FIGHTING CUSTOMER CHURN RATE: AN EXPLORATION OF CUSTOMER DEFECTION IN FINANCIAL SERVICES

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ABSTRACT

Few empirical studies have analyzed financial niched products to evaluate customer churn regarding financial literacy levels in emerging markets. This paper examines the relationship between customer financial literacy and customer churn and investigate the reasons why customers churn in a financial niched product (Consortium) in Brazil. A mixed method was chosen, and a survey was conducted to measure the financial literacy of 2,004 customers. These consumers were tracked for three months after signing the contract and were then separated into churners and non-churners. In the qualitative phase, a semi-structured interview with 12 churners was carried out to identify motivations and reasons why they defected. Results show that churners have lower financial literacy levels. Ultimately, findings suggest three main reasons for defection: 1) Misleading negotiation of the financial niched, 2) Financial restraints, 3) Customer withdraw. Managerial implications are discussed and solutions proposed.

Key Words*: customer churn, defection, Consortium,*

Track*: Services Marketing*

1 Introduction

Churn management has been treated as the main challenge for managers and academics to identify the leading causes and to bring forward tangible solutions. More so in a financial niched product in an emerging market (Brazilian Consortium Segment), the industry background of this research (see Appendix 1 for more detail). It represents a threat to the profitability and might lead to natural negative word-of-mouth that could put in risk the sustainable development of this sector. Furthermore, a common sense in this industry is that the supposedly low level of Financial Literacy of the customers makes it harder to Consortium companies to deal with them during their contract period. Financial Literacy, in turn, is defined by "the ability to make informed judgments and to take effective decisions regarding the use of management of money" (ANZ Banking Group, 2015, p. 02) and will be one of the variables of this research in the following sections.

Hence, this study is important mainly because (1) it is one of the most important segments in the national financial industry; (2) due to its consistent growth in the last decades and consequently more relevance in Brazilian media and; finally, (3) in consequence of the persistent ineffectiveness to manage and improve the retention of the current customers by Consortium managers. In other words, this study aims to analyze and understand the reasons for this outcome and the extent to which organizations can endeavor new techniques and models to control this situation.

This research was segmented in two parts. First off all, on the quantitative part, the hypothesis "*Are financial illiterate people more susceptible to churn in a Consortium?*" was motivated by a commonly accepted idea that less financially experienced and savvy people would be more inclined to give up the consortium share and, finally, churn it. On the second part, the specific objective of this study expects to understand the Consortium client qualitatively: their drivers of choice and their perception of the Consortium business model and why they eventually churned. For this reason, a semi-structured interview was conducted to observe and develop a deep understanding about customer's perceptions on Consortium industry. Twelve churners were invited to this interview that intended to give insights about the following research question: "*What are the customer churn determinants in the Consortium industry?*". Taking advantage of both quantitative and qualitative methods allow this research to reach a broader view of the problem. Moreover, the direct contact with churners enabled a close connection with customer's dissatisfaction factors and attributes that, eventually, made possible drawing some strategies to fight them and enhance customer loyalty and retention in the long-term.

2 Literature Review

In favor of collecting the major references and scholarships available to break down the research question, this study describes first Financial Literacy where it is possible to verify what affects customer churn rates in organizations. Next, churn is examined considering researches in different industries. Finally, the manuscript investigate CRM (customer relationship management) literature – the supportive framework - in light of traditional researches conducted in the last decades that would be the basis for our analysis.

2.1 Financial Literacy

The Organization for Economic Co-Operation and Development (OECD) states that financial education has always been important for consumers to establish a standard to budget, manage, save and invest their resources efficiently, enduring a comfortable financial long-term life. It states twenty-six principles and good practices that should conduct consumer/investor's behavior and financial literacy. Moreover, it defines financial education as "the process by which financial consumers/investors improve their understanding of financial products, concepts and risks and through information, instruction and/or objective advice, develop the skills and confidence to become more aware of financial risks and opportunities, to make informed choices, to know where to go for help, and to take other effective actions to improve their financial well-being" (OECD, 2005, p. 04).

There is an accepted idea that the more experience and education, the more sophisticated and competent an individual might be to manage his/her financial aspects (Edmiston & Gillett-Fisher, 2006; Moore, 2003). Then, literate consumers usually increase the economic security and well- being of all their families (Hogarth & Hilgert, 2002) and become less vulnerable (Roquette et al., 2014). Hence, the opposite is also true, and people usually fail to make the correct decisions because they did not have a personal finance education (Chen & Volpe, 1998), which, in turn, make these people seek professional assistance from financial planners when realizing they cannot handle properly this aspects (Volpe et al., 1996). In other words, seemingly, people are financially irresponsible because they do not know how to make good decisions (Edmiston & Gillett-Fisher, 2006).

2.2 Defecting Customer (Churn)

As part of a marketing and customer relationship management strategy, managers of any industry are worried about customer churn and the reasons a customer decides to switch the suppliers (Larivière & Van Den Poel, 2004). Additionally, they are aware that a long-term "cradle-to-grave strategy" might result in profitability gains (Garland, 2002). Churn rates can vary from industry to industry. Therefore, defection management would be defined as the control and administration, in a coordinated way, to avoid and analyze customer churn through its lifecycle in any organization (Reichheld & Sasser, 1990). To be successful, it should implement retention programs to increase switching costs and extend the length of time that a customer stays to allow them to spend more at the company and that is especially important in cost-cutting, competitive and mature industries where customer acquisition costs are elevated and, hence, customer retention would impact significantly the long-term profits margin (Glady et al., 2009).

2.3 Customer Relationship Management (CRM)

The CRM term has emerged in the 1980s from the information technology (IT) vendor community, willing to describe a technology-based solution that would become known as a sales force automation (SFA) (Payne & Frow, 2005). However, as an SFA tool, it was more interested in routine tasks automatization to enable sales forces to concentrate more on selling than on administrative assignments (Chen & Popovich, 2003). Within the academic professionals, relationship marketing, CRM, and one-to-one marketing are often used correspondingly (Payne & Frow, 2005), although CRM is more discussed regarding tech solution. It is possible to consider CRM a recent management discipline with its roots in relationship marketing and can be described as an evolution of marketing concepts integrated into newly available data and technologies (Payne, 2006).

As Chen and Popovich (2003, p. 676) states, "CRM is a more complex and sophisticated application that mines customer data that has been pulled from all customer touch points, creating a single and comprehensive view of a customer while uncovering profiles of key customers and predicting their purchasing patterns". Authors proposed a different and simple model based on the combination of process, people and technology, called "A CRM Implementation Model" which guides this study.

3 Methodology

Firstly, a quantitative questionnaire was initially applied to recent clients to understand the level of financial literacy they have. The sample consisted of 2,004 clients interviewed in an after-call process. The sample frame was segmented between Churners and Non-Churners during the three first installments, considering the contract signed. The survey consisted of a Likert scale administered by a marketing team in one Consortium company, in a regular and existent after-sales process. In other words, this is a standard process in the company, so just a few questions were included in the existing script. Calls were conducted during weekdays and trained interviewers adapted its procedure to add the financial literacy questionnaire. All interviews were recorded by security purposes. All customers were asked if they would be able to participate in the interview. Seven survey interview questions were adapted from Moore (2003) in a close-end text format. Then, interviewers had to select the chosen answer and record the final results. The answers were categorized and analyzed to be presented in this report.

In the second part, a semi-structure interview was conducted with twelve selected churners, among the 2,004 samples researched previously. Interview questions were general and open-ended. The main goal was to listen to the customer and understand his/her customer journey, challenges and complaints qualitatively. The main findings were summarized into categories to facilitate the analysis. In order to avoid significant costs, since customers are spread throughout Brazil, and to avoid any possible harassment, since customers can be very upset about this situation, the interviews were conducted by telephone and recorded automatically. The recruiting process was designed to reach six (6) churners with lower financial literacy (scoring 21 at most) and (6) churners with higher financial literacy (scoring 22 at least). Besides, it was an attempt to select people from all over Brazil in order to avoid any culture or specific issue. A semi-structured interview was conducted to create a relaxed environment to allow a proper conversation. The researcher was introduced as a third-party management consultant that would conduct a consulting work in the company willing to improve some sales and marketing process. This was necessary to create an atmosphere of trust that would motivate the interviewee to speak freely. Calls were conducted during weekdays and all interviews were recorded by security purposes. All customers were asked if they would be able to participate in the interview. A script was formulated and eventually validated by some company managers in accordance with the research necessities and considering possible legal issues with churners.

4 Data Analysis

In order to analyze the data collected, "churners" were defined as 1 and "non-churners" were defined as 0. Also, other variables that were collected in the survey were also analyzed as independent variables such as gender, age and income bracket. The 2,004 observations collected were gathered in the Minitab version 22 to conduct the statistical analysis.

The statistical results are demonstrated in Table 1. Considering Financial Literacy, Income Bracket, Age, and Gender as independent variables, only Financial Literacy achieved a reasonable p-value (0.076), but none of them are statistically significant under a traditional cut-off of 0.05 to reject the null hypothesis.

Coefficients

Term	Coef	SE Coef	T-Value	P-Value	VIF
Constant	0.388	0.184	2.10	0.036	
Financial Literacy	-0.00388	0.00218	-1.78	0.076	1.00
Income Bracket	-0.00002	0.00694	-0.00	0.998	1.04
Age	-0.00174	0.00122	-1.43	0.154	1.04
Gender					
F	0.208	0.167	1.25	0.213	28.79
M	0.161	0.165	0.98	0.329	28.77

Table 1- Official P-value of Financial Literacy 0.076 after 90 days

However, a relevant trend can be identified. Sixty days after the conclusion of the research with the 2,004 clients, a first statistical analysis was conducted to check the structure of the data and the initial results. The Financial Literacy variable achieved a p-value of 0.116 (after sixty days), seen on Table 2, consistently higher than the final and official p-value (after ninety days) of 0.076, seen of Table 1.

Term	Coef	SE Coef	T-Value	P-Value	VIF
Constant	0.358	0.178	2.02	0.044	
Financial Literacy	-0.00333	0.00212	-1.57	0.116	1.00
Income Bracket	-0.00243	0.00670	-0.36	0.717	1.03
Age	-0.001837	0.000950	-1.93	0.053	1.04
Gender					
F	0.181	0.164	1.11	0.269	29.55
M	0.144	0.162	0.89	0.373	29.51

Table 2 – Non-official P-value of Financial Literacy 0.117 after 60 days

Thus, there is a possibility that the churn rate would increase in the next months, considering the current trends in the company churn management, which, in turn, would potentially reduce the P-value of Financial Literacy to a statistically significant level in a period of six months (180 days) that is considered the best time-frame to draw reliable conclusions about churn management in Company A. It happens for two important reasons:

1. According to the data provided by Company A in graph 1, most part of the clients usually churns until the sixth month (180 days), which means that the 90-day period might be a limitation of this research, not reflecting the real values.
2. Company A pays variable compensation to salesforce segmented in four months after the signed contract. It means that salespeople would put some effort into after-sales in this period since, in case of a churn situation, he/she would not receive his/her compensation for that sale. After these 120 days, he/she would focus only on new deals, which means that the client is without any support from the fourth month and could churn the company easily after this.

Ultimately, this paper is an exploratory research. In other words, this is a research question, and an industry that has not been studied clearly and deeply together and some definitive conclusions would not be recommended to be drawn since it is the very first steps of scientific analysis in this field. Moreover, this paper adopted some proxies to estimate the financial literacy level based on the literature available so far that was applied in a different industry and in a different country. As a clear limitation of the research, it demands some carefulness to interpret the results.

Hence, following a transparent approach to justify and evaluate the alpha and the design choices this paper accepts a significance level of 0.10 ($\alpha = 0.10$) considering the trailblazing approach that this research can bring to Consortium industry in Brazil, even though it means an extreme care to draw conclusions and infer outcomes at the end of the paper. Thereby, a p-value of 0.076 is statistically significant considering all arguments mentioned above, and it is possible to reject the null hypothesis in this case and conclude that there is difference in the Financial Literacy level of churner and non-churners.

5 Implications

Furthermore, the study demonstrates the reasons why the company struggles to keep its customers. Three major challenges were identified:

(1) **Misleading Negotiation**; First and foremost, it was noticed that a relevant share of the churners complained about a fake or misleading negotiation between customer and salesman. For example, some salesman promised a quick nomination to customers if they close the deal immediately, which is impossible promise in the Consortium segment. In other situations, the salesman induced and prepared the customer to answer properly the questions that the "welcome call" team would ask in the following week to avoid a possible sales cancellation. When the customer finally realizes that there is no guarantee of nomination, he/she exhibits a high level of dissatisfaction with the company and immediately looks for a lawyer, engages in a negative word of mouth and reveals his/her frustration on social media. It seems to be reasonable to employ some defensive marketing approach to retain customers (Fornell & Wernerfelt, 1988) or, at least, to not leave them as detractors.

(2) **Financial Restraints**; Secondly, Consortium companies usually focus on lower economic classes as their customer target. They are typically more susceptible to struggle in economic crisis and downturns since they have a lower financial backup to support them in these moments. Apart from that, the credit score analysis in Consortium companies, especially in Company A, is purposely more flexible than in banks and other financial institutions in Brazil. It is a way to reach out to more customers and increase its customer base. However, it pays the price. In some situations, customers might be unexpectedly unemployed or would need to re-prioritize his/her investments and expenditures for any reason. Thereby, either defaulting or churning the contract is a natural path followed by the customer.

(3) **Customer Withdrawal**. Ultimately, as observed in the research, customers apparently took their risks in an unlikely attempt to be chosen in the first months and get their respective credit. Thereby, eventually, they are neither dissatisfied with the company nor feeling deluded by the salesman. They understood the mechanisms and bet they could be lucky enough to be nominated. And when they realize that eventually they were not, they simply withdraw. It is a decent indication of low financial literacy since this decision is not financially savvy at all.

Ultimately, this paper was able to find a p-value statistically significantly under an alpha = 0.10. However, it was clear that the difference in the means is significantly low (Non-Churner 29.216 – Churner 28.967 = 0.246), which means that it has no practical significance to the body of knowledge and Consortium managers. In other words, managers should not worry too much about how literate a potential customer is because there are other reasons that explain the high customer churn rate in this industry (Table 3).

	Overall (N = 2,004)	*Churner (N = 795)*	*Non-Churner (N = 1,209)*
Mean	29.11726547	28.9672956	29.21588089
Standard Error	0.126938628	0.203174705	0.162557013
Median	30	29	30
Mode	22	22	22
Standard Deviation	5.68254207	5.728662049	5.652217455
Sample Variance	32.29128438	32.81756887	31.94756216
Kurtosis	-0.08560848	-0.034236528	-0.114069832
Skewness	-0.491169937	-0.452335422	-0.517453019
Range	35	35	35
Minimum	7	7	7
Maximum	42	42	42
Sum	58351	23029	35322
Count	2,004	795	1,209
Confidence Level (95.0%)	0.24894557	0.39882305	0.318925436

Table 3 – Churner and Non-Churner Means

In addition to the theoretical contributions, the study pursued to make a pragmatical contribution to Consortium companies. The five commandments below (Table 4) are an endeavor to consolidate all the body of knowledge visited during this research with the main takeaways from the findings, considering the unique Consortium segment context.

CHURN CHALLENGE – CONSORTIUM COMPANIES SHOULD FOLLOW "FIVE COMMANDMENTS"	
1)	Define clear sales and churn goals to salesforce representatives
2)	Include loyal customer attraction bonuses in the salesforce compensation
3)	Implement a CRM strategy and hire an After-Sales team
4)	Identify a customer target and encourage its attraction
5)	Invest in communication with the customer to avoid misunderstandings about Consortium

Table 4 – The Five Commandments

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7 Appendix

Consortium (free translation to *Consórcio* in Portuguese) is a quintessential financial service available in some countries of South America since the 1960s, being a formal industry in Brazil. Having developed initially through big banks, the Consortium system has been spread in countless specialized companies around Brazil that endeavor to challenge these huge players and to differentiate themselves from the intense competition (ABAC, 2015). Officially constituted in 1962, this typical Brazilian service was born with a group of employees that worked at *Banco do Brasil*, aiming to buy cars. Consortium is a gathering of different people, under the management of one company, that have the same consumption purpose, to raise funds to acquire a credit line in order to buy assets (cars or real estate) or services (trips, surgery, academic courses), via self-funding (ABAC, 2015). Around 120 companies are represented by this association, and they are accountable for about 250 thousand direct and indirect jobs, 4 million clients and a market valued at R$ 20 billion in the entire country (ABAC, 2018). The last ten years has been very successful to the entire system, ensuring constant coverage and publicity in the economics pages. Notably, the top five company have approximately 50% of the market share. Most importantly, four companies are huge Brazilian Banks, and one is an Automaker, which demonstrates the industry dynamics and complexity to specialized companies.

The core operation of a Consortium is relatively simple. In general, the administrative company is in charge of attracting and selling the credit shares, let's say a car to simplify, to customers. The price paid is a large number of installments that represent the sum of the car plus an administration fee, which is the actual company's revenue. All in all, some characteristics are clear in the Consortium industry:

- Every participant pays the exact same amount of money.
- Every participant must keep paying from the first to the last installment, regardless of the drawn results.
- A participant might be either the first or the last one to receive the credit. It is all about luck.

In other words, this is the main difference from other plans, most notably the financing and leasing one. Although it is way more expensive, a financing plan allows one to enjoy the purchased goods from the moment he/she signs the contract, which is usually the desire of any client.