

Customer retention: Building customer loyalty for long-term success



AI-ready financial infrastructure for PE-backed software and MSP businesses.

Disclaimer: To produce this document, we have used industry reports and collated the views of investors in our network.



“Customer acquisition is marketing. Customer retention is product.”

Marc Benioff - Founder and CEO of Salesforce



Why is customer retention important?

Gross dollar retention, net dollar retention and logo retention are three key metrics which determine the health of your recurring revenue streams. These are seen as stability indicators for technology companies.

What is this ratio and why is it so important?

Retention metrics help investors assess how much your customers love your product and the effectiveness of your company's customer retention strategies. As investors/acquirers will often come from financial backgrounds, they will use these metrics to determine the strength of your solution.

Strong retention metrics are vital for technology companies as it can cost up to five times more to acquire a new customer than to retain an existing one*. This means that technology companies need to be able to retain customers in order to thrive in the long term.

In this document, we will explain the main terms used in retention calculations and explore three key metrics:

- I. Gross dollar retention
- II. Net dollar retention
- III. Logo retention



Common customer retention terms

When calculating retention, it is important to understand the key terms used in the calculations. Your numbers will be driven by any changes in customer behaviour over the last 12 months.

Key elements to understand when calculating retention rates

Overall, retention calculations look at the ARR from your customers today (MRR in latest month x 12) and compares this to the ARR from your customers 12 months ago. Any movements are categorised into one of the following groups:

- **Downsell** = Customers generating **less** recurring revenue now than they were 12 months ago
- **Loss** = Customers who you were recognising recurring revenue from 12 months ago but are not now
- **Expansion / upsell** = Customers generating **more** recurring revenue now than they were 12 months ago
- **Win** = Customers who are generating recurring revenue now but were not 12 months ago

For example, if a customer's MRR was £10k in March 2022 and the same customer's MRR is £12k in March 2023, then this would be calculated as a £24k upsell $((12k-10k) \times 12)$.



Gross retention

Gross retention measures the percentage of customers who renew their subscriptions for another period of time on a dollar basis. A high gross retention rate indicates the product works well and the business has an effective customer success process.

£'000s	Jan 2023	Feb 2023	Mar 2023
Starting ARR	10,115	10,001	10,065
Downsell	(61)	(60)	(85)
Loss	(807)	(450)	(450)
Gross retained	9,247	9,490	9,529
Expansion	3,362	3,186	3,060
Net retained	12,609	12,676	12,589
Win	2,777	2,981	3,463
Closing ARR	15,386	15,627	16,052
Opening number of clients	70	70	70
Clients won in year	28	30	32
Clients lost in year	(2)	(2)	(2)
Closing # of clients	96	98	100
Closing avg ARR	160	160	161
Gross retention	91.4%	94.9%	94.7%
Net retention	124.7%	126.7%	125.1%
Logo retention	97.1%	97.1%	97.1%

Calculation

$$\text{Gross retention} = \text{Gross retained} / \text{Starting ARR}$$

What is a good score?

The maximum possible gross retention score is 100%. A good gross retention rate depends on your customer base. The following rates are considered strong depending on the size of your customer demographic:

- SMEs >80%
- Enterprise > 90%



Net retention

Alongside revenue growth, net retention is seen as one of the most important metrics for any technology business. Higher net retention demonstrates a more stable customer base and higher growth potential, which attracts investors/acquirers.

£'000s	Jan 2023	Feb 2023	Mar 2023
Starting ARR	10,115	10,001	10,065
Downsell	(61)	(60)	(85)
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Logo retention	97.1%	97.1%	97.1%

Calculation

$$\text{Net retention} = \text{Net retained} / \text{Starting ARR}$$

What is a good score?



Logo retention

In order to fully understand a company's recurring revenue streams, investors consider logo retention alongside gross and net retention. This ensures a more balanced assessment as it will not be impacted by large movements in a single customer.

£'000s	Jan 2023	Feb 2023	Mar 2023
Starting ARR	10,115	10,001	10,065
Downsell	(61)	(60)	(85)
Loss	(807)	(450)	(450)
Gross retained	9,247	9,490	9,529
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Logo retention	97.1%	97.1%	97.1%

Calculation

Logo retention = (closing # of customers – new customers) / opening # of customers

What is a good score?

The maximum possible logo retention score is 100%. Good logo retention scores vary depending on the size of your customers. The following rates are considered strong based on the size of customers you serve:

- Small businesses: **70% - 80%**
- Mid market: **85%**
- Enterprise: **90% – 95%**



How else should I be digging into churn?

Retention is a key driver of customer lifetime value. It is therefore critical to understand this on a cohort basis. This allows you to identify your most profitable customer profile and focus your sales and marketing efforts on acquiring more of these customers.

What other ways can I look at my customer retention?

- I. Create customer cohorts – do certain types of customer behave differently? Some examples include:
 - I. Geography
 - II. Sector
 - III. Feature (e.g. customers on the *'premium'* plan have lower churn than on the *'basic'* plan)
 - IV. Value
 - V. Customer acquisition channel
 - VI. Year won
- II. Investigate usage periods – do customers consistently churn after a certain time period?
- III. Feature usage – do customers churn after using or not using a particular feature for a certain time period?
- IV. Analyse feedback – make sure you understand why customers are leaving so you can rectify the issues
- V. Drill into usage/engagement metrics – identify patterns around declining usage and churn



Glossary

Acronym	Explanation
SaaS	Software as a Service
ARR	Annual Recurring Revenue
MRR	Monthly Recurring Revenue
SME	Small and Medium-sized Enterprises



The authors

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Who do we work with?

High-growth technology companies with institutional investors looking to:

- Have an accurate real-time view of KPIs ;
- Spend less time collating information and more time focussing on growth ;
- Make more informed data-driven decisions ;
- Deploy follow-on capital more efficiently ; or
- Ensure their portfolio companies are ready for corporate finance transactions at any time.

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