

IS CUSTOMER RETENTION ALWAYS THE ANSWER?

New retention marketing research¹ in relation to non-contractual businesses such as retailing is challenging long-held assumptions that it is usually more profitable to focus on retaining existing customers than acquiring new ones.

Retention marketing traditionally focuses on meeting the needs of existing customers so that you keep or expand the share of their business that you currently satisfy. The rationale behind this focus on retention is based on the assumption that long-term customers are cheaper to service, more tolerant of higher prices and more likely to recommend your product or service to new customers.

However, recent evidence suggests that while these assumptions may hold in contractual relationships, such as B2B settings or subscription services like insurance or cellular phone supply, they may prove false in non-contractual settings, such as grocery, fashion or petrol retailing, where the relationship between buyer and seller is not governed by a contract or membership.

In non-contractual settings, useful questions for marketers who want to determine what is the likely growth through retention versus acquisition include:

- How much can you feasibly reduce customer defection?
- What are the potential customer gains from acquisition?
- How easy is it to tell if a customer is a new or existing one?
- Which customers should you focus on?

REDUCING CUSTOMER DEFECTION

Annual brand defection in service and portfolio markets is around 10 to 20 per cent. How much can this be reduced? Not much in industries where a lot of the defection is involuntary. A drop in defection from 10 per cent to 5 per cent may be impossible if much of the defection is caused by moving home or other changes over which the supplier, and sometimes the customer, have no control. For example, about half of those



who change their main grocery store do so because a new store has become more accessible.

There is a tendency to forget how much consumer behaviour is controlled by the consumer's environment. Usually the environment helps sustain brand loyalty, but a changing environment can induce customers to switch brands – such as when your favourite airline changes the time of its last flight back to your home town.

GROWTH FROM ACQUISITION

There is usually more potential to grow sales using an acquisition strategy. If defection is 15 per cent a year, this is the maximum you could save through an excellent retention strategy, whereas, acquisition is limited only by the pool of potential new customers.

According to AGSM marketing professor Grahame Dowling,² almost by definition there tends to be no large niche players, and the way to become a big brand is to gain more buyers. In mature markets, these new buyers come from the defection losses of the other brands.

For example, if all brands were to

suffer a 15 per cent defection in a year and your brand had 1 per cent of the market, you could gain 1485 per cent if it was possible to gather up every other brand's defectors. Of course, this is generally not feasible, but in rare cases the share gain from recruitment can be dramatic. For example, Levi sold 20 times the number of 501 jeans in the UK in 1987 compared with 1984, mainly as a result of an extremely effective advertising campaign.

It is important to remember, however, that the Levi example is an exception to the rule – particularly in relation to allocating promotional spending

between acquisition and retention. It is well documented that price promotions mostly encourage purchasing among past customers of the brand (rather than new customers). Similarly, advertising operates mainly on current and past customers in established markets, which means advertising serves to remind buyers of their current purchasing preferences. Thus, much of the spending on advertising and promotion influences retention, not recruitment, and should be allocated to the retention budget.

IS THAT CUSTOMER A NEW OR EXISTING ONE?

How do you know whether a particular sale is to a new or existing customer? This distinction is fundamental to the calculation of customer retention and customer lifetime value and yet, in many markets, it is problematic. In subscription markets, such as electricity, car insurance or mobile phone subscription, the distinction is relatively simple – customers who renew their subscription with you are retained customers and new customers have either switched from another brand or are new to the category. However, in



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many non-contractual or 'portfolio' markets, customers have a number of brands that they are willing to purchase and they choose from among these brands on a specific purchase occasion.

In portfolio markets, it is less easy to classify customers into those whom you have retained and those who have defected. A Shell petrol buyer in April may be defined as 'old' if she bought in March and 'new' otherwise. But most 'new' petrol buyers are just light or infrequent buyers; they are not necessarily new.

The classification of a customer as new, retained or recovered will also change with the interval used for collecting data. For this reason, the classification of customers in portfolio markets requires quite long series of transaction data.

WHICH CUSTOMERS SHOULD YOU FOCUS ON?

Customer-to-customer recommendation

Recommendation is the most common way that customers find a new brand or supplier and should be encouraged.

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Recommendation is higher for recently-acquired customers for two main reasons:

- new customers are more interested in the product and more likely to have researched it and discussed their purchase with family and friends; and
- long-term customers may have once recommended your brand but, as time passes, they run out of people to recommend it to.

Recently acquired customers

If you are setting up a retention marketing program, recently acquired customers merit special attention because if they have switched to your brand from another they have demonstrated they can defect and will be more likely to do so again. For example, in the cellular phone market it has been found that when equally satisfied short- and long-term customers confront

a service failure, the long-term customers are less likely to defect. The explanation is that long-term customers can offset one failure against a longer history of good service, whereas recent customers lack this comparison and may conclude that poor service is typical. Thus, depending on their spending level, if all customers have been subject to a service failure, there is a case for giving most attention to the new customers.

New-to-the-category buyers

Real recruitment occurs when customers are new to the category, such as students getting their first bank account, first-time parents buying nappies or couples setting up home together and choosing a supermarket. In many markets, suppliers try to give this type of buyer extra attention because they are likely to become more profitable over time. However, their attraction as customers varies with initial spending, induction cost and retention rate. For example, first-time parents require considerable acquisition spending but are substantial buyers while they stay. Students are expensive to enrol and their accounts usually make a loss at first. If they switch while still a student they could be a poor acquisition. New recruits to supermarkets impose no initial costs on the store and can give some profit immediately. The point of these comparisons is to demonstrate that the profitability of new-to-the-category buyers will vary, depending on the category, and generalisations across

categories are not very useful.

Brand switchers

How valuable are potential customers who have switched brands or stores? There is evidence that switchers buy less, certainly at first, than existing customers. They may also be unattractive customers because, on the basis of past behaviour, they seem more likely to defect than established customers. In addition, if you don't target them more effectively than your competitors, the switchers you acquire from a competitor will be similar to the ones who have defected from your brand. In portfolio markets, unless your targeting is better than that of your competitors, the choice is between spending money to either retain or acquire low-loyalty customers. New customers should be compared with the ones you lose and, in the absence of superior targeting, these two groups will have the same spending patterns.

In summary, companies looking for future growth (especially in non-contractual settings) should remember that acquisition will come about as a result of treating all customers as well as possible. By spending more on improving your core product, service and communications (within budgetary constraints), your current customers will have no pressing need to defect. More importantly, they will also help you to grow through recommendation and referral. 🌟

Dr Kathy Hammond teaches the popular Retention Marketing executive program at the AGSM, which will be offered again later in the year. She is also director of the London Business School's Future Media Research Program.

FOOTNOTES

- 1 W. Reinartz and V. Kumar, 'The mismanagement of customer loyalty', *Harvard Business Review*, vol. 80, no. 7, p. 86, July 2002.
- 2 Grahame Dowling, 'Customer relationship management: in B2C markets, often less is more', *California Management Review*, vol. 44, no. 3, pp. 87-104, Spring 2002.