

Service  
Quality  
Payoffs

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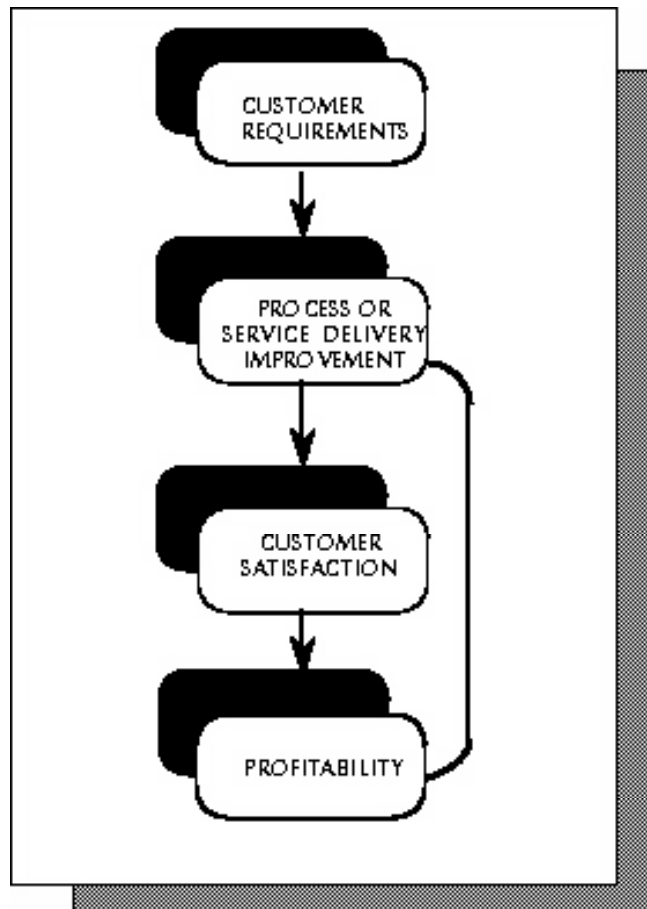
# SERVICE QUALITY PAYOFFS

**Notes:**

When making decisions to spend significant resources on service quality improvements, executives usually want to know the specific payoff or return they can expect on their investment.

In both manufacturing industries and service industries it is often difficult to make reasonable estimates of expected payoffs. However, in manufacturing a direct correlation between the purchase of equipment and productivity or quality that also results in a reduction in costs may be evident. In service industries, the impact on the bottom line may be less direct.

The model below shows the relationship between a service quality improvement and the bottom line. Occasionally this relationship is direct, but more often it is linked by customer satisfaction and one or more other variables.



**Notes:**

There are many potential benefits of a service quality initiative. Some are directed at cutting costs, others at enhancing revenues. Specific benefits an organization might expect include:

- increased customer satisfaction
- increased employee satisfaction
- increased productivity
- decreased number of customer complaints
- decreased employee absenteeism
- decreased employee turnover
- decreased regulatory involvement
- decreased operating costs
- increased customer loyalty

However, these and other benefits are never easy to measure.

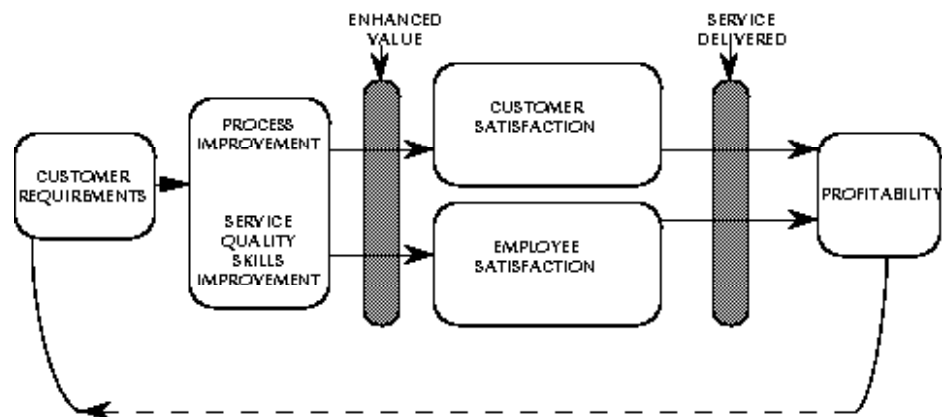
The model below shows some of these links.

To assist executives in making critical decisions on service quality initiatives, we have compiled the following list of quotes, facts, figures, research and models from other organizations. While one can never assume that the same benefits will accrue to every organization, the following pages do offer substantial evidence

to support the decision making process.

We hope that you will find the following examples both interesting and informative. If you have stories or examples of your own that you would like to share with us, please call us at

(800) 870-9490 fax number (954) 938-5025.



## GENERAL RESEARCH

### Notes:

A \$60,000 study by Laventhol and Horwath, in which they surveyed 1,000 businesses from all sectors, showed that poor service can cost companies more than 20% of their profit every year.

- Laventhol and Horwath

What difference does customer satisfaction make?

In a study of 800 organizations, those that received the highest customer satisfaction ratings charged 10% more for their products and services. They also had market share growth of 6 percent versus a market share decrease of 1 percent for the low service providers.

- Strategic Planning Institute

In 1982, a study analyzed the customer service activities

and financial results of 185 U.S. industrial companies with annual sales ranging from \$50 million to \$8 billion. The study's main finding: the difference between very good and very bad service can make a difference in absolute sales of 6 percent or more.

- William H. Davidow and Bro Uttal. *Total Customer Service*. 1989

In fact, of the top nine reasons consumers give for buying a specific product, eight pertain to the abilities of the customer service system (e.g. responsiveness, technical skill, professional attitude).

- John J. Franco. "Why Customer Service Matters," *International Executive*, Spring 1985, pp. 16-17.

By far the largest costs that outstanding service saves are those of replacing or preventing lost customers. A common rule of thumb is that the marketing costs of landing a new customer run three to five times the marketing costs of retaining an old one.

- Robert L. Desatnick. *Managing to Keep the Customer* (Jossey-Bass, 1987), p. 3.

When asked whether service would be essential in the future for companies to succeed, three-fourths of 322 European executives polled expressed strong agreement that Service Quality was the most critical factor.

- Arild Lillebo. "Serving Tomorrow's Needs," *Profile*, August 1983

Households headed by 35 to 50-year olds will control 42 percent of household income by the year 2000. More than half of these individuals will have incomes of \$35,000 and over (in 1985 dollars). They will demand good service, and they will be able to pay for it. If they don't get it from your company, they'll get it from your competitor.

- Cheryl Russell. "Editor's Note: Bad Service," *American Demographics*, November 1987, p.7

**Notes:**

By some estimates, the quality of service drops off sharply when demand exceeds as little as 75 percent of theoretical capacity.

- Heskett. *Managing in the Service Economy*, p.38.

The Profit Impact of Marketing Strategy (PIMS) Study of 2,600 business units found at least a dozen elements of strategy that strongly influenced business performance, but the most effective element was quality as customers perceive it.

Companies that ranked among the top one-fifth in perceived quality had average return on investment of 32 percent and an average return on sales of 14 percent, versus 17 percent and 6 percent, respectively for companies in the lowest quintile of perceived quality. PIMS data about chemical businesses in very similar markets showed that the winners in market share and production volume characteristically offered "superior service" to immediate customers and continued to upgrade it.

- Robert D. Buzzell and Bradley T. Gale. "The PIMS Principles: Linking Strategy to Performance," Free Press, 1987, p.7.

A mid-1989 Gallup survey, conducted for the American Society for Quality Control found:

- 72% of the 601 responding CEO's said their greatest competitive quality challenge in the next five years will come from ;other American companies. Only 9% cited Japan as their chief quality rival.
- 54% said that Service Quality was an extremely critical issue to their companies-product quality was rated extremely critical by 51%.
- 80% agreed that employee motivation, an actively involved corporate leadership and employee education are very important ways to improve quality.
- 82% have a quality education effort already underway at their organizations. At these companies, an average of 66% of all employees were affected by the effort. 27% reported that 100% of the employees at their companies were involved.
- 5% of the overall operating budget is the average amount devoted to education and training. 45% of this is spent on quality related education and training.

**Notes:**

45% of the CEO's said that poor quality costs their organization less than 5% of gross sales annually.

18% said the cost is between 5% and 10%.

- Figures taken from Training magazine, April 1990, p.101.

In 1987 the Gallup Organization asked 615 senior executives of U.S. companies to select the most critical factor for their business in the 1986-1989 time period, from the cost of materials and labor to the availability of capital. The clear winner was Service Quality, ranked first by nearly half the sample.

- '87 Gallup Survey: Executives' Perceptions Concerning the Quality of American Products and Services, American Society for Quality Control, 1987.

It has been estimated that, where customer service is rated by customers as "superior", customer retention averages 90% over a 10-year period. Where customer service is rated as only "adequate", customer retention over that same period averages only 70%.

- "Managing the Asset," The Customer Communicator, May 1990.

- The average business never hears from 96 percent of its unhappy customers. For every complaint received, the average company in fact has 26 customers with problems, six of which are "serious" problems.
- Out of those customers who are unhappy, 90 percent will not buy again.
- The average customer who has had a problem with an organization tells nine other people about it, and 13 percent of customers who have had a problem discuss it with more than 20 people.

The good news is that the complaint itself is not the greatest problem. Its how the company handles it. Of the customers who register a complaint, between 54 percent and 78 percent will do business with the organization again if their complaint is resolved. The figure goes up to 95 percent if the customer feels the complaint was resolved quickly. Satisfied complaints also tell an average of five people about the good treatment they received.

- Consumer Complaint Handling in America: An Update Study, Parts I, II, and III. Study by Technical Assistance Research Program's Institute for the Consumer Affairs Council, United States Office of Consumer Affairs, September 30, 1985.

**Notes:**

Persons who complain represent less than 5 percent of all dissatisfied customers.

- Technical Assistance Research Programs, Inc., Consumer Complaint Handling in America: An Update Study, Part II (Washington, D.C., 1986), p. ES-4.

The single best way to drive away a customer is to make him keep coming back to get the same problem fixed.

- M.D. Bemaschi, K. Kono, and G.L. Willette. "An Analysis of Automobile Warranty Service Dissatisfaction (Summary)," Proceedings of the Fourth Annual Conference of Consumer - Satisfaction, Dissatisfaction and Complaining Behavior, 4 (1979), pp. 141-143, cited in Gilbert, "Service Begets Sales..."

A study done for the U.S. Office of Consumer Affairs reveals that customer service departments are fielding over twice as many complaints today as they did seven years ago.

- Technical Assistance Research Programs, Inc., Consumer Complaint Handling in America: An Update Study, Part II (Washington, D.C., 1986), p. ES-4.

The true measure of success of many customer service departments is based on how cheaply they can deal with them. The more problems they report up the line, the less heed their bosses pay, creating a vicious circle that leads to ever more customer service problems.

- Claes Fornell and Robert A. Westbrook, "The Vicious Circle of Consumer Complaints," Journal of Marketing, Summer 1984. pp.68-78.

A 1988 study by Temple, Barker and Sloane, Inc. revealed that firms with high Service Quality have 25% of the employee turnover rates of other area firms.

- Temple, Barker and Sloane, Inc.

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## **Airline Industry**

British Airways research indicated the four things customers expect from an airline:

1. Care and concern demonstrated by airline personnel
2. Ability of the front line to solve problems
3. Spontaneity and flexibility in applying company policies
4. Recovery from mistakes by making things right for passengers

- Leigh Bruce. "British Airways Jolts Staff with a Cultural Revolution," International Management, March 1987, pp. 36-38

**Notes:**

1981 SAS lost \$8 million, but in 1982 SAS showed a profit of \$12 million even though international airlines as a group lost \$2 billion. Mr. Carlzon achieved this turnaround by doing many things right, from segmenting his service target (business travelers), exercising charismatic leadership (he walked the talk), to redesigning his fleet of planes to suit business travelers, but his most effective action was redefining service as “moments of truth” when customers came in contact with SAS employees. He determined and communicated that these 50 million “moments of truth” averaging 15 seconds were the one thing that would ultimately determine the success or failure of SAS.

-Jan Carlzon. “Moments of Truth,” Ballinger, 1987, pp.21-29.

The U.S. Department of Transportation reported that the number of air passenger complaints made to DOT more than quadrupled between 1985 and 1989—the same time that deregulation took place.

- U.S. Department of Transportation, Office of Consumer Affairs. Air Travel Consumer Complaint Report, January 1986 and January 1988.

Fliers continue to rank Delta as either the best major domestic airline or the second best, behind American. For Delta, as with IBM, word of mouth and customer past positive experiences have created an invisible cocoon that keeps competitors at bay. Trying to combat that advantage is like wrestling with fog.

- William H. Davidow and Bro Uttal. Total Customer Service, 1989.

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## **Automotive Industry**

Ford recently rated the business performance of its 850 largest U.S. dealers against the satisfaction of customers during the customers’ first year of ownership. Dealers who did the best job of satisfying customers sported returns on investment nearly 30 percent higher than average.

- William H. Davidow and Bro Uttal. Total Customer Service, 1989.

In a study correlating service ratings with market penetration in the automobile business, dealers that excel at preparing new cars for delivery, cheerfully honoring warranties, and fixing things right the first time can expect roughly twice as much market share as dealers that flub those jobs.

-Gilbert. “Service Begets Sales...”

One study of why customers switch car dealers, for example, has shown that 68 percent do so because of “indifference shown them by a dealer’s sales or service persons.” Only 14 percent switch because of dissatisfaction with the actual car.

- Tom Peters. “More Expensive, But Worth It,” U.S. News and World Report, 3 February 1986, p.54.

Improved phone access by adding trunk lines and additional CSR’s resulted

**Notes:**

## **Communications Industry**

in a 54% increase in the number of calls received and a 49% increase in basic sales.

- Cablevision Industries research

Cable Customers with frequent outages downgrade (drop premium channels or other services) 80% more often than those with few outages.

- Viacom Research

Cable customers who rate their service below expectations are twice as likely to disconnect than those who gave good service ratings.

- Viacom Research

Service Quality is found to have a direct bearing on the ease and favorability of franchise renewals. Systems with good service records negotiated longer term contracts with fewer obligations, while systems with poor service obtained shorter refranchise terms and significantly greater obligations to franchising authorities.

- Warner Cable research

Customer relations skills training is making a difference at Sprint Corporation, according to Rick Boeshaar, Sprint's director of the National Service Center and the Central Region. The company's annual customer service representative turnover rate has dropped from 40% to 15% and its customer satisfaction rating has risen from 74-75% in 1987 to 92-93% today.

- Sprint

Service clearly plays a significant role in the issues surrounding reregulation: "...complaints over cable rates and service at the local level are fueling the debate to regulate cable at the federal level... if you don't solve your problems at the consumer-voter level, members of Congress increasingly will decide that they have to solve them for you."

- Rep. Ed, Chairman of the House Telecommunications Subcommittee. "Cable Industry Urged to Solve Its Problems," Multichannel News, 29 May 1989.

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## **Consumer Products Industry**

In 1982 a Coca-Cola study showed a satisfied customer told 4-5 others, a dissatisfied one told 9-10 others. A particularly ticked-off customer told as many as 20 others.

- Coca-Cola

**Notes:**

## **Energy/Utilities Industry**

In 1987, the Los Padres division of PG&E had a satisfaction level of 87%. In 1988, the division manager made a decision to develop a “Top-Down Strategy” and set a 5-year goal to achieve 93% customer satisfaction. Managers communicated their commitment, all employees underwent skills training to improve internal and external services and recognition and recovery programs were developed. One year later, they had achieved a 92.75% level of customer satisfaction.

- Los Padres Division of PG&E

Complaint handling costs estimated by New York State Gas and Electric:

Phone Complaint	\$10
Written Complaint	20
Meter Check	80
High Bill Investigation	125
PSC Complaint	400

- New York State Gas and Electric

In 1985 the Long Island Lighting Company took steps to raise employees' awareness for sensitivity in customer contacts and began training all employees in 1986. Between 1985 and 1987, customer complaints to the New York State Public Service Commission decreased 85%.

- Long Island Lighting Company

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## **Financial Services Industry**

In measuring “Return on Customer Service Training Investment” in the financial services industry, “Return” is the savings generated by customer service improvements related to that training, and “Investment” is the cost of providing the training and monitoring its effectiveness. On average, these returns on training investment increased steadily from 17% the first year after the training was conducted, to 206% in the fifth year.

- Customer Service Newsletter, Customer Service Institute, February, 1989 (from materials published by the Financial Services Industry Group of Temple, Barker and Sloane, Inc.)

Seafirst Bank embarked on a major change to become a customer focused organization. In three years, it became 3 times more effective at attracting and retaining customers. It earned a net profit of \$625 million, reversing cumulative losses of \$311 million between 1980 and 1987, and is now a top

**Notes:**

performer in the industry.

- Seafirst Bank

First Interstate Bank of Idaho reports specific improvements in both employee skills and morale after receiving customer relations training. In addition: Closed account reports showed 42% due to dissatisfaction before training versus 30% after.

- First Interstate Bank of Idaho

Companies can boost profits by almost 100% by retaining just 5% more of their customers.

In 1982 Charles Cawley, President of MBNA, was frustrated by letters from unhappy customers. He began an improvement program based on feedback from defecting customers. By 1990, its defection rate was one of the lowest in the industry, with about 5% of its customers leaving each year. In the same time, profits increased sixteen fold.

As a credit card company cut its defection rate from 20% to 10%, the average life span of its relationship with a customer doubles from five years to ten and the value of that customer more than doubles-paying from \$134.00 to \$300.00.

Reducing defection by just 5% generated 85% more profits in one bank's branch system, 50% more in an insurance brokerage and 30% more in an auto service chain.

- Frederick Reichheld and Earl Sasser. Zero Defections: Quality Comes to Services, Harvard Business Review, September/October 1990.

A Philadelphia bank broadened the responsibility of its customer service representatives by allowing them to resolve all customer problems about amounts less than \$1000, without asking for supervisory approval. For the added responsibility, the representatives' pay was increased by over 50%. The net result was an almost 50% increase in customer satisfaction, and the total cost to the bank of resolving the problems was less than before the job upgrade.

- Anonymous

Another bank measures each of its customer service departments on how well they do the parts of their jobs that research has shown are key to customer retention. Results are posted daily and bonuses keyed to these results. Customer retention for this bank is measurably ahead of its competition. So is employee retention. The positive work environment this contributes to has resulted in this bank receiving over 10,000 applications for fewer than 500 openings - in a year when the local labor market was so tight that one of the

**Notes:**

bank's nearby competitors had to move some operations out of the region because they could not fill their openings.

- Anonymous:

In the case of retail banks, surveys indicated that in 1987, 42 percent of the customers who switched banks did so because of service problems. The switchers on average, had used three bank "products" - checking accounts, savings accounts, and so forth- and had total deposit balances of more than \$23,000 a piece. In total, banks that lost customers because of service problems saw earnings worth hundreds of millions of dollars walk out of their vaults.

- Gary H. Raddon. "Quality Service- A Low-Cost Profit Strategy, " Bank Marketing, September, 1987 pp.10-11.

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## **Hospitality Industry**

When Marriott Corporation studied the impact of employee turnover on customer loss, they found that every 10% drop in labor turnover resulted in a reduction of "Customer nonrepeats" from 1% to 3%.

- Robert Woods & James Macaulay. Rx for Turnover: Retention Programs that work, The Cornell H.R.A. Quarterly, May 1989.

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## **Insurance Industry**

A 1990 study on the auto insurance industry found the following:

- For auto insurers with Consumer Reports Service Quality ratings greater than 85%, the ratio of general expenses to premiums was, on average, 2%.
- For insurers with Service Quality ratings below 85%, the ratio of general expenses to premiums was, on average 6%.

- Temple, Barker & Sloane. The High-Cost/High-Quality Myth in Insurance, February, 1990.

One insurance company reports that:

- Satisfied policy holders are three times as likely as dissatisfied ones to refer them as good company for life insurance if asked by a friend today.
- One in three dissatisfied policy holders has bought at least one life insurance policy from a competitor since they bought their last policy, compared with one in seven for satisfied customers.

**Notes:**

- If customers need additional life insurance, satisfied policy owners are four times as likely to buy them than are dissatisfied customers.

Eight benefits of providing good service:

1. Higher closing rate
2. Better persistency
3. More repeat and cross sales
4. Third-party advertising
5. More employee pride in work and company
6. Greater job satisfaction
7. Less turnover
8. More long-term profitability

- Life Insurance Marketing and Research Association

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## **Manufacturing (misc.) Industry**

Shelby Williams Industries dominates the contract chair seating market. Sales have grown at 17 percent a year since 1981 and margins hover around 7 percent-the best in the business. Its success is based on the premise that all operations take a back seat to customer service.

- Manfred Steinfeld. "The Shelby Williams Approach to Building a Unique Identity in a Low-Technology Market," *Journal of Business Strategy*, Spring 1987, pp.87-89.

In the pest control business, "Bugs" Burger Bug Killers charges at least four times what competitors do and brings 9 to 12 cents of each dollar to the bottom line, a remarkably healthy performance for the industry. The main reason for BBBK's success is the extra value customers get in the form of a service guarantee.

- Christopher W.L. Hart. "The Power of Unconditional Service Guarantees," *Harvard Business Review*, July-August 1988, pp. 54-62. Tom Richman. "Getting the Bugs Out," *Inc.*, June 1984, pp.61-64.

In 1986 Bell & Howell acquired a nationally-based records storage and management company from Bekins Van Lines for approximately \$35million. After acquiring the company, Bell & Howell launched a concerted Service Quality improvement effort over the next three years which improved customer satisfaction by 30%. As result, Bell & Howell was able to sell the business in 1989 for \$70 million.

- Jeffrey Wilson, former President, Bell & Howell Records Storage and Management Company. PIMS Conference (The Strategic Planning Institute), February 1989, Orlando, Florida.

**Notes:**

General Electric estimates that their answer center (24-hour hotline) is worth about one point of market share, which translates to about \$15 million. The hotline drives costs down, too. A customer service encounter would cost GE about \$300 to handle versus \$10 when it's done over the phone.

- General Electric

In one service business, a 2% increase in repeat business was found to have the same impact in margin as a 10% cost reduction.

- Frederick Reichheld and Earl Sasser. Zero Defections: Quality Comes to Services, Harvard Business Review, September/October 1990.

A national study conducted in 1989 by Sandy Corporation indicated that customer dissatisfaction costs the average service companies 10.6% of their annual revenue. The study also revealed that: 37-45% of all service customers are dissatisfied but don't complain; 28-30% of those dissatisfied customers don't complain but switch.

- Sandy Corporation

Loyal customers - the ones not lost because of bad service - are worth thousands of dollars in sales over the life of their relationship with a company. Example: one of Federal Express' smaller accounts may represent ten year revenues of \$180,000;

- the patron of an upscale grocery spends \$50,000 in revenue;

- appliance makers can expect roughly \$3,000 in sales to a loyal customer over 20 years.

- "Making Service a Potent Marketing Tool." Business Week, June 11, 1984, pp.165-167.

In a 1983 study, Whirlpool asked customers which sources of buying information were most trustworthy:

29%.....said friends

15%.....said relatives

6%.....said advertising

- Whirlpool

General Electric has found that word of mouth has twice the effect on a consumer's repurchase decision than corporate advertising does.

-The Information Challenge, General Electric Company, Louisville, Kentucky, 1982.

In research conducted by General Electric on making decisions:

61% said recommendations from friends are important

29% said manufacturer's advertising is important

- General Electric

Notes:

## Retail Industry

Why do retail stores lose customers?

15% dissatisfied with product

13% prefer the competition

3% move away

1% die

But...

68% leave because of store indifference

- Bruce R. Matza (MI based consultant)

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## Technology Industry

IBM estimates that if it can improve satisfaction 1% for its AS/400 customers worldwide, it will gain more than \$200 million over five years.

- IBM

Research among 200 Silicon Valley vendors reported in Positive Impact found:

- 87% of manufacturers say they will rely in the development of new products to realize growth objectives, while 75% of buyers surveyed said they thought there were already too many products on the market to evaluate properly.
- 44% of buyers say they need multiple vendors to satisfy their total technology needs, while manufacturers say meeting compatibility and connectivity standards is low on the list of priorities.

- Positive Impact

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