

Customer satisfaction and loyalty

- where product and service quality hit the bottom-line!

by Paul G Linnell

The intuitive link between customer satisfaction and loyalty is one that has been traditionally hard to quantify. Many market research companies agree that even “satisfied customers” will defect. Unfortunately this fact has done more to drive companies to inaction than it has to demonstrate the clear business gains that can be derived from maximising customer satisfaction.

The problem is that customer satisfaction is seldom expressed in financial terms. Many organisations simply categorise customer satisfaction measurement as a form of “marketing intelligence” instead of using it as a management tool to build the customer into their quality improvement processes and increase profit. As a result, companies often know the cost of providing good service but they rarely know the cost of providing bad service.

A recent study conducted by CTMA in New Zealand showed that a quarter of respondent companies didn't have a systematic approach to measuring customer satisfaction and only 13% adopt an approach that would allow them to effectively manage it upwards. The ability to move from simply measuring levels of customer satisfaction and loyalty to being able to actively manage them upwards makes a significant difference in justifying investment in this area.

Economic truths of customer satisfaction

The economic imperative for more companies to take the measurement and management of service quality and customer satisfaction more seriously is clear when you consider the implications of poor service that CTMA has confirmed in another recent New Zealand study.

There are five key economic truths that impact an organisation wishing to improve the bottom-line of customer service.

The key economic truths of customer satisfaction:

- Problems drive customers away.
- A lot more customers experience problems than you think.
- As satisfaction levels drop loyalty drops faster!
- Effective customer service and response pays back.
- Unhappy customers spread the word!

1. Problems drive customers away

Although actual loyalty levels vary from one industry to another, there is typically a 25% drop in loyalty between those customers who have experienced a problem and those who have not. In revenue terms this could be the equivalent of losing some, or all, of the revenue from one in every four customers who experience a problem.

2. More customers experience problems than you may think

For many organisations, the only measurement of customer problem-experience comes from their complaints department. As many as half of your customers may actually be experiencing problems, even though only 5% may complain and bring the problem to your attention.

3. As satisfaction levels drop loyalty drops faster!

A popular corporate satisfaction metric is to determine through surveys what percentage of customers are either “very satisfied” or “somewhat satisfied”. Although even “very satisfied” customers may not be 100% loyal, there is a significant drop in loyalty between the “very satisfied” and “somewhat satisfied” customers sometimes as much as 50%.

4. Effective customer service and response pays back

Our research also confirms the importance of effectively dealing with customers when they do

As satisfaction levels drop, loyalty drops even faster.

complain. Customers can be very demanding but, with an effective response, it is still possible to obtain a more loyal customer afterwards than you had before they experienced the problem!

5. Unhappy customers spread the word!

How often do we find ourselves taking part in one of those "...you'd never guess what happened to me the other day..." type conversations? You know it's not going to be a good-news story. Our research confirms that customers tend to tell twice as many people about a bad experience with customer service than a good one.

Revenue at risk from dissatisfaction

The degree to which poor customer service can have a negative impact on both an organisation's revenue and profit can be estimated using a combination of company-specific survey data and company-specific financial data.

Economic modelling can also help to identify the potential return on investment (in terms of increased revenue and profit) that may arise from specific service quality improvement initiatives. For example:

- Estimate the increase in sales resulting from a 5% reduction in customer problems.
- Assess the revenue benefits from encouraging more customers to complain.
- Calculate the return on investment in complaint handling skills training.

This type of modelling can produce a compelling business-case for investment in customer service and customer-driven quality improvement programmes.

Simplified revenue at risk model

A more simplified model, based on the five economic truths of customer satisfaction, demonstrates the considerable bottom-line benefits that can be achieved by from service excellence.

The model (see Figure 1) uses the number of active customers and the average annual revenue derived from those customers. Survey data can reveal precisely how many customers experience problems but for the model we have assumed a conservative

35%. We have also assumed the typical 25% drop in loyalty from those customers who experienced problems.

From these inputs, the model shows that for a company with 500,000 customers, each providing, on average, an annual revenue of \$200, there is nearly \$9 million revenue at risk from poor customer service.

Take the model one step further and it shows the annual profit at risk through poor service. Simply enter the average annual profit per customer on the second line instead of the average annual revenue per customer. Thus, for a company earning 25% profit from the \$200 revenue per customer each year, the profit at risk would be more than \$2 million dollars.

	Survey data	Company data
Number of customers		500,000
Average annual revenue per customer	-	\$200
Percentage of customers experiencing problems annually	35%	↕
Number of customers experiencing problems annually	175,000	
Drop in loyalty due to problem experience	25%	↕
Customers at risk due to problem experience	43,750	
Annual revenue at risk		\$8,750,000

Figure 1. Simplified revenue at risk model

Using more sophisticated modelling and more robust company-specific survey data, it is possible to include additional influences such as complaint-handling effectiveness and customer loyalty behaviour. This provides a valuable insight into revenue and profit at risk from poor product and service quality.

Direct costs of poor service

Unhappy customers also cost you more in many ways. In addition to the significant revenue risks that arise from problems experienced by customers, there are areas where unnecessary additional costs are incurred. These will vary from one industry to another but consider how the following may apply in your organisation:

Other costs of poor service:

- Lower sales and marketing effectiveness.
- Increased service costs.
- Increased compliance costs and organisational wear and tear.

Unhappy customers cost you in more ways than you think.

Sales and marketing effectiveness

Consider your organisation's sales and marketing budget. A major portion of sales and marketing effort often goes into replacing existing customers who have left as a result of poor service. By keeping your existing customers happy, marketing and sales can grow the business by attracting new customers, not waste resources simply replacing those who have defected.

Increased service costs

Customers who complain about problems they experience generate additional costs to the organisation such as the:

- Cost of time taken to handle the complaint.
- Cost of product repair or replacement.
- Cost of making good the poor service.

Increased compliance costs, organisational wear and tear

Customers who have experienced problems in the past tend to be more demanding and are sometimes slow to comply with policies and procedures.

This often leads to additional processing costs and de-motivated staff. Staff who are de-motivated tend to have a negative influence on customer satisfaction, and so the spiral continues in a downward direction. In short, unhappy customers cost you more and wear you down.

Quality for profit and profit from quality

Since the quality-revolution of the 1980s, companies have needed to increase their focus on reducing costs and increasing productivity. Unfortunately, for many this has had counter-productive results. All too often, the productivity improvement or cost reduction has been at the expense of customer satisfaction and has led to lost customers and lost revenue.

The potential returns from investments in product and service quality is therefore one of the greatest remaining opportunities for business improvement. For appreciable growth to be achieved, organisations must now strive to retain their best customers, relentlessly discover and fix the problems they experience and find out why they are at risk.

Simply put, it is a matter of building value by managing the quality of the customer experience.

From our work with clients around the world, we have identified four important steps an organisation must take in order to fully exploit these opportunities and transition from merely measuring to managing customer satisfaction:

Step 1: Start measuring customer satisfaction in financial terms

By expressing customer satisfaction / dissatisfaction in financial terms, an organisation can estimate the economic importance that the problems experienced by customers have to the business. This helps to drive appropriate management actions, justify resources expended on remedies and measure the effectiveness of improvements.

Step 2: Establish a baseline of customer satisfaction and loyalty

To begin the improvement process, an organisation must establish a baseline of customer satisfaction and loyalty that will also identify specific areas of poor performance and sources of customer dissatisfaction. This can be best achieved by adopting a “product and service quality” approach to customer research.

Such a baseline should include estimates of revenue or profit risk, identify problems that customers experience and their impact on loyalty, identify what customers do when they experience problems and how well the organisation responds when they complain.

The baseline not only provides a financial estimate of the size of the problem, it also provides a prioritised list of actions that need to be taken to fix it.

Step 3: Establish a “Learning from Customers” programme

Establish, and provide adequate resources for an ongoing programme for learning from customers. The initial task is to prioritise and manage the actions arising from the customer satisfaction and loyalty baseline. The ongoing role is to provide the organisation with a continuous capability to track the changing needs of customers, identify problems they experience and prioritise them for remedial action.

Managing customer satisfaction is managing profitability.

Step 4: Conduct ongoing tracking of customer satisfaction

Moving beyond the findings and actions arising from the baseline, an organisation must put mechanisms in place to track customer satisfaction and loyalty on an ongoing basis. This provides the regular systematic feedback necessary for the ongoing management of customer satisfaction and loyalty, and the measurement and control of effective improvement initiatives.

Corporate transformation "To Do" list:

- Start measuring customer satisfaction / dissatisfaction in financial terms.
- Establish a baseline of customer satisfaction and loyalty that provides a financial estimate of the size of the problem and prioritises actions that need to be taken to fix it.
- Establish a "Learning from Customers" programme to champion and enable customer-driven quality-improvement throughout the organisation.
- Conduct ongoing tracking of customer satisfaction to monitor improvements and manage satisfaction.

When measured in financial terms, it is easy to see why customer satisfaction should become the foundation to all other measures of business performance. Satisfied customers will return to buy more, recommend you to others, cost less to sell to, and cost less to service. In short, organisations that actively manage customer satisfaction are actively managing their ongoing profitability.



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