We have become a service economy. Yet few organisations are truly delighting their customers. This chapter introduces the concept of service quality and defines what this means to the customer. At the end of this and subsequent chapters, a checklist is provided to allow you to take practical steps to develop and sustain a customer focus within your organisation.

Service in a Competitive Environment

Over recent years organisations have placed increasing emphasis on customer service as a means of gaining competitive advantage.

Who would have imagined 15 years ago, for example, that organisations such as Amazon.com could capture market share from the high street by offering the customer a wide selection of value-for-money products backed by a quality service? Or that companies such as First Direct could fundamentally challenge the traditional way customers do business with their bank by offering a friendly, efficient service 24 hours a day, 365 days a year?

In 1954 Peter Drucker wrote in The Practice of Management: 'There is only one valid definition of business purpose: to create a customer.' He said that an organisation's ability to remain in business is a function of its competitiveness and its ability to win customers from the competition. The customer is the foundation of the business and keeps it in existence.

As competition has become more global and more intense, many organisations have realised that they cannot compete on price alone. It is in these marketplaces that many companies have developed a strategy of providing superior customer care to differentiate their products and services. Surveys suggest that service-driven companies can charge up to 9 per cent more for the products and services they provide. They grow twice as fast as the average company and have the potential to gain up to 6 per cent market share.

Through undertaking a major change programme which was intended to focus on the customer, The Royal Bank of Scotland went from near to making a loss to a £200 million incremental profit within two years.

Through focusing on the customer, retailer Tesco managed to increase its profitability and market share, becoming the market leader in a highly competitive and cost-conscious marketplace.

Financial services is typical of many sectors in its change of focus towards customer service. The nature and number of competitors and the ability of retailers, banks, building societies, insurance brokers, estate agents and other financial service companies to offer similar products at similar prices has led to increasing emphasis being placed on personal service as a means of adding value to customers. However, like very many other market sectors, few organisations succeed in leading the way.

Benefits of a customer-centred organisation

In increasingly competitive marketplaces, best-practice organisations have demonstrated clear benefits of focusing on the customer Excellent service enable a business to:

• differentiate itself from the competition;
• improve its image in the eyes of the customer;
• minimise price sensitivity;
• improve profitability;
• increase customer satisfaction and retention;
• achieve a maximum number of advocates for the company;
• enhance its reputation;
• ensure products and services are delivered 'right first time';
• improve staff morale;
• increase employee satisfaction and retention;
• increase productivity;
• reduce costs;
• encourage employee participation;
• create a reputation for being a caring, customer-oriented company;
• foster internal customer/supplier relationships;
• bring about continuous improvements to the operation of the company.

Recent years have seen enormous pressure on service organisations to improve the way they do business with their customers. A lack of good service even risks public humiliation as the Passport Office found to its cost when its Service Charter mark was withdrawn for inefficient delays in: issuing passports during a busy summer period. The challenge for a: business today is to 'inject' innovation into its life-blood so that it becomes part of its very being.

Successful service organisations constantly strive for higher levels of customer

service.

When online bookseller Amazon was established, its founder recognised that it could not offer comfy sofas or coffee to those who browse through its virtual bookstore, so it set about finding innovative ways to enhance the customer experience.

Only a few organisations have been able to do this successfully, but their success is noteworthy. First Direct revolutionised the retail banking sector with its introduction of a telephone banking service. Its focus on speed, convenience, quality and service resulted in 38 per cent of new customers being referred from existing ones. Sandwich chain, Pret a Manger, which started in one store in Victoria, now owns over 500 outlets. It puts it success down to a 'relationship of trust' with its customers, attention to detail and constant innovation.

Changing Customer Behaviour and Expectation

Today's consumers are increasingly sophisticated, educated, confident and informed. They have high expectations of the service they want to receive. They want greater choice and will not be 'sold to' or manipulated.

Value for time

Already, the 24-hour society is here. A report by Future Foundation predicts that, by 2007, over 2 million people in the UK will be working between 9 pm and 11 pm and around a million will work between 2 am and 5 am. In a survey commissioned jointly by BT and First Direct, over 50 per cent of respondents wanted pharmacies and public transport accessible 24 hours a day. A third of those surveyed also wanted 24-hour access to a wide range or other retail outlets and sports, leisure and entertainment facilities.

Supermarkets are leading the way in 24-hour shopping. Asda opened the first 24-hour stores in 1994. Tesco had 81 round-the-clock stores in 1999, and in addition offered home shopping from over 100 stores. The home shopping service allows people to order goods over the Internet; the Web page displays each customer's most frequently purchased items at the beginning of the list to aid selection and the order is relayed to a computerised trolley where on-board computers guide an order-picking assistant on the most efficient route round the store to collect the groceries.

Consumers are increasingly mobile and are looking for value for time. MORI carried out research for mobile phone operators Orange and found that a third of small companies and 40 per cent of medium companies have employees who are consistently mobile. They are reliant upon technology to keep in touch with their office and the customer For example, VeederRoot is a company that manufactures, installs and services 8,000 instruments that measure petrol levels in the underground tanks below many of the UK's petrol stations. Field engineers are supplied with a laptop computer linked to an Orange handset so that they always have access to the latest customer information. They can call for the latest customer report in advance of each visit and diagnose problems on site without having to travel back to the head office. This process has resulted in increased levels of productivity and customer and employee satisfaction.

Consumer rights

Today's customers know their rights and are more likely to make their opinions known if they feel that these have been violated. Research by the Henley Centre found that 35 per cent of adults in the UK agree that they love to complain every now and then. The survey also showed that 45 per cent of adults had complained in person about poor service (up from 39 per cent in 1997) and 42 per cent on the telephone (up from 27 per cent in 1997).

A MORI poll shows that a clear majority of customers claim that social responsibility influences their choice of products and services. Consumer concern over human-rights violation and environmental abuse has endangered sales of brands as diverse as Nike, Coca-Cola and Shell. The debate over genetically modified food has brought together a wide range of consumer interest groups to stop the development of such foods.

What is emerging is a 'pull' scenario in which the customer is becoming empowered. This is facilitated by new media, where Internet 'infomediaries' (information intermediarie, making comparisons and completing transactions) offer the consumer greater choice, and Web sites have the chance to receive opinions from customers which can be expressed to a far-ranging audience. Working on the basis that most airlines fly at 65-70 per cent capacity, Priceline.com allows the consumer to name the price that they are prepared to pay for airline travel. It then contacts the customer within the hour with the option of a non-refundable ticket at the price the customer has stipulated. According to an Oftel survey of July 2001, 45 per cent of UK homes had access to the Internet. This equates to 10 million homes and 33 million people. E-mail too has been widely adopted, substantially replacing both the fax and the phone as a means of both global and local communication.

One-to-one service

It is no longer financially viable for many companies to 'mass market' their products or services.

A DTI and CBI survey found that the real differentiators in marketing are innovative and customised products and customer support. Customisation and individualisation are key. Online bookseller Amazon knows the purchase histories of individuals, and can offer a bespoke service to the customer. Levi's offers a customised section in-store where you can make a product personal and unique.
Smart competition

The advent of increasing globalisation allows organisations to compete on a regional, national and pan-continental basis. Amazon.com has broken traditional consumer purchasing patterns on a global scale via the use of technology. Today, its market share is threatened by cyber competitors. The message is clear: nobody can rest on their laurels. Competition is global, not local.

Technology

One of the greatest drivers of change is the range of possibilities opened up by the increased use of technology. From buying products or services online to using the Internet to pay bills via a mobile phone, the use of technology can potentially revolutionise organisations' interface with customers.

Chubb Insurance Group processes its claims on the spot; Chubb representatives visit a customer's premises, input data via a laptop computer and print out a cheque there and then. US home delivery retailer, Peabody, uses its customer database to remind individuals in advance when they are likely to be running out of household provisions.

Cisco, the US manufacturer of networking equipment, has empowered its customers to serve themselves using its Web site in real time. Customers can instantly access their purchasing information on the Web site. The company estimates that, in one year, this way of working saved Cisco $268 million, of which $125 million was saved on customer support (customers supported themselves using the Web), $8 million on recruitment and training (as this was transferred to the Web), $85 million on software distribution costs (as software was downloaded over the Web) and $50 million by moving to paperless information distribution.

Customer Retention

As customers begin to experience a better service their expectations rise. Furthermore, the service experienced is transferable in the mind of the customer. The customer makes conscious and unconscious comparisons between different service experiences - irrespective of industry sector. Customers' expectation, for example, of the service experience they will receive from a ear rental service may be based not only on their expectation and experience of the service itself but also experiences they may have had in the high street or on the Internet, with other ear rental companies and other leisure and travel organisations.

A company's ability to attract and retain new customers therefore is a function not only of its product or product offering but also the way it services its existing customers and the reputation it creates within and across marketplaces.
Many organisations, however, overlook the potential of existing customers to develop their business.

Caring for existing customers

Statistics underline just how crucial retaining customers can be:
Reducing customer defections can boost profits by 25-85 per cent (Harvard Business School).
• The price of acquiring new customers can be five times greater than the cost of keeping current ones (US Office of Consumer Affairs).
• The return on investment to marketing for existing customers can be up to seven times more than to prospective customers (Ogilvy & Mather Direct).

Yet, while most companies regard the acquisition of new customers as a crucial element in their sales strategy, very few of them record customer retention rates and even fewer analyse the reasons why previously satisfied customers become dissatisfied and go. Frederick Reichheld states statistics for the average attrition rates in US companies:

• 50 per cent of customers are lost in a five-year period;
• 50 per cent of employees are lost in four years;
• Replacement customers will not contribute to profit unless they are retained for at least three years.

Only best-practice organisations, such as Toyota, have customer retention levels higher than 70 per cent. Put another way, most organisations lose significantly more than 30 per cent of their customers before, or at the time of a repurchase decision, mainly through poor service. The only reason market shares do not drop is because competitors are usually in the same position and are losing customers to their competitors! The result is a constant churn of dissatisfied customers looking for a company in which they can put their faith.

Research conducted by the Tarp Organization in the US demonstrates that service is a key determinant in choice of product. Its importance increases however when consumers are asked why they change products:

Reason for choice of product -7 per cent technical specifications
50 per cent manufacturers- response and liability.

Reason for changing product -8 per cent quality or cost
40 per cent dissatisfied with service.

A customer's reasons for initial purchase decisions, therefore, can be based on both tangible and intangible factors, the service features relating to both performance and a sense of caring:

Tangible

Sense of caring
Courtesy
Willingness to help
Ability to problem solve

Intangible

Performance
Quality
Reliability
Cost

The loyalty ladder

Most service organisations' customer bases consist of those people who use products or services on a more or less frequent basis. Some customers for example may only have a relationship once with the company at one extreme; at the other, customers will use the organisation's products or services on a regular basis.
Customers' relationships with the business can be depicted in terms of a loyalty ladder. The more advocates you have, the better your retention rates and long-term profitability.

Reasons for developing long-term relationships with customers

On average it is estimated to cost five times as much to attract a new customer as it does to keep an old one. Long-term relationships with customers are therefore more profitable because:
• The cost of acquiring new customers can be high.
• Loyal customers tend to spend more and cost less to serve.
• Satisfied customers are likely to recommend your products and services.
• Advocates of a company are more likely to pay premium prices to a supplier they know and trust.
• Retaining existing customers prevents competitors from gaining market share.

Loyalty programmes

In recent years competitive markets have been flooded with customer loyalty programmes. Some of the best-known schemes are the frequent-flier programmes of the major airlines and loyalty schemes introduced by food retailers. During the last 10 years, more than 150 loyalty programmes have been established in the UK, issuing over 50 million cards and costing over £3 billion in rewards.

According to Customer Loyalty Today, 51 per cent of all British shoppers possess a loyalty card and of those who shop at supermarkets which offer them, 70 per cent have a card. Everyone it seems is launching loyalty schemes, sending individually addressed letters and customised promotions to offer the appearance of building a relationship with customers.However, observed data and predicted norms show that few buyers are100 per cent loyal in a year and those who are tend to be light buyers of the product or service. In reality customer loyalty may be divided among a number of brands. Customers will regularly buy from a repertoire of goods and services within a given field. Therefore customer loyalty programmes may engender behavioural loyalty but they may not guarantee attitudinal loyalty when a competitive brand develops its own loyalty schemes or the customer cashes in his or her rewards: they may be as susceptible to changing products or services as ever. Furthermore, reward schemes may change the way customers think about the product but not necessarily in a positive way. For example, they may come to expect rewards on an ongoing basis.

Frederick Reichheld, director of US company Bain, writing in the Harvard Business Review, says, Creating a loyalty base system requires a radical departure from traditional business thinking. It puts creating customer value rather than maximising profits and shareholder value at the centre of business strategy and demands significant changes in business practice.

Reichheld says this means recognising that companies have to target the right customers - those whose loyalty can be developed, and not those who are easier to attract by cutting prices. Smart organisations such as Tesco target increased purchase and repeat visits by analysing usage and buying patterns.

Customer lifetime value

Customer lifetime values enable an organisation to calculate the net present value of the profit the business will realise on a customer over a given period of time. It is an immensely powerful tool because it allows companies to work out how many transactions it will take to recoup the initial investment in attracting and servicing each new customer and generate a worthwhile return.

When companies invest in programmes to strengthen customer loyalty they can therefore do so knowing whether the resulting changes in purchase behaviour will increase the profit derived from each customeii Customer lifetime value is calculated by working out the customer retention value and average annual revenue to arrive at a total revenue figure from which cost can be detracted to arrive at a gross profit - or lifetime value for each customer.

Customer lifetime values have become a cornerstone in the transformation of ScotRail's marketing strategy which has reversed the long-term decline in passenger numbers. Using a new customer database and a lifetime framework model the company has been able to quantify the cause and effect relationship between service performance and retention rates. This in turn has enabled it to calculate likely changes to lifetime values in a broad range of scenarios and shape its customer service strategies accordingly.

Using calculations of lifetime values, US car insurers discovered that with certain segments of young drivers it took 10 years to break even, but only 10-15 per cent would stay that long, and it takes at least 4 years before most US insurance companies break even on the average customer. But one company's bad customer can be another's money-spinner. American Car Insurance Company, USA, enjoys a remarkable 98 per cent retention rate in ear insurance for US military officers. The reason for this success is the company's responsiveness to its market and the development of a system tailored to its customers' needs.

It is generally accepted that mobile populations are inherently disloyal. Analysis of demographics and previous buying history gives some indication of a customer's inherent loyalty. People who buy because of personal referral tend to be more loyal than those who buy because of an ad. Those who buy at the standard price are more loyal than those who buy on price promotion. Research also shows that home owners, middle-aged people and rural populations tend to be more loyal customers than other sectors of the population.

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