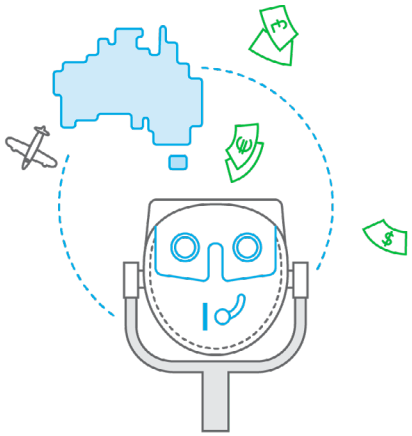
CUSTOMER CHURN

– What it is and how it affects tech companies



Acquiring new customers is one thing; retaining them is quite another!

The loss of customers in a subscription-model business is referred to as 'customer churn'. In a B2B model, it also gets called 'logo churn', as the company loses the right to display the lost customers' logos on its website and other materials.

Over the long term, customer churn can be very corrosive to a tech company. This is especially the case as a company and its products mature and new customers become more difficult to acquire.

New businesses that are busy acquiring copious new customers can usually cope with a higher degree of churn and afford to focus their efforts on acquisition. However, in more mature companies, customer retention strategies become critical – possibly even more so than acquisition.

With all of that said, a degree of churn is inevitable. But by understanding the patterns of churn in your business and the reasons for it, as well as the trends within your industry, you will be in a better position to put effective strategies in place to limit it.

Churn metrics

Churn can be expressed and measured in a few ways. Here are some examples.

– Customer churn:

This refers to the percentage of customers lost.

An example might be where a company acquires 100 customers and loses three. In this case they experience customer churn of 3%.

A reverse (and possibly more positive) way of expressing this is that the business has a retention rate of 97%. But either way, it amounts to the same thing.

– Revenue churn:

This method measures churn using income loss rather than the raw number of customers, as the results can differ considerably between the two.

For example, losing one big customer who pays a subscription of $1,000 will result in greater losses than five customers who each pay $100.

Revenue churn is a better indicator of the company's health and of the actual impact of churn. For this reason, it tends to be considered a more accurate and insightful measure of customer loss.

Loss of revenue can be used to estimate your customer churn percentage. This is done by using average customer revenues as the size of the user-base increases. In the case of a segmented client base and variable pricing, this metric is particularly useful. The way to do this is to divide revenue churn dollars by APRU (Average Revenue per User), then divide the result by customer numbers.

Here's an example:

A business has opening customers of 12,000, APRU of $10, and revenue churn of $8,000. The formula would be:

- Customer churn % = ($8,000/$10)/12,000 X 100 = 6.66%.

Relevance of churn to ARR

ARR is the value of a subscription business's recurring revenue normalised for one year, and MRR is the number of subscribers under a monthly plan x ARPU.

Churn matters to ARR as a lower churn rate means higher ARR values and revenue stability.

With regard to MRR. the financial impact of churn is referred to as 'Churn MRR'. This is calculated as either:

- Churn % x opening MRR, or
- Customer numbers lost x ARPU.

Why customers leave

There is usually no single reason for customers leaving but rather a range of them. These may include:

- Cheaper prices elsewhere for a similar product.
- Poor Market Fit (PMF) – for example, where after trying out your product, your customers may decide it isn't going to be able to help them long-term.
- Customer service / communication are lacking. This may include not getting back to customers quickly when they have a query or failing to provide adequate guidance on using the software.
- Poor UX (User Experience) – such as where the software is slow to load or full of glitches.
- Lack of personalisation – e.g. where the product has been developed in a generic way not tailored to unique customer requirements.
- Customer goes out of business. Unfortunately, sometimes this just happens!

Strategies to reduce churn

It's important to analyse your data when attempting to reduce churn. For example, understanding the characteristics and needs of exiting customers provides information to feed into your churn reduction prevention strategies.

Gathering feedback is also an important action – such as from reviews, forums and direct customer surveys.

Once you know where the problems are, you can put strategies in place to reduce them. Here are some ideas.

- Determine where your customer service and communications need to improve and put steps in place to do so.
- Set up a comprehensive new customer on-boarding process to guide them in the use of your product to meet their specific needs.
- Remind customers when renewal time is approaching rather than simply going ahead and charging them, as this may lead to exits.
- Offer incentives to exiting customers to stay – such as a discounted subscription or extra services.
- Make a particular effort to focus attention on your loyal customers in order to keep them on board.
- Stay competitive and attuned to customer needs. Markets are never static, and your customers' needs are likely to change over time. This means you should be prepared to adapt accordingly.

A great customer success strategy is important and should be developed early in the business. Its tempting to save resources by not having a CSM (Customer Success Manager) position or to not full resource this area, however lost customers often mean that the cost of acquiring new customers can outweigh the savings.

How we can help

RSM Australia's services include advice and financial modelling for SaaS companies that are looking for ways to retain customers and reduce churn. We are also a FinTech Gold Partner.

Our services start with a free consultation to check whether or not we are a good match for you.
Get in touch to book a call!