

## **Does customer satisfaction pay?**

In 1987 the American Consumer Association revealed that it cost five times as much to win a new customer as it did to keep an existing one. This was the trigger which propelled many organisations in the advanced economies into a customer focused business strategy. The 1990s saw a huge expansion in the customer service function in most companies, a greater emphasis on service quality and widespread adoption of customer satisfaction measurement. More recent evidence that it might cost twenty times as much to win customers than to keep them seemed to ratify the 'customer is always right' stance adopted by most businesses. The pre-eminence of the customer has been long enshrined in most balanced scorecard models including Malcolm Baldrige and EFQM and has recently been recognised by the new ISO 9000 quality standard which requires companies to measure customer satisfaction to verify that their products and services are meeting customers' requirements.

For most organisations, however, all this customer focus, whilst intuitively justifiable, has been little more than an act of faith and in recent times a gradually increasing number of heads have been tentatively raised above the parapet to question wisdom of organisations' obsession with customers. Some of this sniper fire has been firmly rooted in ignorance. People have pointed out that satisfied customers defect, so satisfying customers must be pointless. This is like saying that strikers costing over £10 million do sometimes miss easy chances, therefore no football club should have one. Of course, the bigger picture almost invariably shows that satisfied customers and expensive strikers are better than dissatisfied and cheap ones and that very satisfied and very expensive ones are usually better still, albeit rarely perfect. But wouldn't it be useful if we could quantify this? How much more valuable is a totally satisfied customer who scores 10 for satisfaction compared with a very satisfied one (9), a quite satisfied one (7), a somewhat dissatisfied one (5) etc?

We do know that the value of customers can vary enormously. Pareto analysis has long been applied to customers, but American marketing academic Philip Kotler has recently extended this concept into the 80-20-30 rule. As shown in the chart, he suggests that some customers are so unprofitable that they can consume as much as half the revenue generated by the profitable ones.

Figure 1: The 80-20-30 rule

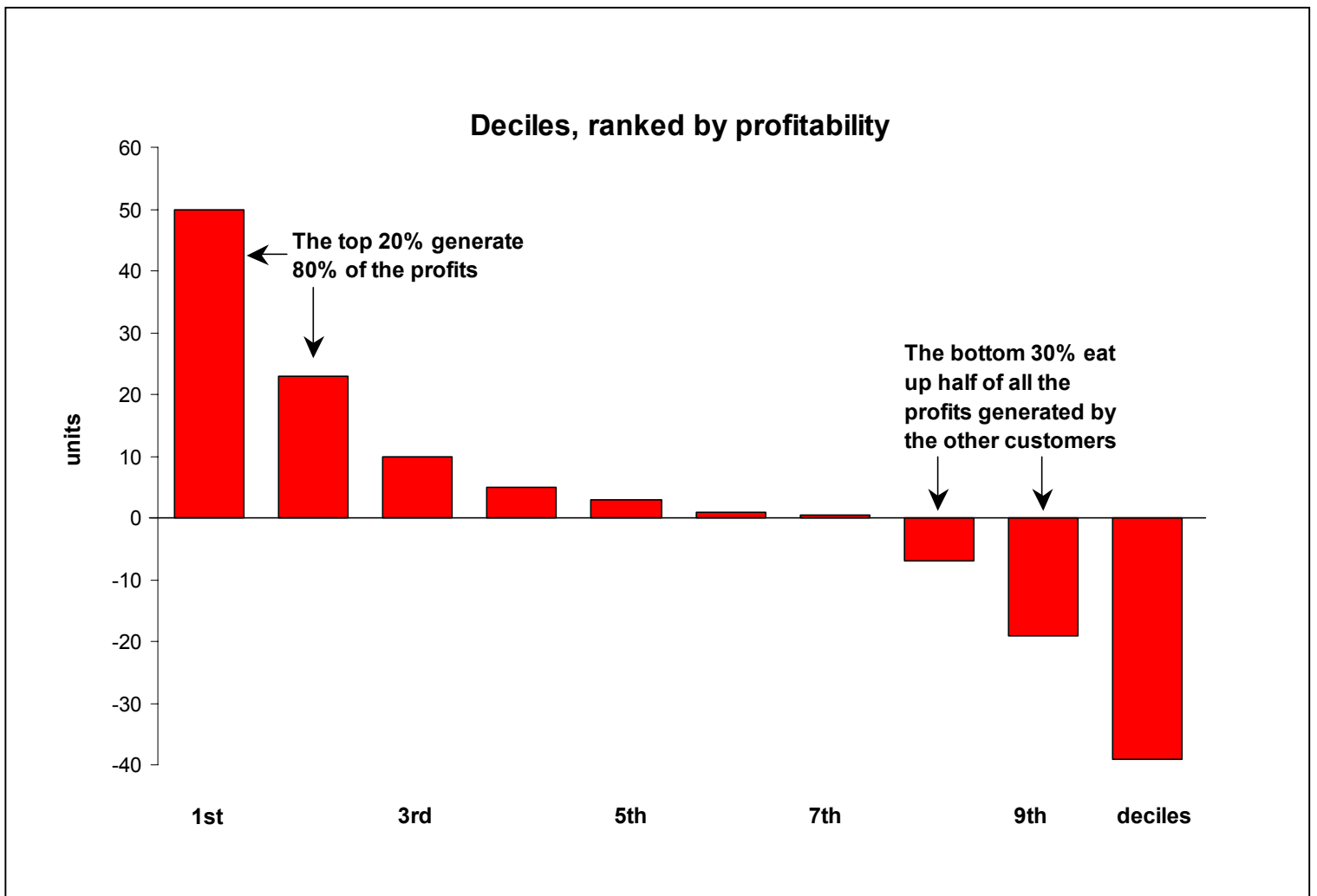


Figure 1

In reality the 80-20-30 rule is much more applicable to some sectors than to others. In banking, where large numbers of customers are serviced completely free of charge (current account holders with credit balances), it is easy to see the applicability of the concept. But that's rather like saying that if you give products away free to some customers while others pay large amounts for highly priced products, the latter will be more profitable. Hardly a revelation, and it certainly doesn't enable us to judge whether it pays to make customers satisfied. To make that type of judgement you have to be able to compare the impact made on your business by varying degrees of satisfied customers, but this can be tricky.

In the researcher's perfect world you could split your customers into three identical groups, work hard and invest resources to create high satisfaction in group A, ignore group B (the control group) and actively create low satisfaction in group C. Provided

there were plenty of customers in each group, you could conduct this experiment for five years and assess the result with a high degree of statistical reliability. Doing this would ensure that all other factors which may influence customer loyalty such as new competition, national marketing campaigns, the state of the economy, fashion, the weather and anything else which changes over time, would not affect one group more than any other. So the resulting change in customer base would be almost certainly due to the differing levels of customer satisfaction in the three groups over the period. Ask the CEO of your organisation if such an experiment can be conducted and you may be seeking new employment fairly quickly! However, if you have enough data, you can draw those conclusions without experimenting on real customers, as shown in the Toyota example.

Figure 2: Customer satisfaction pays at Toyota

Linking customer and market data Automotive industry illustration				
	To dealers on customer satisfaction	Bottom dealers on customer satisfaction	Difference	
Net profits	\$102,158	\$69,693	\$32,465	47% better
Net profit as % of total sale	1.61%	0.89%	0.72%	81% better
Net profit per employee	\$1761	\$1056	\$705	67% better
New vehicle selling expense: % Total new vehicle sales	4.72%	5.09%	0.37%	7.3% better
Net profit as % gross profit	12.12%	6.97%	5.15%	74% better
Salesperson turnover	23.60%	41.20%	17.60%	43% better
Advertising	\$79,032	\$112,858	\$33,826	30% lower
Source: Toyota Motor Sales, USA				

Correlation techniques are used to measure the extent to which two or more variables are related. The two examples in Figure 3 show that customer satisfaction is strongly related to staff helpfulness but has little relationship with staff appearance. If you wanted to improve customer satisfaction it would clearly make more sense to improve staff helpfulness than staff appearance.

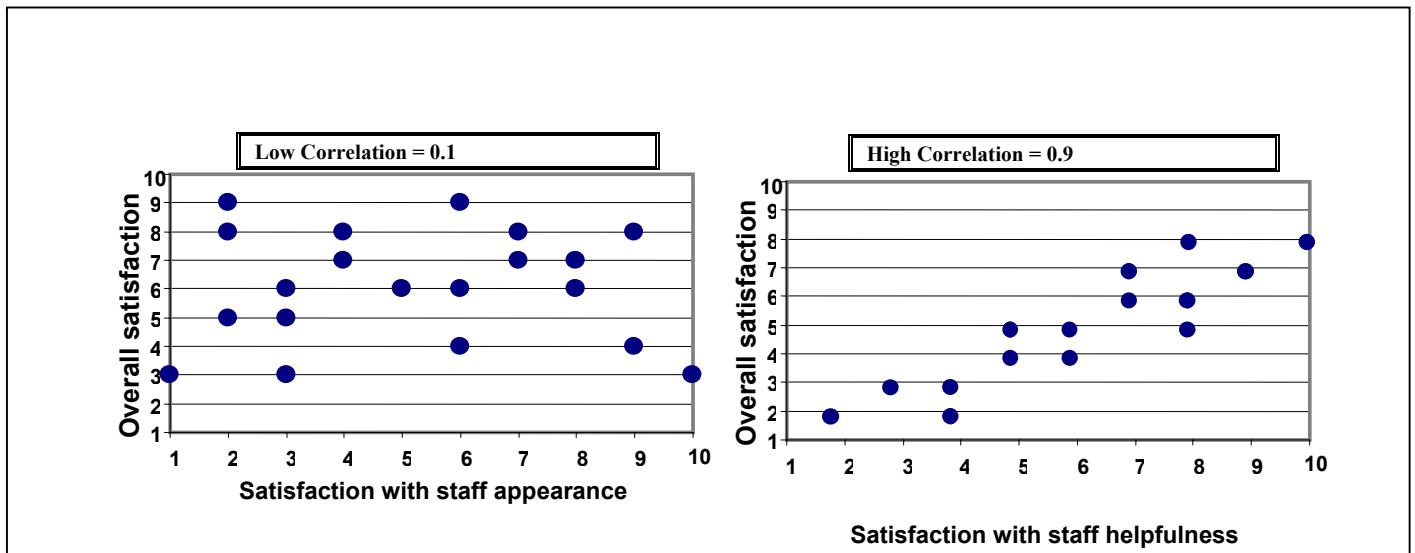


Figure 3: Correlation

The same techniques can be used to establish the relationship between financial performance its possible drivers, and the process is known as Profit Chain Modelling. As shown in Figure 3, correlation works by establishing the extent to which two or more variables are related. Will a movement in one result in a similar change in the other? The units of analysis in Figure 3 are individual customers, who have provided scores in a survey. Using individual customers as the units of analysis for profit chain modelling is unusual since most companies cannot accurately identify profitability at that level. It is therefore more feasible to build profit chain models using points in time or business units as the units of analysis. Like most statistical techniques, the reliability of correlation increases with the size of the data set, which means that it can take several years to build up enough data to conduct robust time series analysis. Consequently, most of the successful profit chain models have been based on making comparisons across business units such as stores, branches, divisions, brands etc. Provided you have information on the financial performance of each unit of analysis you can collect data on customer satisfaction and loyalty (for Customer-Profit Chain modelling) and on employee satisfaction and commitment (for Employee-Customer-Profit Chain modelling). The more units of analysis you have, the more reliable the models will be, but worthwhile models have been developed with as few as ten to twenty units.

The Employee-Customer-Profit Chain model built by the Canadian Imperial Bank of Commerce is based on its 1,300 branches and is extremely reliable. CIBC uses its employee survey to produce a composite measure of ‘employee commitment’ at branch level and customer surveys to establish a measure of ‘customer loyalty’ by branch. Both are compared with branch profitability.

Figure 4: Profit chain modelling at the Canadian Imperial Bank of Commerce

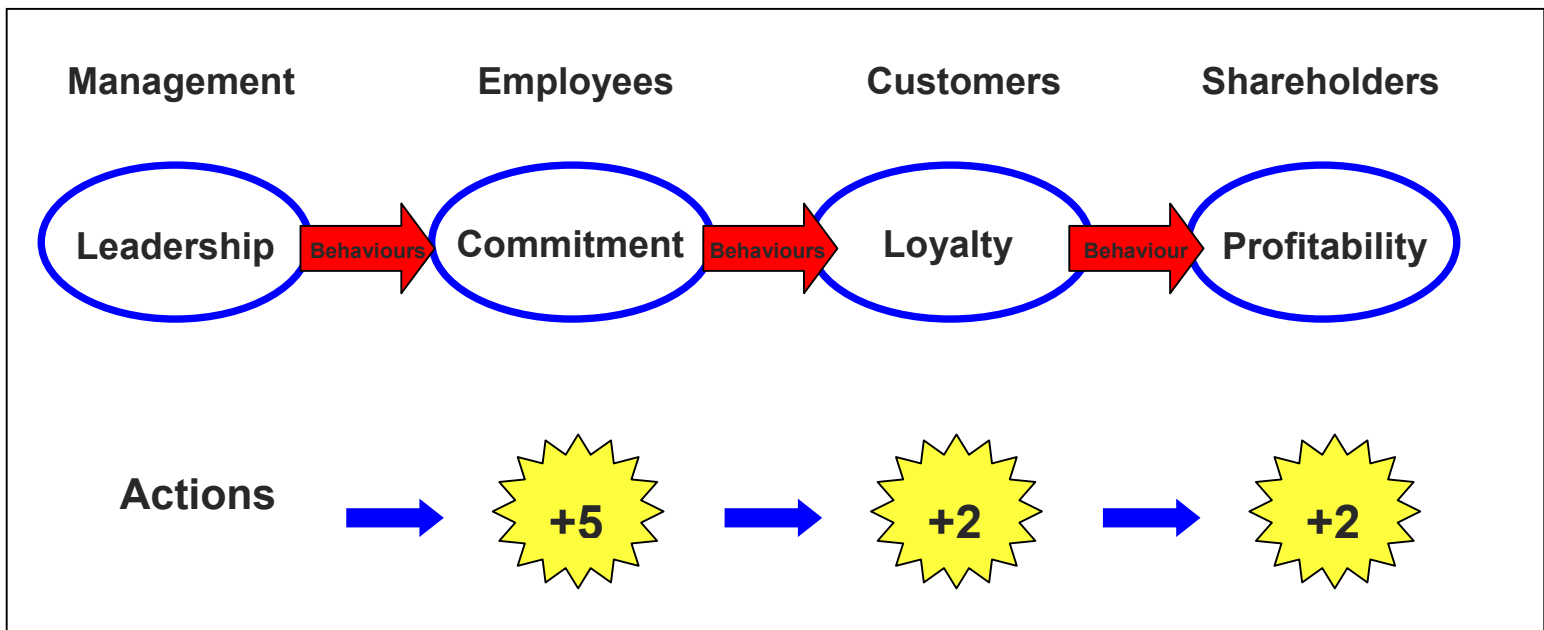


Figure 4

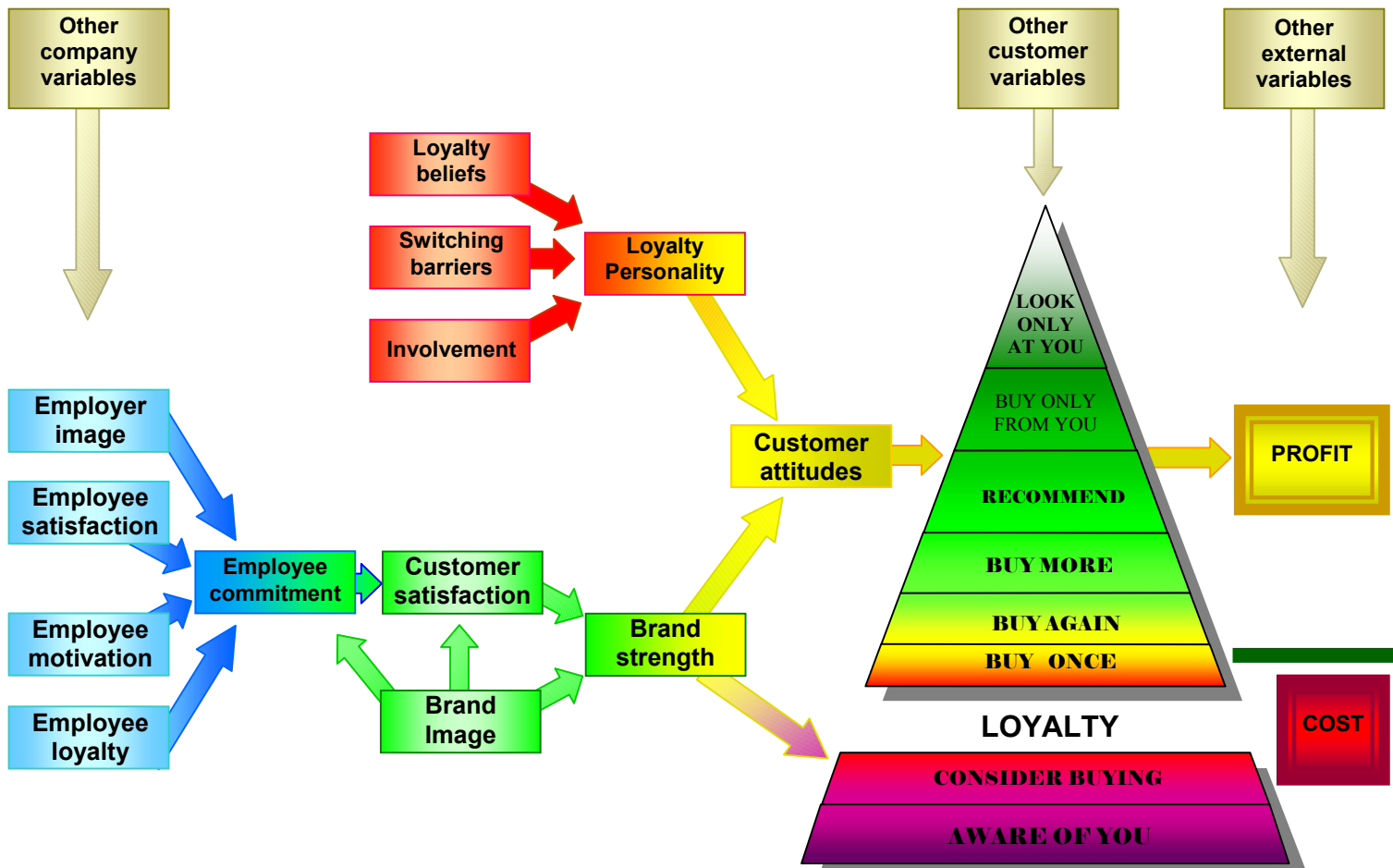
Since building its profit chain model, the bank has learned that a 5% increase in employee commitment results in a 2% gain in customer loyalty which, in turn, drives a 2% gain in profit and for CIBC, this was worth \$72 million in one year!

Other companies have also built similar models demonstrating the value of improving employee and / or customer satisfaction. The earliest, and probably still the most famous is the Sears model which shows that for them, a 5% increase in ‘employee attitude’ produces a 1.3% gain in ‘customer impression’ which results in an additional 0.5% increase in profit. In the industrial sector, Dow Chemicals have built a model showing that a 1% increase in loyalty generates a 1.2% increase in account share (the main driver of profitability in their market) and IBM demonstrated that a 1% increase in its Customer Satisfaction Index was worth an extra \$500 million in sales over the following five years.

These are not the only profit chain models that exist. I know from The Leadership Factor’s work that other companies have built profit chain models but are reluctant to allow them to enter the public domain because they see them as a strong source of competitive advantage. And how right they are! A detailed and reliable profit chain model provides an unparalleled platform for making strategic and operational decisions. Sophisticated correlation techniques such as canonical correlation, path analysis and latent variable modelling (such as partial least squares) will identify just how much of your profit is accounted for by customer loyalty, customer satisfaction, employee commitment and other variables. Over time you can refine the model to accommodate more of the ‘other variables’. Even if customer satisfaction accounts for only 25% of profit or employee commitment for only 15%, that knowledge provides a huge boost to managers’ decision making capability since it enables them to calculate the likely return from investing in various employee or customer initiatives.

Of course, profit chain modelling is not simple. If it were, everybody would be doing it. The CIBC's Employee-Customer-Profit chain of 5%-2%-2% is unique to the Canadian Bank, as are the components of its 'employee commitment' – 'customer loyalty' – branch profitability model. No two companies, even direct competitors in the same sector, will have identical models. It is also simplistic to assume that profit will be explained just by two variables (however powerful) such as employee commitment and customer loyalty – the full CIBC model is far more complex. However, The Leadership Factor has developed a generic Employee-Customer-Profit Chain model which is widely applicable as a starting point for most companies.

Figure 5: A generic Employee-Customer-Profit Chain model.



## THE TLF SATISFACTION PROFIT CHAIN MODEL

Figure 5

Shown in Figure 5, the model demonstrates that there are many variables that may affect the outcome. However, it provides a valid basis for building your own Employee-Customer-Profit Chain model. The customer and employee data can be collected from surveys. All you need therefore, are sufficient units of analysis for which financial data is available – plus some well honed statistical skills and plenty of patience!

### **Author Information**

Nigel Hill has been involved in customer satisfaction for 15 years, forming The Leadership Factor to specialise in the discipline in 1996. He is the author of several books including The Handbook of Customer Satisfaction & loyalty Measurement and How to Measure Customer Satisfaction. He presents seminars and workshops on Advanced Customer Satisfaction and Loyalty Measurement in the UK, US and Australia.

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