AutoNation: Driving customer loyalty in a fragmented industry

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Vikash Singh
has more than 14 years of experience in the automotive and travel industry. He has hands-on experience in revenue management, pricing optimisation, marketing mix and econometric modelling, advanced customer analytics, revenue forecasting/modelling, and digital and web analytics. Prior to joining AutoNation, Vikash worked in a number of analytics and management positions at Carnival Cruise Lines and Grand Circle Cruise Lines. He has an MS in industrial engineering from the University of South Florida and a certification in general management from Harvard University.

AutoNation Inc., 200 SW 1st Ave, Fort Lauderdale, FL 33301, USA
Tel: +1 954 769 3028; E-mail: singhv@autonation.com

Sheena Banton
has 12 years of marketing experience across financial services, and the technology, travel/hospitality and automotive industries. Her specialties include marketing strategy, customer loyalty and channel management, with a focus on leveraging data, technology and analytics to drive insights, decisions and results. Sheena has a BS in marketing from the Stern School of Business at NYU and an MBA from the Kellogg School of Management at Northwestern University.

AutoNation Inc., 200 SW 1st Ave, Fort Lauderdale, FL 33301, USA
Tel: +1 917 861 8141; E-mail: bantons@autonation.com

Abstract Most companies strive to improve their customer retention yet struggle with how to approach customers with relevant messages, products and offers to drive profit. The purpose of this case study is to illustrate how AutoNation (www.autonation.com) has leveraged analytics to drive its customer loyalty in a fragmented, automotive industry. Strategies such as RFM segmentation, propensity-based modelling and control group methodologies are used to define a dynamic customer journey, support marketing programming and deliver value.

KEYWORDS: Customer Segmentation, AutoNation, Customer Loyalty, Automotive Customer, RFM segmentation, Propensity Based Segmentation

INTRODUCTION

AutoNation, headquartered in Fort Lauderdale, FL, is America's largest automotive retailer.[1] AutoNation is a component of the S&P 500 Index and owns and operates 370+ new vehicle franchises across 30+ automotive brands (OEMs) in 15 states. AutoNation offers a diversified range of automotive products and services, including new and used vehicles, automotive repair services, and automotive finance and insurance products. In June 2015, AutoNation sold its 10 millionth vehicle, the only auto retailer to have achieved this milestone.[2]

With an ongoing fight for market share and retail volumes among OEMs, however, multi-brand dealership groups need a solution that allows cross-selling between brands and keeps the customer loyal to a particular dealership group. This introduces challenges in the OEM–dealership relationship and requires a balanced approach that serves the customer best, which in turn builds long-term loyalty and lifetime value.

The first challenge is that the typical AutoNation customer gets communications and offers not only from AutoNation, but also from OEM brands, all with limited synchronisation. It can therefore feel as though AutoNation is running 370+ separate businesses in silos. AutoNation therefore seeks to reach its customers effectively and build a customer journey that promotes loyalty to AutoNation.

AutoNation announced in January 2013 that it would completely replace the localised brand names of its retail operations with its own, coast-to-coast brand name.[3] This re-branding was supported and approved by the major OEMs, including GM, Ford, Chrysler, Nissan, Toyota and Honda. With national branding, AutoNation was poised for an opportunity to approach customer segmentation, refine its customer journey and promote loyalty to the AutoNation brand.

This case study describes how AutoNation is building a customer segmentation strategy and framework to manage the customer journey, achieve customer lifetime value and drive long-term financial value for AutoNation.

THE AUTOMOTIVE CUSTOMER

Approximately 85 per cent of new car buyers say they were satisfied or very satisfied [per industry Customer Satisfaction Index (CSI) scores] with the car-buying experience,[4] yet same-brand repurchase rates in the automotive industry range between 40 and 50 per cent.[5,6]

Moreover, customers who service their vehicles with AutoNation are five times more likely to repurchase from AutoNation than customers who never service their vehicle there. Overall, nearly one-third of sales revenue and three-quarters of service revenue are generated from existing customers. Thus, service visits not only build loyalty, but also drive a significant share of AutoNation's gross profit. Therefore, in order to build loyalty and retain customers, service visits are the key to sustaining engagement between multi-year buying cycles.

It comes as no surprise, then, that the primary focus of the traditional automotive customer journey is the service reminder programme and communication cadence. For instance, AutoNation's traditional customer journey can be summarised in four phases (Figure 1), the longest of which is the service and retention phase:

1. acquisition and conquest;
2. onboarding and engagement;
3. service and retention;
4. repurchase.

This traditional customer journey has served AutoNation well during a time when the automotive industry was at its peak and marketing dollars were in abundance.

The challenge with the traditional customer journey, however, is that it is a 'one-size fits all' approach; it is neither

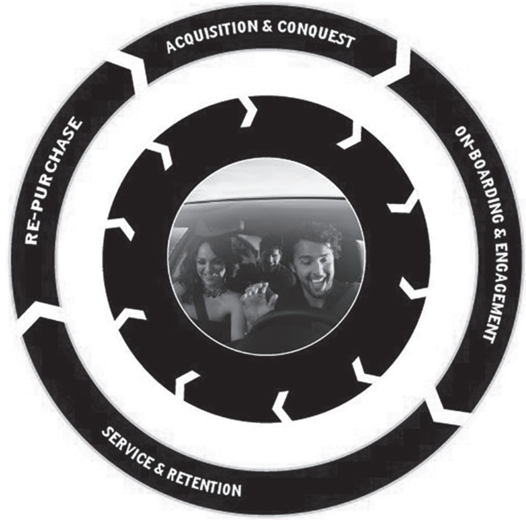


Figure 1: AutoNation's customer journey

dynamic nor tailored to any particular customer segment. It also does not take into account changing macro-economic factors, such as the plateauing automotive industry[7] or shifting consumer demands and technology preferences towards a fully online experience.[8]

Therefore, as AutoNation strives to grow its market position in a stagnating environment, it must continue to develop customer segmentation strategies and refine its customer journey as a means of realising more value with limited resources.

DEVELOPING A SEGMENTATION STRATEGY

The objective of AutoNation's customer segmentation strategy is three-fold:

1. develop differentiated customer servicing and retention strategies;
2. optimise marketing spend and campaigns via refined targeting, offers and tailored communications; and
3. provide a mechanism to measure and monitor the health and performance of the customer database.

Different segmentation strategies were considered, including Recency-Frequency-Monetary (RFM), decision-tree algorithms, unsupervised clustering and propensity-based modelling. AutoNation ultimately settled on a combined approach — RFM for customer segmentation and propensity-based modelling (ie likelihood to purchase/service scoring) for campaign execution[9] (see Figures 2 and 3, respectively, and Table 1 for a comparison of the strategies).

RFM segmentation

The primary purpose of RFM segmentation is to set a benchmark for evaluating customer database health and growth. It is based on three simple customer attributes: recency of purchase, frequency of purchase and monetary value of purchases.

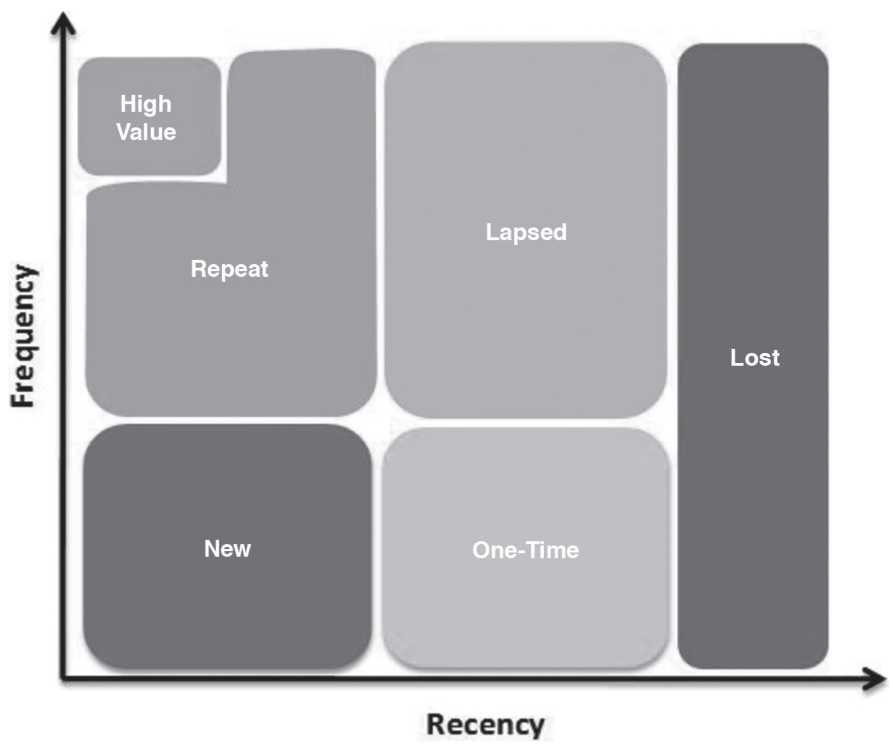


Figure 2: Recovery-Frequency-Monetary segmentation model

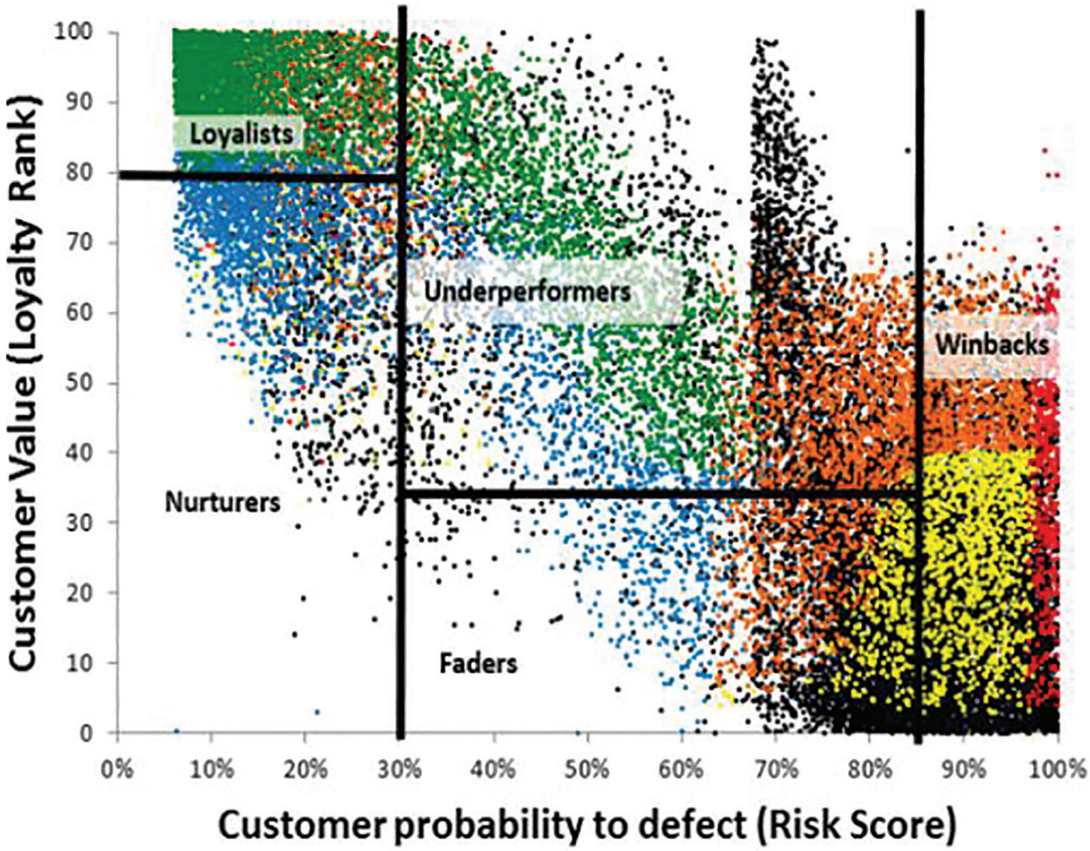


Figure 3: Propensity-based modelling

Table 1: Segmentation approach comparison

Segmentation approach	**Pros**	**Cons**
RFM model	Simple to understand by business stakeholders	Is backward-looking and therefore sacrifices forward-looking, predictive qualities
	Ability to differentiate meaningful KPIs by customer segment	RFM customer segments are kept static for a long period of time (6–12 months)
	Based on actual transactions and results versus predicted response	Challenging for marketers to use for optimising their programmes in the short-term
Propensity-based modelling	Predictive and forward looking; ability to predict consumer behaviour and target consumers for specific communications	Based on predicted response, not on actual transactions and results
	Helpful in identifying and treating customers *before* they deflect and become inactive	Logistic regression and propensity scoring can be more difficult concepts for business stakeholders to grasp
	Based on a multivariate scoring system that uses variables like year-to-date revenue, purchase likelihood, inter-order wait times, purchase delay, etc (versus just RFM variables)	
	Evaluated frequently compared to RFM to identify and prioritise target audiences for marketing campaigns	

Key: KPIs: key performance indicators; RFM: Recovery-Frequency-Monetary

RFM segmentation was also selected for its simplicity to understand by business stakeholders and its ability to differentiate meaningful key performance indicators (KPIs) by customer segment (eg less than 10 per cent of high-value customers drive over 50 per cent of total service revenue). RFM customer segments are kept static for a long period of time (6–12 months) to measure and monitor AutoNation's retention, churn and defection rates.

While RFM segmentation is easy to understand, manage, measure and communicate, it sacrifices forward-looking, predictive qualities that marketers leverage to optimise their programmes. Hence AutoNation does not use RFM segmentation for campaign execution purposes. This is where propensity-based modelling comes into play.

Propensity-based modelling

The primary purpose of propensity-based modelling is to develop communication strategies and execute campaigns. It is rooted in the following two components:

1. A Scoring system that uses variables like year-to-date revenue, purchase likelihood, inter-order wait times, purchase delay, recency, etc;
2. Risk assessment defined by likelihood that the customer will not make another purchase before they deflect and become inactive.

This modelling was selected alongside RFM for its ability to predict consumer behaviour and target consumers for specific communications. Propensity-based modelling is evaluated periodically to identify and prioritise target audiences for marketing campaigns.

As an example, AutoNation optimises its programmes by communicating to customers who are in-market and likely to purchase or service a vehicle in the next couple of months. The combined approach further optimises the programmes by only featuring offers to a segment of customers who require incentives to consider AutoNation for service, whereas a loyalist may not need an offer or incentive to transact.

MEASURING PERFORMANCE

Like many retailers, AutoNation utilises complex, multi-channel programmes to communicate with its customers. Evaluating the impact of individual marketing campaigns or components is challenging because customers are exposed to a variety of messages and offers through many different channels (Figure 4). In addition, these same customers are exposed to a variety of messages and offers from the OEM brands across similar channels. How then should one approach measuring the effectiveness of a campaign, communication strategy and subsequent impact on customer performance?

To tackle this dilemma, AutoNation combines two analytical tactics to measure performance:

- *Campaign control holdout*. Used for performance measurement of individual campaigns, a campaign control provides incremental lift analysis of a treated population versus that of a smaller, representative sample withheld from the campaign. A drawback of this tactic is that the campaign control group in one period could receive campaigns in a previous or subsequent period and thus misrepresent cumulative performance over time.
- *Universal Control Group* (*UCG*). UCG is used to set benchmarks for segment performance and measure the impact of AutoNation's overall campaign strategy on customer database performance. It consists of a randomly selected group (<5 per cent) of customers which is representative of the entire customer database. The UCG was suppressed from all AutoNation campaigns and communications for over two years. The UCG allows for the measurement of the cumulative effect of all AutoNation

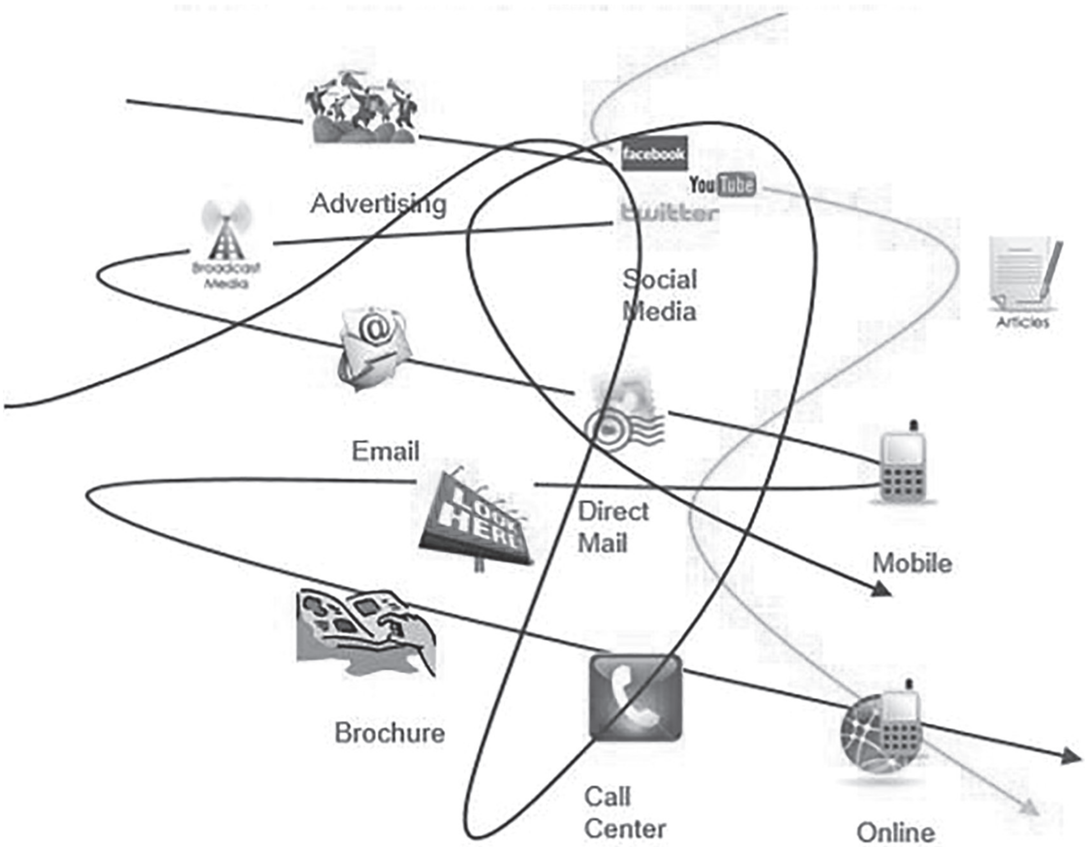
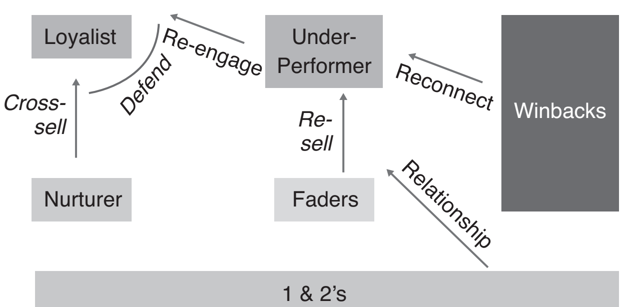


Figure 4: Retail customer communication landscape

marketing communications and the measurement of a 'true', natural purchase rate of a customer segment.

THE EVOLVING CUSTOMER JOURNEY

With RFM segmentation, propensity-based modelling and performance measurement in place, AutoNation is evolving its customer journey into something that is dynamic and actionable for the business and that builds customer loyalty to AutoNation. For illustration, for each customer segment a strategic objective has been defined (identified by the arrows in Figure 5), with a corresponding communication strategy (referred to as the 'Customer Care Offer'; see Figure 5).



Segment	Segment Description	Customer Care Offer
Nurturers and 1 & 2	Low Risk/Moderate Value Visited an AN store 1-2x	No Offer
Nurturers	Low Risk/Moderate Value	Offer vs No-Offer Test
Faders	Low Value/Mid Risk	Offer
1 & 2	Visited an AN store 1-2x	Offer
Loyalists	High Value/Low Risk	No Offer

Figure 5: Sample customer segments

Therefore, as customers graduate into and begin to deflect out of segments, there is an appropriate course of marketing actions to take. The ultimate goal, of course, is to prevent attrition as well as to promote engagement.

CONCLUSION

Most marketing programmes at AutoNation have an integrated analytics framework to identify eligible sales and service customers and to maximise incremental profit generated by programmes. Segmentation and modelling continue to be important strategies for AutoNation, as the automotive industry continues to plateau, margin compression on vehicle sales continues to tighten and resources are constrained.

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