3 million this year. "From the customers we've lost that we've then been able to get back," says Zane "we've heard that they just thought we didn't care whether they came in or not. It wasn't that the price was bad, it wasn't that the products were bad---they just felt when they came in that no one really cared that they were here."

These experiences have taught Zane to look for ways to let customers know he appreciates them. One way is to offers free coffee and soft drinks to customers. "A lot of

our customers come in on Saturday mornings to have coffee, hang out for 15 or 20 minutes, read the paper, and leave,” says Zane. What’s helped Zane reduce the number of customers unintentionally pushed away is that he thinks of such customers in terms of relationships, not transactions.

3. Pulled away customers

A competitor has pulled these customers away by offering a better value advantage that often goes beyond price. Perhaps service was more personable or more reliable or product quality was higher or the product was more innovative. Studies show that often customers will switch even when the new provider is more expensive or less convenient if they perceive the overall value proposition is stronger.

A company which has created a value proposition that routinely “pulls” customers away from competitors is Price Automotive, a Toyota/Dodge dealership with two Delaware locations. Since converting to a ‘one price’ hassle free sales experience several years ago, Price has shot up to #5 in sales among the 125 Dodge stores in their zone and #17 among 134 Toyota stores. Moreover, service dollars have doubled and the dealership enjoys one of the highest percentages of customer-pay work (versus warranty work) in the U.S. Even more remarkable is the fact these solid performance numbers have been achieved without any media advertising! Says dealership general manager, Michael Price, “Our results validate that people hate to negotiate, and that happy customers really do spread the word.”

What’s the ‘pull’? In addition to a ‘frictionless’ pricing system, every customer who buys a new or used vehicle from Price gets \$1,600 worth of services over 5 years. This including 4 free oil changes, 5 free diagnostic service inspections, emergency roadside assistance that exceeds manufacturers’ limits, and mobile repair services. Says Price, “In an industry where location is king, we capture and keep customers based on ‘no-hassle’ sales and service. If anything, our location is a bit of a nuisance. We’re surrounded by industrial parks and high density housing. In fact, at our Dover location, on summer weekends, beach traffic is so heavy that you can’t pull out of our lot for a demonstration ride.”

4. Bought away customers

For ‘bought away’ customers, price is all that matters. Competitors offer to ‘buy’ these customers and offer low-ball, introductory pricing offers to get them. Defecting customers are considered ‘bought-away customers’ when these introductory pricing offers and when they are basically disloyal and open to switching providers back and forth attract them.

The lesson with bought away customers is this: Cutting price to snare such a customer is probably pointless---companies will get less money, and they probably won’t keep the customer anyway.

5. Moved away customers

For consumer-oriented businesses, these are customers who drift apart from the service provider because of either relocation or as a result of changing needs due to age, life cycle changes or and a change in geography. **At some point, these customers no longer** have continuing need for a company's services. For example, a manufacturer of women's panty hose loses customers because slacks and pantsuits have replaced skirts and dresses as the working woman's wardrobe of choice. A day-care center who loses the child because the parents buy a home in a neighboring town, or a printing company who loses a client because the regional office is closing and the printing will now be handled by corporate headquarters three states away are all examples of 'moved away' customers.

But for many companies, 'moved away' losses that were once unavoidable due to customer geography changes are now greatly reduced because of e-commerce. For example, Jennifer Dolan, a self-described "stay-at-home mom" near Boston does half her shopping on the Web. She uses the Web to get quick access to her favorite high-end retailers, that pre-Internet, weren't accessible to her. A former Californian, she missed Nordstrom Inc. after her 1991 move to the East Coast. Now she does much of her clothes shopping with Nordstrom via the Internet.

Successfully identifying and classifying lapsed customers' reasons for defection is crucial to your segmentation plan. We've examined, in-depth, the issues associated with customer loss and recovery; and we've concluded that the economic opportunity former customers represent is both impressive and largely untapped. In one instance, for example, a book club compared the marketing results from selling to an attractive list of potential customers versus an equal-sized list of former customers. They generated close to ten times the revenue from former customers over the same period of time. Most would agree: That's too good to pass up.