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DATA

RESILIENCE

How E-commerce Brands Win Customers For Life

DATAFORGE PRESS

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The year 2020 represented cataclysmic change for many brands. According to Shopify's The Future of Ecommerce 2021 report, the COVID-19 pandemic accelerated 10 years of e-commerce growth in 3 months. It led to a rapid increase in consumer expectations as storefront traffic fell and online shopping grew. Brands that did not sell online or who were slowly incorporating e-commerce as a Direct-to-Consumer (DTC) channel were left scrambling. While e-commerce isn't a new phenomenon, most companies did not expect 2020 to be the year that their e-commerce strategy would largely be the driving force between the success of their business or the collapse of it.

This guide summarizes Ambition Data's video series, Resilience: An eLearning Series for e-commerce Brands In 2021, and was written for e-commerce and Direct-to-consumer brands that want to drive more revenue through customer-centric thinking.

The content of this guide is broken up into four segments:

1. Customer Segmentation
2. Customer Acquisition
3. Customer Retention
4. Customer Loyalty

You'll get the most value from this guide by reading the segments in order as some concepts build on others previously mentioned.

Thanks for downloading this guide. Here at Ambition Data, we are committed to helping e-commerce leaders develop better strategic thinking in 2021 and beyond.

For questions or more info contact us at info@ambitiondata.com.

PART ONE

Customer Segmentation

Identifying and selecting between categories in everyday life is vital to our ability to navigate the world and make good decisions. To live a healthy lifestyle, we categorize and choose from tens of thousands of different options when we go grocery shopping. When we want to take a week off, some available vacation options include sunbathing on a beach, touring a big city, or unplugging and pitching a tent in the great outdoors. Making the right choices out of seemingly limitless options with similar characteristics is essential to accomplish the things we want or need to do in our lives.

This same process of categorizing, selecting, and taking action extends to how brands communicate with their customers. In business, this process is known as customer segmentation. A brand's customer base also has shared characteristics that allow companies to reach them and communicate to them in a highly personalized way. In this section, you will learn how to properly categorize your customers to give your data science and marketing teams the capacity to perform powerful analyses which prime your organization to properly engage your customer base.

What is customer segmentation?

Simply put, customer segmentation is dividing customers into groups based on common characteristics. The classic top-down approach might be to segment people by:

Demographics such as age, sex, income, or occupation

Psychographics like what you spend money on or what you like to do.

Geography, which is your country, city, or state.

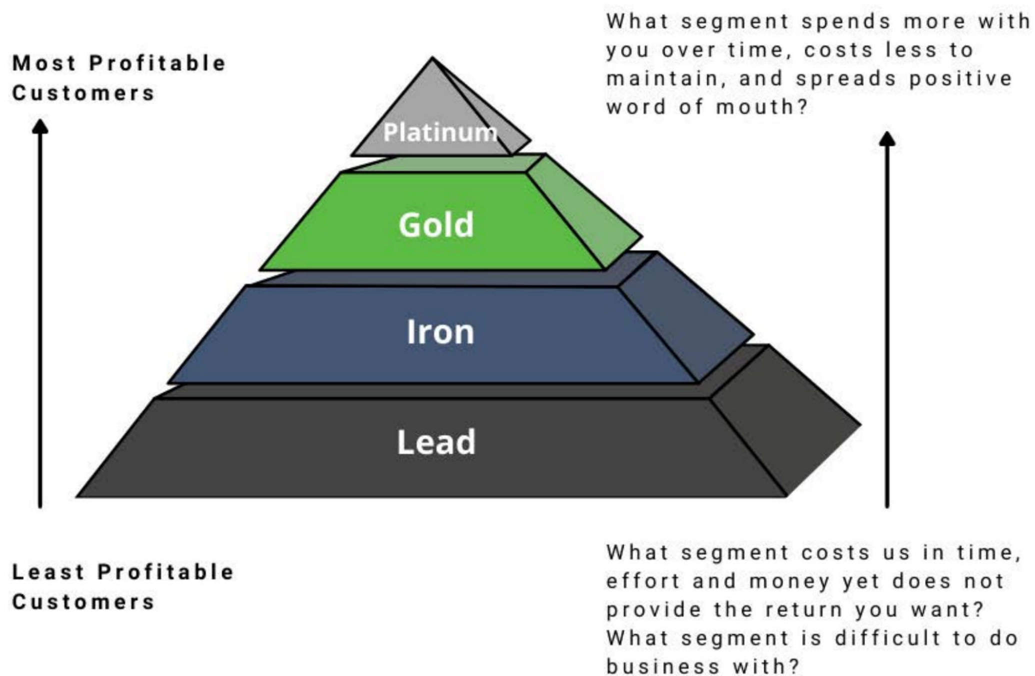
We often call this market research, and it's common in advertising or product marketing. It starts with a vast universe, for instance, everyone in the United States, and then works down toward a narrower market segment, often called profiles or personas. However, this type of customer segmentation is not meant to be individualized. So, if you try to apply market research segmentation to specific individuals in your customer database, you will come up with very spotty results, if any.

There is another way, a data-driven way to get to know individual customers.

If you've been selling products to customers for a few years, then you have access to a very powerful bottom-up segmentation of your existing customers. This segmentation captures all your customers, and it provides a framework to help you unpack more richness about your customer base. When you do it correctly, you can track it back to your bottom line. This data-driven approach to customer segmentation uses existing customer data and their lifetime value.

What is an example of customer segmentation?

Near the millennium, researchers Valarie A. Zeithaml, Katherine N. Lemon, and Roland T. Rust published a book called Driving Customer Equity: How Customer Lifetime Value is Reshaping Corporate Strategy. In the book, they defined a customer pyramid model with four types of customers based on profitability.



At the top of the pyramid, the platinum tier describes the company's most profitable customers who are also committed to the company.

Next, the gold tier includes customers whose profitability levels are not as high because they want price discounts or are not as loyal as the platinum tier.

Third, the iron tier contains essential customers who provide essential volume to use the firm's capacity but whose loyalty and profitability are not substantial enough for special treatment.

Finally, the lower tier is called the lead tier, consisting of customers who could be costing the company money.

These four tiers have specific characteristics. The general idea is that platinum customers are loyal customers and therefore should be treated as such. You need to ensure you're not over-marketing to them. They already love the company.

The gold customers, however, are those that don't yet have that same loyalty. Often, they need a little bit extra like a service guarantee or something to make them feel good to move them up to the platinum level.

How can customer segmentation help you?

- Customer segmentation by lifetime value can help you reverse engineer where your best customers came from and then use that information to find more of them.
- It can also help you identify when customers need a personal nudge to encourage retention.
- It can help you build partnerships within your company across the organizational chart for the customer's benefit.
- It can help you turn retention into loyal advocacy, and it can even guide your innovation efforts.

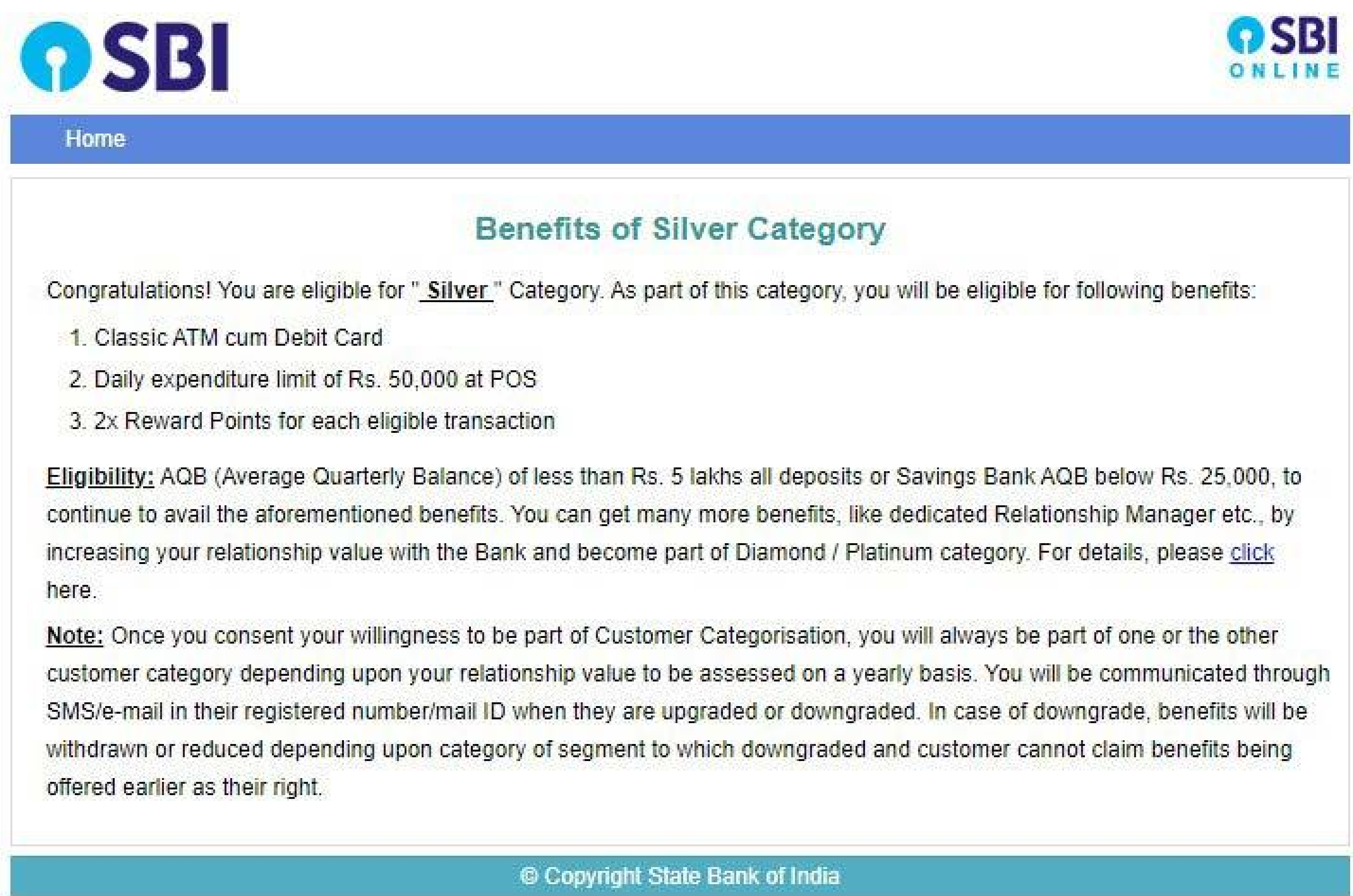
But that's not all; investors are now using customer lifetime value segmentation to evaluate companies. Proper segmentation by lifetime value can help organizations in more than a dozen ways.

The iron level contains many different variables and frequently requires research to discover what will move these customers to higher tiers in the pyramid. Since it's a larger level in terms of volume, many different triggers cause these customers to move up.

The researchers concluded that the lead customers were customers who were costing the company money. What we have found subsequently is that these lead customers are still an essential part of the customer mix. Even though a customer may cost you money today, it doesn't necessarily mean that you should cut out all your lead customers. The customer pyramid is the four-part model that we often use to segment customers by their lifetime value, including their profitability.

What is an example of customer segmentation?

There is a fascinating example in the banking space that we can take a look at. Typically, customer segmentations are buried deep in the algorithms inside a company - out of sight from customers and the public. The State Bank of India does things differently. They are transparent with their segmentation and let their customers know what category or segment they fall under and their benefits for being in a particular category.



SBI

SBI ONLINE

Home

Benefits of Silver Category

Congratulations! You are eligible for " Silver " Category. As part of this category, you will be eligible for following benefits:

1. Classic ATM cum Debit Card
2. Daily expenditure limit of Rs. 50,000 at POS
3. 2x Reward Points for each eligible transaction

Eligibility: AQB (Average Quarterly Balance) of less than Rs. 5 lakhs all deposits or Savings Bank AQB below Rs. 25,000, to continue to avail the aforementioned benefits. You can get many more benefits, like dedicated Relationship Manager etc., by increasing your relationship value with the Bank and become part of Diamond / Platinum category. For details, please click here.

Note: Once you consent your willingness to be part of Customer Categorisation, you will always be part of one or the other customer category depending upon your relationship value to be assessed on a yearly basis. You will be communicated through SMS/e-mail in their registered number/mail ID when they are upgraded or downgraded. In case of downgrade, benefits will be withdrawn or reduced depending upon category of segment to which downgraded and customer cannot claim benefits being offered earlier as their right.

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What makes this so interesting is that SBI makes it incredibly clear for customers to understand the different segments - almost like a travel program. If customers take specific actions they will know what category they fall into and its benefits. Based on the description SBI makes it clear that the eligibility for this particular segment is an average quarterly balance. The benefits customers get from the Silver category are an ATM card, a daily expenditure limit, and reward points. They also tell their customers how to get more benefits, such as a Relationship Manager in the higher Diamond and Platinum categories.

This eligibility process is fascinating because it is rare for customers to understand how they are categorized and for a company to be incredibly transparent with its approach. They even tell customers how often category statuses are reviewed and updated. In this case, it is every year. Then they will inform customers if they've been upgraded or downgraded, just like a travel rewards program. E-commerce companies, however, classify customers a lot faster than once a year as people's circumstances in life can change quickly. But overall, this is an excellent example of a transparent customer segmentation program.

In this e-commerce example, customer segmentation appears across the four categories explored in the customer segmentation pyramid - platinum, gold, iron, and lead. Then the 200,000 customers are sent a campaign. You'll notice there is a small number of platinum customers and a large number of lead customers. This ratio of few platinum to many lead customers is almost always the case across every company.

HOW TO FIND QUALITY CUSTOMERS!

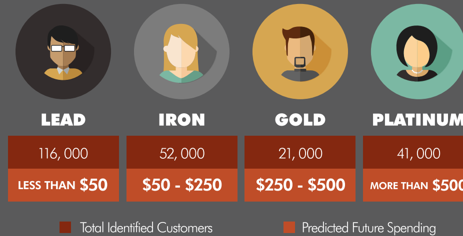
1 GET STARTED

Meet Shaun. Shaun runs marketing at an online retailer, running weekly sales that target 200,000+ customers.

He wants to find out how customer quality is related to his campaign response rates.

2 ANALYSIS

He uses the latest in customer-centric analysis and categorized his customers into four groups, based on their **predicted future spending:**



	LEAD	IRON	GOLD	PLATINUM
Total Identified Customers	116, 000	52, 000	21, 000	41, 000
Predicted Future Spending	LESS THAN $50	$50 - $250	$250 - $500	MORE THAN $500

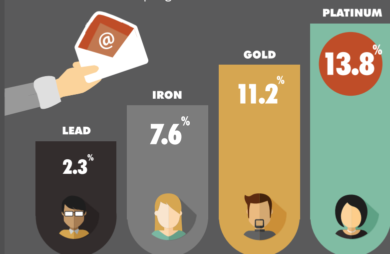
3 INSIGHT

He applies his analysis to an upcoming email campaign for a weekend sale.

WHAT DID HE FIND?

4 EMAIL RESPONSE

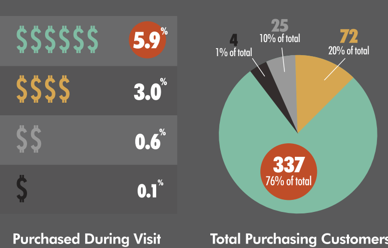
Not only did higher quality **PLATINUM** customers respond more to his recent campaign...



5 PURCHASING CUSTOMERS

... but the **PLATINUM** customers are **60x more likely** to purchase as well.

Purchased During Visit	
$$$$$$	5.9%
$$$$	3.0%
$$	0.6%
$	0.1%



6 NOW WHAT?

Instead of mass marketing to everyone, Shaun now has strategies to drive his business, based on customer quality!

This includes:

- Maintaining his **PLATINUM** customers
- Acquiring comparable customers
- Nurturing his **IRON** and **GOLD** customers

WANT TO SEE HOW **CUSTOMER CENTRICITY** CAN OPTIMIZE YOUR MARKETING STRATEGY?

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(@AmbitionData)

DESIGN BY VIRTUAL NATIVE

In this example, an email campaign was sent. You'll notice that the platinum customers, which are the most loyal, respond more positively to the email campaign. This positive response isn't a surprise, but if you were aggregating the metric across all four different segments, you would come up with a much lower number than if you were to look at the platinum group alone.

We can also take a look at who purchased and see that platinum customers are also 60 times more likely to buy as well. That's why it's vital to understand campaign response at a segmented level.

60x is a massive number compared to the gold, iron, and lead responses - but notice that some lead customers still purchase from this campaign. These lead purchases emphasize the fact that you shouldn't cut out all your lead customers! Through this segmentation example, we learn that by applying customer segmentation to a campaign, brands can quickly understand performance based on customer quality, which customers they might need to nurture, and which customers are most likely to buy.

What is Customer Lifetime Value?

Customer Lifetime Value (CLV) is the present value of the future cash flows attributed to the customer during their entire relationship with the company. Let's break that down a little bit because there's always confusion between customer lifetime value and recency frequency modeling.

CLV uses recency frequency modeling to project forward. We think about recency frequency modeling as driving while looking out the rearview mirror. That is chunky, somewhat directional, and tends to bucket customers inaccurately because it only looks at the past. CLV is more like looking out the front of the car and projecting forward with more fine-grained, tighter-fitting models that tend to bucket accurately. That's essentially the difference between CLV and RFM.

$$CLV = \sum_{t=0}^{T} m \frac{r^t}{(1+d)^t}$$

m *is the net cash flow per period (while the customer is still "alive")*

r *is the retention rate*

d *is the discount rate*

T *is the time horizon for the calculation*

Let's look at one CLV formula and the different components. While there is no "right way" to measure CLV, you can use this formula to get acquainted with the calculation. The CLV formula that is right for your company depends on a variety of factors, including continuity of purchases and purpose for the formula. **Contact us at info@ambitiondata.com to learn more.**

'm' stands for margin, which is a constant. Some companies subtract customer acquisition costs to get a true net. And if we want to use CLV to estimate something like the upper bounds of spending, customer acquisition costs need to be excluded. Generally, we treat 'm' as a constant because margin multiple only changes when retention varies.

'r' stands for retention over time. Most companies have 60 to 90% retention. If it were 20% retention, you would lose a hundred percent of the customers you acquired at year five as your cohorts roll forward. That's not a constant, but many companies make this an average. Doing that is bad because it underestimates the customer value and doesn't classify customers accurately.

'rt' assumes that revenue is booked at the beginning of the period. So 't' equals zero. 'rt' can be adjusted to whenever you book revenue.

'd' stands for discount rate. This discount rate is the time value of money. It would not be accurate to project customer lifetime value without discounting for cash because today's dollars are worth more than those received tomorrow. It's a good idea to align with your CFO for the proper discount rate to use for your company.

Finally, the capital **'T'** stands for time horizon. For most companies, this is at year 15. There's truly little difference between year 15 and infinity. So, the maximum value to pull all CLV in might be five to 10 years, depending on the business's maximum of 15. It also depends on how you use CLV. If you use it for short-term decisions like marketing decisions, you may want to use a shorter-term because not everyone will be spending immediately. Suppose you are looking at it for company valuation purposes to know how much your company is worth. In that case, you should take the maximum or longer time horizon to rack up as much value from your customer base as possible.

How do you do customer segmentation with CLV?

Once you've refined the formula, then you need to apply it to your customer data system. There are quite a few systems that can work. You can code it in Python. You can pick up the Lifetimes package from GitHub in 'r.' Almost any system will work as long as it allows segments with the following criteria.

Check out this 4-step checklist for effective customer segmentation

STEP 01

CAPTURE ALL OF YOUR CUSTOMERS IN ONE SYSTEM

If customers live in different transactional systems, you want to bring them all together and de-duplicate your data so you can get a clean view of your customer base. It helps to have a master customer ID since other identifiers like email can give inaccurate results.

STEP 02

DEFINE AND SET SEGMENT SPLIT POINTS

Segment split points are how you classify customers within the segmentation framework. What exactly makes the difference between platinum, gold, iron, or lead? That's a little bit of an art and science, and there are no hard and fast rules here. Getting your segment split points right and getting people within your company to agree on what makes a good split point helps adoption.

STEP 03

DEFINE AND IDENTIFY OUTLIERS

Have the flexibility to define and identify outliers and treat them accordingly. For example, wholesalers can come through your e-commerce system and buy a whole bunch of products at once. Perhaps the wholesaler purchase needs a slightly different treatment or classification than a regular platinum customer who buys a lot from you. There needs to be alignment on identifying regular customers and identifying outliers. This discussion needs to happen as you create your customer segments.

STEP 04

REMOVE TEST DATA

Ensure that you remove internal and test data to make your data nice and clean. After this last step, you can be off to a good start with customer segmentation.

After going through the 4 steps in the checklist above, apply customer lifetime value to find out who your best customers are and where to find more of them. Getting more high-quality customers is the focus of the next section on customer acquisition.

PART TWO

Customer Acquisition

One phrase that rings true in every facet of life is "quality over quantity." We want to have a few close friends to celebrate accomplishments with or turn to when the going gets rough, not hundreds on Facebook that can't be bothered to give you a call to see how you're doing. We prefer to read one great article or book that provides us with a thorough understanding of a particular subject than dozens of 2-minute blogs that only provide surface-level information.

This notion of quality over quantity also applies to your customers. More specifically, it applies to the customers that your acquisition efforts are bringing in. Once brands start to gain a bit of momentum in the marketplace, customer acquisition requires an approach focused on the quality of customers rather than the volume of customers. In this section, you'll learn how to identify high-quality customers and create a more cost-effective approach to customer acquisition.

What is customer acquisition cost?

Customer acquisition cost (CAC) is a relatively simple formula shown below:

$$CAC = \frac{\left\{\begin{matrix}\text{Sales} \\ \text{salaries + tools + costs}\end{matrix}\right\} + \left\{\begin{matrix}\text{Marketing} \\ \text{salaries + tools + costs}\end{matrix}\right\}}{\text{Number of new customers}}$$

To calculate CAC, you add up your sales expenses plus your marketing expenses (including salaries, tools, and other costs) in a given period and then divide that total by the number of new customers acquired in that same period. For example, brands might calculate CAC for a year or a quarter. As long as you remember to use the same time period for each part of the equation, CAC is a straightforward formula. The CAC number is significant because it represents the efficiency of your marketing and sales process. It is something that investors and analysts look very closely at to try to understand how well a company is performing or can perform.

Let's consider an example of a company with $125,000 of marketing and sales expense a month. These expenses could include commissions, salaries, advertising spend, and customer support for free trials. All of those expenses fall under that $125,000. Over the course of the month, they bring in 50 new customers. Using the formula outlined above, you can see that this company's CAC for that particular month is $2,500.

$$\text{CAC} = \frac{\$125{,}000}{50} = \$2{,}500$$

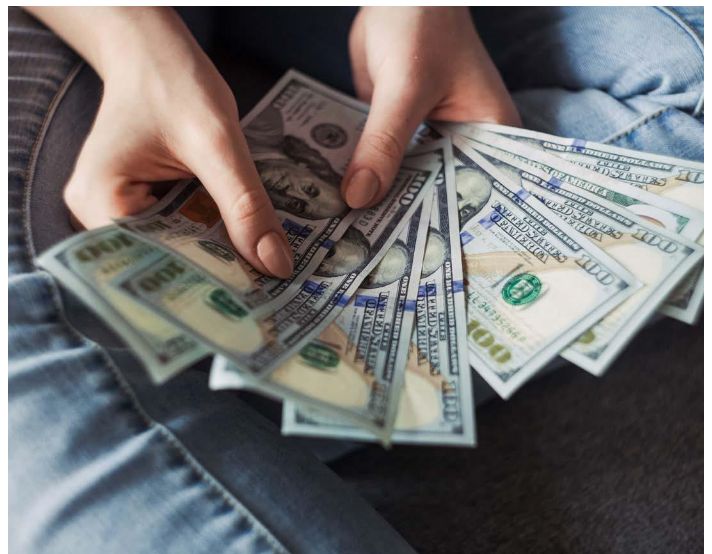
That number becomes interesting if you trend it over time and watch how it performs. Companies can expect CAC costs to be high initially but decrease as they find where they fit in the marketplace and get a sense of where they are getting these good customers.

How much should you spend on customer acquisition cost?

It's not uncommon for small, newer companies to spend as much as 20-30% on marketing and sales costs. As you go higher beyond that number, it starts to become a question of, "how much do you have to spend to get customers in the door who don't stay?" 20% can generally be considered the average that most companies spend on marketing and sales costs. Below you can see the average cost to acquire a customer for a number of different industries as reported in Hubspot's Ultimate Guide to Calculating, Understanding, and Improving CAC in 2021.

- **Travel: $7**
- **Retail: $10**
- **Consumer Goods: $22**
- **Manufacturing: $83**
- **Transportation: $98**
- **Marketing Agency: $141**
- **Financial: $175**
- **Technology (Hardware): $182**
- **Real Estate: $213**
- **Banking/Insurance: $303**
- **Telecom: $315**
- **Technology (Software): $395**

In an industry like travel, it costs around $7 to acquire a customer. At the complete opposite end, the costs for an industry like SaaS technology companies would be much higher - around $395 to acquire a new customer. Overall, customer acquisition costs will vary, and the percentage that you dedicate to customer acquisition should be directly related to how efficient your sales and marketing processes are running.



What is the CAC:CLV ratio?

In the previous example, we calculated CAC for a company with $125,000 in sales and marketing expenses during a month and acquired 50 new customers during that same period, resulting in a CAC of $2,500.

The proper ratio between CAC and CLV (how much money per customer you get from a customer over their lifetime) is about 3X. This ratio means that the average CLV should be about 3X more than what it costs to acquire a customer. To have a healthy CAC:CLV ratio, for the example used above, customers would have to spend $7,500 or more with the brand over the course of their lifetime. (7,500/2,500 = 3).

This ratio becomes much more interesting when you trend it. Looking at CAC over time to see if it is rising or falling in relation to CLV can provide valuable insights. If CAC is going up and CLV is going down, then this is a major red flag. In other words, you're paying more to acquire a customer who doesn't spend as much with your company. On the other hand, if CAC is falling and CLV is rising, then that's a very positive sign that you have a healthy, sticky business. Using the CAC:CLV ratio in this way can help give you a sense of your business's performance over time.

What are customer acquisition channels?

Channel	Definition
Direct	Source exactly matches direct AND Medium exactly matches (not set) OR Medium exactly matches (none)
Organic Search	Medium exactly matches organic
Social	Social Source Referral exactly matches Yes OR Medium matches regex ^(social|social-network|social-media|sm|social network|social media)$
Email	Medium exactly matches email
Affiliates	Medium exactly matches affiliate
Referral	Medium exactly matches referral
Paid Search	Medium matches regex ^(cpc|ppc|paidsearch)$ AND Ad Distribution Network does not exactly match Content
Other Advertising	Medium matches regex ^(cpv|cpa|cpp|content-text)$
Display	Medium matches regex ^(display|cpm|banner)$ OR Ad Distribution Network exactly matches Content
(unavailable) or (other)	Sessions don't match any channel description.

Looking at CAC alone gives you a single number. To make it more useful, you need to understand where that customer came from in the digital world by analyzing your customer acquisition channels. Channels allow companies to measure where traffic comes from and where it gets recorded.

The chart to the left from Google Analytics shows different online customer channels.

Direct traffic means that somebody visited your website by typing in your URL or by clicking a Bitly link that didn't have a campaign code in it. They visited your site "directly."

Organic search is another way that people can visit your website. It means that they used the Google search engine and clicked on an organic link that directed them to your website. Paid search (running ads on Google) can complement organic search and is another channel listed above. You can have social or affiliates or any number of different channels. These are the ones that are out of the box with the Google system.

There are a few more things that you will sometimes see in this channel structure that might be tricky to understand at first. The first is the value 'none,' which always throws people off because it means the tracking system used has no value that it can pick up and attribute to a channel, so you don't know which channel to connect to the visitor. The other one has to do with direct, and the confusion that sometimes comes from direct, none, or referral. Direct means that someone typed a URL in their browser, which took them directly to a page. Referral means that someone visited your page outside of a search engine - they might have clicked on a hyperlink in an article that drove them to your webpage. All of these have very slight differences that you can see in the definitions above.

Google also uses a more elaborate system underneath channels called source and medium. Source and medium can be powerful for effective CAC:CLV analysis. We will explore source and medium in the next section on campaign codes.

What are campaign codes?

Campaign codes are a great way to boost customer data value and help brands better understand the circumstances around acquiring a customer. In addition to looking at channels in the Google system, brands can also look at 'source' and 'medium.' You can think about 'source' as large chunks of traffic coming through similarly to channels and think about 'medium' as an identifier alongside 'source.' If one element of a 'source' is paid search, PPC might be the 'medium' or affiliate might be the 'medium'.

The campaign name is one of the most powerful and underused features in the entire system. The example below shows how structured campaign names can provide insight into how a customer came in.

Structured Campaign Names

social	Acquisition - Southern California - Black Tees
	Acquisition - Southern California - White Tees
	Acquisition - New York - White Tees
	Retention - West Coast - Sock Owners
	Acquisition - West Coast - Striped Socks
	Awareness - New York - Ambassador Profile
	Awareness - Southwest - Ambassador Profile
	Acquisition - Southwest - White Tees
	Acquisition - New York - Black Tees

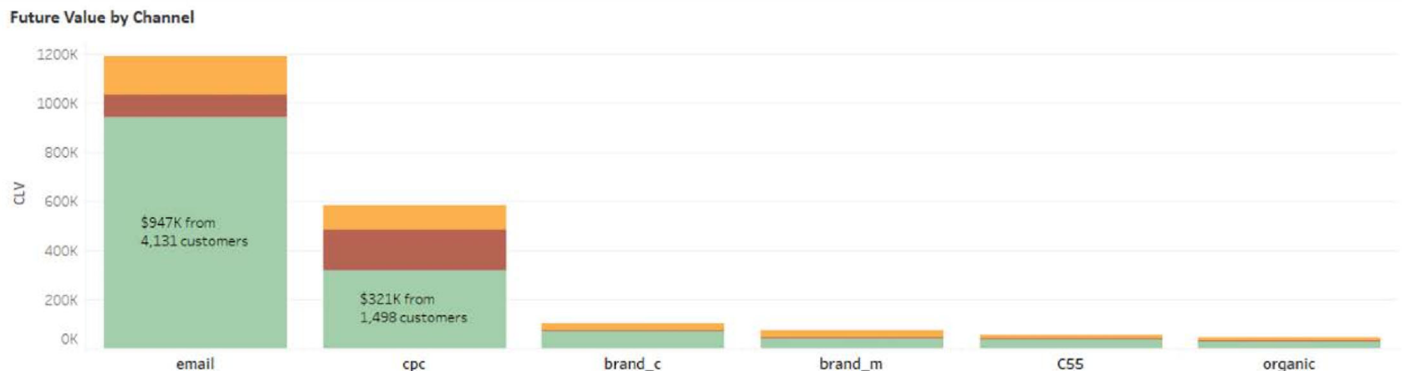
In the example given, campaigns are named "Acquisition," "Retention," or "Awareness." You can name your campaigns anything you want. In this example, notice the use of dashes as dividers within the campaign name itself. The type of divider is essential because some dividers are read into the campaign code structure, so make sure to use one that's not going to be read into your campaign code structure and break up your data. In the example above, dashes aren't read into the campaign code structure and are used to add additional information such as target geography and product.

Utilizing campaign names allows you to get a sense of how your customer journey is shaping up. Similarly structuring your campaign names to the example above will show you if customers enter through retention efforts or through acquisition efforts. You can also see what kind of product a particular acquisition effort focuses on. Overall, structured campaign names are a powerful insider secret of getting more value out of customer-facing data.

What is a good customer acquisition strategy?

How do you know your customer acquisition strategy is working? One way to do that is to look at the CAC:CLV ratio. In the example below, you can see that running email campaigns cost $250,000 over the course of a year. This brand's fully loaded customer acquisition costs were $250,000 associated with email. For that $250,000, they received $947,000 of customer lifetime value. That ratio is 3.7, which is excellent. Remember from the previous section that you want CLV to be about 3X more than customer acquisition costs.

In this example, we can tell that email is performing well. Since email yielded 4,131 customers, you can back into the numbers and divide your spend of $250,000 by the number of customers you acquired and understand that you can afford to spend about $60 per customer through email.



You can break that down further by customer quality (high-value customers, medium value, low value) and then skew the number higher or lower, depending on what kind of customer you are targeting.

Now let's look at the second column in the graph related to paid search. This column is another channel where the company spent $250,000 in CAC. In return, they got $321,000 of customer lifetime value. The ratio here is 1.2 (321,000 / 250,000), which is not great. Since there are 1,498, customers you can tell there is an inefficient spend of about $214 per customer in this channel. This company would need CLV to go up or CAC to go down to get a healthy ratio. They might try to improve this gradually by aiming for a 2X return and cutting back spend gently to $150,000 to see if performance is improving.

We need to make a notable caveat about paid search because it's often an assist channel, and you don't want to keep cutting spend back to achieve the 3X ratio. You must have a certain amount of spend to get in the game and see the right metrics come through. That is why we are not suggesting that you cut it all the way back to what gives you a potential 3X return. If you continually keep cutting spend, you might not get enough velocity because you haven't put enough time into the system. It is just one thing to keep in mind. Otherwise, you can take your different ad campaigns and flex the spend up or down according to the customer's quality that you're getting back, reflecting the customer lifetime value. It is a great way to use CAC:CLV to understand performance without digging into attribution analysis depths.

How do I reduce customer acquisition costs?

Drawing from the paid search example in the previous section, you can see that the ratio between $321,000 in customer lifetime value to an assumed spend of $250,000 gives a ratio of 1.2, which is not great. Remember, a healthy ratio is about 3X between CAC and CLV. So what can you do to reduce that spend?

You could move the CAC number down until you got a 3X ratio. In other words, you could keep dropping spend until it aligns with a customer lifetime value ratio, but not recommended. Instead, you want to move down spend gently. It's clear; there's not enough efficiency here. However, we want to be careful to keep enough momentum, enough juice in the game so that the channel is performing. This momentum is particularly important with paid search because this is often an "assist" channel.

A new customer might look at a paid search ad first and eventually convert on email or eventually convert on social or another channel. This creates a rat's nest of attribution modeling, which we won't cover here, but all this emphasizes the idea that you do not want to cut back spend harshly. You want to be gentle and reduce the CAC number gradually and get to a higher and higher customer lifetime value.

But what if customer lifetime value won't budge?

You need to look at customer lifetime value at two levels. The first is the overall CAC:CLV, and the second is the channel-based CAC:CLV. Take it with a grain of salt when your channels are above or below your ideal mark, and then use that to make a judgment call about how well you think they are performing and whether you can improve their performance.

What is a good example of customer acquisition cost reduction?

Check out this clip from our CEO's podcast, the Customer Equity Accelerator, to learn how former Chief Analytics Officer of Electronic Arts, Zack Anderson, used the CAC:CLV ratio to slash customer acquisition costs at Electronic Arts. **Click here to listen.**

Now that you know about Customer Acquisition Costs (CAC), where customers come from, and how to find good customers, let's explore how you can keep those customers coming back in the next section on customer retention.

PART THREE

Customer Retention

One of the main ideas in James Clear's bestselling book Atomic Habits is that cultivating good (or bad) habits result from the frequency with which you do something, not by the intensity at which you do it. For example, walking for five minutes a day will result in a healthier lifestyle than running for one hour once a month.

Customer retention is a lot like that. Getting customers to come back and make repeat purchases with your brand results in success over the long run. Retention is different from customer acquisition. These customers have already purchased from you once before, and now you want to get them to buy from you again. It's also helpful to think of customer retention as something different from true customer loyalty, which is when customers are not considering buying from any brand but yours. In this section, you'll learn about other retention tactics that you can use to get customers to make those early, repeat purchases to drive more revenue for your brand.

Why is customer retention important?

Ask most people why they think customer retention is essential, and they will usually say customers who return are obviously good for business. Or that it is easier to sell to customers you already have instead of trying to acquire new ones every time. The more significant reason to look at customer retention is that a surprising number of businesses have a high volume of one-and-done customers. These are customers who buy once from you and never return. The problem is rampant in retail, but it applies to other industries as well.

Knowing which customers are good customers who come back to support the business economically is essential. It doesn't make any sense to use an aggregated generic "customer" to understand your customer base. It makes more sense to know which customers are genuinely in love with your brand and the ones that look like they will become the next generation of loyal customers.

What is the customer retention formula?

The formula used to calculate customer retention (CRR) is not complicated.

$$\text{Churn} = \frac{\{\text{Customers paying at the start of the period}\} - \{\text{Customers at the end of the period}\}}{\text{Customers paying at the start of the period}} \times 100$$

You can calculate your customer retention rate by taking the customers who are still paying you at the end of the period, minus the new customers you've acquired, and divide that total by customers at the start of the period. You then multiply that number by 100 to get the rate.

Let's apply the formula to an example below:

$$\text{CRR} = \frac{\{120\} - \{30\}}{100} \times 100 = \mathbf{90\%}$$

In this example, the company:

- Had 100 customers at the beginning of Q1
- Acquired 30 new customers at the end of Q1
- Ended Q1 with 120 customers

Therefore the customer retention rate would be 90%, which is an excellent customer retention rate. Generally, a 90% retention rate or higher is fantastic. It shows a lot of stickiness in your customer base. It is particularly attractive for start-ups or companies that want to be acquired because it gives potential investors a sense of minimal risk. Companies with longer sales cycles or who sell more expensive products should consider using a more extended period when calculating the customer retention rate.

What is customer retention versus loyalty?

It is helpful to think about customer retention and customer loyalty in two different ways. Loyalty means that customers don't think about the competition. They are advocates for your brand. They love your brand, and they keep coming back. Loyalty equals cost-effective growth. A high retention rate can reflect loyalty, but it could also mean that it's difficult for a customer to leave. Banking is an example of an industry with a high retention rate where it is also difficult for customers to leave.

You can think about retention as the act of getting the second or third purchase. It requires a slightly different strategy than how you should be dealing with loyal customers. Retention still has a downward pull of competition embedded behind that second and third purchase.

Loyalty is an emotional pull. Retention is a transactional pull.

What is customer retention versus churn rate?

The formulas for customer retention and churn rate are just the inverse of one another. You have already read about customer retention in a previous section. Now, let's look at the churn rate.

$$\text{Churn} = \frac{\{\text{Customers paying at the start of the period}\} - \{\text{Customers at the end of the period}\}}{\text{Customers paying at the start of the period}} \times 100$$

Calculate churn rate by taking the customers who pay you at the start of the period, minus the customers at the end of the period. Divide the total by the customers at the beginning of the period then, multiply by 100 to get your rate.

Here are some key takeaways about the differences between customer retention rate and churn rate:

- Customer Retention Rate (CRR) is a formula that you want to be higher
- Retention rates should constantly be getting higher
- Churn rate is a formula that you want to be lower - low churn is better

It makes sense to look at both retention and churn over the same period of time. The big question for most companies is, "Can we prevent churn?" At the point where a customer has decided to leave, it's usually a statistical long-shot to try to save them, so a zero-churn rate is not a realistic goal. Churn will happen because people's lives change.

Instead, companies could focus on growing their customer retention rate which is literally the other side of the coin. Focusing on customer retention growth will calibrate you to the right metric instead of trying to stop people as they head out the door.

How do you increase customer retention?

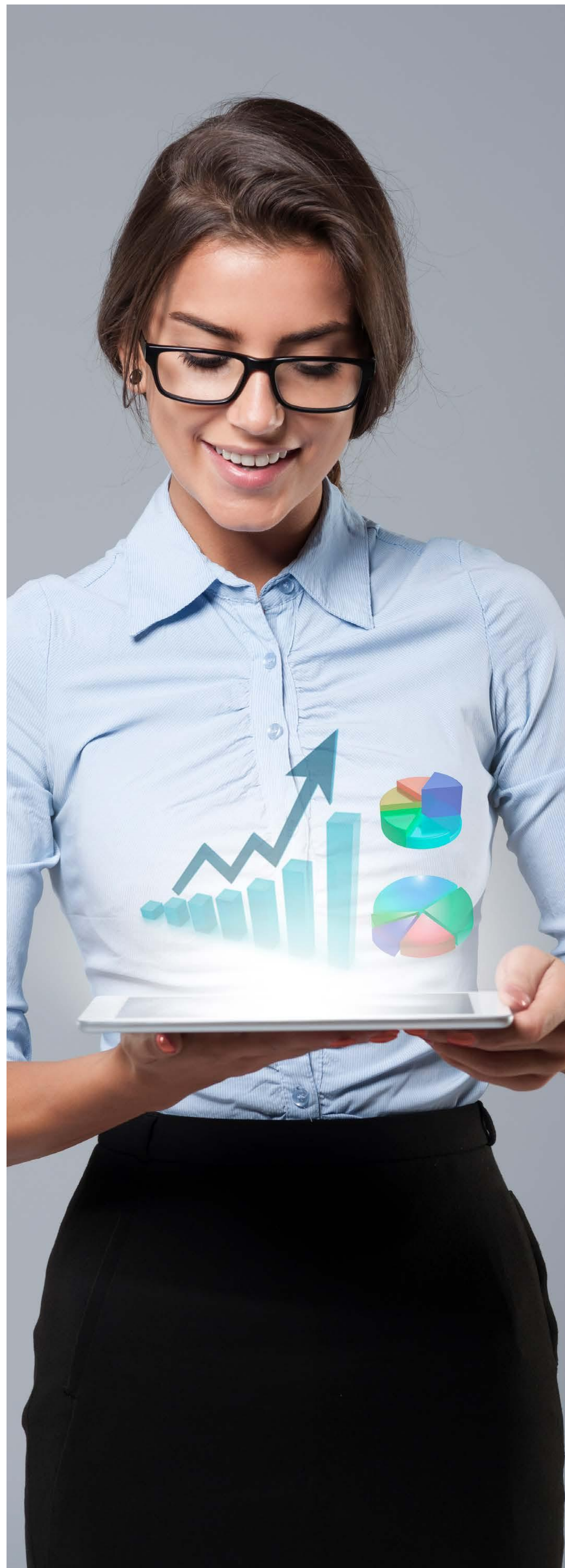
All brands want to have a good strategy in place to increase customer retention. First, it's necessary to understand that there are two types of retention. There's retention that you can see and retention that you can't quite see.

A subscription model is an excellent method for retention up until a certain point. Usually, companies cannot predict when someone decides to cancel their subscription, which can mean it's challenging to prevent.

Another type of retention that you can't see easily is in industries that make it difficult to switch to a competitor. Think about the hassle of getting rid of your cable service or changing your insurance policies, or again, banking. Several industries make it challenging for a customer to leave a company once they are plugged in. Unfortunately, making customers suffer before they go away or end their account is a technique used to increase retention. Not recommended, but it does create friction that causes more customers to stay. E-commerce retailers have an advantage because every transaction provides clarity.

When it comes to increasing retention, targeting the middle of the customer lifetime value group is a good approach. These customers are in the gold, or iron tiers from the customer segmentation pyramid explored in the section on segmentation. This middle group has the most potential because a slight increase in transactional cadence can significantly impact customer lifetime value even if the average order value is smaller. It is usually better to have frequent, small purchases that signal continued engagement than a big one-and-done buyer that disappears.

Retention is also closely aligned with customer satisfaction and service quality. We often measure these via Net Promoter Score (NPS). We'll explore NPS in more detail in the section on customer loyalty. We highly recommend adding customer feedback to any retention metric, especially when you're trending retention, to understand which customers are trending higher and why. It would be best to match that feedback to customer lifetime value to know where to prioritize your most powerful customer retention strategy.



An excellent example of customer retention

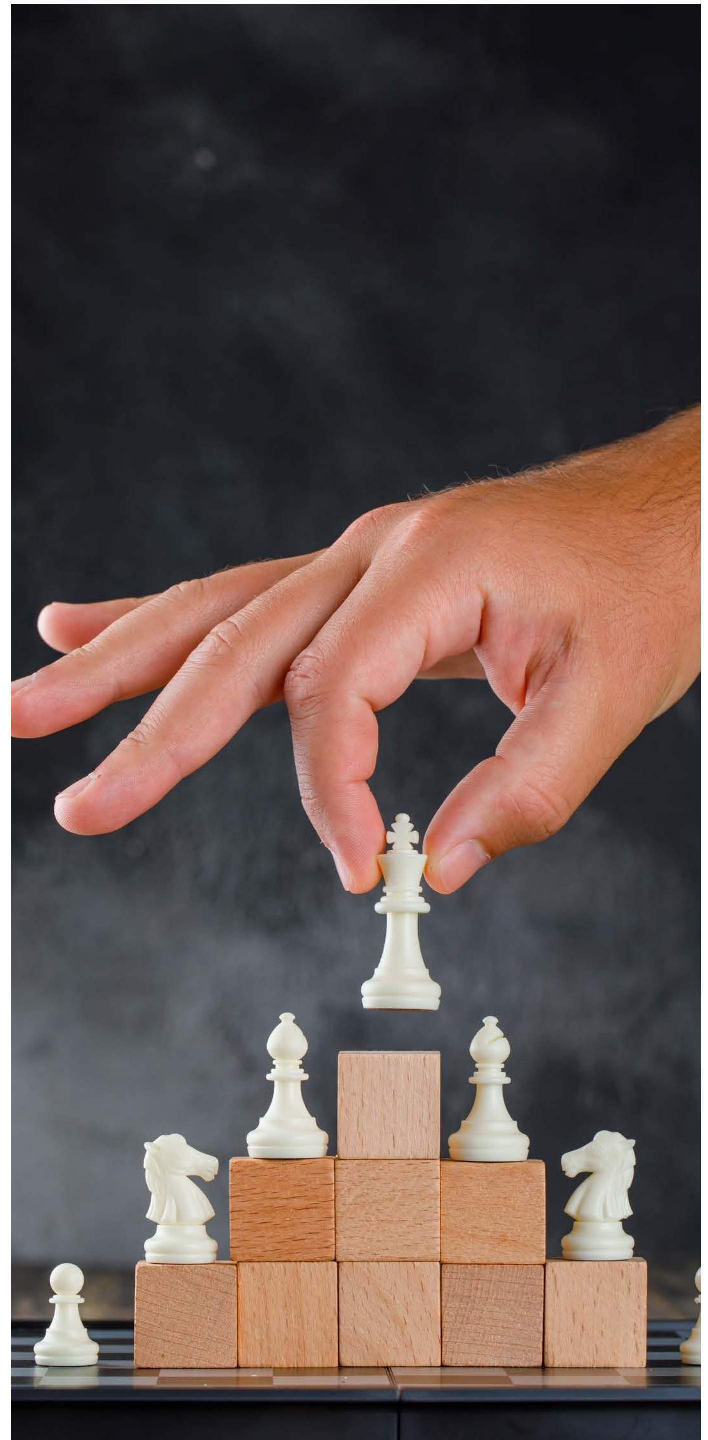
Starbucks is an excellent example of increasing the transactional cadence of a customer base. Years ago, they had several baristas in their stores who had all this knowledge about who was a regular customer, what kind of coffee that customer liked, and how often they came in to buy coffee - but none of that was digitized.

Not only did Starbucks have the advantage of being an addictive product, but they also had a product that had a high frequency of purchase. They decided to make a mobile app. This app was an excellent decision because it took all the granular knowledge that baristas previously had about what kinds of products people like and transformed that expertise to be attached to the customers themselves in the form of a convenient app.

The app has a little bit of gamification. It allows you to collect stars, earn rewards, receive different specials that are highly personalized, order ahead, and pay with the app. There are many functionalities customers get from the Starbucks app, but it extends beyond the store. Before the app, all the customer information was locked up in the physical store and couldn't be seen or accessed.

The app is rated 4.8 out of 5. Three million people have rated it, and at least 16 million people have downloaded it. It's a huge success, but again, partly due to the nature of their product. Now, all those features wouldn't matter if they didn't make an impact on Starbucks' bottom line. Patrick Grismer, CFO of Starbucks, said, "we know from our experience that when customers join our rewards program, their total spend with Starbucks increases meaningfully in both the frequency for regular and super customers, as well as the amount of the spend."

Take note of what Patrick is talking about; there are the regular and the super users. The regular users translate to the middle of the customer segmentation pyramid, customers that have the potential to be high value, and the super users translate to the top of the pyramid, the high-value customers. This app is an excellent example of successful retention because it increased the customer's transactional value in both the high-value tiers of customers (which is difficult) and the middle tiers. Plus, Starbucks got all sorts of valuable information to mine about their customers, allowing them to create stronger emotional bonds, which we'll explore in the next section on customer loyalty.



PART FOUR

Customer Loyalty

From ancient samurai warriors and Stoic Roman emperors to Beliebers and Trekkies (Justin Bieber and Star Trek fans for the unassimilated), loyalty is about more than just enjoying your job or a television show. Having unwavering support or allegiance to a country, cause, group, or person is among several standard definitions of what it means to be loyal.

But how does someone become loyal? And what can brands do to create loyal customers - customers that will only buy from a specific brand to meet a particular set of needs or desires? Customer loyalty is about transforming customer behavior from purely transactional purchases to ones imbued with emotion and passion. In this section on customer loyalty, you will learn how emotional hooks enable customers to bond with brands so that your company can capture high-quality, loyal customers for life.

What are the basic types of loyalty programs?

When people think about customer loyalty, the first things that usually come to mind are coupons, points, or scoring systems that reward them with a free sandwich or coffee after buying a certain amount. That scoring system is just one type of loyalty program.

High value customers	All other customers
Inspired Premium Programs	Loyalty Programs
Preferred Support	Customer Service

A loyalty program appropriate for retention-focused customers is designed to increase purchase frequency. It is important to stratify the difference between loyalty programs appropriate for high-value customers and loyalty programs that brands might use for retention-focused (most) customers.

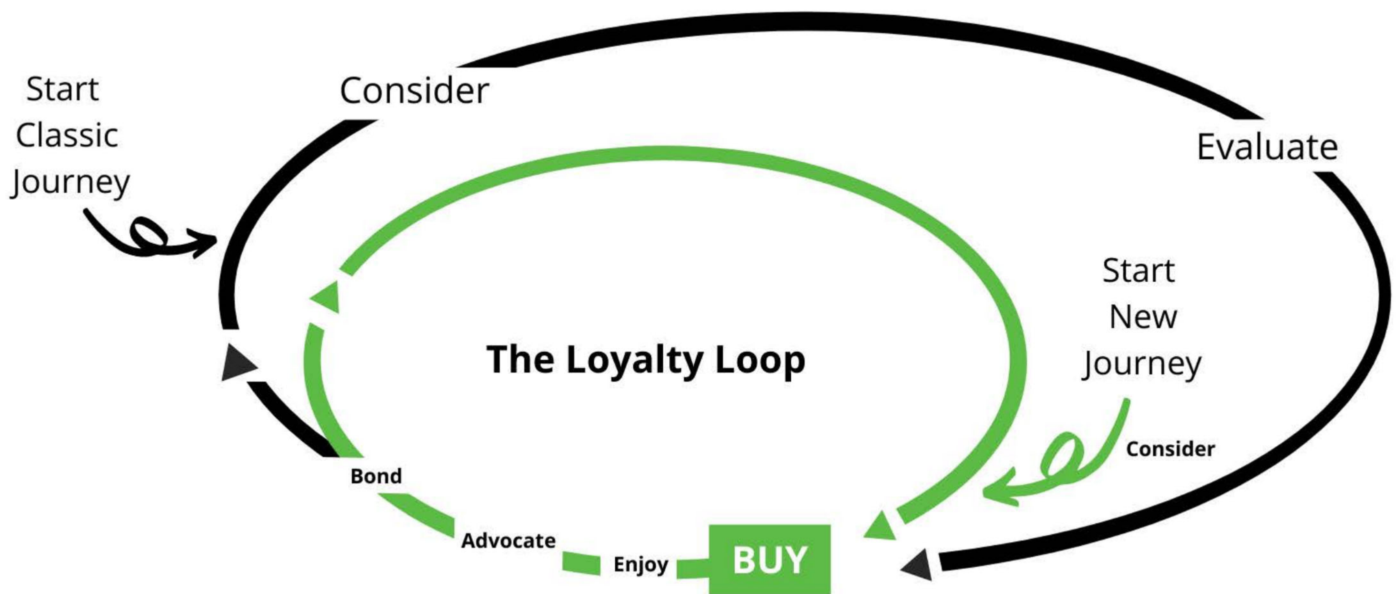
For high-value customers, the goal is to turn retention into loyalty through inspired, premium programs with an emotional hook. You want to give customers a sense that this is a personal offer or that the program is only for a narrow group of high-value customers. That is a different type of loyalty program than the average points or scoring system programs mentioned previously. Most companies don't separate between loyalty programs for all customers and programs for high-value customers. They have one kind of loyalty program.

One application of this is service support systems. Customer service is essentially a loyalty program in its own right. You can appreciate this idea if you have ever had lousy customer service that caused you to leave a company. Premium support or a personal number that only high-value customers can access can help support emotional loyalty. The chart above outlines a basic differentiation in loyalty efforts between high-value and all other customers.

As you continue to read through this section, think about the emotional hook of loyalty compared to the transactional hook of retention.

What is the difference between retention and loyalty?

How do consumers transition from a single purchase into long-term, brand-loyal customers? The concept below is from a paper published in 2015 by David C. Edelman and Mark Signer that outlines the consumer decision journey and shows how businesses move customers into the loyalty loop. The decision journey starts when the consumer identifies a need, and they consider all the options to satisfy that need.



Let's take the example of buying a new shirt. In the consideration phase, someone chooses from many different brands and many different styles of shirts. As they move from consideration to evaluation, they might consider things like price and different features like material and quality.

They go through this extensive process of considering and evaluating (sometimes referred to as "in-market" for the product) as a consumer before becoming a customer - and then something magic happens. They get inspired by a particular brand or a particular item, and they buy!

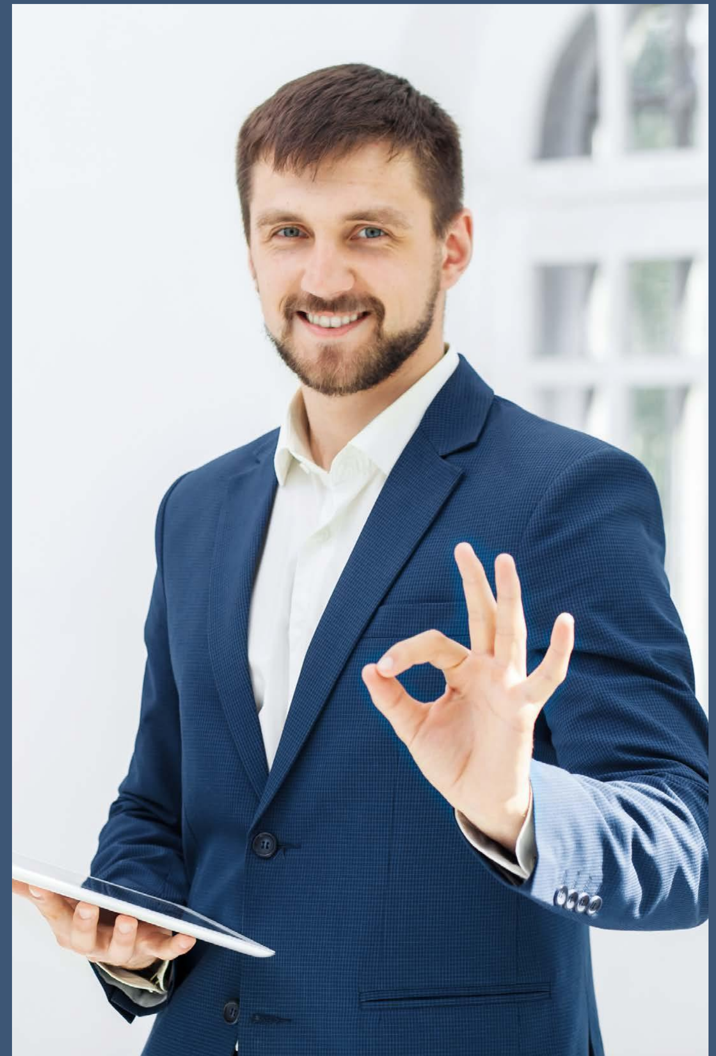
At that point, there is the potential for the loyalty loop as the new customer experiences the brand through delivery times, packaging, product usage, and other post-purchase steps. The customer may choose to advocate for the brand and even bond to the brand with repeated purchases where competitors are not considered.

We separate between customer retention and customer loyalty because the first trip through the decision journey does not necessarily move consumers into the loyalty loop. However, very expensive products can move consumers into the loyalty loop after one purchase. Luxury car brands might be such an example, where purchase and post-purchase experiences give customers royal treatment like expensive chocolates every time they service their car. However, for most products that are lower in dollar value, it can take multiple purchases before customers move into the loyalty loop.

That is why the step between the first purchase and the second and third purchases is vital to getting customers into your brand's loyalty loop. When customers transition into the loyalty loop, they stop considering other brands. They love your brand. As long as customer service remains strong and products continue to meet expectations, they may be here to stay. The more customers in a brand's loyalty loop, the more the brand can grow.

What is the difference between customer loyalty and brand loyalty?

You just finished reading about the loyalty loop and how customers can become advocates post-purchase. We explored the point at which customers stop considering and evaluating other brands and make all future purchases with one brand to fulfill a particular desire. They love their experience with the brand and become loyal customers. Once customers transition into the loyalty loop, the statistical likelihood of a repeat purchase is very high. You can probably count on them coming back and buying from your brand in the future. Other customers do not transition to the loyalty loop. For whatever reason, they still entertain competitive brands. In either case, this is not the same as brand loyalty, which is how consumers perceive your brand.



People don't have to make any purchases with your brand to feel really good about it. Let's take the example of someone who visits Disney World as a child. They would have made great memories there and, as a kid, never spent one cent of their own money with Disney World, but they still may have a great brand affinity.

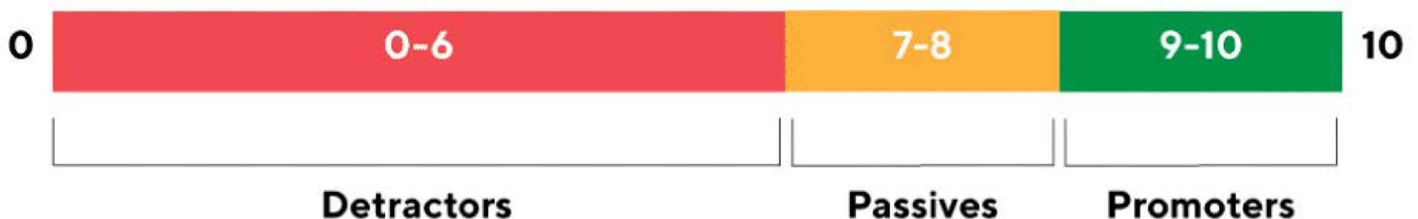
There can be a very nice interplay between brand loyalty and transactional loyalty. We often call brand loyalty the "grease in the wheels," which means that good brand loyalty will enhance overall customer transactional loyalty.

What is the difference between customer loyalty and satisfaction?

Customer satisfaction is another case where there is a very close relationship with customer loyalty. As we explored above, customer loyalty is very transactional. Loyalty shares a close relationship with another metric, Net Promoter Score (NPS), which commonly measures satisfaction. While there are other ways to measure customer satisfaction, NPS, with all of its pros and cons, is a clean way of understanding if a customer wanted to tell someone else about your brand at a particular moment. NPS can give a brand valuable information, and it can signal that someone has stepped into the loyalty loop.

The way the Net Promoter score works is by asking someone if they would refer your brand to someone else. It allows companies to know if customers would tell their friends about their brand and the customer's experience when they made a purchase.

Net Promoter Score

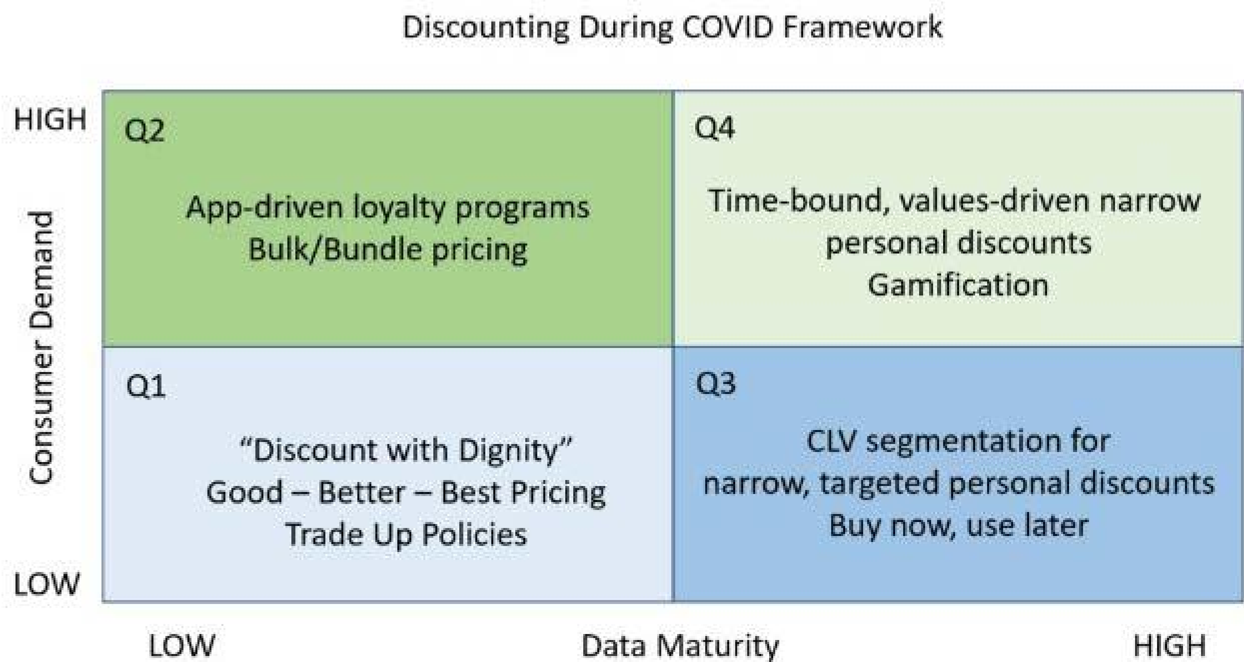


When the score comes back from 0 - 6, it indicates a negative score, and that person is a detractor. When the score is 9 - 10, it is a positive score, and that person is a promoter. You then subtract the difference between the detractors and the promoters to get your NPS score. The middle people who are at 7 and 8 are considered passive and not included in the calculation. A Net Promoter Score above 50 is excellent, while a score above 70 is top-notch. According to Survey Sparrow, the average Net Promoter score for e-commerce brands is 63.

Brands can match Net Promoter Score to customer lifetime value, which would give them an interesting metric because they might assume that the promoters are naturally their high-value customers. But what if the promoters were detractors? That would provide brands with an early signal that something is wrong that needs addressing right away because it could affect their future growth.

Should you use discounting to improve loyalty?

The answer to this question is the typical, "it depends." In the quadrant below pulled from our Discounting During COVID article, brands can see the situations where offering a discount could be appropriate. This discounting framework applies during COVID and post-COVID. It has to do with thinking about an organization's data maturity and consumer demand.



Quadrant one is for brands that have low consumer demand and low data maturity. In this quadrant, they can "discount with dignity" to attract people using the best pricing or trade-up policies. It offers customers the flexibility to bring an item back if they didn't like it and exchange it for something else or receive credits. Some jewelry companies operate in a way that allows their customers to upgrade their diamond ring. This upgrade option will enable them to feel more comfortable with that initial purchase.

Quadrant two is app-driven loyalty programs that sometimes have bulk or bundle pricing behind them. The Starbucks app started in quadrant two when it first rolled out. The company had high consumer demand (coffee is a product bought almost every day), and in the next section, we'll explore how they moved to quadrant four.

Quadrant three is for brands that have high data maturity but low consumer demand. They can think about CLV segmentation and narrow targeting to offer more personalized discounts to encourage somebody to buy now. It can also encourage customers to buy in advance and redeem later. That was a common technique used during COVID by the hotel industry, which is an industry that generally has high data maturity.

Quadrant four is for brands that have high data maturity and high consumer demand. Quadrant four is what Starbucks pushed toward when they moved from a regular loyalty program to something that was time-bound, value-driven, personalized, and incorporated gamification. Overall, quadrant four is probably the best use of discounting. It is what we would call "hyper discounting," understanding precisely who you should be offering discounts to at precisely the right time and for the right product. That is a challenging task, but it is worthy and vital as companies grow their overall customer-centric data maturity.

What is an example of a good customer loyalty program?

Let’s build on the Starbucks example that we explored in the retention section to illustrate how brands move from retention to loyalty. Brands can drive loyalty using trust, surprise, delight, and things that meet and beat customer expectations.

The Starbucks app has a user-friendly design. That means it works as expected, and customers can easily use it to order a cup of coffee or anything else from Starbucks. This app is a lovely form of friction-free commerce.

There is also a delight component found in the app. Starbucks includes music, geolocation mapping to show customers where the nearest store is, and they offer special member events and birthday rewards as a way to incorporate gifting into the app. There are many different ways that Starbucks is adding features without overwhelming the user to stay gently within the surprise and delight area.

They’ve also created a very engaging loyalty program with lots of gamification. There are challenges that customers can play, which are often related to particular products or experiences that they want them to try in order to become closer to the brand. That is an emotional pull that drives brand loyalty. Starbucks also extends special offers and the ability to earn stars (everything in the app is about stars), very much like a hotel program. You have a basic level of stars, and then you have a higher level of stars. Customers might also lose their stars over time if they do not use them. The app also offers mobile-pay ordering, a significant element not just for convenience and saving time but something that has become increasingly important in the COVID-era.

Lastly, the app integrates heavily with other platforms and services. Some examples of integrations are with Lyft, Spotify, and Chase credit cards. There are many different ways that Starbucks is firing on multiple pillars to create an emotional pull that draws customers back again and again. But not only is this app a great way to get customers to return, but it also encourages them to be emotionally attached and think of the brand as a friend, as something that’s there for you all the time. This rewards program is a powerful example of a company that has moved from transactional retention to true emotional loyalty with lots of happiness, surprise, delight, and generally outstanding convenience.

CONCLUSION

Brands that sell online have a lot to consider if they want to drive more revenue. We hope that after going through this guide, you'll be able to apply what you learned to bolster your brand's segmentation, acquisition, retention, and loyalty efforts to drive more revenue. If you need more guidance and expertise with any topic presented in this guide, feel free to connect with our CEO Allison Hartsoe on LinkedIn here https://www.linkedin.com/in/allisonhartsoe/.

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