

Chapter 2

Measuring Retention

Back in the mid-1990s I was becoming frustrated with our company's growth. For ten straight years our gross revenue had been growing at 20-30% per year. Suddenly, when we got to about 1.5 million per year, we got stuck. In fact, we were stuck there for three straight years.

I was adding sales people as fast as I could. We were training them and setting them loose on the world. They were certainly busy hunting for and landing new accounts. Still, we couldn't seem to break through this mysterious 1.5 million dollar barrier. No matter how much we sold, it seemed, we never got any bigger. The growth we had come to expect had suddenly disappeared. And no one knew why.

No amount of internal meetings, nor restructuring, nor price hikes, nor discounts made any difference. One Saturday afternoon I decided to do what I like best – sit down and analyze some data. It certainly seemed better than mowing the lawn.

Suddenly, I had a revelation. Maybe we were losing accounts as fast as we were adding new ones. This was an uncomfortable thought, and seemed all but impossible given all the accolades we were always earning. But, to paraphrase Sherlock Holmes, "When you eliminate all the likely and unlikely culprits, you are left with just the impossible ones and you should look there."

The easiest way to find out quickly if we were losing accounts was to examine the data that was sitting in our accounting system. I spent the entire afternoon ferreting out how many of our accounts from the previous year had come back for more consulting the next year. The result was depressing and shocking. The answer was only 33% of our clients had stayed with us from one year to the next.

If two out of three of your clients are leaving every year, you need to do a lot of hunting for new accounts just to stay even. And that's exactly what we had been doing.

Before you sneer at our lowly 33% retention rate, let me flash forward six years to 2002. We have improved our own retention rate using many systems and procedures we developed, but we have also developed an easy-to-use measurement tool. We have also used that tool to measure many of our client's retention rates.

That first Saturday afternoon was a watershed event. There wasn't very much useful literature available on Client Retention, but what I had found indicated good companies had retention rates of nearly 100%. Several were openly bragging that they had *never* lost a client.

When we began rolling out our Retention Consulting Service, we measured our clients' retention rates. I can tell you we haven't found any company with a 100% retention rate. 100% retention is impossible, of course. People die, companies go out of business or change the nature of their business. Everyone loses clients for reasons beyond their control and for reasons that are within their control. Nobody's perfect.

The rather surprising thing we learned as we began measuring other company's retention rates, was that our original 33% rate wasn't so bad after all. The best we found among high tech companies, other than ours, was just 22%. The worst retention rate we found was 7%. We did find an accounting firm with a retention rate of 78%, but that was the best rate we found in any company in any industry.

So what's going on with companies and consultants claiming retention rates of 80, 90 or even 100%? Well, I have some ideas about it. First of all, some companies have very few, but large clients. If you only have two or three clients, then it might be possible to keep them all. Or, if you have a product or service that absolutely locks your clients to your company, you might have this licked. If you're a monopoly, you probably don't have a retention problem either.

On the other hand, if you have more clients than you can track in your head and they are able to roam around in our free market economy looking for alternatives, then you probably don't have an 80 or 90 percent retention rate. You may think you do because you haven't been able to actually measure it, or you may think you do because you want it to be so.

If you Can't Measure it, it isn't a Process

Any business process that you develop needs to be measurable. You have to be able to measure your current situation (before you implement a new process) and you need to measure your progress as the new process goes into effect.

If you don't have a way to measure a process, you will not be able to determine whether the process is successful or not. As you make mid-stream corrections to your process, you will not be able to properly judge the effect of those changes. In fact, if you can't measure a process, it's not much of a process anyway.

Retention is clearly not a one-shot deal. It is a process and needs to be continually measured. One of the challenges to implementing a good retention process is that retention is a difficult thing to measure.

Several years ago, when we first began questioning our own retention rate, we knew we needed to first determine what our retention rate really was. There was no option in our CRM software or in our accounting software that would automatically produce a retention rate. No magic function key. In fact, there was no simple way to figure it out at all. It wasn't even clear how to define retention. So, that's where we started – just defining what we were trying to measure.

Simple Retention Rate

The simplest type of retention calculation looks at your client list from the past and compares it with your current list. It is based solely on how many clients remain active with your company from one year to the next.

We defined “active” as a client that had given us money. And that is easy enough to track within any Accounts Receivable System. Very simply, if a client gave us money for anything whatsoever in the past year, then we defined them as active. We recognized that this isn’t always an accurate measurement of activity, but we had to start somewhere. We call this Simple Retention. And, while it was easy enough to calculate, it did require some significant manual effort. The easiest way at that time, was to print out a hard copy listing of clients from our Accounts Receivable system.

You can examine annual, quarterly, monthly or even weekly retention rates; we chose annual. It made our analysis fairly simple and gave us sufficient data to be meaningful. In deciding how to get “meaningful” data and results, there are two considerations.

The first consideration is the number of accounts you are going to track. If this is going to be a manual effort, then it needs to be limited to a small enough number of accounts so you can actually examine the statistics within a reasonable timeframe. On the other hand, it has to be a statistically significant sample of your entire database. At the time of our first analysis, we had about 500 accounts. We chose to “randomly” examine 100, or about 20% of our client base.

To do this sampling, we printed out a report from our accounting system. At the time, that was QuickBooks. The report was the Sales by Customer Summary and it listed all our active accounts alphabetically along with their revenue. For our Simple Retention analysis the actual revenue figures are not important, because they won’t come into play until we get to the more sophisticated Revenue Retention Analysis. What is important is the timeframe the report encompasses and how you select particular accounts from that report.

If you are starting to analyze your annual retention, and it is now March 3, 2002, for example, you want to get two separate reports, each covering a year. You want the most current year which runs from 3/3/2001 through 3/2/2002. QuickBooks, and most accounting packages, will allow you to do this. In addition, you want the matching report spanning 3/3/2000 through 3/2/2001. You can either print these reports, or you can output them to an Excel spreadsheet. I recommend the spreadsheet approach because that will allow you to do some additional analysis when you move on to the more sophisticated approach.

	3/3/2000-3/2/2001		3/3/2001-3/2/2002
1 to 1 Adventures	6,082.00	1 to 1 Adventures	5,000.00
A&B Computers	5.95	A&B Computers	15.00
A&S	75.00	A-Z Rentals	100.00
A.H. Halls	974.00	A.H. Halls	1,873.00
ABC Ltd	8,102.00	ABC Ltd	567.00
Abbott Company	5,132.00	Abbonte Corp	12,000.00
Able Tool	2,104.55	Able One	516.97

Able One	1,477.00	Abrahams	1,345.00
Abrahams	1,332.00	Accents	25,873.00
Accents	25,873.00	ACME Corp.	2,000.00
Acre Corp.	2,560.00	Action Items LLC	524.00
Action Items LLC	24.00	ADG Industries, Inc.	1,561.11
ADG Industries, Inc.	1,983.13	Allen Lamp	1,000.00

Figure 2-1: Samples from two consecutive years

Figure 2-1 is a slice of sample output from QuickBooks showing two consecutive years of accounting data. In the leftmost column you can see there is a total of 13 clients who contributed money to us from 3/3/2000 thru 3/2/2001. Of these 13 clients, 9 continued spending money with us the following year. That translates to a 69.2% Simple Retention Rate.

This is the point where many people begin to feel uncomfortable. They look at their 69.2% Simple Retention Rate (and many are looking at numbers much lower than that) and try to “fine-tune” or “retouch” the numbers.

We begin to hear comments like “A&S went out of business, so we shouldn’t count that one.” Or, “Acre Corp was disputing all our bills so we decided to stop doing business with them. We can’t count that one either.”

Simple Retention Analysis does not differentiate between “it was the client’s fault”, “it was our fault”, or “it was no one’s fault”. It is simply a measure of the percentage of clients that came back for more. If you lose a client, no matter what the reason, you need to replace that revenue with a similar amount of revenue from some other source. The bottom line of your profit and loss statement does not take into account all the different reasons that clients go away.

Revenue Retention

A more sophisticated version of retention rate calculation takes revenue into account. It looks, for example, at last year’s total revenue to see how much revenue those clients from last year generated for you this year. We call this Revenue Retention. This analysis doesn’t require any more data than is already available in the tables shown above, but it does require more calculations.

Revenue Retention analysis is meant to answer the following question: “If a client gave us \$100 last year, and that client is still with us, how much are we likely to get from him this year?”

Basically, what we do to calculate Revenue Retention is to add up all the money we received *last year* from the clients who are still with us this year. We compare that with the money we have received *this year* from those same clients. Specifically, we divide this year’s income by last year’s income. The larger the number we get, the better. Breakeven is 1.00.

Figure 2-2 shows the key results of a typical Retention Analysis.

	<i>Total Revenue</i>	<i>Total # Clients</i>	<i>Total # Clients Retained from Prior Year</i>	<i>Revenue Retained from Prior Year</i>	<i>Simple Retention Rate</i>	<i>Revenue Retention Rate</i>
1999	1,494,929	521				
2000	2,132,526	532	193	865,045	37.04%	75.70%
2001	2,143,048	555	191	655,118	35.90%	78.90%

Figure 2-2 Revenue Retention Analysis

What you should do with this Analysis

Armed with at least a couple of numbers from Figure 2-2, you can start developing a plan. The plan, whatever it is, should focus on getting the best possible return for the money or effort you are going to put in. The simplest way to approach this is to determine which of your Retention Rates has the lower percentage. In the case of the sample in Figure 2-2, the Simple Retention Rate is clearly the lower number. You will probably get the best bang for your buck by focusing on raising this. Once you get the Simple Retention Rate up to the level of the Revenue Retention Rate, you can begin working on Revenue Retention. Later chapters in this book will focus on specific techniques for each.

Digging Wider and Deeper

While the analysis shown above comes directly from virtually any Accounting System, you will be able to extract significantly more information if you have an integrated CRM/Accounting System. For example, at our firm we use GoldMine and QuickBooks. The specific versions are not really important for this discussion. What is important is the ability to segregate various types of clients.

We sell a variety of products and services, but let's say we have a computer hardware division and a consulting division. Within our CRM system we track whether clients are dealing with our hardware division, our consulting division or both. Because our CRM system is integrated with our Accounting, we can look at our Retention figures for each of our divisions. This has produced some startling results for us.

We also have several sales people. It is instructive to run the Analyses comparing retention rates by sales person or by customer service person.

Of course, we have clients who are geographically diverse and are associated with different territories or offices within our company. We have found it interesting, therefore, to look at Retention Rates based on which office the client works with.

And, finally, we have big clients and little clients. No matter what spin you hear from various companies about treating all clients equally, the fact is that your biggest clients deserve the best treatment and should cause you the greatest concern with regard to

retention. It is interesting to split out your Focus, A, B and C level (see chapter 5 for a discussion on account levels within your CRM system) to make sure you are retaining the “right” accounts.

Automating your Measurements

If you have any significant number of accounts you will quickly discover that it takes a lot of work to accurately determine these numbers *if you are doing it manually*. That is why very few companies have ever done it. Realistically, it is only practical to regularly monitor Retention Rates if you have an automated way to do so.

That’s why our company developed a spreadsheet based, automated method to regularly produce these numbers with minimal effort. It doesn’t do anything that cannot be done by hand, but it does turn a half-day effort into a 3- minute exercise allowing us to spend the time we just saved analyzing the results and developing plans.

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