

A Lippincott Mercer Commentary

Keeping the customer (profitably) satisfied

Which is the more enlightened company: the one that cuts costs across the board, not knowing the impact on customer satisfaction, or the one that confidently spends whatever it takes to keep satisfaction scores high?

Neither. What both companies must do is to understand, and selectively invest in, the particular aspects of their service that drive repurchases by customers. The goal is to link customer satisfaction to sustained profit growth.

Finding the satisfaction that matters

How good should an airline meal be?

If you are guided by customer satisfaction, the answer is: very good. Airline customers often complain about food and criticize it in customer satisfaction questionnaires.

However, customers don't buy airline meals; they buy airline tickets. And tickets give them a bundle of service features, including check-in service, cabin service, food, in-flight movies, seating, and timely arrival. Some of these features influence a customer's choice of airline much more than others. If providing a better meal has little effect on whether a customer will fly again on the airline, what is the return on investing in better food?

Many products and services look much like the airline ticket: They are bundles of features, some of which influence customers more than others (Exhibit 1). The complexity of these bundled purchases usually gives managers an opportunity to save cost, if they can work out which features to cut back on without affecting customer behavior. But like a game of Jenga or pick-up sticks, taking out the wrong piece will bring down the whole structure.

Exhibit 1: Services chosen as bundles provide opportunities for optimization

Customer chooses:	Customer experiences:
Airline ticket	Check-in service, cabin service, food, in-flight movies, punctuality, seating...
Supermarket	Product quality, choice, check-out speed, store appearance, special offers...
TV cable package	Bouquet of different channels, each presenting a mix of individual programs...
Mobile phone	Handset utility, activation, network performance, billing, customer care...
Theme park	Ticketing, rides, queues, eating places, grounds, entertainment...
Credit card	Credit limit requests, disputed charges, debt collection, fraud controls...

The challenge, then, is to understand the subtleties of how a customer's satisfaction with each of the different features influence overall purchase behavior. Most customer satisfaction programmers don't focus on that. Instead, they build up and monitor an aggregate customer satisfaction index. Such indices are well regarded when they go up—though even then they confirm only that a company is spending money effectively, not that it is doing so efficiently. But when the satisfaction indices go down, they offer few clues about what actions a company should take.

One obstacle to spotting the opportunities is a natural desire to simplify the problem. If as a customer you try to terminate your mobile phone service, your provider will typically ask why you are leaving. They will code your response as one of five to ten standard reasons, such as a better deal, dissatisfaction with network performance, customer service problems, or a phone upgrade. They will then produce internal reports about why people are leaving, so that they can focus the company's satisfaction efforts. But most customers don't have a single reason for leaving. The different possible sources of dissatisfaction are like the risk factors for heart disease: Over an entire population, you can talk meaningfully about the contribution that each factor makes statistically, but you can't determine the single factor that was decisive for each individual.

If aggregate indices hide the effects we are looking for, and oversimplification distorts the picture, how can companies get a clear picture of what drives the satisfaction that matters so that they can redirect their investments to increase repurchase?

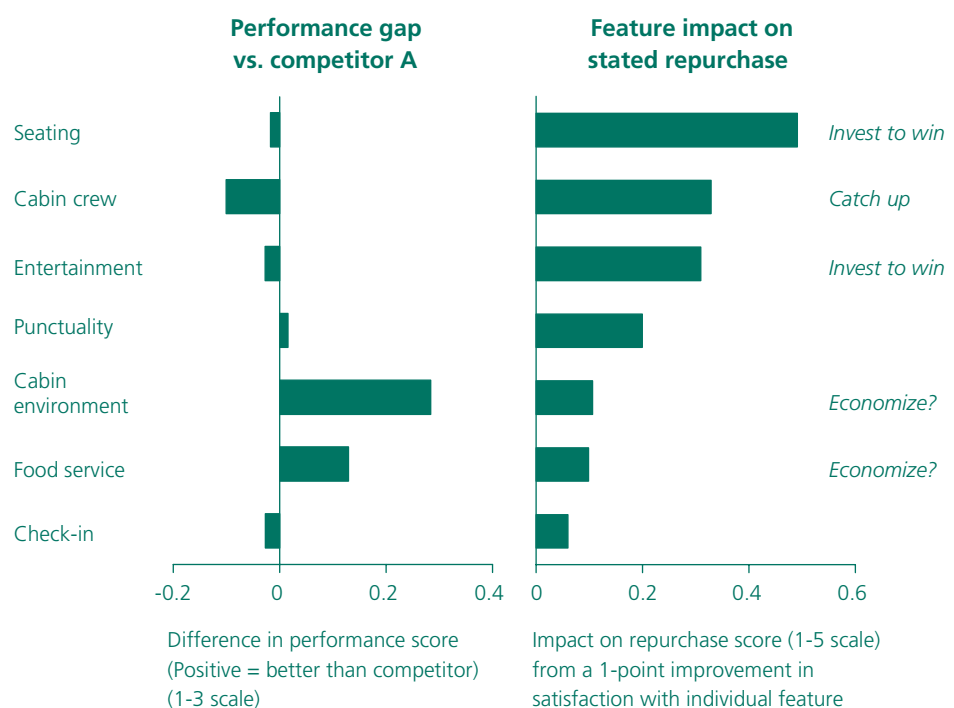
New insights from old research

In some cases, companies may already be sitting on all the data they need. Returning to the case of the airline, this company was looking to prioritize its spending across the different aspects of its service. The airline's traditional way of thinking was influenced by its organization, which was structured by function: the seating people understood priorities in seating and the catering people understood priorities in food. Nobody could make objective trade-offs among these areas in order to decide how to prioritize spending.

For several years, the airline had been monitoring customer satisfaction using a questionnaire that passengers completed during their flights. The airline had been learning from the questionnaire operationally, again by function: the seating people looked at satisfaction with seating, and so on.

Hidden within these questionnaire answers were valuable insights about the drivers of overall satisfaction and of customers' intent to repurchase. Factor analysis of the raw data from 1,500 questionnaires allowed us to quantify statistically how important customers' stated satisfaction with each product and service feature (such as seating, cabin crew or entertainment) is in influencing their overall intent to repurchase from the airline. Combining this analysis with the airline's relative performance in each feature from an industry questionnaire conducted across different airlines, we could for the first time identify in which areas incremental investment would have the biggest business impact (Exhibit 2).

Exhibit 2: **Factor analysis of an airline's in-flight questionnaire reveals the experiences that drive repurchase, suggesting investment priorities**



Note: Sequence of service features has been changed to protect client confidentiality.

Of course, focusing on customers' stated intent to repurchase is not enough. What matters is what customers will actually do, not what they say they will do, and so it is important to quantify the link back to real revenue. For our airline, this link was difficult to measure directly, because we were focusing on passengers in the Economy cabin, where repurchase cycles are long. But by analyzing different routes and periods of time, we did quantify a correlation between changes in the stated intent-to-repurchase score and changes in the airline's market share (relative to its share of capacity on the route). This analysis both validated the measures we were using and allowed us to estimate what the revenue impact would be of lifting satisfaction in each of the different product features.

As a result, investment can be shifted towards activities that have a major impact on customer behavior, but which are often under-funded because it is difficult to justify a business case by traditional means. For example, our analyses in several projects across different industries have justified big increases in customer service training.

In industries with a shorter repurchase interval, it becomes possible to quantify the revenue impact more directly. The supermarket illustrated in Exhibit 3 designed a customer satisfaction score that correlated well with the sales level. Like the airline, it also had detailed, historic operational surveys of customer satisfaction that we could re-analyze. With these data, we could quantify the increase in like-for-like sales that would result from measurable improvements in customers' satisfaction with each aspect of the overall shopping experience.

Exhibit 3: For a supermarket, correlating the stated satisfaction score with revenue quantifies the benefits of improvements



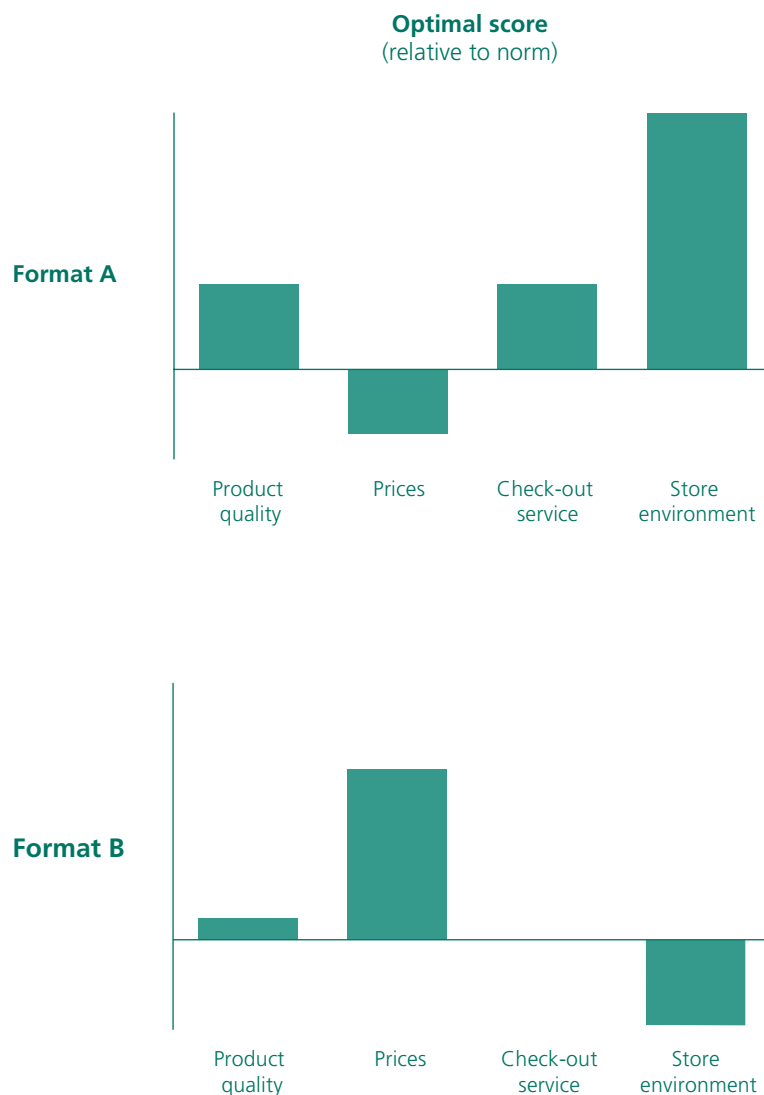
Note: Sequence of service features has been changed to protect client confidentiality.

Tailoring for different customer groups

The analysis described here generates simple, high-level results directly from detailed data at the level of individual customers without intermediate steps of aggregation or averaging. This transparency allows managers to cut the analysis different ways to look at sub-categories of customers: those flying on certain routes, or on night flights, or flying for business rather than leisure.

In the retail world, these analyses show that the optimal level of customer satisfaction for each aspect of the service is different in different stores, which can be correspondingly grouped into different retailing formats (Exhibit 4). Stores with format A serve relatively service-sensitive customers; for them, return on investment will be maximized through high levels of satisfaction, particularly for aspects such as staff availability and store appearance. Stores with format B serve relatively price-sensitive customers; here, returns are maximized through lower levels of satisfaction on these service features, as well as more money invested in improving the customers' price perception through pricing, promotions, and communications.

Exhibit 4: **To maximize return on investment, a retail chain must manage different stores for different profiles of customer satisfaction**



Acting on the insights

How should managers use these new insights into which aspects of customer satisfaction drive customers to actually repurchase?

First, there are some straightforward quick wins. Once you know how good an airline meal should be, or for how long you should ask customers to queue for a supermarket check-out or a ride in a theme park, you can set resource levels accordingly, shifting spend from lower- to higher-impact activities. Where raw data for analysis exists, these quick wins can be achieved in just four to five weeks. The quick wins can reduce costs by identifying the Jenga piece that you can pull out without damage; they can also save your business by preventing you from pulling out a piece that would collapse the tower.

To capitalize fully on the findings over time requires generating a continuous flow of such insights, which means moving from analysis of past customer behavior to experimenting with and predicting future customer behavior. This, in turn, requires institutionalizing a culture of continuously testing customer response and then using what you learn to take actions that optimize the economics of the business as a whole.

The difference between mining past behavior and testing future behavior is significant. Deliberately designing in-market experiments (e.g., increasing or lowering queue size, altering telephone operator scripts, varying promotion conditions) allows you to attribute differences in response to quite complex combinations of stimuli. By creating a rapid cycle of in-market testing, where the results from one cycle of tests shape the next, you constantly adapt what gets tested and what is learned. Your understanding of how to optimize your treatment of customers continues to grow.

Continuous learning in this way delivers two benefits. It provides rapid feedback from the market, allowing you to detect the influence of shifting customer behaviors, attitudes, and the effect of competitors' actions. While market research swiftly becomes dated, constantly testing in the market keeps you ahead of the game. It also reveals a stream of new ways to generate economic value through changing the customer experience, moving from quick hits to sustained value generation.

To realize this greater scale of value generation means institutionalizing the testing and decision-making, based on the sort of holistic, economic optimization described. That, in turn, requires a degree of operational co-ordination and cooperation among functions that does not exist in most organizations. It depends on working approaches, tools, and skills that support the increased complexity of cross-business research, testing, and decision-making based on economic value. It is not a question of setting a target for each function and asking the functions to maximize their performance, because that would not address the cross-functional trade-offs. Instead, senior management must inform, guide, and fund each function to invest in strong performance only where the economic returns merit doing so.

Measuring the effectiveness of spend in terms of its impact on customer behavior is the starting point. Organizations must then use this information to trade off competing investments from the different functional areas that contribute to the customer experience in order to maximize the value from the customer overall.

It may be tempting to address this problem by creating a “customer-led” organization, shifting responsibilities away from classic functions to teams focused cross-functionally on particular customer groups. But simply re-orienting the organization can create as many problems as it solves by fragmenting the responsibility for functional delivery and causing operational inefficiencies. This is a matrix problem, one of optimizing the application of different functions to different customer groups. And although a highly matrixed organization may be unattractive as a *solution*, it is still worth recognizing the problem as a *matrix problem*. The preferred solution will differ by company and situation, but it will be more about developing new skills, capabilities, and processes than about any particular organization structure.

If this degree of implementation complexity seems off-putting, then stick with the quick wins. And by then you will know, quantitatively, whether institutionalizing the approach is worth the effort. ❖

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