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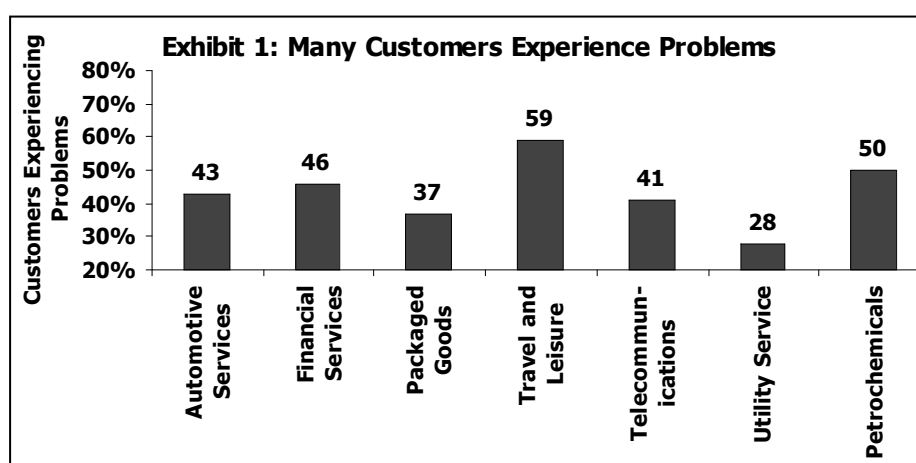
Customer Loyalty And The Bottom Line



Customer Loyalty and the Bottom Line

Evalue knows many organisations with missions to "delight" customers with product and service quality which "exceeds customers' expectations". Delighting customers may well be a waste of resources, if it cannot be justified in terms of its impact on increased revenues and the bottom line.

In addition, these lofty ambitions are often unrealistic. In the real world, many customers are presented with problems and disappointments with product and service delivery, as shown in Exhibit 1. Then, to make matters worse, they are frustrated in their attempts to resolve their problems. In Evalue's experience¹, for most organisations, it is easier and more rational to focus first on reducing customer disappointments than it is to attempt to delight them.



Organisations with an advanced approach to customer value management realise that the purpose of customer satisfaction measurement is to identify areas where quality can be improved. Management moves from simply measuring customer satisfaction to using the data collected for making decisions. They have less concern about reporting high satisfaction scores and more interest in identifying deficiencies. For this reason, it is more accurate to characterise these efforts as *dis/satisfaction* measurement. Further, a serious effort is made to justify customer-driven quality in terms of bottom line results. The emphasis moves to improving and tracking customer value in addition to customer satisfaction.

Baseline Dis/satisfaction Measurement

Only when an organisation understands the gap between customer expectations and reality can improvements be planned, cost-justified, managed and delivered consistently to maximise customer value. Our baseline dis/satisfaction measurement service enables our clients to:

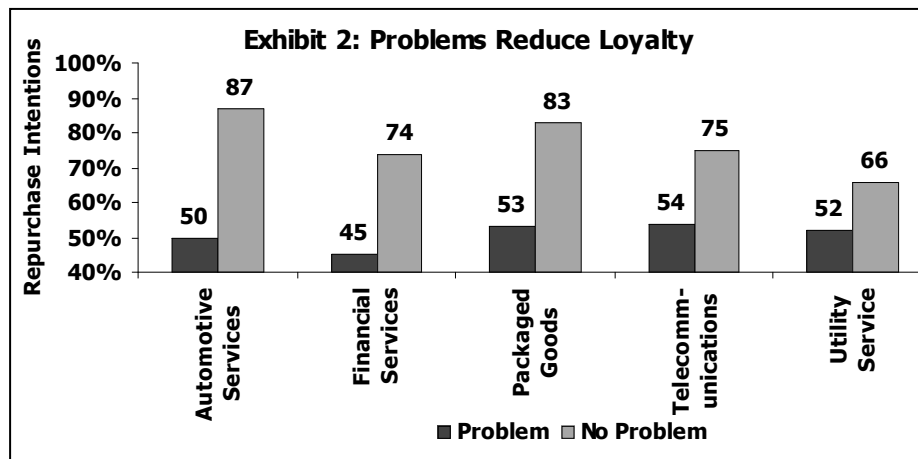
- ◆ Measure customer satisfaction and loyalty as they relate to the client's products, services and contact handling across all touch points.
- ◆ Pinpoint specific areas of customer dissatisfaction and the specific problems that cause the most market damage – or lost loyalty.
- ◆ Identify the profits lost as a result of specific customer problems and poor contact handling practices.
- ◆ Identify the key satisfiers and retention factors in the customer/ organisation relationship.

¹ Evalue was formerly TARP Australasia. TARP findings like "it costs five times as much to gain a new customer as it does to keep an existing one" have become part of the global customer service culture. All data in this letter are sourced from TARP or Evalue research.

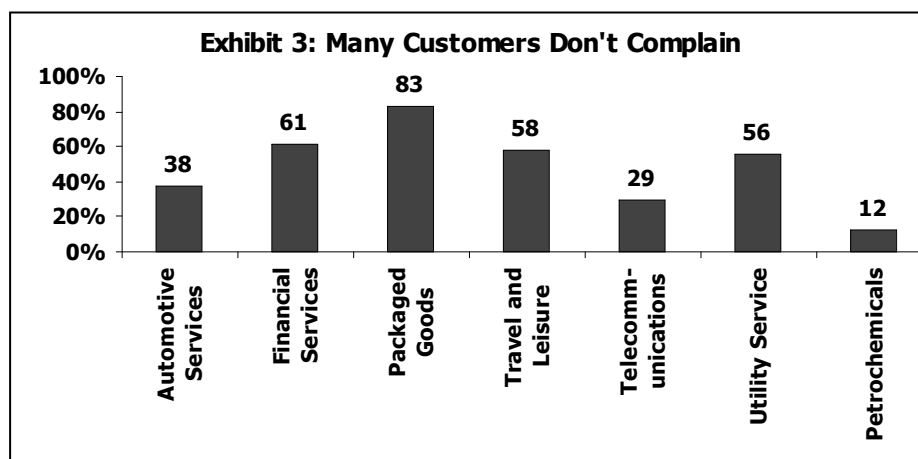
- ◆ Identify areas of advantage and disadvantage versus competitors in products, services and contact handling.
- ◆ Benchmark customer satisfaction and loyalty against other organisations.
- ◆ Use customer expectation data to fine-tune customer service standards.
- ◆ Identify the key drivers that should be incorporated into ongoing customer satisfaction and loyalty tracking systems.

The Tip of the Iceberg

Across most industries, problem experience reduces customer loyalty by 10% to 30%. Exhibit 2 illustrates the potential impact of problems on customer loyalty for a variety of industries.



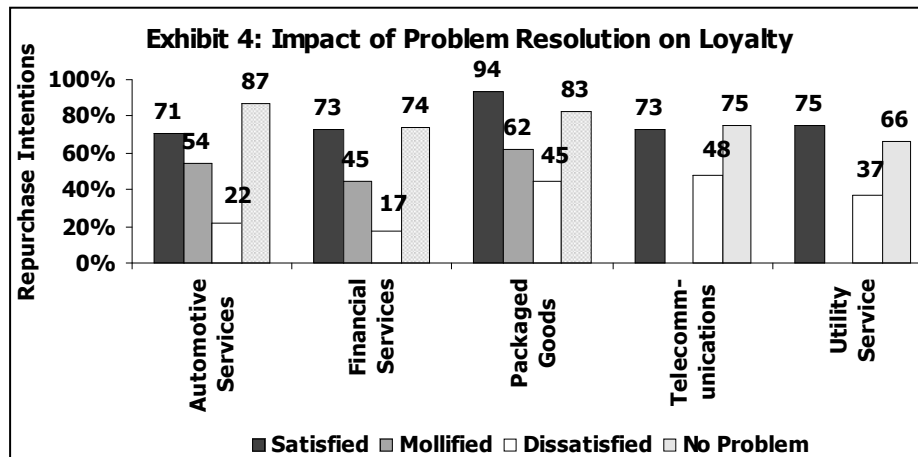
When a problem occurs, you can retain the loyalty of customers only if they tell you about the problem. Unfortunately, many customers never contact the organisation when they need assistance or have a problem, thereby depriving it of a chance to retain their loyalty. On average across all industries, around 50% of all consumers and 25% of all business customers with problems never complain to anyone. They often just take their business somewhere else. See Exhibit 3.



Most of those who do complain grumble to the receptionist, the delivery person, the field sales representative or the accounts clerk. The contact centre usually receives only 10% to 60% of all the complaints filed. When your product or service has a retail distribution channel (e.g., insurance agents, supermarkets) your contact centre will usually get less than 15% of all the problems, and sometimes as little as 1% of the complaints – the tip of the iceberg.

A Complaint is a Gift

An organisation can, however, recover all of a customer's loyalty if it can get the customer to call with a problem and then provide a solution that satisfies this customer. Exhibit 4 illustrates that customers who are satisfied have loyalties similar to those of customers who had no problem. It also shows that if they are mollified, you have a good chance of retaining their loyalty, but if they are dissatisfied, their loyalty is lower than it was before the organisation tried to deal with the problem. In other words, if you're going to offer customer service to help retain customer loyalty, you must be in a position to resolve the problem. Otherwise, you have a customer who has been dissatisfied, not once, but twice.



In many industries, a complaining customer whose problem is solved becomes more loyal than a customer with no problem. This, we believe, is because until the customer has a problem, "service" and "quality" are merely advertising slogans. Once the customer encounters a problem and the organisation acts to resolve it, the customer thinks, "Wow! They really do have great service."

These behaviours also apply to monopolies and government agencies. Although customers of these organisations probably cannot switch brands if they are not satisfied, they can demand extra services, become repeat complainants or escalate their complaints to regulators, thereby driving up costs.

Word of Mouth

Service also affects an organisation's ability to influence word of mouth. Exhibit 5 gives average word of mouth data for small and large transactions. We have found that twice as many people hear about a bad experience, as about a good experience. Also, people tend to pay more attention to bad word of mouth. Negative word of mouth has twice the negative impact as positive word of mouth has positive impact. In our modelling, we usually assume that one out of 50 customers hearing negative word of mouth will not buy, while one out of 100 customers hearing positive word of mouth will buy.

**Exhibit 5: Word of Mouth Behaviour
(median persons told of experience)**

	Satisfied	Dissatisfied
Small problems	5	10
Large problems	8	16

Closing the Gap Between Customer Expectations and Reality

How does an organisation measure the gap between reality and the expectations of its customers, and how can it use this information to prioritise, plan, cost-justify, manage and deliver improvements in products, services and contact handling?

First, you need the profit value of the average customer². We used to think that this data was universally available. We have learned that only about one third of companies have this data at hand, but it can be assembled from the following data elements:

- ◆ Number of annual sales to average customer.
- ◆ Period of loyalty of average customer.
- ◆ The average profit per sale.

Second, you need data on customer problem experience, complaint behaviour, and the impact of contact handling. We field surveys to customers who have recently contacted the organisation and customers within relevant segments to address these issues:

- ◆ **Question/ Problem Experience**
 - ◆ The percentage of customers experiencing a question/ problem recently
 - ◆ The specific questions/ problems customers experience
 - ◆ The average number of questions/ problems experienced per customer
 - ◆ The questions/ problems considered to be the most serious from the customer's perspective
 - ◆ The percentage of customers who request assistance in resolving their most serious question/ problem
 - ◆ The reasons why customers do not request assistance
 - ◆ The touch points that customers use to request assistance (eg., store, field rep., contact centre, web site, etc.)
 - ◆ The average number of contacts the customer must make to receive final action on their most serious question/ problem
- ◆ **Contact Handling Effectiveness**
 - ◆ Customer satisfaction with the action taken to resolve the most serious questions/ problems
 - ◆ Estimate of the average time required for final action
 - ◆ A comparison of the time required for final action with customer expectations for response time
 - ◆ Satisfaction with the contact experience in terms of access (eg., ease of contacting), personnel (i.e., professionalism, knowledge, and courtesy), and response characteristics (i.e., timeliness, clarity, and helpfulness)
- ◆ **Key Drivers of Customer Satisfaction/ Dissatisfaction/ Loyalty**
 - ◆ Satisfaction/dissatisfaction with the organisation in terms of the key areas of the organisation/ customer relationship (eg., product quality, purchase experience, service experience, etc.)
 - ◆ Ratings of the most important areas of the organisation/ customer relationship
- ◆ **Key Competitive Advantages/ Disadvantages of the Organisation**
 - ◆ Position in marketplace relative to competitors (i.e., who is the best in the marketplace, who is better than the organisation)
 - ◆ Reasons why competitors are better than the organisation, in terms of product and service quality and contact handling effectiveness

² In a government or other not-for-profit environment we use the additional costs incurred in correcting the problem.

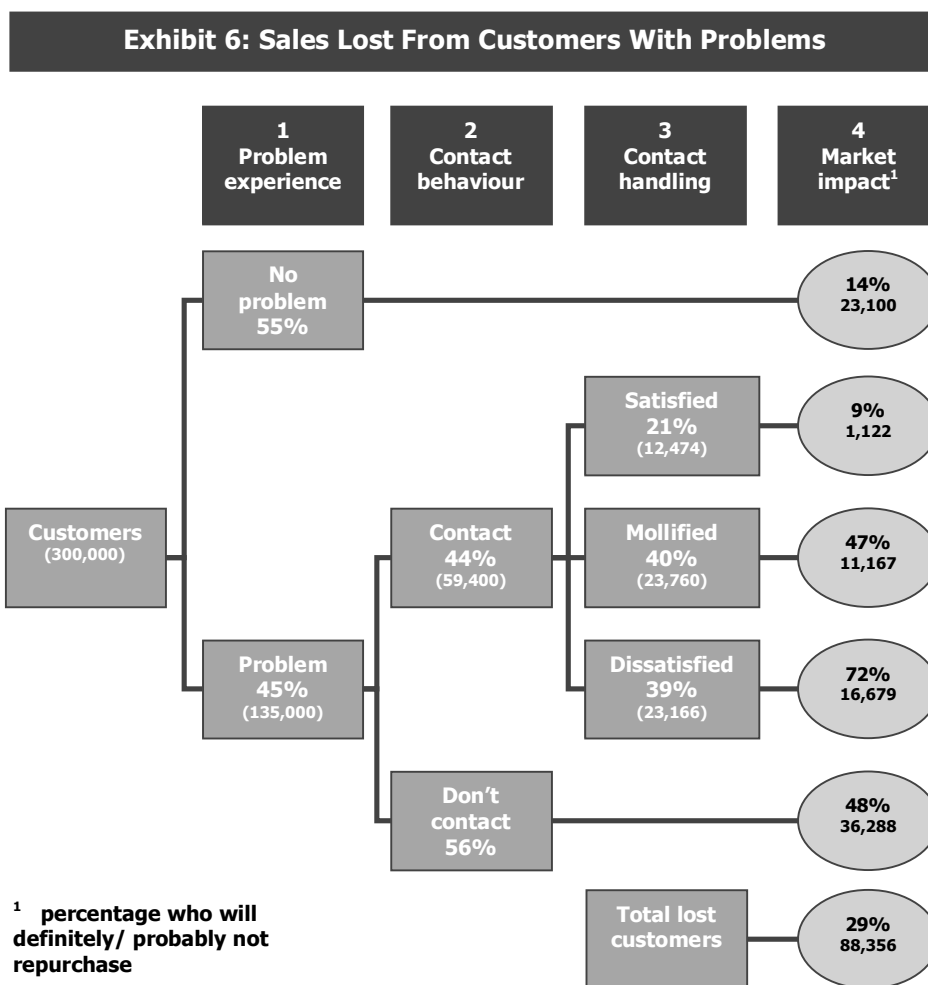
◆ **Market Impact - the impact of question/ problem experience, contact behaviour and customer satisfaction with the action taken on:**

- ◆ Overall satisfaction with the organisation
- ◆ Willingness to repurchase the same product/ service
- ◆ Willingness to purchase additional products/ services
- ◆ Willingness to recommend the organisation
- ◆ Word-of-mouth behaviour

◆ **Items of Special Interest to the Organisation**

Quantifying Market Impact

With this organisation and survey provided data, we can quantify the market impact of product and service quality and contact handling effectiveness. A typical example is explained in Exhibit 6. Our example company has 300,000 customers.



55% of its customers have had no recent problems or concerns with its products or services and only 14% of these do not intend to repurchase from the company. This customer loss is due to pricing, product features and other competitive issues. While all of these factors can be addressed, they are in the domain of product development and marketing, not quality and customer service.

Of the 45% who had a problem or concern, only 44% contacted the company. Of these customers, 21% were satisfied with how their problem or concern was resolved and only 9% or 1,122 of these customers do not intend to repurchase from the company. They are more likely to repurchase than those who had no problem at all!

Continuing this process, we calculate that the total number of lost customers is 88,356 or 29% of the customer base. We need to adjust this calculation by:

- ◆ Adding the potential customers lost due to negative word-of-mouth. In this example the answer is 3,976, derived by a process similar to that outlined above.
- ◆ Subtracting the number of customers lost due to pricing, product features and other competitive issues, rather than quality or contact handling issues. Extrapolating the customer loss from customers who had no problems, we obtain a figure of 18,900.

The net loss is 73,432 customers or 24% of the customer base. In our example the company has advised that the average customer makes five purchases per year, generating an average profit of \$35 each, over a 3.5 year average loyalty period. We can conclude that product and service quality problems and contact handling practices reduce the lifetime value of this company's customer base by \$45 million. In other words, they reduce profits by \$12.8 million per year. This is the breakeven maximum amount that can be spent annually on product and service quality improvements and customer contact handling improvements.

An important lesson to be learned is which aspect of the service system loses the most customers. Note the largest number of customers (36,288) is lost from those who never contact the company. This makes a strong case for aggressive solicitation of feedback and easy accessibility of customer service systems. Further, it is essential that customers who do contact the company are satisfied with the resolution of their issue.

Quantifying Product and Service Quality Improvements

The next question to be posed is: "Which particular product or service quality issues cause the most market damage, or lost loyalty?" To answer this question, we need to distinguish between the frequency of problems and their severity. The top six specific problems³ our example company's customers face are listed in Exhibit 7.

Customers face frequent problems with product availability and installation times, perhaps because the company is supplied by an overseas factory. Each of these top two problems causes between \$4 million and \$10 million market damage, in terms of lost customer lifetime value. At the least, the company should examine how to manage customer expectations about installation times. The high cost of spare parts is a less frequent but very severe problem, causing comparable market damage, but it may also be outside the control of the company in any meaningful way.

³ In practice, the problems are more specific and vivid than these generic examples.

Exhibit 7: Market Damage Caused by Specific Problems

Customers Experiencing Problems: 45% (135,000)		Repurchase Intentions		Customers Lost		Value of Customers Lost	
Problem Experienced	Problem Frequency ¹	Will Not	May Not	Min.	Max ² .	Min.	Max.
Products on back-order	46.4% (62,640)	10.3%	15.4%	6,452	16,098	\$4.0m	\$9.9m
Installation took longer than promised	39.0% (52,650)	13.7%	12.4%	7,213	13,742	\$4.4m	\$8.4m
Errors in invoices	28.2% (38,070)	11.5%	6.7%	4,378	6,929	\$2.7m	\$4.2m
Sales rep. product knowledge inadequate	22.1% (29,835)	15.1%	10.2%	4,505	7,548	\$2.8m	\$4.6m
Post installation training of poor quality	18.5% (24,975)	28.0%	22.9%	6,993	12,712	\$4.3m	\$7.8m
Spare parts too expensive	17.8% (24,030)	32.1%	27.2%	7,714	14,250	\$4.7m	\$8.7m

¹ Based on multiple selection

² Based on "will not" plus "may not" repurchase

There are frequent and annoying errors in invoicing. Customer problems with training occur less frequently but are very severe. The good news is that these problems are more within the control of management, and should be given priority attention. The cost of fixing them should be much lower than the cost of ignoring them.

The baseline dis/satisfaction survey examines customer experiences across a much longer list of potential problem areas. Management can conclude that the above ranked list of "most damaging" problems should be given priority attention over less frequent and/ or less severe problems. Of course, the complete list is likely to identify several "quick wins".

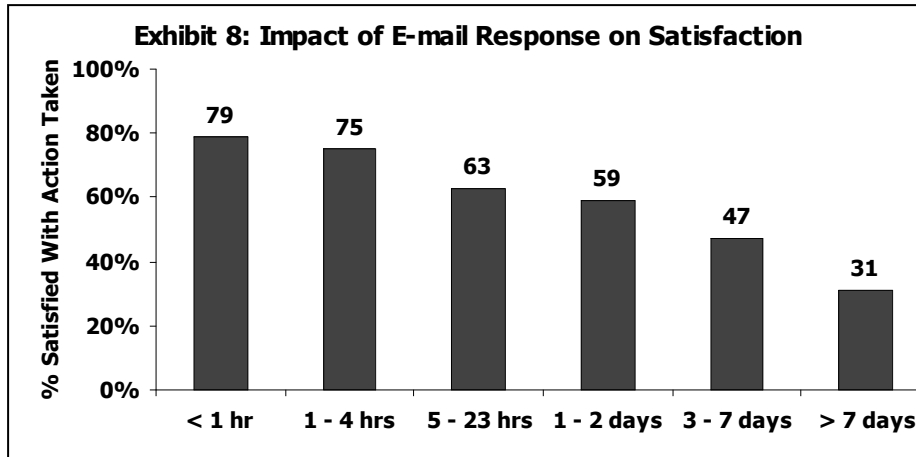
Quantifying Contact Handling Improvements

The baseline dis/satisfaction study examines customer expectations of and satisfaction with contact handling across all touch points. Management obtains valuable diagnostic information about:

- ◆ The touch points customers use to resolve questions/ problems (eg., store, sales rep., contact centre, web site, etc.).
- ◆ The ease of access of customers to the organisation, and to the right person within the organisation (eg., store locations, contact centre queue lengths, telephone menu system navigation, etc.).
- ◆ The professional capabilities of the staff customers contact (eg., knowledge, courtesy, helpfulness, etc.).
- ◆ The relationships between customer expectations of and satisfaction with specific aspects of contact handling.
- ◆ The impact of specific aspects of contact handling on customer loyalty.

This information can be used to set customer-driven service standards for contact handling. Exhibit 8 shows the relationship between e-mail response times and customer satisfaction with the action taken as a result of the e-mail, for our example company⁴. A response within four hours has much the same impact as an immediate response. A slower response on the first day may as well be handled within two days.

⁴ Please note that we have found that expectations of and satisfaction with contact handling by web form and e-mail vary dramatically by industry and organisation. This exhibit is illustrative only.



Market damage (lost loyalty) calculations may also be made to determine the priorities for, and breakeven expenditure on, contact handling improvement initiatives, using the process outlined above for evaluating product and service quality improvement initiatives.

Concluding Comments

Our baseline dis/satisfaction measurement service offers seven key benefits. It:

1. Provides benchmark measures of customer satisfaction and loyalty across products and services, and contact handling across touch points. In so doing, the research findings become *actionable*.
2. Pinpoints specific areas of customer dissatisfaction and those problems that cause the most market damage (i.e., lost loyalty). Because the customer problems that occur most frequently are not necessarily those that cause the most market damage, it is essential also to identify the severity of specific problems. It is then possible to target finite resources for quality and service improvement to those areas that have the greatest impact on customer loyalty. In so doing, the research findings become *actionable*.
3. Identifies the profits lost as a result of customer problems/ poor contact handling practices, enabling the organisation to target its finite resources to those areas that have the most significant impact on profitability. In so doing, the research findings become *actionable*.
4. Identifies the key satisfiers and retention factors in the organisation/ customer relationship that can be reinforced to delight customers and further increase loyalty to the organisation. In so doing, the research findings become *actionable*.
5. Identifies areas of competitive advantage and disadvantage. Baseline research can be used to compare customer satisfaction with the organisation versus competitors. When this information is linked with the information concerning market damage, a powerful priority setting tool is available for identifying competitive advantages and disadvantages in the marketplace. In so doing, the research findings become *actionable*.
6. Enables the organisation to use customer expectation data to fine-tune its customer service standards, based on actual customer expectations. In so doing, the research findings become *actionable*.
7. Provides the organisation with an empirical definition of the key drivers that should be incorporated into an ongoing customer satisfaction and loyalty tracking and management system. In so doing, the research findings become *actionable*.