How to Measure Your Risk of Customer Defection

By Laura Patterson, President

If your company is the like most, it is likely that you are letting a fifth of your customers defect! Research by MarketingWizdom found that the average business loses 20% of customers annually. This directly affects your bottom line.

Retaining your best customers should be one of your business imperatives. According to Walker, by 2020, customer experience will overtake product and price as the key brand differentiator. Clearly, to create a long-term sustainable company, it is essential to make your customers the heart of your business.

I suspect creating customer loyalty is an integral part of your strategy. I began my career as a customer relationship manager for a financial services firm, and customer retention was the focus of my job—it has remained a key facet of my career and our company's core capabilities ever since.

We have found that five critical factors influence the success of any customer relationship initiative.

1. Clearly defined business outcomes related to customer acquisition, retention, and growth
2. Agreement about who the customer is and what they want and need from your category (and you)
3. Well-defined customer segments (and their desired behaviors) and customer-experience objectives
4. A documented, integrated customer strategy
5. Explicit measures of success, and the development of quality data and processes needed to support these metrics

Customer loyalty is an important barometer of success

Customer satisfaction and loyalty are two of the most common indicators of success. A variety of models are used to measure and quantify customer loyalty, ranging from simple recency and referral models to Recency, Frequency, and Monetary Value (RFM) and customer lifetime value models. Recent research is examining those models to ascertain which, if any, truly measure customer loyalty.

Loyal customers are the lifeblood of your company. These customers:

- Stay with the brand despite competitive offers, changes in price, negative word-of-mouth, and product failures
- Increase business/engagement in some way
- Actively promote the brand to others

Therefore, determining how vulnerable you are to customer defection is important. How can you measure vulnerability? Create a vulnerability index.

How to calculate your customer vulnerability

A vulnerability index serves as a way to measure loyalty in the face of competitive pull. Its purpose is to help you identify your most loyal customers—those who are going to stick with you through thick and thin.

To calculate your customer vulnerability index, you will need excellent market intelligence about your competitors' campaign's channel, offers, and markets. Once you have this information, follow these seven steps to construct your vulnerability index:

1. **Map the competitive activity.**Include the competitor's name, offer, duration of offer, and the offer's focus area and market.
2. **Generate**a list of loyal customers in the market where the campaign ran.
3. **Map**customer repurchase and engagement cycle based on frequency and last purchase date.
4. **Isolate**all the customers whose repurchase or renewal dates fall within the competitor's campaign period. This is your observation set (OS) and the set of customers who will experience the greatest competitive pull—therefore, they are the most vulnerable.
5. **Define your observation period,**which is generally the campaign launch date and one purchase cycle after the last date of the competitor's campaign.
6. **Monitor purchases by vulnerable customers.**Track all the customers whose purchases drop during the observation period. These customers constitute your vulnerable set (VS).
7. **Calculate the vulnerability index.**Divide your VS by your OS and multiply that number by 100:

Vulnerability Index = (VS/OS) x 100

What does the vulnerability index tell you?

The index provides you with a way to determine the proportion of customers who are at risk to succumbing to competitive pressure, thereby giving you some idea about the level of loyalty in those customers. If the index is high, you know that there is something to worry about and you need to take action, as soon as possible. If the index is low, you can assume, with some degree of confidence, that your customers are exhibiting robust loyalty to your company.

If your vulnerability index begins to climb and exceed that of your competitors, you can anticipate that your customer defection rate is going to increase. By monitoring your vulnerability index, you will know who your most loyal customers are, and you will be able to develop and implement strategies to withstand competitive pressure.

Because Marketing is charged with finding, keeping, and growing the value of customers, customer retention falls within the domain of Marketing. Therefore, we highly recommend that your Marketing organization have at least one objective aimed at retaining customers, and that you keep tabs on and report on customer vulnerability.