

Acquiring Books of Customers VS Improving Customer Retention



Avoiding the Tug of War Over Customers

By Peter Weigand
CEO Skipping Stone



For years, retail energy providers have been locked in a tug-of-war over the same pool of customers. With no new markets opening, retailers rely on three familiar strategies to manage churn – the purchase of books of customers, win-back and retention programs, and sales and marketing efforts. Since everyone has similar strategies, its time to explore something else.

In this paper, we'll explore the hidden costs of the current churn replacement strategies, highlight why retention is more profitable, and introduce a new AI-driven solution that's changing the game. If customer count and the margins they generate is a priority for your business, this is a conversation you can't afford to miss.

Current Strategies Retailers Use to Replace Churned Customers

In the U.S. retail energy market, the number of addressable customers has been stagnant for years as no new markets have opened, so there is a tug-of-war over the same customers.

Retailers currently use three main strategies to replace churned customers and grow their business:

1. Buy smaller retailers' books of customers (the "Buy Books" model)
2. "Win-back" or retention programs for reactive management of churn
3. Sales and marketing activity to acquire new customers

Let's compare each strategy.

1. The "Buy Books" Model

A pattern has emerged over the past several years, whereby large energy retailers acquire smaller retailers to grow their business. In many cases the acquisition of a book of customers simply replaces churned customers, keeping the large retailer's customer count stable.

This "Buy Books" model has created a rinse and repeat cycle where a small retailer sells to a big retailer, waits out the noncompete, then starts another energy retail business with the goal to grow it quickly and then sell it to a large retailer. Often, the new small retailer will offer cheap introductory deals and use aggressive customer acquisition methods to obtain customers quickly. This of course results in increased overall churn, with customers leaving one retailer to sign with another. It has also led to issues with regulators and reputation damage for retail energy in general in several markets.

Over the years of stagnation of the customer pool, the "Buy Books" model has become the standard model of larger retailers for maintaining or growing customer count.

The buy-books cycle is expensive for the buyer who, in addition to the purchase price of the book, often must cover the cost of personnel departures, IT normalization, regulatory risk, and transition customer loss and/or bad debt.

The model and method of buying books has become almost cookie cutter in how these transactions work. This is not without its issues:

- I have seen prices of \$300 to \$450 or more per RCE (residential customer equivalent). At these prices it takes more than a year for payback and several years to get a satisfactory ROI.
- While the cost per RCE is high in my opinion, the competition among large retailers to buy books keeps the asking price high. The down- side of not buying a book is the reduction in customer count and therefore a negative impact on the P&L.
- In most cases the large retailer reduces head count and lowers operating costs as soon as possible. This can be expensive in either stay bonuses for key people or severance costs with potential HR liabilities from laid-off staff.

2. Win-Back/Retention Incentives

Typically, these programs are administered by customer service, and while these programs do provide some results, it is like putting your finger in a leaking dam.

- Often the customer does not call to say they are leaving. Instead, they have already signed with another retailer, so it's already too late. Changing the customer's mind again is difficult, expensive, and a hassle for the customer.
- If the customer does call to complain and threaten to leave, offering incentives or a better rate sends the message that you could have given them a better deal all along. Perhaps not the message retailers want to send.
- There are so many incentive programs it is hard to differentiate and make it compelling for the customer. The more enticing the incentive, the more it costs the retailer.

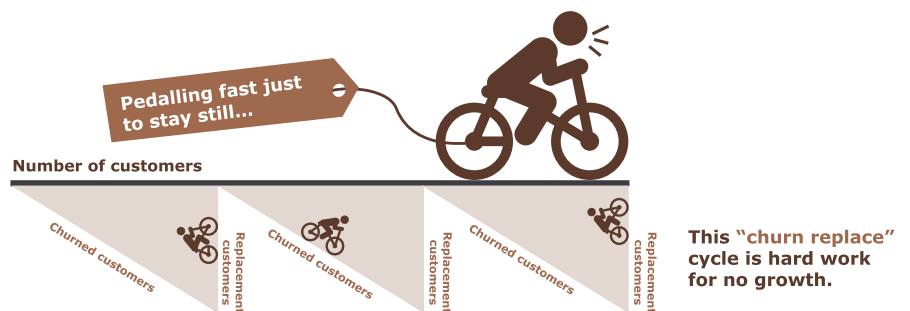
3. Sales & Marketing Activity

Every retailer has a sales and marketing program. Because energy is a commodity, various retailer websites, ads, pricing programs, etc. look nearly identical to customers.

- Many of the traditional sales methods, such as door-to-door or telemarketing, are being banned or made nearly impossible by regulators.
- Other methods, such as shopping sites and discounted introductory deals, result in customer growth but reinforce the "lowest price wins" mentality, which is not a great profitability model. The only way to make money is to increase the price later or get the customer to switch to a more profitable pricing program.
- Marketing to mass market customers can be expensive since those customers don't think about buying energy on a daily or even monthly basis.



Sales and marketing will always be a core strategy. If only churn management performed better, then it could break the "Buy Books" cycle, or at least make book acquisitions additive instead of a customer count replacement method.



Churn Management Basics

It's significantly cheaper to retain customers than to replace them.

Acquiring a new customer can cost **5 - 25 times more** than retaining an existing one.

Harvard Business Review¹

53%

of marketing spend is reaching only existing customers.
Bain & Co.²

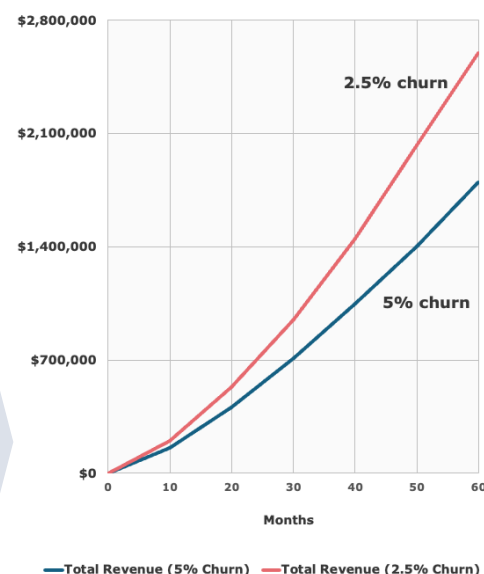
Increasing retention by as little as 5%, profits can be boosted by 25 to 95%.

Bain & Co.²

After five years, a company with 2.5% churn per month is 50% (yes 50%) larger than the company with 5% churn on a revenue basis.

Twilio³

Churn's Impact on Total Revenue



Jonah Lopin, previously HubSpot's vice president of services, has some further observations: ⁴

- Many companies view churn rates as a given rather than as an opportunity.
- By the time you see an increase in your churn rate it is six or eight months after the point in time when you actually failed the customer.
- Many marketers believe there is a magic number. Instead of fixating on a certain number, the best managers look at what their churn was last year and ask themselves how they can do better.
- Many firms are attracting the wrong kinds of customers. They promote low prices, which attract deal seekers who then leave quickly when they find a better deal with another company.

A Better Way: Stopping the Tug of War Over Customers

A new methodology that is proving very effective, utilizes AI and behavioral science to dramatically reduce churn.

I did a global search to identify a better and different solution to focus on churn reduction for energy retailers. The one I found most interesting and promising is from an Australian company called SmartMeasures. (<https://smartmeasures.ai/>)

Headquartered in Melbourne, SmartMeasures supports the Australian retail energy market (which is very similar to the U.S. in terms of maturity, competitors, etc.). They are also entering the U.S. retail energy market.

The chief reasons that I focused on SmartMeasures were their proven results and their willingness to do pilot programs at no risk to the retailer. Few vendors are willing to do risk-free trials, and no other vendor I researched could show demonstrable results in retail energy. Proving the viability of the solution to a retail energy provider suggests a confidence in the approach that is based on experience.

SmartMeasures uses a two-step approach:

STEP 1

Leading with predictive AI to comb through and apply algorithms to a retailer's billing and customer care systems to identify customers at risk of churning.

STEP 2

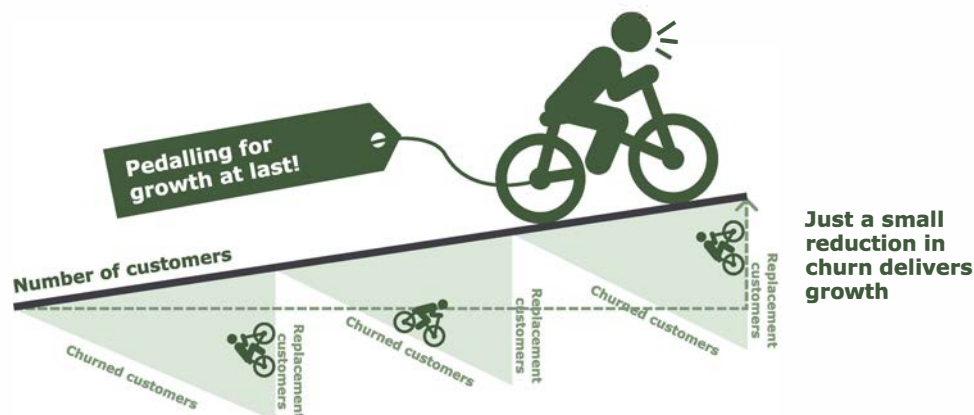
Leverage behavioral science to craft customer-segmented messages that get a strong positive response in terms of reduced churn and happier customers that do not churn.

Having looked at the weekly reports they provide to the retailer, I was impressed by the additional insights uncovered by AI that would be useful in many operational aspects of the sales & marketing side of the business.

SmartMeasures uses their own software to deliver results without the need for the retailer to buy and install software. This "managed service" offering is low cost and doesn't require additional AI/IT-trained staff, behavioral scientists, or computer hardware to deliver results. The retailer maintains control of any messaging and SmartMeasures uses the retailer's existing systems to capture response data, so there is no requirement to modify billing or customer care systems.

When discussing their cost structure, I found that it is a fraction of the customer cost-to-acquire via sales and an even smaller fraction of the RCE book cost-to-acquire. The bottom-line impact and program ROI on keeping existing retail energy customers is eye opening. Case studies on the SmartMeasures website further illustrate this finding.

There may be other solutions out there, and if I find one that is better, I will write about it.



About the Author

Peter Weigand (peterw@skippingstone.com) has been active in the retail energy sector for many years and is the former President of Commerce Energy, a nationwide electric and gas retailer, since sold. He has been engaged in retail energy markets across the globe. His current role is CEO of Skipping Stone, a global energy markets consulting firm.
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Footnotes

¹<https://hbr.org/2014/10/the-value-of-keeping-the-right-customers>

²https://media.bain.com/Images/BB_Prescription_cutting_costs.pdf

³<https://blog.rjmetrics.com/2013/08/16/top-tips-to-decrease-your-churn-rate>

⁴<https://hbr.org/2014/10/the-value-of-keeping-the-right-customers>