EVERESTTM

Return on Investment Report

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A Research Report
for Managers

Introduction

Making the Investment in 'Customer Focused Quality'

'Customer Focused Quality' is a unique closed-loop process that involves using Everest as a platform to transform customer complaints into bottom line results by enabling:

- Superior customer service
- First rate product and service quality
- High employee productivity

Effective service clearly is a must for enhancing loyalty and improving the bottom line, but companies still need research and data to support their decision before making a commitment to 'Customer Focused Quality' using Everest. This document explores the analytics of effective customer service programs including:

1. The impact of service on loyalty and the bottom line
2. How to quantify the cost implications of various service levels
3. Understanding the impact of service and quality on revenue
4. How the data can be used and implications for senior executives

There is an intuitive belief that customer service will enhance satisfaction and loyalty and somehow lead to better profitability. However, almost all service enhancements require an up-front investment which executive officers are unlikely to approve unless that payoff can be quantified.

Service impact

1. Quality and service improvements can be directly and logically linked to enhanced revenue
2. Higher quality allows companies to charge customers higher fees and service charges without alienating them

Basic customer behavior

Examples from the research organization TARP, demonstrate the importance of four items:

1. The impact of problems on customer loyalty
2. The failure of most customers to complain about a problem
3. The potential impact of quality and service on loyalty
4. The impact of service on word-of-mouth

TARP has found that problematic experiences reduce customer loyalty across all industries by varying degrees between 15% - 30%.

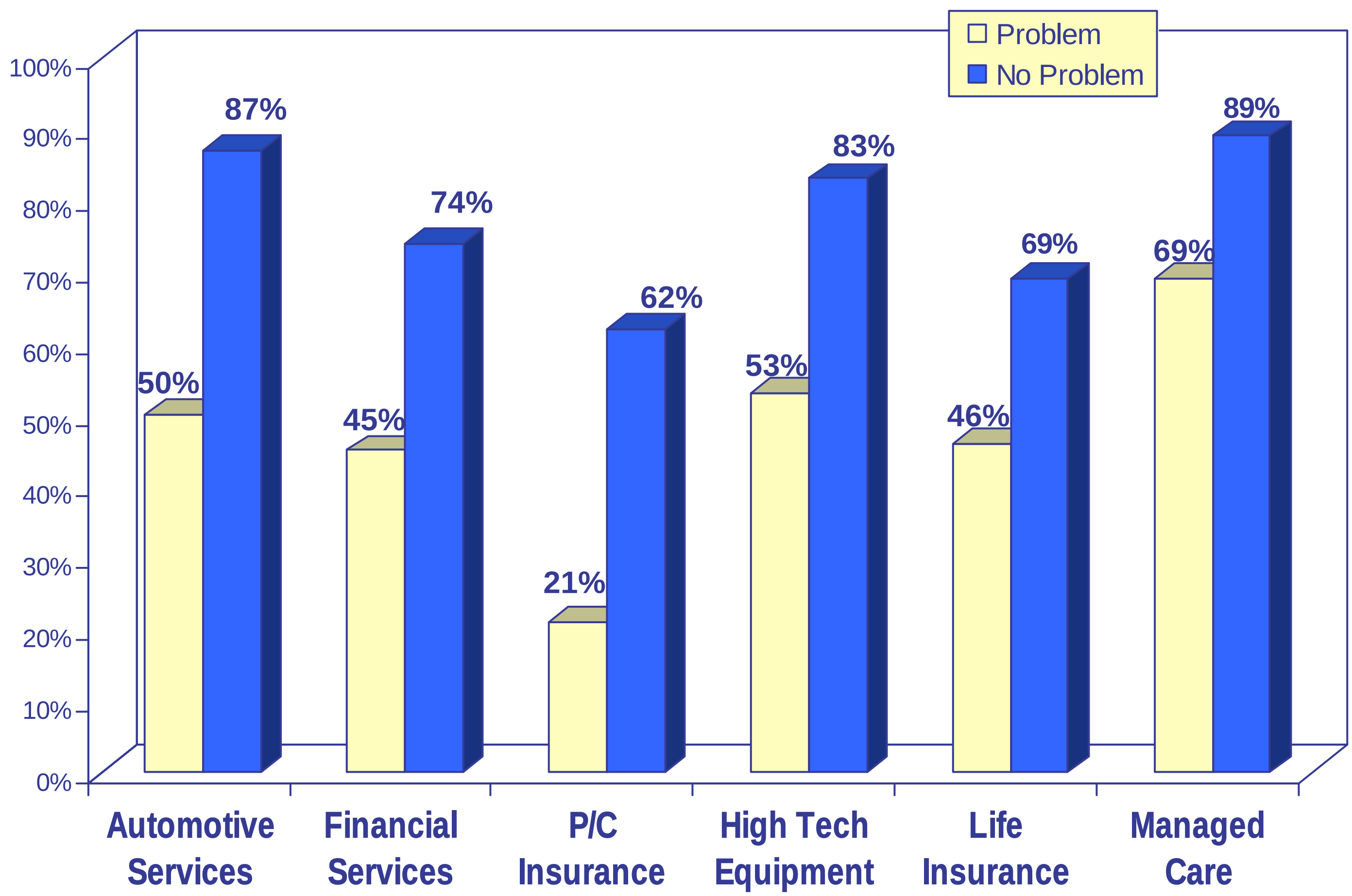
On average, customer loyalty will drop by about 20% (see chart) if the customer has encountered a problem. What does that mean for your bottom line? Out of every five customers who experience a problem, one will leave or purchase services from another institution the next time she or he goes into the marketplace. If your average customer is worth $1,000, then you can estimate that for every five customers with problems, you are losing one customer and $1,000 in revenue.

EXAMPLE:

- **Average drop in *loyalty* 20%**
- **For each 5 customers with a *problem*, 1 will be lost**
  (5 x .2 = 1)
- **If customer is worth $1,000, 5 problems leads to 1 lost customer … $1,000 in lost revenue**
- **If 5 problems prevented or fixed, 1 customer will be retained … $1,000 in *revenue***
- **For every 1000 problems addressed, 200 customers are retained … $200,000 in revenue … it quickly adds up!**
- **Handling/Preventing problems can now be directly linked to revenue and profit … the "*bottom line*"**

CHART: **Impact of Problem Experience on Customer Loyalty (% of customers who will definitely or probably repurchase)**

Source: TARP Industry Specific Data



The reduction in loyalty and revenue due to a problem is called "market damage." Quantifying the level of market damage helps motivate top management to fix the problems and allocate the resources to provide world-class service. This motivation is called "the economic imperative."

Once problems are linked to loyalty, simply reverse the analysis. Beginning with the premise that if you *prevent* five problems, you will retain one customer worth $1,000, you can now justify quality and service initiatives.

Many studies confirm the loyalty link, including research done by Fred Reichheld of Bain and Company and Earl Sasser of the Harvard Business School, which indicates that a 5% increase in customer loyalty can result in a 100% increase in profitability.

Build Customer Loyalty from Problems

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 company when they need assistance or have a problem. On average, across all industries, TARP research indicates that 50% of all consumers and 25% of all business customers with problems never complain to anyone at the company. They often just take their business elsewhere.

A company can, however, win back a customer's loyalty if it can get the customer to call with a problem and then provide a solution that satisfies the customer. In a TARP financial services industry study, results showed among the customers who register a complaint, 54-70% will buy again if their complaint is resolved. The figure goes up to 95% if the customer feels the complaint was resolved quickly. Furthermore, customers whose complaints were satisfactorily resolved tell an average of about 5 people about the good treatment they received.

Even if they are at least mollified (the response was acceptable), you have a good chance of retaining their loyalty, but if they are left dissatisfied, loyalty is reduced to a level below what it was before the company tried to deal with the problem. <u>If you're going to offer customer service to help retain customer loyalty, you must be in a position to resolve the problem.</u> Otherwise, you have a customer who has been dissatisfied, not once, but twice.

The example chart (page 5), calculates sales lost over a 5 year period from customers who encounter a problem and do not buy again, not considering for the moment the potential customers lost due to negative word-of-mouth or natural attrition. An important lesson to be learned from this example is to observe which aspect of the service system loses the most customers. The largest number of customers (78,750) is lost from those who never contact the company. This makes the case for aggressive solicitation of complaints and easy accessibility of service systems- both core capabilities enabled by Everest.

Closing the Loop

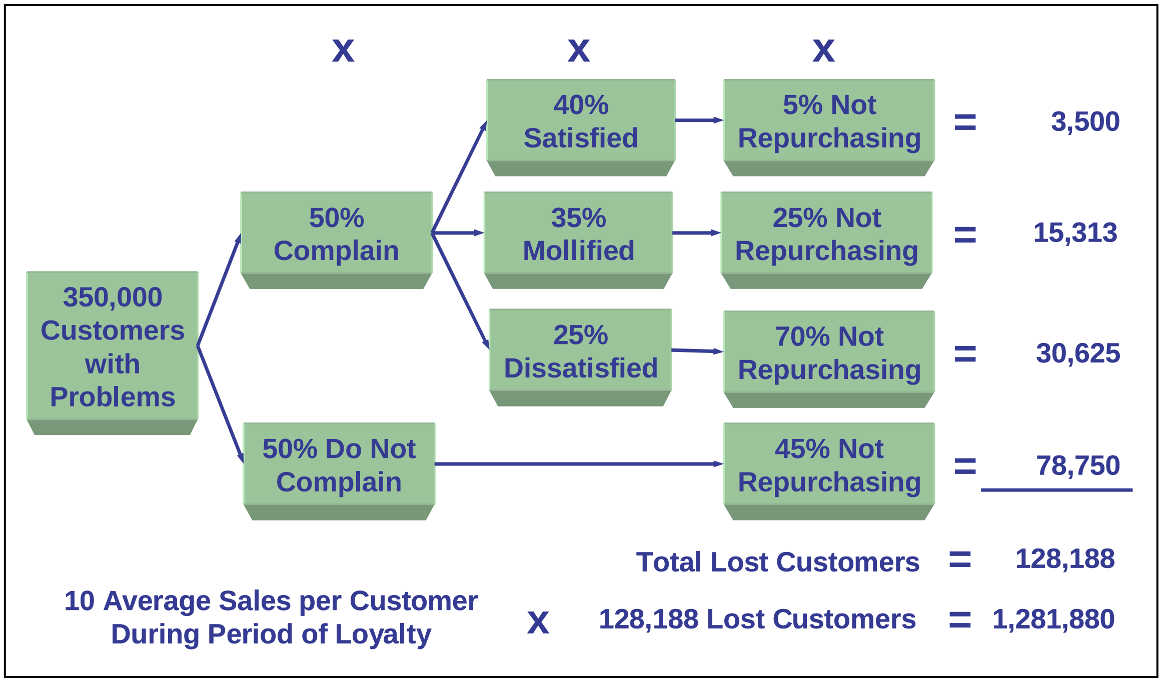
Many companies separate customer service and quality improvement initiatives. The 'Customer Focused Quality' process realizes the importance of *closing this loop,* resulting in increased customer loyalty and improved product and service quality.

Product and service quality is ultimately judged by the customer or end-user. In many organizations however, this information does not penetrate beyond a front-line employee or the customer service department. With a 'Customer Focused Quality' process in place, employees have a tool to successfully capture all types of customer concerns and the customer feedback is available for customer service, sales, marketing, manufacturing, quality assurance and management.

Everest supports the root cause analysis that generates the permanent solutions necessary so that similar or repeat problems are avoided. These continuous business process improvements ultimately lead to an overall reduction in customer complaints. The final step in closing the loop is to communicate the resolution to the customer and gain their acceptance.

Customers who are satisfied with a problem resolution have loyalties approaching and even exceeding those of customers who had no problem. A 1998 TARP study found that customers who complain and are satisfied *are up to 8% more loyal than if they had no problem at all.*

CHART: **Sales Lost from Customers with Problems**



Source: TARP Market Damage Model

Word-of-Mouth Effect

Service also impacts a company's ability to influence word-of-mouth, the other people told of a customer's problem, and its resulting effect on lost potential customers.

The magnitude of word of mouth varies by product, price and industry, but it can be the single most influential and cost effective marketing tool available.

On average, twice as many people are told about a bad experience than they are about a good experience. The original TARP study for Coca-Cola in 1981 found that a median of 5 persons heard about a good experience and a median of 10 heard about a bad experience for a small ticket packaged good.

A study for a domestic auto manufacturer found that a median of 8 persons were told about a good auto repair experience (big ticket cost) and a median of 16 received negative recommendations about a bad experience.

Median Persons Impacted by a Problem

	Satisfied	Dissatisfied
Small Problems	5	10
Large Problems	8	16

Subsequent research conduct by TARP for Coca-Cola and IBM further showed that resolution on first contact achieved 10% higher satisfaction and loyalty than resolution via multiple contacts. Not to mention the doubling of costs due to the additional calls and related phone tag.

Also, people tend to pay more attention to bad word-of-mouth. TARP's general assumption is that negative word-of-mouth has twice the negative impact as positive word-of-mouth has positive impact. Our usual factors are that 1 out of 50 customers hearing negative word-of-mouth will not buy, while 1 out of 100 hearing positive word-of-mouth will buy.

The Value of Customer Retention

TARP has examined the cost to obtain a new customer vs. retaining a current customer via complaint handling. The original study examined the advertising cost to win new auto customers vs. the goodwill expense to retain an existing customer for a domestic auto company. The company had a cost of $375 in advertising for each car sold. They had about a 50% base loyalty rate, which meant that the actual advertising cost **per new customer won** was actually $750. The goodwill expense to retain a customer averaged $150.

Therefore, it was 5 times as expensive to win a new customer as to keep a current customer. More importantly, it may also cost 16 times as much to bring the new customer to the same level of profitability as the lost customer. This formed the basis for establishing many of the customer service 800 numbers in the early 1980s. (See, Business Week*, Making Service a Potent Marketing Tool*, June 11, 1984, pages 164-170.) Since then, TARP has found the real ratio of cost to win a new customer vs. retaining a current customer varies from 2 to1 to 20 to1.

Customer retention is thus as important, if not more important, than new customer attraction.

The key to customer retention is customer satisfaction. A highly satisfied customer stays loyal longer, buys more, talks favorably about the company and its products, pays less attention to competitors, is less price-sensitive and costs less to serve than new customers because transactions have become routine.

Productivity as a Path to Service Quality

Companies using Everest experience a variety of significant productivity gains. Examples highlighted here demonstrate some of the most commonly recognized results found from Everest Case Studies, and end-user feedback.

1. **Time saved with reporting and charting of data:**

    The built-in reporting and charting capabilities of Everest replace time consuming methods including spreadsheets that must be regenerated each day, week or month.

2. Faster response time to the customer:

Everest automates the tasks required for complaint management by creating user-defined Actions that can be as unique as a company requires. Category Standard Actions can be associated with a specific problem and default owner facilitating the necessary and correct workflow for complaint resolution.

3. **Shorter problem resolution times:**

Everest requires ownership for every concern (complaint) and action (to-do). Automated reminder, past-due and escalation email notices support timely resolution of all issues according to user-defined requirements. Due date reports and aging summaries enable management to monitor the status of all open issues.

4. Improved employee communications:

Integrated email (MAPI compliant) and documents easily generated from templates facilitate fast, consistent internal and external communications. Templates use database fields to insert relevant information automatically.

5. Real-time information access enables a single-customer perspective:

Detailed information is instantly accessible throughout the organization enabling any employee to thoughtfully engage the customer regarding the details of any issue. This prevents the need for callbacks and enables employees to provide excellent customer service regardless of their customer knowledge, experience or work role.

6. Fewer problems over time and pro-active problem prevention:

Employee hours spent resolving customer problems can be measured or estimated to analyze unproductive time and added expenses imposed by recurring problems. The ‘Customer Focused Quality’ process requires root cause analysis and corrective actions necessary to implement effective permanent solutions.

Calculating a Customer Service ROI Using the Market Damage Model

The following section explains the Market Damage Model which allows a company to calculate two key sets of numbers:

1. How much is the cost of *NOT* providing perfect quality and service?
2. How much is the return on various investments in service?

To perform an analysis, you need five pieces of data:

1. The long-term profit value of a customer
2. The number of customers who experience problems
3. The impact of problems on loyalty
4. The impact of the service system on loyalty
5. The percentage of customers who bother to contact the company about problems

With this data, you can quantify the ROI of problem prevention, enhanced service accessibility, and improved customer satisfaction with service. The following example is based upon data from a bank, in which a customer is a high net-worth private banking client, with an annual profit value of $25,000. The bank had 2,000 customers and a 40% problem experience per annum. (We use the one-year value to be conservative--disloyalty would not necessarily result in the forfeiture of the entire profit value.)

The rate of attrition is based upon how the service system performs. If 800 customers encounter service problems, first calculate the customers lost due to problems and how they are handled. In the case of this example, 70% of customers with problems contacted the bank, which is higher than the industry average. When contacted, 60% were completely satisfied, 30% mollified, and 10% were left dissatisfied--about average performance for a high-end bank service system.

Remarkably, even private banking clients don't often contact the institution. The ‘non-contactors’ are the greatest source of controllable attrition. TARP has observed this behavior in almost all industries. Calculate the customers lost from customers who had problems (Clprob), and then estimate the sales lost from customers who had no problems and would have gone to competitors for reasons not related to quality (CLnoprob). In this bank, there was a 10% attrition among clients who had no problem but still moved their business to another bank due to factors such as moving out of the area. Therefore, 80 customers would have been "natural attrition."

Remember that there are other factors that lose customers, such as price, product features, and convenience. For example, because of interest rates, performance of the investment portfolio, and clients moving to other locations, XYZ Bank is losing private clients even though its service is above average.

Customers lost from natural attrition are subtracted from the total loss because they would have been lost even if perfect service had been given. The result (CLyr) shows that problems are costing this company 117 customers. At $25,000 profit per customer, that loss can be valued at $2.925 million annually. This loss is due to 40% of the customers experiencing a problem and only 70% of them contacting the institution. When they do contact, only 60% are completely satisfied. The 30% mollified are those for whom the company "sort of" solved the problem.

With this baseline calculation complete, estimate the impact achieved by changing the three major parameters available to us: 1. reduce problems that customers encounter, 2. get customers to tell us when they encounter a problem, and 3. make every effort to satisfy them when they do contact the company with a problem. Looking at the problem this way is called the sensitivity analysis, because it quantifies the sensitivity of the revenue stream to problems encountered (level of quality) and accessibility and effectiveness of the service system in satisfying customers (level of service). A company can now implement different service strategies to improve one or more of these three parameters.

If XYZ Bank implements a program to reduce problems, from 40% to 25% (Program A), it will reduce lost customers by 67 and add $1.675 million in profit. If a second program (Program B), allows customers to address their complaints through multiple channels, the bank will have an opportunity to solve more problems. By having more unhappy customers call and solving more of their problems, the company can retain many more sales and cut the loss in profits by (in example B) almost $2.725 million.

In Program B, TARP research has observed another common impact of the service system on basic quality. If complaints are actively solicited, the front line staff tends to raise its level of service to avoid complaints. By soliciting complaints and increasing the rate of customers who contact the company, you create an environment where the number of problems actually goes down--because the levels of quality and customer service go up.

Once you have quantified the profit impact of an investment in quality and service, you can then estimate the return on investment (annual profit saved divided by annual cost of program), as demonstrated in the example.

The ROIs portrayed in the examples below are not at all atypical. In one computer company, TARP found the ROI of an aggressive, high-visibility customer support hotline, where reps could resolve about 60% of customer problems on first call (versus the current situation where the customer has to call his reseller with only a 20% success rate), was over 800%. A pharmaceutical company CFO estimated that, for every dollar spent on service improvement, the company enhanced revenue by ten dollars.

Impact of Problem Experience
On Repurchase Intention
Percent of customers who would buy again

	Problem	No Problem
Credit Cards	79%	93%
Retail Banking	56%	80%
Commercial Banking	78%	97%
Private Banking	68%	98%

Calculation of Overall Expected Customer Attrition

Baseline Current Situation

A. [CL.sub.Prob] - [CL.sub.NoProb] = customers Lost due to problems
197 customers - 80 customers = 117 customers lost due to problems

B. [CL.sub.Yr] x [P.sub.c] = Profit Lost due to problems
117 customers x $25,000 profit per customer = $2,925,000 lost profit annually

Sensitivity Analysis Results

Formula terms	Baseline	Program A	Program B
% Experiencing problems	40%	25%	25%
% Contacting	70%	70%	90%
Contactor satisfaction	60%	60%	90%
Annual customers lost	197	130	88
Annual customers saved		67	109
Additional annual profit		$1.675 mil.	$2.725 mil.

Calculation of Return on Investment

	Program A	Program B
Annual cost of program	$500,000	$750,000
Additional annual profit	$1.675 mil.	$2.725 mil.
Return on Investment	235%	263%

Customer Fee Tolerance

Fees and service charges are a major source of revenue for many service companies including banks. They are also a major source of customer dissatisfaction. Data from a major East Coast bank shows that customer tolerance of fees rapidly degrades as problems increase. While this is logical, the message is, "If you want to enhance fee income without losing customers, you'd better have near-perfect services."

Dissatisfaction with Fees vs. Problems Experienced

	% Dissatisfied
0	10%
1	22%
2	31%
3	39%
4-6	52%
7+	74%

Number of problems encountered in last 3 mos.
N = 3,520 respondents

Calculating Productivity Savings

The chart below shows annual savings created by saving just 1 hour each week as a result of improved productivity.

Annual Salary	Annual Savings
$30K	$731.71
$50K	$1,219.51
$75K	$1,829.27
$100K	$2,439.02
$150K	$3,658.54

Calculation uses 8hr/day, 50 weeks/yr = 2000 total hours/yr

1hr/week = 50hours/year increases total hours per year from 2000 to 2050
$30,000/2050hrs =$14.63414634/hr. x 2000hrs = $29,268.29 - $30,000 = $731.71

EXAMPLE:

30 employee example:

20 employees saving 1hr each week with an average salary of $30,000 =	$14,634.20
8 employees saving 1hr each week with an average salary of $50,000 =	$12,195.10
2 executives saving 1hr each week with an average salary of $100,000 =	$ 7,317.08
Total Annual Savings:	**$34,146.38**

Summary

When analyzing measures of customer effectiveness, the following questions should be asked:

- What are the most prevalent problems our customers are encountering?
- What is the damage to loyalty if a customer has a problem?
- How much does poor service and product quality cost us each month in business?
- How much does poor service and product quality cost us each month in productivity?
- To what degree is our service impeding our ability to raise fees or prices?
- Do we solicit complaints or do we hide from unhappy customers?
- For each problem we hear about in the service center, Account Management, or Executive Customer Relations, how many others are out there that we do not hear about?

Organizational considerations:

- Embrace complaints--portray them as money left on the table
- Demand that problems be quantified in terms of customers affected and revenue put at risk
- Use multiple sources of customer and employee input
- Get staff involved in looking not only at the cost but the revenue impact of service quality and marketing initiatives
- Champion service quality throughout the organization to spark enthusiasm among employees and management to succeed with new customer quality initiatives

SOURCES:

1. John Goodman, et al., “Selling Quality to the CFO,” Quality Progress, March 2000.

2. John Goodman and Marlene Yanovsky, “Show me the money!” ABA Banking Journal, January 2000, v92 i1 p28.

3. “Fredrick F. Reichheld and W. Earl Sasser, Jr., “Zero Defections: Quality Comes To Services,” Harvard Business Review, September/October 1990.

4. TARP – Technical Assistance Research Programs, Arlington, VA.