

Improving satisfaction throughout the customer life-cycle

Pablo Montesano and Javier Anta

It is becoming ever more crucial for companies not only to keep customers happy but to keep the right customers happy. But how can they measure the value of customers through the whole customer life-cycle? In this article the authors explain the methodology developed by Arthur D. Little that helps companies to measure satisfaction levels and translate the results into actions with sustainable results.

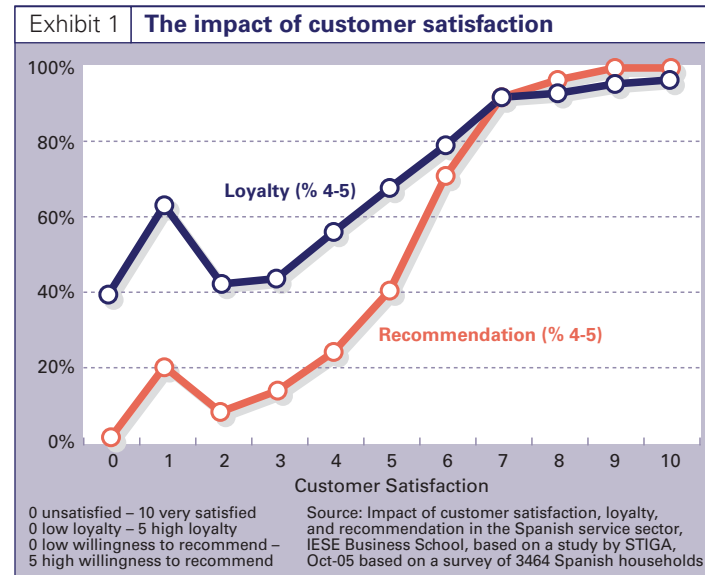
Companies are continuously striving to find new ways to maximise the value of their customer base. "Value" is understood as the discounted margin from the revenues of all customers during their lifetime with the company. It can be increased by acquiring new customers and/or expanding the worth of existing ones. As markets become more mature, gaining new customers at reasonable acquisition costs becomes increasingly difficult. Therefore companies concentrate their efforts on establishing stable and long-lasting relationships with existing customers.

In particular, companies are progressively realising that managing customer satisfaction is key to succeeding in this effort. Unsurprisingly, studies have shown that as a customer's satisfaction increases, so do his or her loyalty and willingness to recommend the service to others (see Exhibit 1). On top of this, satisfied customers are more receptive to cross-selling actions and have proven to be less costly in terms of customer care. For example, the contact rate by customers at the telecommunications branch of El Corte Inglés, Spain's leading department store, is much lower than that at rival operators, despite it being a pure reseller of the services of these competitors. This is the result of the retailer's well-deserved reputation for always putting customer needs first.

Despite the evidence, service companies rarely consider building loyalty, capturing cross-selling opportunities and managing customer satisfaction as part of one and the same process. Satisfaction is typically measured in periodic customer surveys that are used to compare the position of the company relative to that of its competitors. Yet these results are seldom translated into the individualised commercial actions launched by marketing & sales to retain and increase revenue per customer. In the process, valuable resources are lost when attempting to cross-sell to unsatisfied customers who will probably never agree to increase their spending with the company, and trying to retain satisfied customers who would have stayed with the company anyway.

Arthur D Little



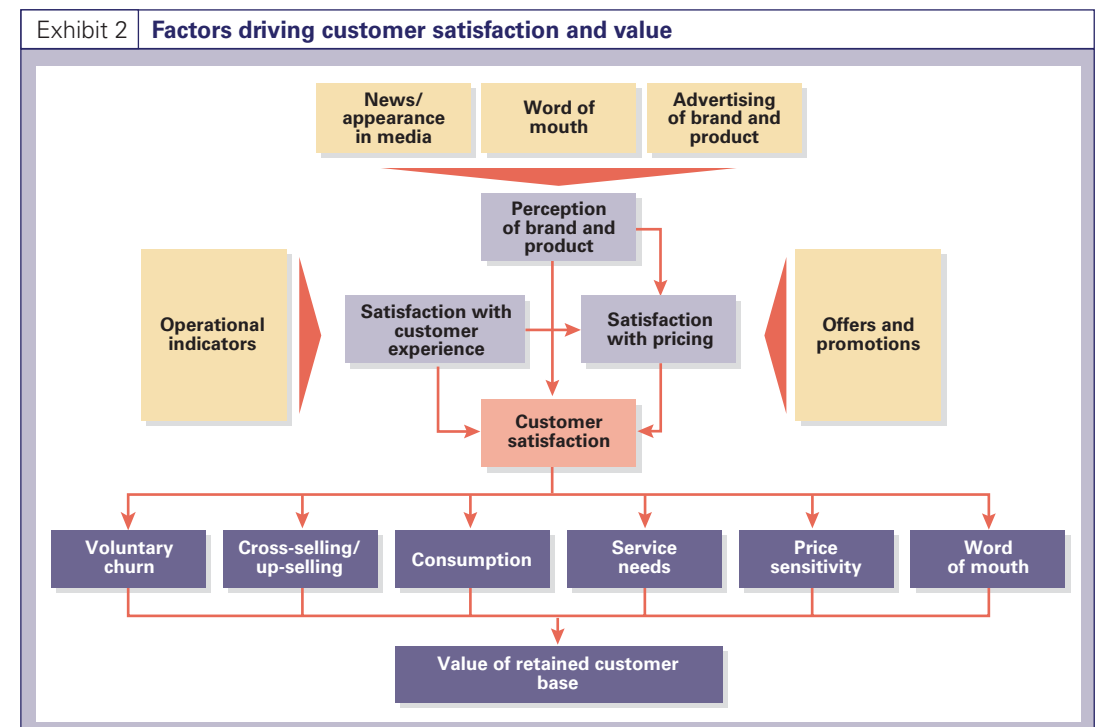


Consider the case of Iberia, the Spanish airline. Reasons for dissatisfaction in commercial air travel are fairly straightforward: delays in departure times, flight cancellations, luggage misplacement, etc. Iberia realised it was possible to measure the experience of each of its air miles programme members with respect to most of these variables. With this powerful information, the company is able to offer individualised rewards – such as free air miles, access to the VIP lounge and upgrades – to valuable customers who have suffered negative experiences.

Companies could therefore extract additional value from their customer base if they knew the satisfaction level of each customer at every point in time. In this article, we will describe an approach developed by Arthur D. Little to do precisely this. It is based on the application of standard statistical modelling techniques to measure customer satisfaction in a reliable, systematic and impartial way.

We will focus exclusively on one of the three factors that drive customer satisfaction, namely the customer's experience of the quality of service (see Exhibit 2). We will not address the two other factors, namely pricing and brand and product image. Whereas much has been written about the impact of the last two on customer perception, how customer experience influences overall satisfaction

remains virtually unexplored. This is surprising, given the importance of customer experience in explaining changes in overall satisfaction. As we have found out in a recent project for a telecom operator, perception derived from day-to-day interactions with the company could explain up to two-thirds of the variances observed in customer satisfaction.



The approach used to develop a customer experience statistical model is divided into four steps:

- Define contact moments, attributes and operational indicators that make up customer experience.
- Establish a relationship between customer experience and satisfaction for the "typical customer".
- Predict satisfaction based on customer experience for each individual customer.
- Apply the model results to day-to-day customer value management and operational improvement actions.

1. Defining customer experience

Customers evaluate quality of service by comparing the perceived performance against their expectations for a number of attributes during a contact opportunity. Although the weight of each attribute and the expectations attached to them can differ from one customer to the next, customers tend to agree on which attributes define a contact moment.

The first step in setting up a customer experience model is to identify and examine all the interactions that occur between the company and its customers. At this point three basic concepts need to be introduced: contact moments, attributes and operational indicators.

The interaction between a customer and a service company takes place during a series of contact moments throughout the customer life-cycle. For example, the most typical interactions that take place between telecom operators and their customers are during the sign-up process, at the reception of the monthly bills and during calls made to the call centre to resolve any particular issue. How well the company performs on these occasions, usually called "moments of truth", is a key determinant of the way customers perceive the service received from the company.

Customers evaluate quality of service by comparing the perceived performance against their expectations for a number of attributes during a contact opportunity. Although the weight of each attribute and the expectations attached to them can differ from one customer to the next, customers tend to agree on which attributes define a contact moment. Customers calling a company's call centre to voice an inquiry or report an incident, for example, typically evaluate the following elements:

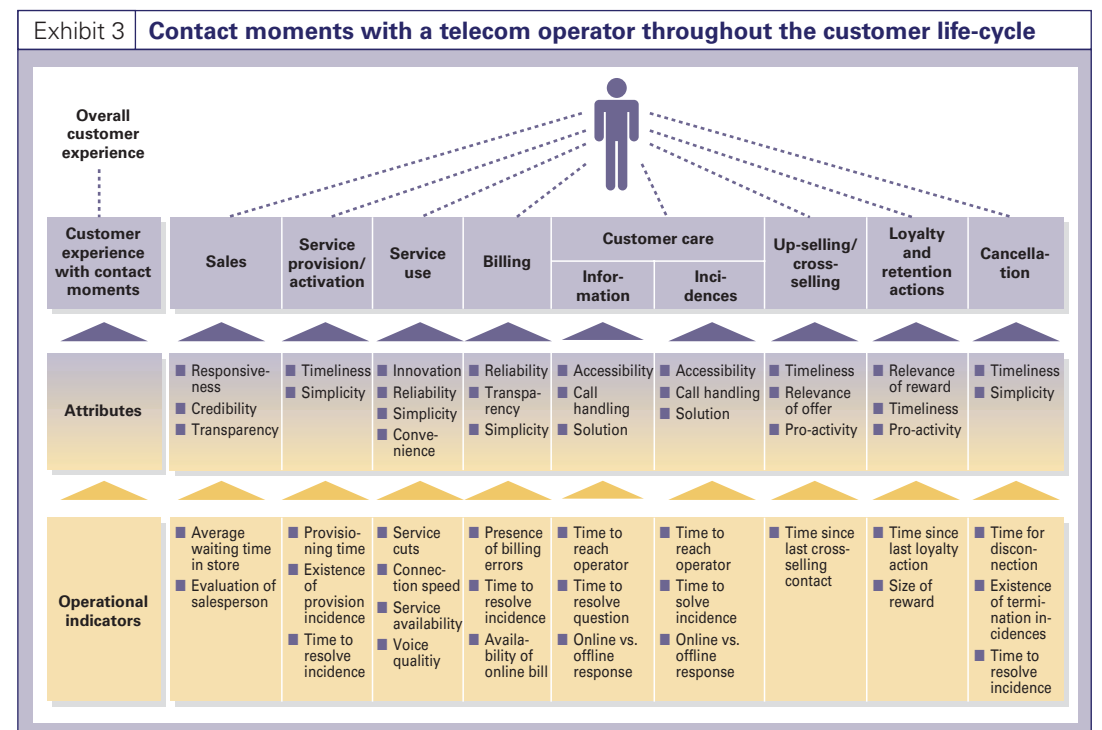
- **Accessibility:** How many communication channels are open to me? Are call centre calls free of charge? How easy was it to contact a representative from the company?
- **Call handling:** How long did it take to reach someone with the ability and authority to solve my problem? Did the representative show friendliness and respect?
- **Solution:** Has the problem been solved? How long did it take? Was I kept informed during the different stages of resolution?

Once these attributes are identified, it is relatively simple to match them with internal operational indicators, which

reflect how well the company is performing on the different aspects that are valued by customers. Indicators not only need to be fundamentally related to attributes but must also be measurable on a customer-by-customer basis and in a timely manner. For the attributes identified in our previous example, operational indicators include:

- Time in seconds to reach an agent;
- Number of transfers per call;
- Average call duration;
- Number of requests solved online;
- Time between the moment an incidence was reported by a customer and the moment the solution was communicated back.

In Exhibit 3 we show a high-level picture of contact moments, attributes and indicators at a telecom operator.



2. Establishing the relationship between customer experience and satisfaction

In order to measure the level of satisfaction derived from customer experience, it is necessary to carry out specific surveys that target a sample of customers who have recently experienced a contact moment, such as a call to the call centre.

The second step is to link global satisfaction survey results with aggregate information about the quality of service. In this way you are able to form a full picture of the relationship between the customer's perception of service quality and the company's actual delivery (as measured by operational indicators). Once this step is completed, you can establish the weight of the different operational indicators and their relationship to overall satisfaction for the average customer.

In order to measure the level of satisfaction derived from customer experience, it is necessary to carry out specific surveys that target a sample of customers who have recently experienced a contact moment, such as a call to the call centre. In this way, it is possible to match customer responses with operational performance and, more importantly, to guarantee that the interaction is still fresh in the customer's memory.

The survey has to be very simple and focus on the customer's evaluation of the recent interaction experience ("How would you rate your overall satisfaction with the service we provided you?"), each of the attributes involved ("Please score the treatment you received from our agent"), and the perception of customer experience so far ("Considering all the interactions you have had with us so far, how would you rate our quality of service?").

These surveys must be conducted periodically and matched with the corresponding operational indicators for each period. The larger the data set, the richer the model. The secret lies in automating all parts of the data-gathering process, so that more time is dedicated to analysing the results and fine-tuning the model, and less to obtaining the information.

Once all the necessary information has been gathered, regression analysis is used to determine the relationship between the different variables. In this way it is possible to establish how variations in one element can explain

variations in others. As a result, a set of regression equations are obtained using the following configuration:

- operational indicators are used as predictors for satisfaction at contact moments;
- the different values of contact moment satisfaction are in turn predictors of customer experience satisfaction;
- finally, customer experience satisfaction acts as a predictor of overall satisfaction.

At this point it is necessary to check the statistical significance of the results obtained. The predictive strength of the model is reflected by the R2 coefficient, which can range from 1 (perfect predictive power) to 0 (no predictive power). There is debate about which figure is acceptable; certainly any figure higher than 0.5 will do. In the example of the telecom operator, customer experience explains up to 65 percent of customer satisfaction variance. In this real-life situation, operational improvements have quite a large impact on customer satisfaction. If your R2 results turn out to be statistically poor, the chances are that the operational indicators used were not the right ones, and/or the number of customers surveyed or time periods considered were too small.

3. Predicting individual customer satisfaction

Having developed a satisfaction model for the average customer, it is now possible to estimate satisfaction scores for any given customer, based on the individual operational indicators that reflect his or her experience as a customer. Ideally, these results are calculated automatically and on a near-real-time basis, much in the same way as the algorithms used to determine the individual value of a customer.

To analyse the relationship between satisfaction and churn on a customer-by-customer basis it is necessary to combine the inputs from the satisfaction score with additional information on customer demographics and service utilisation. This technique was first adopted by retail banks,

To analyse the relationship between satisfaction and churn on a customer-by-customer basis it is necessary to combine the inputs from the satisfaction score with additional information on customer demographics and service utilisation.

which found that service use information combined with data on spending patterns turned out to be good predictors of churn.

Churn prediction relies on a statistical method called survival analysis. This procedure is based on the identification of common patterns in the behaviour of defecting customers and their application to different customer profiles in order to determine how likely a customer is to leave the company during a given period.

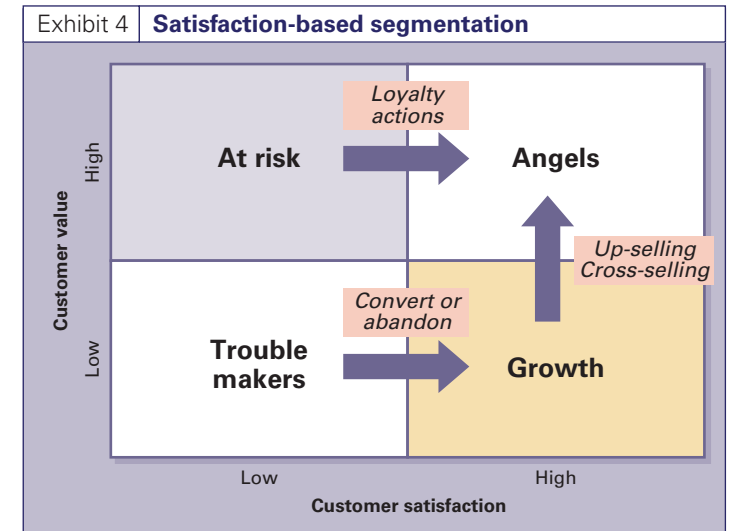
Churn prediction relies on a statistical method called survival analysis. This procedure is based on the identification of common patterns in the behaviour of defecting customers and their application to different customer profiles in order to determine how likely a customer is to leave the company during a given period.

Banco Espírito Santo of Portugal, for example, uses statistical modelling techniques on customer transaction information in order to identify how customers respond to specific offers, their perception of the product's quality and their satisfaction with the service. By identifying ahead of time when a customer is at risk of leaving, the bank was able to reduce customer asset erosion by 15 to 20 percent.

A strong inverse relationship between churn and satisfaction has been found in the case of telecom operators. In particular, the likelihood of churn diminishes significantly for satisfaction scores over 8/10. Additionally, changes in customer satisfaction translate into changes in churn with a lag of one month for mobile services and three months for broadband.

4. Extracting value from customer experience management

In order to exploit the power of the customer experience model described above, a company should complement its existing customer segmentation with the newly obtained information. Companies usually fail to realise that they need to manage several segmentations simultaneously. On top of the more traditional sociographic and needs-based segmentation approaches used for product development and advertising, the customer experience model allows companies to build a specific segmentation for managing retention and cross-selling initiatives based on customer value and satisfaction (see Exhibit 4).



There are three types of customer-specific actions that can be defined using this segmentation:

- **Retention or loyalty actions**, with the aim of reducing churn rates amongst the company's most valued customers. By identifying those customers who have a high likelihood of churning due to low satisfaction scores, companies can define specific actions and rewards to retain them. Those actions can be applied both reactively ("What to do when the customer calls to cancel the service") and proactively ("What to do with the customer before he decides to cancel the service"). In the short term, rewards make up for operational deficiencies that cause dissatisfaction.
- **Up-selling and cross-selling actions**, focused on turning the positive experience generated in customers into additional revenues. Only customers who are believed to have high levels of satisfaction should be cross-selling targets.
- **Converting or abandoning low-value**, low-satisfaction customers. The margin these customers bring is lower than the value they destroy from negative mouth-to-mouth. Direct retention actions on this group are probably unprofitable. Therefore the company

should focus on driving them to competitors or improving their satisfaction levels over time by enhancing the overall quality of service.

Results from applying these simple rules at a telecom operator speak for themselves: 5 per cent reduction in churn, € 32 million in additional cross-selling revenues and € 4 million savings from avoided retention commissions.

The model also proves to be a very important decision-making tool for the identification and prioritisation of operational improvements. The absence of negative customer experiences is the most powerful and sustainable driver for increased satisfaction. Not only does the model allow companies to identify precisely which operational areas should be improved, but it also makes it possible to calculate the expected return on investment from these actions in terms of reductions in churn and improvements in cross-selling.

The absence of negative customer experiences is the most powerful and sustainable driver for increased satisfaction.

Insights for the executive

The approach described above has proven to be of great utility to service companies that have a large number of customers and face maturing market conditions. Sectors with these characteristics include telecommunications, travel services, hotels, air and rail transportation, utilities, road assistance, retail banking, insurance, healthcare services, department stores, supermarkets and car dealerships. The power of this business decision tool is at its greatest when companies enjoy a first-mover advantage over the competition. The tool can also be applied in business-to-business environments, particularly for companies with a large distributor base that requires constant monitoring.

When developing customer experience models, executives should consider the following aspects:

View customer management as an end-to-end process

A common mistake is to dissociate commercial actions from customer operations. As we have seen, these two areas are intrinsically linked: how well customer opera-

tions are run affects customer satisfaction, which in turn influences the effectiveness of retention and cross-selling efforts. In order to become a customer-centric company, it is critical for the organisational structure, processes and systems to support a single view of all the contacts a company has with its customers.

When setting up a predictive model for customer experience, it is necessary to involve several areas within the organisation, such as marketing and sales, customer operations (including customer care, billing, etc.), quality control and IT. The support of the IT department is particularly critical in the initial phases in order to be able to systematically measure and capture all the necessary information to build the model.

In other words, setting up a customer experience model without the necessary changes to the organisation renders this approach useless. Implementation is just as important as the design of a robust model.

Don't try to build the perfect model from the beginning

Large volumes of data and the use of statistical techniques easily lead to overload. We recommend starting with a controlled environment, running a pilot model with a sample of customers and choosing only the most significant predictive variables. Once this model has proved robust, extend it to other customer segments and variables.

Fine-tuning a model will take up to a few years. But the results are worth it: based on our experience a model can prove to be so accurate as to predict with a ± 5 percent margin of error the outcome of a satisfaction survey on a specific customer, based on that customer's recent experiences with the company.

Satisfied customers mean satisfied shareholders

Customer satisfaction affects future customer behaviour and thus the level and risk of future cash flows. Empirically, studies have shown a positive correlation

between customer satisfaction and shareholder value. The American Customer Satisfaction Index, for example, has been shown to be a relevant indicator of economic performance, both for individual companies and for the economy as a whole.

In the same way that Wall Street analysts look at financial ratios to give investment recommendations, they will soon start to consider independent surveys of customer satisfaction. One way or the other, companies are likely to pay a lot more attention in the future to how satisfied their customers are.

Acknowledgements:

The authors would like to extend special thanks to Bart Janssen, Manager in the Rotterdam office, for his valuable contributions to this article.

Pablo Montesano

*... is a Manager at Arthur D. Little in Madrid, where he belongs to the TIME and Strategy & Organisation Practices. He has more than seven years' experience in strategy consulting and has been actively involved in several projects relating to client value management.
E-mail: montesano.pablo@adlittle.com*

Javier Anta

*... is a Consultant at Arthur D. Little's Madrid office, where he mainly works for the TIME and Strategy & Organisation Practices. He specialises in client management and business decision making.
E-mail: anta.javier@adlittle.com*