Why could ‘frustration churn’ be costing you over 15% of the potential value of your business?

How to reduce operating costs and improve long-term profitability by eliminating the root causes of ‘frustration churn’

If you lost 1-2 pints of blood your doctor would be worried and so would you. And yet many businesses still lose around 15-20% of their customers each year almost without noticing. While many organisations put this down to competitor activity (mainly price and sales promotions), **in our experience around 40-60% of customer churn is due to internal factors under your direct control** that relate to the experience customers have of consuming your products and services and the experience they have interacting with your organisation (that is your people, processes and systems).

Losing customers is painful, but worst of all is losing your most valuable customers. **Depending on your industry sector, the top 10-20% of customers contribute from 50-90% of the total value of your entire customer base.** So if you loose these customers, this can be a significant threat to your profitability and cash flow. For those readers who’s main interest is in determining the potential shareholder value impact of strategies, and are wondering **how a concerted ‘Frustration Churn Elimination’ programme could possibly increase their enterprise value by over 15%** then they should skip down to the Shareholder Value calculation (Page 7) – and don’t forget to come back to read the rest of the article on how they can do it.

What is ‘frustration churn’?

We describe the phenomenon of customers who have chosen to leave you for your competitors as a result of their disappointment with your products and services (and their experience of how you provide them to them) as ‘frustration churn’. Examples of ‘frustration churn’ include billing errors, the product or service doesn’t work reliably, the customer delivery arrived too late or the customer had a poor experience when interacting with your business (people or systems).

What’s the profit impact of neglecting ‘frustration churn’?

There are a number of areas where neglecting ‘frustration’ churn can impact your P&L severely. These include:

i) First and most obviously is the loss of customer lifetime value of the customers that have left your business. Many businesses just take these losses as a fact of nature, executives say let’s just do more acquisition marketing in order to keep the customer numbers steady. A financial analysis by Frederick Reichheld (see Zero Defections Comes To Services – by Frederick F. Reichheld and W. Earl Sasser, Jr. HBR September 1990) calculated that **a 5% reduction in overall churn rates would increase the your customers’ lifetime value by up to 25-85%** (see the article for the full arithmetic and examples from different industries).

ii) Secondly, there is the cost of the additional acquisition marketing to keep the customer numbers from falling. Financial markets seem to hate to see your revenue numbers fall. Acquisition marketing spending (covering

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sales, marketing, advertising, distribution channels) can consume 10-25% of many businesses cost structure. Much of this spending is to acquire new customers to make up for customers that are choosing not to do business with you. In a B2B context, it can take years of effort and hundreds of thousands of dollars to acquire and develop your most valuable customers; it's a damned shame to lose these customers because it's going to take you a lot of time and effort to replace them.

iii) And finally, perhaps this is the secret you should share with your CFO. I've seen clients struggle for years with process improvement and cost reduction programmes that ultimately yield little or no benefit to customers or the P&L. Focusing on eliminating the root causes of the principal reasons why customers defect is one of the very fastest and most effective cost reduction techniques that I've seen in business. Typically, I've seen businesses taking this approach are able to eliminate 10-30% of cost within 30-90 days within a specific business unit (clearly rollout across the whole business takes somewhat longer). I'm not saying it's easy, in the sense that this level of performance improvement requires cross-functional teams and co-operating which gets more difficult as the size and complexity of your organisation grows. Nonetheless, if you can mobilise your project teams, then 10-30% cost reduction is readily attainable in the specific processes that you set out to improve.

Example: We worked with a technology company to help reduce churn and reduce operating costs in one of their service operations functions. They focused on identifying the root causes of churn and poor customer experiences that could be readily fixed and then eliminating them. **The result: They improved their customer experience substantially by eliminating process defects reducing customer churn while reducing operating costs by 28.5% (€5.6 million annual saving) in the operating unit involved.**

Why does 'frustration churn' build up over time?

I don't know what it is about growing older, but somehow it's all too easy for all those delicious meals to cause your waistline to keep widening and more worryingly layers of cholesterol to build up in your arteries. Left unchecked, it's not a great outcome on a personal level as you can end up with a heart attack. In a similar manner, slowly but surely, over time most of your business processes get ever more complicated. As they grow more complex, your operating costs on key processes continue to creep up continuously putting your operating budgets in ever more pressure (ask your CIO or VP Operations to comment on how this feels). That's bad for budgets and your margins, but even worse this complexity becomes the source of ever more opportunities for failures to occur in the 'customer experience' ultimately causing your customers to defect due to 'frustration churn'.

What's worse than 'frustration churn'?

Now if you are in financial services or retail, customer cancellations and defections may be invisible to you. In a retail environment, it may mean customers start shopping less with you and reduce their basket sizes. Unless you are running a sophisticated customer management system like Tesco's Clubcard this level of defection may be invisible to you (a good reason if you are a retailer to introduce something similar to manage your customer assets more effectively). Even worse, is the situation in financial services where instead of just cancelling or closing their accounts, customers instead reduce the balances on their accounts. In these situations, you don't see a cancellation directly, but you do get to see a negative profit impact as once profitable customers become unprofitable customers that you then have to carry within your business. Overall, the value destruction impact of those who reduce balances can be 5-20 fold that of those that just close their accounts completely.

How can you measure 'frustration churn'?

The most obvious method of measuring 'frustration churn' is to collect the cancellation reasons of customers when they come to cancel or significantly reduce their business with you. The Telecoms industry is more active than most in measuring customer churn (particularly for mobile phone contracts and Internet contracts). The data is somewhat inaccurate, sometimes the customer doesn't give a completely truthful cancellation reason (particularly when faced with a stubborn customer service representative who seems very reluctant to process the cancellation) and other times limitations in the call centre systems (or web based systems) lead to an inaccurate reason code being taken. However, the greatest danger I've seen is that inaccuracies in the data capture process end up as being used as reasons (or perhaps more accurately rationalisations) as to why the organisation should not take action on the cancellation data. I've often heard the phrases 'facts are friends' and 'you should never put lipstick on a pig' in organisations that then decide to completely ignore the invaluable feedback and insight that comes from understanding their customer cancellation data.

Now not all organisations have the luxury of having useful cancellation data. In these circumstances, you can fall back to using 'customer experience' data that's collected on key 'moments of truth' with customers. And worst case, if this is unavailable customer complaint data is a great fallback. If the complaint data is not in a database, just collect as many complaints as you can and sit down and do a simple 1 day complaint analysis exercise (it's always worth phoning a sample of these complainants personally to get some qualitative colour and depth on what's actually going on from a real live customer basis).

So why does 'frustration churn' arise in the first place?

I guess at a human level, nobody's perfect. Though for air traffic controllers thankfully their systems are a great deal safer and more reliable than 'Six Sigma' perfection would require (thankfully less than 3 in a million flights end in a crash). So it's down to us to make our processes more reliable. The most frequent reason I see 'frustration churn' being baked into business processes from Day 1 is the rush to hit delivery dates. If you are running a high profile product launch or 'big ticket' IT project, the most obvious failure is to be late. So sadly, in too many occasions this means at the end of the project in the rush to hit the implementation dates, it's an all too frequent issue for Operations folks to find the product/ process/ system is thrown over the fence on implementation day for them to manage the 'teething problems'. In future this may become known as the 'Terminal 5' syndrome (after the fiasco at Heathrow Airport where the new terminal was opened before the baggage systems were ready) ending up with over 10,000 passengers losing their bags on the day of opening. Now typically (Terminal 5 excepted) you can expect the showstoppers to get fixed. However it's a rare organisation in my experience that gets around to enhancing its new business process post launch to take out 30-50% of the excess costs and the root causes of customer frustration. More typically, a sub-optimal process that works somehow is left in place after Day 1, and then in the coming months and years the business process performance slowly deteriorates through growing complexity.

Frustration churn – easy to eliminate in theory but is it much harder in practice?

There's an old song that goes ***"everyone wants to go to heaven but nobody wants to die."*** Eliminating frustration churn is simple in concept but to be most effective it does depend on cross-functional working and co-operation. Typically in our experience of large complex organisations, the root causes of perhaps 80-90% of frustration churn arises either upstream of the customer facing functions that are held accountable for service delivery or from the business rules that define the process concerned (and it's unclear to most people who originated or controls these business rules anymore).

Now cross-functional working may be completely impossible, or just extremely difficult, within your organisation. In these circumstances, I'd say that why don't you just spend a little effort improving what you can. This could still give you an operational productivity improvement of 1-3% that is within your reach. As you start to gain traction, others may rally to your cause.

Why not set yourself a target to see if you can get one or two of your senior colleagues and a small team of folks from across sister departments or functions involved, then you can make some serious headway. A small team, with a little bit of data analysis, thinking and planning can achieve some remarkable results. I've seen a roomful of ambitious folks at mid-levels in their organisation (without having to get CEO sponsorship) develop and implement process improvements that saved their organisation over $10 million within 90 days.

Example: Andy Homer (Group Chief Executive - Towergate) has grown Towergate to be worth over £3 billion ($6 billion USD) in 5 years by applying these techniques. It's now Europe's most valuable privately owned insurance company. Hear what Andy has to say on the impact of these approaches by going to: **http://www.closequarter.co.uk/Interviews/Andy%20Homer%20on%20customer%20value%20creation.mp3** or at TinyUrl: **http://tinyurl.com/6j4pfb**

It's easy for your attention on be focused solely on the competition

When I ask senior executives why they are losing revenues and their most valuable clients, they usually focus on comparisons of their business with competitors and give explanations of competitor activity at best undermining their margins and their revenues and at worst 'stealing their customers'. In a future article, I'll discuss losing customers to competitors because of their perceived stronger offers that we describe as 'comparison churn'. The downside of focusing overwhelmingly on competitors, whose actions are not directly under your control, is that you end up ignoring the 40-60% (in our experience) of customer defections that are caused by things your business does (or fails to do) that are under your control that lead inadvertently to you ruining the 'customer experience' of your products and services.

What are 5 quick tips that you can use now to reduce 'frustration churn'?

i) **You can't keep all of your customers forever, however you can actively manage and reduce your loss of valuable customers.** You should put in place systems and processes that allow you to understand why customers are leaving you, what they think about the customer experience that you are delivering to them. With this insight, you'll then know what you need to do that will increase customer loyalty and minimise customers going to your competitors.

ii) **Keep your monitoring systems simple and make sure they provide rapid feedback on the customer experience** so that people can respond promptly. Many organisations track their customer experience on a quarterly basis and feed that information back to their operating units. However this is somewhat like having a weighing scales that told you your weight 3 months ago – that's not going to tell you whether your diet and exercise programme is working or not. Best practice is to have systems that give feedback on the customer experience and customer defection reasons within 24 hours to operating units.

I would recommend that you get hold of the best customer experience data that you have readily available that can give you insights into customer perceptions of your key 'moments of truth' (whenever your organisation interacts with the customer). If you are interested in perhaps the industry leading approaches for tracking and analysing your customer experience and causes of customer churn then some of the best implementations I've seen (no commission involved here!) are from SatMetrix for 'b2c' consumer environments (see http://www.Satmetrix.com) and Active Retention for a 'b2b' environment (see http://www.activeretention.com). Whether you use these systems or something similar, I would look for those processes and 'moments of truth' that were the root causes of the worst customer experiences for the largest number of your customers.

iii) **You can identify the most promising opportunities by applying a simple strategic 'triage' framework.** I would use one of the following frameworks to 'triage' to identify most promising opportunities from the rest. If you have an accurate breakdown of the churn reasons then I would map the scale of the cancellation volumes against the business resources tied up with each cause (measures of value could be revenues, aggregate customer lifetime value, costs or even staffing levels). If your business doesn't have reliable churn data then I would plot customer experience score (or complaints volumes) against the value tied up in the process concerned.

If none of this customer data is available, I would simply look out for departments or functions under severe budget pressure, cost reduction initiatives that haven't worked out or failing projects that need to be turned around.

iv) **You can rapidly create 'Kaikaku' or 'breakthrough Kaizen' teams tasked with eliminating at least 10% of costs and 'frustration' churn within 90 days.** The team is ideally a cross-functional team, the good news is that if you lock them away for a week they should be able to carry out the data analysis, identify root causes and fixes, triage opportunities, develop recommendations and implementation in under a week (especially if left undisturbed and you take their Blackberries off them during the day). As a simple framework to organise their work, you can use DMAIC as an overall structure (from Six Sigma) and apply simple and powerful methodologies such as the CPP Level 1 tools (from Bennu Group see http://www.bennugroup.net).

v) **Finally, in a 'b2b' environment, focus your immediate improvement on those clients and contracts with the highest value and the worst 'customer experience' scores.** It takes a long time to acquire and develop these clients, however it's all too easy for organisations to stop active monitoring of their relationships with these clients after the contracts have been won and signed.

Example: At one 'B2B' client I worked at, their most valuable client was showing RED status flags across the board amongst their key client stakeholders. Not unsurprisingly, this client cancelled within the quarter that came as somewhat of a surprise to the organisation concerned. On the plus side, they had a great monitoring system, on the downside nobody outside of IT seemed to be interested in using it. In a better world, as soon as you see these RED warnings arising amongst your key stakeholders in your most valuable clients, it's time to step in and take urgent remedial action before it's too late.

vi) **The simplest, fastest and most powerful techniques I've come across for service businesses focus on removing time and complexity from service processes.** A combination of the time compression and error elimination techniques from Lean Thinking (particularly in complex Technology environments) and the complexity elimination and 'Customer Experience' management techniques (that work particularly well in Service businesses and service processes) that can be learned in hours and applied immediately by your own people (see http://www.bennugroup.net).

What straightforward thing can you do right now?

I would find someone who is in budget pressure right now and is in urgent need of getting some rapid productivity improvements in place right now. I'd form a small cross-functional team (as cross-functional as you can manage that's easy to put together at short notice). If you had a little help from your friends from Marketing to help with the data analysis of customer experience data you could save a lot of time (it's in their interest as every customer that you save from 'frustration churn' means they are under less pressure on their acquisition marketing budget to replace them). I would then choose a first process to work on using simple techniques that helped you eliminate complexity and time from the process (see http://www.bennugroup.net for some useful ideas). And then I'd let them free to work on their analysis and recommendations for the next week. Come back in a week's time and be prepared to be amazed by their recommendations and what can be achieved in the next 30 days.

Summary

The key takeaways relating to 'frustration churn' are:

- Eliminating the underlying root causes of 'frustration churn' can enable you to reduce service process operating costs by 10% or more within 90 days
- 40-60% of customer churn is down to internal factors under your organisation's direct control

- Reducing your annual churn rate by 5 percentage points can increase your customers' lifetime value (and ultimately your profits) by up to 100%. Eliminating 'frustration churn' is one of the quickest, simplest and most effective methods to achieve this (just compare the financial cost against reducing your prices by 5-10% to achieve a similar impact)
- There are simple techniques that you can learn and readily apply immediately to improve the effectiveness of your key business processes. These techniques focus on reducing the complexity and the root causes of customer frustration with your business
- Measuring, analysing and acting on customer feedback on why they chose to leave your business can give you key insights on where to focus your initiatives to improve your processes, productivity and customer experience

Value impact calculation:
Take a business with an enterprise value of $1 billion (based on an EBITDA multiple of 5) with a customer churn rate of 15% per annum (retention rate 85%) where 'frustration churn' is responsible for 40% of customer losses (6% per annum). In this example service and customer management functions cost around $40 million per annum operating cost.
A realistic expectation for a 'frustration churn' reduction initiative results would be:

- A 10% reduction in operating costs for service and customer management
- Elimination of around 30% of 'frustration churn' reducing overall churn rates by around 2% per annum

Value impact: Operating cost reduction of $4 million per annum creating $20 million shareholder value (based on EBITDA multiple) however this is dwarfed by the increase aggregate customer lifetime value of 15% that would be worth $150 million for this scale of business.

Total shareholder value impact: $170 million

Straightforward fixes to eliminate 'frustration churn' can turbo-charge profits

The fundamental underlying value of your business is driven by the aggregate value of your individual customers and the cash streams they provide. By reducing churn by around 5%, many businesses can double their customer lifetime values and ultimately profitability. Eliminating the root causes of 'frustration churn' is one of the simplest and most straightforward ways you can protect and extend the lifetime value of your most valuable customers.

My best wishes for your success. **John.**

Further reading

The following articles and books are useful on this topic:

- Zero Defections: Quality Comes to Services by Frederick F. Reichheld, W. Earl Sasser Jr. (Harvard Business Review: September 1990)
- The One Number You Need to Grow by Frederick F. Reichheld (Harvard Business Review: December 2003)
- Managing Customers As Investments (Hardback) by Sunil Gupta
- Customer Expectation Management: Success Without Exception (Paperback) by Terry Schurter and Steve Towers

Books available from Amazon, articles by download from http://www.hbr.org

How Can Close Quarter Help?

John Corr, the Managing Partner of Close Quarter, would be happy to have an initial, 'no cost – no commitment' conversation with you to help you understand how the principles discussed here can be applied to your specific situation and business.

An initial complimentary conversation can be held by phone or in person if you prefer. Typically these conversations take 30-60 minutes.

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About John Corr

For more than 25 years, John Corr has worked with leaders of businesses who are uncomfortable with their current profitability and want to take action to turn around their situation to increase their revenues, profits and cashflow.

John has helped leading firms including: AOL Time Warner, AXA, Barclays, Capital One, Citicorp and Kingfisher in their international operations in the UK, Europe, USA and India. His earlier career includes senior executive positions with Nationwide Building Society, where he was responsible for more than £5 billion per annum new business sales.

About Close Quarter

Close Quarter helps businesses improve their profitability by aligning their organisations on delivering superior client value - the ultimate driver of profitability.

Our ability to see clarity in the midst of overwhelming complexity enables us to provide you with innovative problem diagnosis combined with effective solutions that can be readily implemented. Our specialty is helping you solve complex businesses issues even when all else has failed. But don't take our word for it: listen to the CEOs of major corporations we've helped tell the real story in their own words at:
http://www.closequarter.co.uk/cq-thought-leadership.html.

Helping you and survive and prosper through the 'credit crunch' recession

The 'credit crunch' recession may bring about difficult times. But often in life, the toughest of times act as a catalyst to bring out the very best in you and the team around you. I'm confident that by applying proven business principles you will be able to accelerate your ability to make the vital decisions, focus your efforts and take the key actions required to defend your sales, profits and cash flow through whatever 'credit crunch' challenges come your way.

My very best wishes for your future success. John.

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