Customer Strategy Report

CUSTOMER RETENTION

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By **Terry Sullivan**

www.6ToFix.com

Introduction

Profitable Growth from Existing Customers

In the early 90s, I started my first business, and had the very good fortune of selling the business six years later. It was a real-life lesson in the importance of *customer retention*. The customer base was profitable, loyal, provided referrals, and represented consistent annual recurring revenue. There is always a market for a valuable business.

Key Take-Aways in this e-book

This e-book was designed to be a quick read with the following key take-aways:

- Why Customer Retention deserves its own strategy
- Why selling to existing customers is often more profitable
- Why growing a company on new business alone is problematic

It is estimated that only 1 in 10 small businesses is worth purchasing. A key challenge and expense in any business is acquiring customers. As the saying goes, "The best customer is the one you already have."

Most business owners and managers are focused on two major things: growth and profitability. However, the battle for growth and value is often focused on acquiring new customers. Why is that?

Are new customers the proverbial “shiny new object”? Is a new customer “better” because they are perceived as potentially larger, more profitable, or have less baggage than a current customer? Perhaps, a new customer doesn't know our own shortcomings?

Or is it because customer retention is hard to define and even harder to do? Growing and preserving a relationship is often more difficult than establishing a new relationship.

"…in industry after industry, the high cost of acquiring customers renders many customer relationships unprofitable during their early years. Only in later years, when the cost of serving loyal customers falls and the volume of their purchases rises, do relationships generate big returns. The bottom line: Increasing customer retention rates by 5% increases profits by 25% to 95%."

- Frederick F. Reichheld, Author of "Loyalty Rules! How Today's Leaders Build Lasting Relationships" and creator of the Net Promoter System (NPS).

Top 10 Benefits of Selling to Existing Customers vs. New Customers

Existing customers are:

1. More likely to make a purchase

2. Likely to purchase more of what you offer

3. More profitable (each sale, and over the term of relationship)

4. Less price resistant

5. Less expensive to service

6. Faster to closer

7. Quicker to pay

8. More loyal

9. More likely to provide testimonials

10. More likely to provide referrals

To learn more about Customer Strategy and the 6 To Fix Marketing Strategy Framework for your small business, please visit www.strategicglue.com or email info@strategiclgue.com.

1. Customer Lifetime Value (CLV)

Business Smarts

Customer Lifetime Value (CLV) is the value of a customer over their "lifetime" of doing business with you. For example, if a customer spends $50 per month for one year, their "One-Year CLV" is $600. The important thing to consider is how much a customer will contribute to the business over time…and at what cost.

"Customer profitability increases over the life of a retained customer."
- Leading on the Edge of Chaos, Emmet Murphy and Mark Murphy

How Much You Make Determines Your Spend

CLV and Customer Acquisition Cost (CAC) work together, and help determine how much you *should* spend on a new customer. Without knowing your average customer worth, how can you know how much to spend on acquiring new customers? Or how much to spend on servicing existing customers?

For example, spending $300 to acquire a new customer might make perfect sense if that customer spends $30 per month for two or three years. However, if that customer is active for only one year, it does not make sense to earn $360 on a CAC of $300 – you are likely losing money after cost of good sold and service costs are deducted.

Marketing and Sales Costs

Two of the biggest costs to many organizations are Marketing and Sales. And when it comes to fourth quarter budget slashing, Marketing is typically the first on the chopping block.

Customer acquisition and customer retention costs as well as customer growth expectations are all affected by and potentially impact CLV.

After all, if Customer Support finds a new way to service customers that is more efficient and effective, that can positively impact CLV. Or if Marketing develops an on-boarding program that results in more revenue and profitability per customer in less time, CLV will be impacted, and the break-even period on the costs associated with acquiring new customers may change as well (see Chapter Two).

Know Your Numbers

Many companies know what their customers purchase, and perhaps, some demographic and geographic info as well. But many do not know what their customers are worth to the organization over time.

CLV provides a baseline against which acquisition costs can be measured, but also a dashboard for the internal team to improve that customer relationship leading to more revenue, profitability, loyalty, and brand advocacy.

Sticky Thought: Know the Lifetime Value of your Customers.

2. Customer Acquisition Cost (CAC)

How Much a New Customer Costs

New customers are an important part of growing a business. But, at what costs - financial, opportunity, and otherwise?

“It costs 6 to 7 times more to acquire a new customer than to retain an existing one.”
- Bain & Company

Do You Know Your CAC?

Customer Acquisition Cost (CAC) is a commonly overlooked metric in many businesses. In fact, a sale to a new customer is usually considered such a “win” that the costs of getting that sale are often ignored or simply unknown.

Let’s say it costs your business $300 to acquire a new customer including sales and marketing costs. Depending on industry, gross margins, etc., that might be an acceptable acquisition cost, but it may not be - the point is that you need to know. But, without knowing what a customer is worth to the organization (Customer Lifetime Value), the CAC number is arbitrary.

Breaking Even

As a rule of thumb, most companies want to to break-even on the cost of acquiring a new customer within one year. However, all industries and companies are different; again, the big thing is to know the numbers. If it takes too long to break-even and profit, the CAC might be indicative of other problems like the business model, pricing, sales and marketing efforts, or training and implementation, among others. Any of these issues could likely lead to cash flow and other organizational challenges.

It is difficult to understand the following without knowing the CAC: time needed to recoup the customer acquisition investment relative to customer revenue break even and profit; optimal sales and marketing spend relative to customer recruitment; and the list goes on and on.

CAC and CLV are related numbers that every business should know in order to achieve smart and profitable customer relationships.

What CAC Can Tell the Organization

In cases where CAC is low and CLV is high, profitability is likely high, but likely at the expense of the company forfeiting market share versus profits. In other words, the company may consider investing in more customer acquisition to build more market share.

On the other hand, if CAC is high and CLV is low, the result is likely a long break-even period, and an even longer road to profitability. Multiply this scenario by each customer, and cash flow is likely negatively impacted, along with other issues. High CAC/low CLV may be fueled by inefficient/ineffective sales and marketing; costly training and service; among many others.

Important KPIs

CAC and CLV are critical KPIs that provide insights not afforded by broader success metrics like Revenue and Profit. Additionally, CAC and CLV inform businesses where and how to make changes for improved customer and company performance.

Sticky Thought: Know your customer acquisition cost.

3. Share of Customer

Maximizing Relationships with Existing Customers

Sales to existing customers are often more profitable than new customer sales, as there is a cost reduction in each additional sale.

"Customer loyalty can be worth 10 times as much as a single purchase."
- White House Office of Consumer Affairs

Share of Customer, Profitability

New Customer Example:

Customer Acquisition Cost = $300

Sale to Customer: $300 ($150 gross profit)

$300 CAC + $150 COGS - $150 Profit =

Total loss = $300

Existing Customer Example:

Customer Acquisition Cost = $0
Sale to Customer: $300 ($150 gross profit)

$0 CAC + $300 Sale - $150 Profit =

Total Profit: $150

Current customers are more profitable because the CAC savings goes to the bottom line on each additional sale. Sure, it's not "free" to sell to existing customers, but it is typically much cheaper.

Increase the share of each customer by selling additional products and services or extending the duration in which they do business with you.

Sticky Thought: Profitable sales add up to a valuable business.

4. Growing Relationships

Existing relationships are worth growing.

Existing customers are usually easier to sell yet the majority of time and effort in marketing and sales defaults to winning new customers. Why? Maybe companies don’t know how to grow current customers; or new customers might be seen as "better." Or maybe it's the "shiny new object" of winning those new customers who represent renewed hope, optimism, and less baggage.

“There is a 5% - 20% probability of converting a prospect into a new customer, but a 60% -70% probability of selling an existing customer.”
– Marketing Metrics

A Better Way to Growth and Profitability

In a recent HubSpot “State of Inbound” report, B2B and B2C marketers placed nearly no priority to modest priority, respectively, on gaining more sales from existing customers.

Why not sell additional products and services to existing customers? What better way to reinforce a customer’s initial purchase decision or demonstrate that you are still "relevant"?

Sticky Thought: Your best customer is the one you already have.

5. Growing Your Company

People focus versus product focus.

Whether you plan to grow your company well into the future, or have an exit strategy to sell the business, growth and value equate to customers.

"A 5% reduction in the customer defection rate can increase profits up to 95%."
- Bain and Company

Essential for Growth

Repeat purchases are essential because growth from new business alone is expensive and time-consuming with high

opportunity costs (the forgone alternative - what you could have otherwise pursued with available time, money, and resources).

The Proverbial Bucket: Reduce the Churn

Many of us are growing customer bases by continually putting new customers in the top of the "bucket." Unfortunately, there is often a hole in the bottom of the bucket where existing customers slip out–otherwise known as customer "churn."

Assume your customer churn rate is 20%, and you lose 200 customers per year. Also assume, customers spend $300 each year with a $150 gross profit on each sale.

Reducing the churn rate by just 10% would yield:

$6,000 in revenue (20 x $300) and $3,000 in gross profits (20 x $150)

Now, let's assume you gained 20 *new customers* with a CAC of $300, and their initial purchase is also $300 with a $150 gross margin.

You would spend $6,000 CAC (20 x $300) on getting the new customers and would earn $3,000 gross profit (20 x $150) on the initial sale. But, you actually *lose* money: $3,000 gross profit - $6,000 CAC = $3,000 loss.

Finally, imagine you could make additional sales to 20 *existing* customers (a $300 sale with a $150 gross profit).

20 x $300 = $6,000 - $3,000 COGS = $3,000 profit

Finally, if you add in the "savings" associated with selling existing customers and avoiding the CAC expense, there is a "savings" of another $6,000.

Keep and Grow What You Already Have

The previous examples demonstrate that sales to existing customers are more profitable because the CAC is already a sunk cost. Each incremental sale continues to be more profitable and usually in a shorter amount of time than selling a new customer. There is considerable motivation to retain and grow current customers because of the CAC savings.

As previously mentioned, servicing and selling existing customers is not "free" but typically more profitable.

Sticky Thought: Plug the hole and keep more customers.

6. Growing Your Value

Being the relevant choice for your customers.

The 80/20 rule dictates that 80% of business comes from 20% of your customer base. Perry Marshall, noted marketing author reveals in, "80/20 Sales and Marketing" that the 80/20 concept can be magnified even further to 90/10 or even 95/5 revealing that literally just a few customers are actually worth exponentially more than ALL other customers combined. These are the customers who can really help grow business value.

"80% of your company's future revenue will come from 20% of your existing customers."
- Gartner Research

Staying Even Isn't Profitable

Let's say in five years, you want to sell your business. A company with active and profitable customers makes a business valuable. If you gain a new customer for each lost customer, you are not "staying even" - you are actually losing money because of lower margins due to the expense of acquiring new customers versus making multiple profitable sales to existing customers.

Sticky Thought: Customer retention isn't just about more sales–it's about profitability.

7. Customer Experience

A great customer experience breeds retention.

Customer experience is much more than a sale. Customer experience retains and grows profitable customers. But retention requires *intention*.

"About 4% of dissatisfied customers complain. 96% just go away."
- Harris Interactive, 2011 Customer Experience Improvement study

Keep and Grow What You Already Have

Customer retention benefits include growth, profitability, and loyalty. We make substantial investments in acquiring new customers, so why don't we invest in keeping and growing the customers we already have?

Investing in existing customers means investing in the Customer Experience. If we educate, motivate, and inspire existing customers, they will become better and more profitable customers. And they will become brand advocates spreading the good cheer to others, resulting in better qualified, more profitable sales in less time versus prospecting for new business.

Great service, loyalty/frequency programs, education, training, and onboarding are just a few ways to improve customer experience. Products and services are often easy to replicate; a stellar customer experience offers significant competitive advantage.

Sticky Thought: Customer Experience begets Customer Retention.

What Are Your Challenges?

Most businesses face similar challenges. The 6 To Fix Marketing Strategy Framework focuses on six key strategy areas that marketing can and should affect to foster small business growth and value creation.

Let's talk about your business challenges!

Visit strategicglue.com or email info@strategicglue.com.

About the Author

Terry Sullivan is the owner of Strategic Glue, a marketing consultancy that focuses on helping small and mid-size companies with marketing strategy that fosters business growth and value creation.

With 30 years of marketing experience as an entrepreneur, consultant, and corporate executive, Terry has started several small businesses (including the successful sale of his first company), worked for a variety of small and large companies, and consulted with a vast array of clients in numerous industries.

An Adjunct Professor in the School of Communications and the School of Business at Webster University in St. Louis, Missouri, Terry develops and teaches a wide variety of marketing-related courses. He studied English and management as an undergrad and has a master's degree in International Business from Saint Louis University.

Terry resides in St. Louis, Missouri, and is married with two sons. He enjoys songwriting, movies, reading, exercising, and occasional skateboarding.