synpulse
solve · evolve

Effective churn management — Defining measures means understanding motives

Actively Counteracting Customer Attrition

No provider likes losing customers with a high customer value. In order to avoid this, providers must first understand what drives customer attrition. For the most valuable customers, event-oriented factors generally have the most influence on a high exit probability. When considering the appropriate measures, it is essential to weigh up how problematic these events are in order to select a material or immaterial approach.

Berno Ullings | Dr. Michael Hartmann

The term «Churn Management» first became a topic of discussion in the April 2007 issue of SOLUTIONS. There, we explained how churn customers can be identified and classified. Based on this segmentation, we will now demonstrate which steps can be taken to actively prevent churn.

To remind you: Churn is an artificial word that combines the terms «change» and «turn». Essentially, churn refers to the switching of a customer in favor of a competitor. The churn rate refers to the number of customer losses in relation to the total customer base. As with the segmentation of existing customers by actual or potential characteristics, customers can also be categorized on the basis of the characteristics of customer value and exit probability.

As a result, four churn segments were identified: (1) «loyal petty bourgeois», (2) «terrorists», (3) «cash cows» and (4) «problem children». In the measures catalog, a particular emphasis is placed on problem children.

Understanding the drivers of customer attrition

Problem children are characterized by a high customer value, but also by a high exit probability. In order to draw up specific packages of measures to prevent these customers from withdrawing their custom and, therefore, attrition, it is essential to determine the drivers which can be critical to customer attrition.

Typically, from the service provider's perspective there are both internal and external factors involved (1). In terms of the internal factors, the question of how the provider appears to the customer arises. It is possible to identify three different types:

Forced Churn: In the case of this attrition type, negative communication emanates from the provider. In the insurance sector, this might involve the rejection of a certain type of insurance cover resulting from an unfavorable risk assessment. Similarly, in the banking sector, it could take the form of a rejection of a credit increase, for example. In such a situation, the applicant is driven to enter a business relationship with a different service provider if at all possible.

Induced Churn: Communication toward the customer does not necessarily need to be negative in order to provoke attrition. On the contrary, it is often caused by passive communication with the influence of indirect control factors. In contrast to the quick exit that takes place with a forced churn, a time delay is to be expected with an induced churn. The termination of a business relationship may be beneficial to a provider if the relationship does not generate the required profitability, and attempts to increase the profitability through cross-selling activities were not successful. An example from the insurance sector is the tariff system of motor vehicle insurers. In the banking sector, an induced churn for accounts with low deposits of capital and few transactions may be influenced by a tiered administration fee (the smaller the capital, the higher the fee).

Planned Churn: This final type of attrition is based on a mutual agreement regarding the duration of the customer relationship. Although this arrangement may appear rather incongruous at first glance, it is particularly prevalent in the banking sector, e.g. in the financing of consumer credit. In contrast to the two attrition types listed above, which can be controlled actively, this attrition type can only be controlled passively.

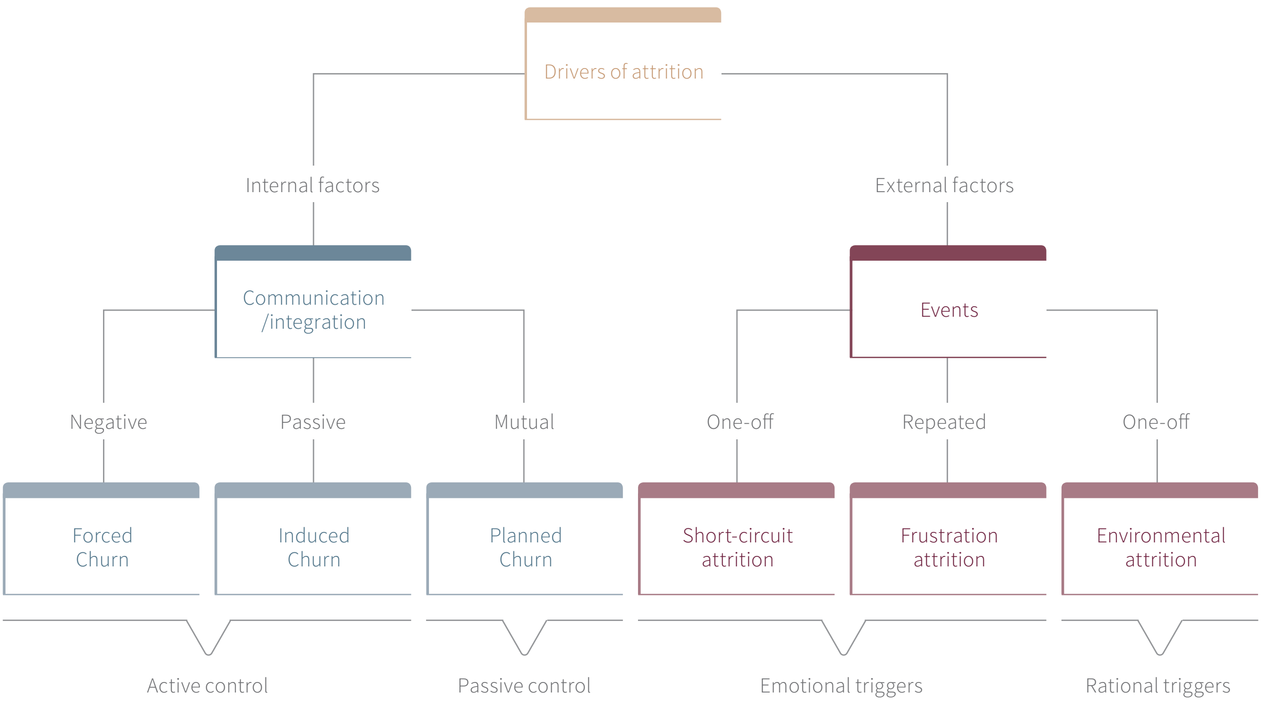
It is influenced not only by internal factors, but also by external factors — in the form of events. Depending on how these events occur, it is possible to identify three different patterns:

Short-circuit attrition: The trigger for the attrition is a one-off event that causes an emotional reaction where the customer wants to terminate the relationship with the service provider as quickly as possible. Such an emotional event is frequently associated with the processing of claims in the insurance industry. However, something as simple as unfriendly service from a bank teller or customer service agent may also act as a trigger.

Frustration attrition: Similarly to the short circuit attrition, this type of attrition is also predominantly emotional in nature. However, the trigger is not a one-off event, but a continuous sequence of small, negative events which build up and cumulatively lead to attrition. Customers lost to frustration attrition are frequently in intensive contract with the service provider via the complaints management system.

Environmental attrition: This final type of attrition may encompass a number of different events. Typical for all these events are influences on the customer‘s environment — predominantly in the form of competitors‘ offers. Changes in the personal situation, e.g. due to spatial or financial changes, may serve as additional influences with a critical effect on attrition.

Another possible driver of attrition is additional know-how in the form of further training or new personal contacts, provoking the first thought of attrition. In contrast to short-circuit and



Source: Diagram by Synpulse, based on Michalski (2005): NDS Private Banking & Wealth Management 02/04

1: Drivers of attrition

frustration attrition, environmental events provide a rational justification for attrition.

Looking at the problem child churn segment, it is evident that the internal factors do not generally come into question as drivers for attrition. This is because the customers in question are attractive clients whom we do not intentionally want to lose. The approach to the planning of measures must therefore focus primarily on the event-driven factors, as well as taking account of both emotional and rational events.

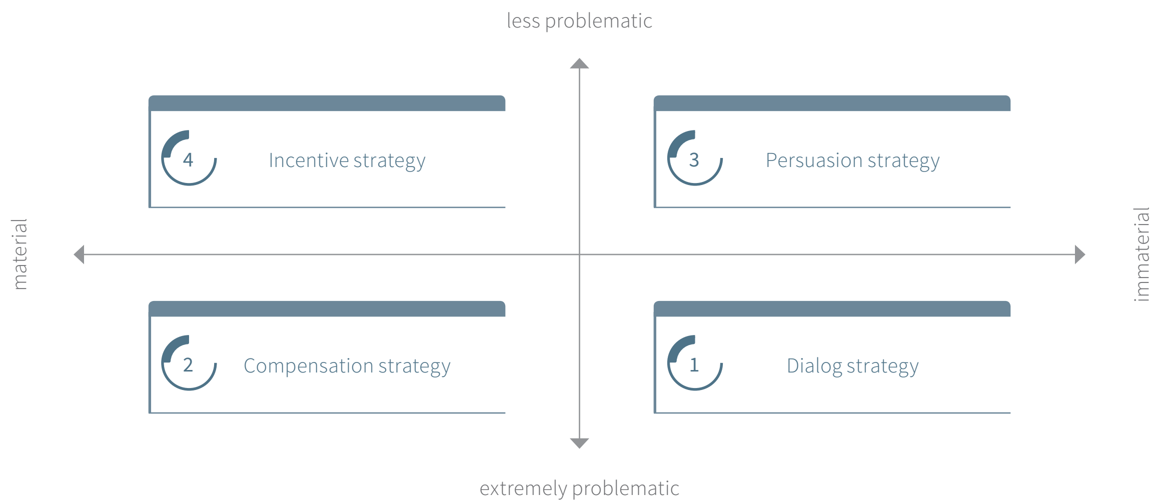
Developing handling patterns and strategies

As described above, exits with emotional triggers can usually be traced back to one or more problematic events. Customers who demonstrate a high exit probability and have been assigned to the emotional category can be handled using two strategies (2): (1) As long as the event is considered less serious, a dialog strategy can be employed, which seeks to discuss the event with the customer and offer improvements. This does not result in the customer being materially compensated. This is in stark contrast to the compensation strategy (2), which is usually employed in the case of a one-off serious event.

The disruptive event is also discussed with the customer. In addition, the customer is offered compensation as a way of making amends for poor service or any damage that has occurred. An example of such compensation might include the free expansion of insurance coverage for a certain period of time or the retroactive waiving of legal fees incurred in the banking sector. The important distinction from other strategies is that this compensation represents a voluntary, one-time offer.

In addition to customers who are at risk of leaving for emotional reasons and who can be identified by a certain level of dissatisfaction, there is an emphasis on those customers who are at risk of leaving due to environmental influences. Here, too, it is possible to differentiate whether a customer should be addressed using a material or immaterial approach in order to prevent the customer from leaving. With the persuasion strategy (3), the customer is urged not to leave by means of benefit arguments and comparisons with competing offers. This strategy is employed when a customer is entertaining thoughts of seeking comparable offers, but is not sure whether they really want to switch providers. Finally, however, the incentive strategy (4), which offers specific advantages in addition to the existing benefit arguments in terms of special conditions, is much more effective.

All four strategies can be pursued in parallel. Dialog and compensation are more suitable for customers who are impacted by emotional events, while persuasion and incentive are better suited to customers with events of a rational nature. Depending on how aggressive the handling measures should appear, either the immaterial- or material-based strategies are applied. Finally, 3 provides an overview of the various possible instruments that can be used, depending on the strategy.



Source: Diagram by Synpulse, based on Michalski (2005): NDS Private Banking & Wealth Management 02/04

2: Handling strategies

Example application and benefits

A selection or combination of these strategies can now be concretely applied to the above-mentioned problem children segment. As a fictitious example, a small insurance company wants to tackle the issue of churn for its car division (see 4 for an example from the banking sector). The company would particularly like to pursue the incentive strategy more intensively. On the one hand, a crucial factor is the finding that the general service quality and specifically, the satisfaction of the customers with the claims process, are above average in comparison to the market.

On the other, it is evident that the increase in churn rate is being driven by external factors. The following were identified as such:

1. The introduction of the revised Insurance Contract Act (VVG), which provides for a premium reimbursement pro rata temporis in the event of a termination prior to the expiration of the contract;

2. A trend toward shorter contract periods combined with a termination right applicable on a month-to-month basis, and

3. High price pressure triggered by the increase in online comparison portals to which the tariff calculator of the insurance company has not yet been connected.

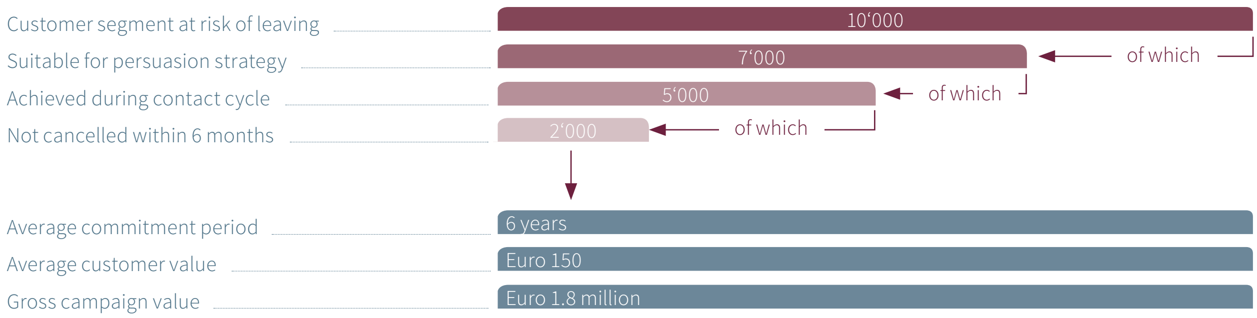
The incentive strategy now consists of the following package: The policyholders in the problem child segment, with the exception of leasing customers, are offered a state-of-the-art portable navigation device worth approximately CHF 450 for use intheir vehicle. In return, the insurance contract is extended by at least three years, whereby the right to a premature termination outside of the statutory requirements is waived. In addition, the insurance company is obliged to adjust the premium on an annual basis and not to exceed the market average in doing so. This package counteracts all three of the external factors mentioned above. The package is financed directly and indirectly. In the problem children segment, the average

Strategy/instruments	Dialog	Compensation	Persuasion	Incentive
Service	Review of service packages	Vouchers for services Voluntary settlement	Product catalog Objective service comparison Clarification of requirement vs. demand	One-time gift Increased coverage Higher no-claims category Preferred customer Individual offer
Communication	Personal contact meeting	Upgrade to VIP customer	Open day Customer events Magazines	Inclusion in user group Personal contact person
Price	Review of conditions	Waiver or reduction of fees	Price comparison Cost-benefit analysis	Individual discount Bearing mutation costs Free account management
Distribution	Explanation of technical restrictions Disclosure of personnel changes	Free use of certain channels	Multi-channel approach	Change of agent Change of branch Access to additional channels (e.g. market letter etc.)

Source: Synpulse

3: Instruments for handling strategies premium volume is approximately CHF 2‘200, which is well above the general average of CHF 1‘050 per vehicle.

The high premium volume can be justified by the high customer value that characterizes this segment. At a gross combined ratio of approx. 93% (claim ratio and cost rate), each policy generates around CHF 160 per year. As a result, the incentive package is directly financed, if only just. Due to the increased customer loyalty, additional capacity for new customer acquisition becomes available. This enables further growth and therefore contributes indirectly to the financing.



Source: Synpulse

4: *Benefit calculation for a churn campaign at a German bank*