

# If Beatrice Blue is Such a Great Customer, How Come You Couldn't Pick Her Out of a Police Lineup?

The Causes and Costs of Customer Defection

## A Guide to Earning and Growing Customer Loyalty

*by David P. Williams*  
*President, LoyalTec, LLC*  
1725 Mendon Road Suite 106  
Cumberland, RI 02864  
[DWilliams@LoyalTec.net](mailto:DWilliams@LoyalTec.net)  
[www.LoyalTec.net](http://www.LoyalTec.net)





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### What You Can Learn About Business From “The Clan of the Cave Bear”

Long before barcodes and credit cards were invented, human society achieved another revolutionary leap— the shift from hunting to husbandry. You're not reading this white paper for a history lesson, but the fact is crucial to how you do business today. So bear with me for a minute.

Hunting consists of tracking, chasing, attacking, subduing and killing animals. It's exciting, difficult, arduous and unpredictable. And the worst thing is, from a famine prevention perspective, once you've eaten your prey; you've got to start all over again when the food runs out.

Husbandry began the day one of our ancestors tracked, chased, attacked, subdued and raised his club to kill his prey – and he noticed that she was pregnant. *Hmmmm*, he thought. *What if I keep her alive for a while? Then I get two animals for the price of one.*

And then the baby turns out to be a female and our hunter starts doing simple calculations... animal husbandry is born. Once it catches on, our ancestors have a predictable, manageable, ever-increasing supply of meat for a lot fewer man-hours. Humanity now has time to build cities, dig wells and invent talk radio.

### What You'll Get From This Paper

This White Paper deals with the crucial issue of customer defection. Here's the problem: most businesses, even those that depend on repeat business, are stuck in the hunting paradigm. They spend the lion's share of their marketing budget attracting new customers and precious little keeping and growing the ones they have. It's understandable – hunting is a lot sexier than husbandry – but it's bad business.

After I introduce myself, I'll talk about the costs – most of the hidden – of losing customers. I'll share with you the true story of Beatrice Blue, a \$100,000 customer who vanished one day and nobody noticed. Then I'll explain how retailers small and large, local and national can take advantage of database technologies to identify at-risk customers and in many cases prevent them from going MIA.

### Who Am I and Why Should You Listen to Me?

I'm David Williams, the founder and President of LoyalTec, LLC. We help retailers increase their profits by mining their own data. Our methodology allows retailers to analyze and leverage the information they collect (or should be collecting) about their customers and their customers' behavior. Our clients increase profits by dramatically growing the value of their customers, keeping good customers longer, and getting them to refer other customers.

Previously, as founder and Chief Technology Officer of Retail Solutions, Inc., I pioneered real-time visibility and analysis of retail point-of-sale (POS) data throughout the entire supply-chain. My clients and strategic partners have included Revlon, Unilever, Pfizer,



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Bayer, Bristol-Myers, Wyeth Healthcare, American Greetings, CVS/pharmacy, Eckerd, Walgreens, Duane Reade, L.L. Bean, and Toys 'R Us.

Before starting Retail Solutions, I designed continuous replenishment programs that automatically placed replenishment reorders on behalf of individual retail stores based on actual consumer take-away – an industry first for national drug retailers.

My twin passions are analytics and loyalty marketing. In my career, I've seen companies that collect detailed data about their customers and fail to capitalize on it. I've also seen companies committed to creating raving fans of their customers who couldn't pull it off because they didn't have the means to treat each customer as an individual. My mission is to place the cutting edge of information technology in the service of enlightened permission-based, one-to-one marketing.

### **The Massive Profit Drain: Customer Defection**

One of largest sources of profit hemorrhage in the restaurant and retail sectors is lost customers. Customers who stop buying from you for one of a few predictable, preventable reasons. But because you don't notice in time, you do nothing. So you've got to spend even more money hunting for new customers to replace the ones you've just lost.

Some studies suggest that the average retailer loses 30% of their customers each year. To stay flat, these retailers have to attract 40% new customers, because it's much more expensive to find a new customer than to keep an old one.

First, you know who your existing customers are. You don't have to beat the bushes or run hit or miss ads to find them. You can communicate with them directly.

Second, your existing customers have bought from you already, so they trust you and spend more than new customers who are just getting to know you. You're top of mind to them, so you have to spend less to stay there.

Third, you've spent time and money teaching your old customers how to buy from you. That education leads to smoother, more efficient transactions. Existing customers know what you sell, where it is in the store and how to buy it.

A study published in the Harvard Business Review calculated that, on average, existing customers are five times more profitable than new customers. If you don't implement a program to identify and catch at-risk customers, you'd better be prepared to spend a fortune bringing new customers in to replace the ones you're losing.

To move from theory to reality, consider this scenario:

- you start with 10,000 customers
- your cost to acquire a new customer is \$35
- you lose 30% of your customers each year



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By the end of five years you will either have 1680 customers left or you will have spent over \$291,000 to stay at 10,000. By contrast, implementing a customer retention program that keeps your annual churn to 10% can save you over \$106,000 while keeping you at 10,000 customers over the same period.

### The Database to the Rescue – Sort Of

A lot of businesspeople understand this. But until recently, there wasn't all that much they could do about customer defection. After all, by the time you can tell that your customer is gone, she's gone. It's too late.

To the rescue, in the last decade, have been the plummeting costs of computer storage space. It's now cost-effective to collect, store and analyze vast quantities of customer data. One of the most exciting uses of this technological advance is the ability to use models that predict customer defection before it happens.

### How to Identify MIAs

Our term for a lost customer is MIA – “missing in action.” In order to analyze data, we have to define MIA in statistical terms. (Our clients don't really care how we do it, but it helps here to talk a little bit about the theory behind our methodology.) MIAs are customers who have not visited in so long, we believe they will not return at all unless we do something proactive. How long differs for each customer – it depends entirely on the frequency they've established during their time as a customer.

For example, if you have a customer who visits once a week, after six or seven weeks, you have to consider them MIA. There's a sub-category of MIA that we call “At Risk.” At Risk means there's a chance they're about to go MIA.

You have to be careful here – customers become At Risk for lots of reasons that have nothing to do with you: vacation, illness, new job, etc. Now is not the time to bother them. Imagine a diner customer who visits for lunch every single day. He goes on vacation for two weeks and when he returns he's got 14 messages from you – it's borderline harassment.

Once your customer has crossed the threshold into MIA, you've probably lost them unless you take action. You still have a good chance of reactivating them at this point. Once they're truly lost, you have to treat them as a new customer acquisition challenge, at five times the cost. (Or more, depending on why they left!)

The key point here is that with advanced analysis techniques, you are able to define a customer as MIA based on *their individual frequency of visits* and not arbitrarily on the shopping patterns of some mythological “average customer.”



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#### Not All Customers Are Created Equal!

Bob has been a customer for 3 years and visits, on the average, every 6 days.  
Sue has been a customer for 5 years and visits, on the average, every 50 days

If Bob goes more than 35 days or so without shopping, he's probably MIA, meanwhile Sue wouldn't be considered missing until she hasn't shopped for close to 80 days. If you attempt to reclaim Bob after 80 days, you've waited too long (he's probably found a new 'favorite' place to shop). If you go after Sue after 35 days, you'll either scare her (depends on your method of reclaiming lost customers) or simply subsidize her with an unnecessary coupon. Be careful. If you start an MIA campaign too quickly, it could back-fire – imagine coming home from a two-week vacation to find five postcards, three voice mails and a note on the door saying “We missed you.”

#### A Cautionary Tale: Where's Beatrice Blue?

A while back, a restaurant hired me to look at the data they had collected through their rewards card program. Among other things, I found a customer who had spent \$5,000 a year in this restaurant (which was not even a fancy place) since they started collecting data. I'm going to call her Beatrice Blue (not her real name, which is too bad, because I like it). Beatrice, I'm guessing, lived or worked near the restaurant, because she seemed to dine there, on average, every 2 days.

But then something astonishing revealed itself through my analysis: one day, this person stopped coming. Completely stopped. She went from visiting every 2 days to not visiting at all. If this were your customer, what would you have done at that point? Probably nothing short of sending a limousine everyday to make sure she showed up. The problem was, I was given the data one year *after* she stopped coming.

There are a few things here that should trouble you.

First, the fact that she stopped coming. What happened? Unless she moved away or got hit by a bus, something went very wrong on the day of her last visit.

Second, how come nobody at the restaurant noticed that she had stopped coming?

Third, how come when I brought it up, nobody at the restaurant recognized her name or knew what she looked like?

I'm not blaming the restaurant management or staff at all. Without the ability to analyze the data, it's just not possible to keep every one of thousands or tens of thousands of customers in their consciousness. Beatrice's average daily ring was about \$25, which is great but not cause for celebration. After all, it's only a five dollar tip (I'm a good tipper) – nice, but not particularly noteworthy.



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Yet because there was no data analysis mechanism in place, they lost a \$5,000 a year customer and didn't even notice. What was her lifetime value? \$50,000? What about her referral value? Another \$50,000?

If the price of avocados goes up by one and a half percent, the owners of this restaurant notice and feel the pain. But Beatrice quietly left, taking \$100,000 of their money with her and they never felt a thing.

Practically every retail business that's saying, "Well, I don't have a customer like that" has a customer like that. Or five.

### **You've Found One: Now What?**

If you have a customer of three years who suddenly goes MIA, you've got two important tasks: get the customer back and plug the hole they escaped through.

#### *Get the Customer Back*

The immediate task is to get this customer back. Contrary to popular belief, it's not that hard. They've already got a relationship with you. They know what you're capable of. They should be easy to get back, but the key there is timeliness. If you discover that someone's MIA and within two weeks, you begin the campaign of getting them back, you've got a very high probability of doing so. If you wait six months before realizing they're gone, the chance of getting them back is minimal.

For one thing, after six months they've probably found someplace else to take their business. For another, if they're an emotional buyer, they say, "It took you this long to realize I haven't been around?" It's critically important to detect an MIA as quickly as possible in order to take effective action.

The longer the gap between visits, the more challenging this becomes. If you have a customer who shops once every six months, it's going to probably take you over a year to realize she's missing and she'll be difficult to get back. But you should detect your regular customers within days or weeks of their going MIA and get them back.

How do you get them back? Here's one approach: Contact them and find out why they left. If it's something you did, apologize sincerely, fix the problem and offer them outrageous compensation for giving you one more try. This is the guilty husband buying a dozen long-stemmed roses after forgetting his wife's anniversary. Desperate times call for desperate measures.

Sometimes it's better not to overtly acknowledge their MIA status. Instead, perhaps simply send an enticing offer (since you've got data on them, you can predict what they will find "enticing") without even mentioning that you noticed they were missing. You may not want to give them a label that cements in their mind that they're no longer your customer.



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### *"Retail Atrophy"*

Sometimes, customers cannot cite a specific reason why they stopped shopping at a particular retailer. In fact, in a published study of "new customers," 70% of them stated that they were "satisfied" or "very satisfied" with their previous supplier, yet they switched. In another study, it was reported that almost 70% of customers who left a retailer, left because of "a vague feeling of indifference." We invented the phrase "retail atrophy" to describe this phenomenon and in our experience, to reverse this atrophy does not always require an enticing offer. Sometimes just a simple reminder about something notable about your business (e.g., the Best of California award you won for your desserts) can make you top of mind again and bring your MIAs back.

As with all things marketing, this is a judgment call based on context.

### *Plug the Hole*

Learn from your MIA's complaints and improve your customer service. Loyalty programs don't work if they're based on marketing gimmicks. They work only if they help retailers build genuine relationships. Loyalty is about the customer experience each and every time the customer returns.

There are infinite reasons for customer defection, but these all fall into a few basic buckets. Learn which ones are responsible for your MIA hole and plug them as quickly as you can.

### Price

Look, unless you're Wal-Mart, somebody else will always offer a better price. The antidote here is exceptional value. The smiles of your staff, the guarantees, the surprises, the little extras and, yes, the unique experience they get because you have data that tells you exactly how they like to be treated. If price were all that mattered, store brands of cola would be outselling Coke and Pepsi and everyone in the 1980s would have been driving Yugos.

### Bad Experience

Second, they had a bad experience. A rude or apathetic staff person. A poor quality meal or product or service. Here, you've got to find out exactly what happened and what systems must be put in place to prevent that sort of thing from ever happening again. Staff training? Incentive-based compensation? Mystery shopper? Better working conditions? A pre-flight checklist before opening?

### Nobody Cared

Third, they just felt ignored and unimportant. This is by far the most common cause of customer defection. Nothing in particular happened, but they just drifted away because they didn't feel that anyone would notice or care if they stopped coming. Here, you prove them wrong by proving them wrong. Implement "top of mind" promotions. Offer levels of



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“membership” to turn customers into people who “belong” at your establishment. Use their data to treat them like a unique, special individual.

One technique that few retailers could use but don't is decile analysis, or ranking customers by profitability in tenths: the most profitable 10% (what we call your “high rollers”), the second most profitable 10% (your “bread and butter”), all the way down to the least profitable 10% (your “cherry pickers”). Almost certainly, 10-20% of your customers are negative profit centers – you're subsidizing them! (Learn more about this in the LoyalTec White Paper, “Are You Giving Away Margin for No Good Reason?” Find it at [www.LoyalTec.net](http://www.LoyalTec.net).)

The 80/20 Principle predicts that the top 20% of your customers are responsible for 80% of your profits. Without these customers, you wouldn't have a business. Doesn't it make sense to treat these people preferentially?

Yet most retailers can't. They don't collect data on individual customers, so they have no way of distinguishing one customer from another. When the numbers get large enough, each customer is nothing more than a transaction.

But any retailer will have customers in the top 10-20% who are spending five to ten times more than their average customer. They should be treating this group right – and by and large, they're not. A few retailers have good people on the floor who recognize some of these customers. I can name a few restaurants in Providence, RI, my town, where when you walk in, if you've been there more than three times, they know who you are and what your preferences are.

But if there's a lot of staff turnover, or low wage staff, or a business where there is minimal contact between staff and customer (like a grocery store), there's no way that business can personally learn about their best customers. Customer data collection and analysis are the only personalization tools that will be cost-effective.

#### Some Other Reason

Fourth, they could have defected for some reason outside of your control. Let these go and focus on the first three.

#### *Fighting the Category Killers*

In the last decade, “category killers” have been emerging in many fields. A good example of this is Pet superstores. Consider a pet owner who used to shop at their local grocery store for pet food - and there's a study on this, that pet owners actually do spend more money when they're at a grocery store – well, now they've stopped and they're buying at Petco.

So, you've just lost that customer and you didn't even know you lost them. How do you compete? How do you protect yourself against this when you don't even know that you lost them? And you can't know that you lost them until you know you had them.



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Therein lies one of the main reasons for putting in a customer loyalty program. So you can identify your customers, figure out who's in which category and know when they're coming, know when they stop coming, know what they're doing and know how to change their behavior.

#### Four Reasons to File this White Paper and Take No Action

##### *"It's Too Complicated and Expensive"*

It really isn't. You need three things: a mechanism for tracking the behavior you're interested in; that's the data capture. You can get off-the-shelf programs that integrate right into your current POS. And cost should not be a barrier – for literally less than a percent of what you're losing every year in sales from MIAs, you could be putting in a program that could prevent that loss, as well as help you grow. We help companies set up data capture systems, in the form of rewards programs, that they can't imagine ever having lived without.

You need some help with the data analysis from a marketing perspective. Not to brag, but that's our strong suit. We'd be delighted to talk with you and let you know whether we can help you make profitable sense of the data. If you choose to go elsewhere, make sure the people you talk to are marketers first and statistical geeks second. (Hint: if they throw around a lot of "customer relationship marketing" lingo, like "highly leveraged best of breed solutions," "multi-channel approaches," and "interactive value-added relationships," they're not real marketers. You're their market – if they can't talk to you like normal people, how are they going to talk to your customers?)

##### *"My Establishment Doesn't Lend Itself to a Loyalty Program"*

If you run a funeral home, you may be right. Or a company that repaves driveways. Or a store that sells only wedding gowns (although if you're located in Hollywood, you could probably make money with a punch card!).

But any establishment that makes most of its money from repeat business can profit big-time from a loyalty program. Even if your products don't have barcodes on them. It's not necessary to begin by collecting every possible piece of data. Simply recording what we call "time and attendance data" -- when they visit and how much they spend -- will give you tremendous ability to target communication and make a big deal of your best customers.

##### *"Loyalty Programs Based on Data are 'Artificial'"*

I sometimes hear, "We don't need a rewards card to know our customers and let them know they're important to us." I sympathize with this feeling, because we've all had the experience of a big company telling us every 30 seconds how important we are while we spend 10 hours in voicemail hell.

But if you have more than a hundred customers, you're just not going to be able to remember all the details that you'll need to treat them as individuals. Let's suppose, for the



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sake of argument, that you have a phenomenal memory and you care deeply for your customers and you know most of them really well. What happens when you go on vacation? Do your customers get a less personalized experience? What happens if you're sick for a day? If you retire?

All that information is stored in a database – the one between your ears! – but without data backup and the ability to transfer this information, you're taking an unacceptably and unnecessarily high risk with one of your business's most valuable assets.

To avoid the feeling of artificiality, you have to craft a rewards program, not a loyalty program. Loyalty may be the result, but you can't create loyalty. You reward the behaviors you want to encourage and gather data to help you do this.

Here's a key point: don't make your rewards program a discount program. Just giving out discounts cheapens the program and rarely leads to loyalty. Actually, discount programs attract the price-sensitive "cherry pickers" who probably represent the least profitable 20% of your customer base.

*"I'm Not Losing Any Customers"*

A lot of retailers refuse to believe massive customer defection is happening to them. If you put 100 retailers in a room and told them that the average retailer loses 30% of their customers a year, everyone would look around the room and say, "It must be them."

Here's the problem with the problem: if you have it, it's invisible to you. If you can't see and feel the problem, you won't think you need to spend the money or the time or the energy to fix it.

The good news there is that it's such an easy problem to fix once you acknowledge it. Because the fix is predictably and significantly less expensive than the problem over a very short term. In the long term, of course, there's no comparison. But even over the span of a few months, a program designed to identify and reclaim MIAs will be profitable in most cases.

An effective customer retention program represents an ultimate competitive advantage. While all your competitors' customers go through the revolving door at a rate of 30% a year, you're not losing your customers to them. Eventually you'll end up with the lion's share of the market. And the more valuable your customers are to you over their lifetime, the more you get to spend to acquire and delight them.

### Next Steps

If these four excuses don't resonate with you, let's talk about what you should do next.

*If You Currently Collect Data on Your Customers*



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If you are already capturing data on your customers but would like to turn the program into a customer retention and profit growing machine, give me a call. We'll talk about your business and what the opportunities are for getting more smiles and dollars out of your data.

If, after that conversation, we like and trust each other, we can talk about a sample data run. If we can't deliver eye-popping revelations about action items you can implement immediately to increase profits and decrease costs, we part company with no hard feelings.

*If You Currently Don't Collect Data on Your Customers*

If you'd like to get started on the incredibly profitable path of loyalty marketing, but you don't have the data, or the systems, or the infrastructure, give me a call anyway. I'd be glad to spend a few minutes helping you map out a way to get from here to there. If there's a way I can assist you on that path, I'll let you know. If not, I'll recommend other solutions.

Now, if you'll excuse me, I've got to go hunting for dinner. A herd of wild broccoli just trampled by my office window.



LoyalTec, LLC  
1725 Mendon Road Suite 106  
Cumberland, RI 02864  
401-333-7900  
[DWilliams@LoyalTec.net](mailto:DWilliams@LoyalTec.net)  
[www.LoyalTec.net](http://www.LoyalTec.net)

### Author's notes:

Do you know someone who should read this document? Have them send a blank email to [MIA@aweber.com](mailto:MIA@aweber.com). They will instantly receive instructions for obtaining their own copy.

If this copy was emailed, faxed or photocopied for you, you will not automatically receive future cutting-edge documents on building and profiting from customer loyalty. Some of the titles in the works include:

- \* **How Retailers Blow it with Conventional Loyalty Cards, Coupons and Promotions**
- \* **How to Find and Fire Your Cherry-Pickers**
- \* **How to Identify and Reward the 20% Responsible for 80% of Your Profits**
- \* **The Secret to Not Losing Customers: Steps to Take Before It's Too Late**

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I need your feedback. Whether you agree or disagree with me, I'd love to discuss it with you. Please drop me a line at [DWilliams@LoyalTec.net](mailto:DWilliams@LoyalTec.net) or call me at (401) 333-7900.