



Managing Complexity

Optimizing Customer Experience Investments

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INTRODUCTION

In corporate reports (annual, 10K, 10Q, etc.) in virtually every industry, companies identify customer experience as either a key differentiator or the strategy for driving growth. For example:

AutoZone: “While many companies talk about providing customer service that exceeds expectations, we live it. We understand what well trained, highly motivated AutoZoners can mean to both our customers and the financial health of our business. At the end of the day, people buy parts and products from people – not stores.” (Bill Rhodes, Chairman, President and CEO, AutoZone, Inc.; 2008 Letter to the Shareholders)

McDonald’s: “Our customer satisfaction scores are on the rise. Stated simply, we are running better restaurants. As a result, customers are visiting us more often – with a double-digit growth in guest counts versus 2004 . . . And, our owner/operators are sharing in this success, recognizing a higher average cash flow that enables them to re-invest in their restaurants, enhancing our overall customer experience.” (Jim Skinner Chief Executive Officer, March 17, 2008 investment call)

Why do so many companies emphasize their customer experience models and invest so heavily in training, measurement programs, and incentives? Intuitively, there seems to be a monetary link. Satisfied customers come back, providing a stable revenue base. They spend more money, increasing transaction or basket size. They are less likely to be vulnerable to competitive offers. And they create positive buzz, accelerating the acquisition of new customers.

Both academic and corporate research provide empirical results that validate the intuitive link between satisfaction and financial performance. Increases in satisfaction and loyalty have been linked to financial metrics such as return on assets, stock price performance, short-term branch profitability, sales per labor hour, market share, net present value, cash flow growth and stability, Tobin’s q, same store sales, and churn reduction. One organization has even bet its investment portfolio on customer satisfaction. Claus Fornell and the CFI group invest in companies based on their performance on the American Customer Satisfaction Index. On a cumulative basis (2001 to 2004) the portfolio gained 75% compared to a loss of 19% for the S&P 500 and 4% for the DJIA .

Given the intuitive and empirical evidence linking customer experience to financial results, it’s clear that corporate strategies to create great customer experiences are well-founded. But how do they put that concept into practice in complex, multi-location businesses?

Across our client base in seven industries, we see three critical best practices:

- Linking customer perceptions to the operational realities that create those perceptions;

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- Creating multi-dimensional models that allow for complex relationships between the drivers of satisfaction and loyalty;
- Helping business leaders optimize customer experience investments.

LINK OPERATIONAL BEHAVIORS TO CUSTOMERS' PERCEPTIONS

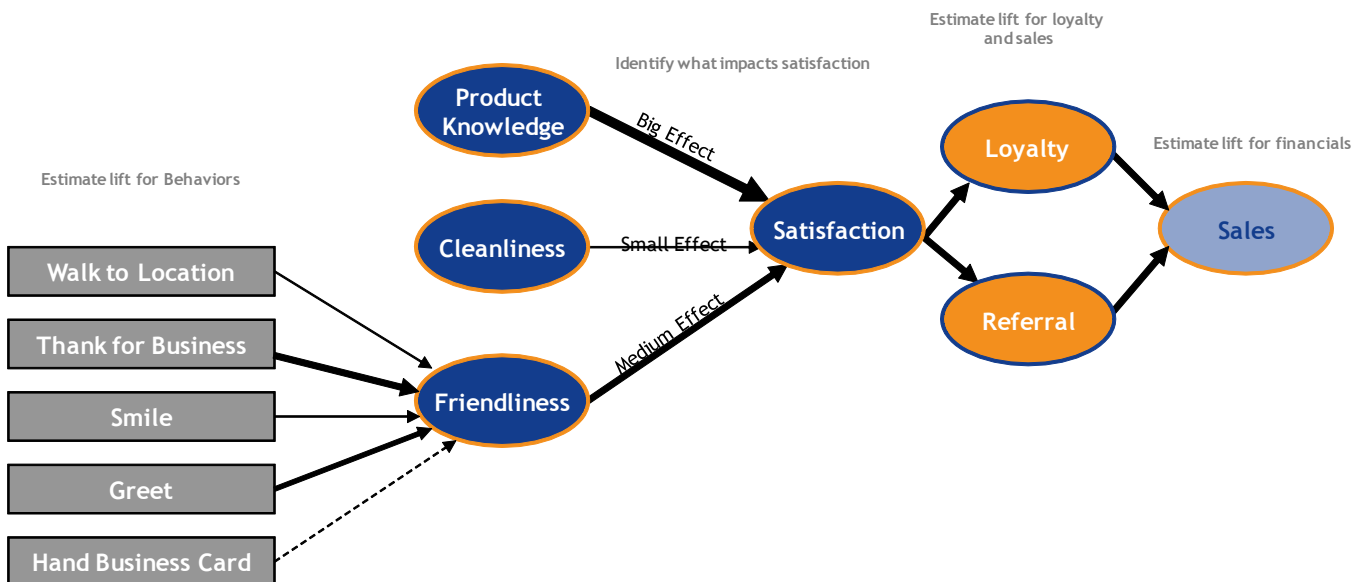
Customer experience in multi-location businesses really consists of two things: The perceptions customers walk away with (which affects their later behavior) and the operational realities that created those perceptions (see the Market Force white paper titled *Better Together*). If the customer walked away believing he received friendly service, what happened in the location to create that perception? If she walked away believing it was hard to find what she needed, what did she experience around merchandise availability?

Many companies measure operational behaviors using mystery shop or customer intercept methodologies. They also measure customer satisfaction using phone, web, or IVR surveys. Unfortunately, most treat the data streams as completely separate, with operations driving store-level efficiencies and marketing driving customer satisfaction. Keeping the datastreams separate means that business operators don't know what specific behaviors they must focus on to increase customer satisfaction—and marketers don't know what specific behaviors are creating customer satisfaction. Organizational structures that operate in silos exacerbate this issue.

Our research demonstrates that both datastreams are required to understand customer experience and optimize investments that drive financial performance.

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CONCEPTUAL MODEL



MODELING AND ALLOWING FOR COMPLEXITY

In order to really understand customer experience, organizations must allow for complexity. Simple models showing the one-dimensional relationships between one variable and another don't tell the full story behind the data. They miss important effects and lead to erroneous conclusions. For example, for a Market Force restaurant client, we found that the best way to increase perceptions of value was to improve food quality-not reduce price! A simple model would have led to that very conclusion, and yet the data showed some interesting complexities and led to quite different actions. So it's essential that the models allow for complexity.

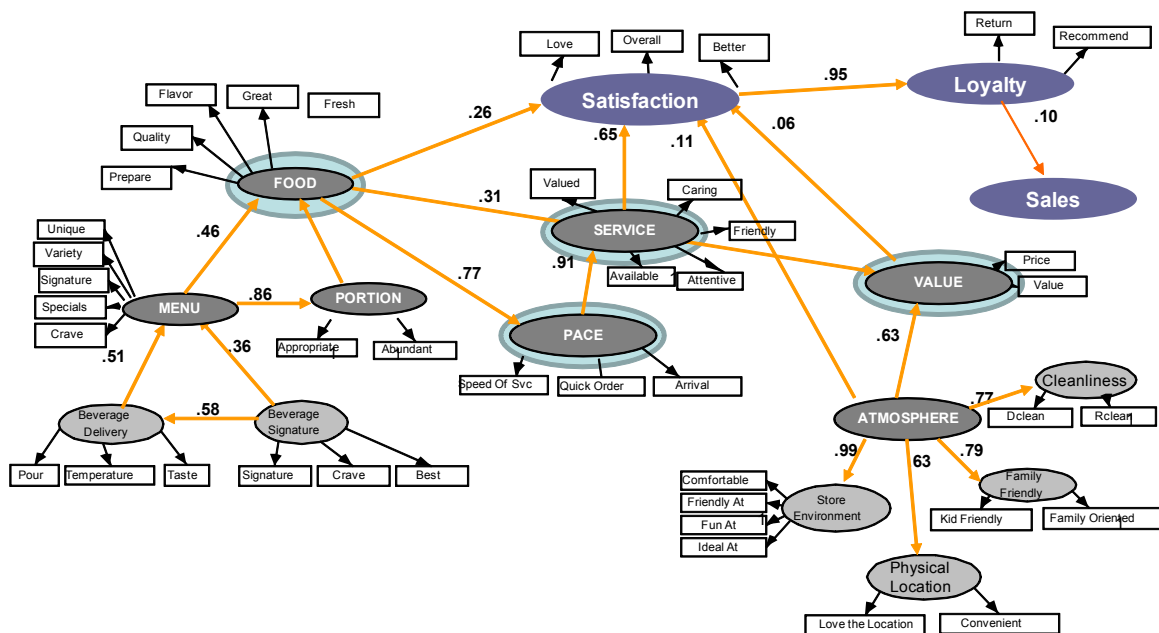
Complex models also can estimate the effects of making a 1% change to a specific behavior or perception on a financial metric, like same store sales. If I increase the pace of service, what happens to my same store sales? If I experience drops in the perceptions of friendliness, what happens?

The simplified model below, created from a restaurant client, demonstrates both complexity and the ability to estimate effects on same store sales. In this model, we found that a 1% increase in satisfaction resulted in a \$30MM increase in same store sales. The model also estimated the impact of each of the customer perceptions measured in the customer satisfaction survey and the in-store behaviors measured in the mystery shop questionnaire on sales. The client is able to tell exactly what levers to pull in order to increase satisfaction, loyalty, and same store sales.

For example, the model clearly indicates that service elements have a bigger impact on satisfaction than food, and both matter more than atmosphere or value.

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ACTUAL RESTAURANT MODEL



The model also illustrates other complex and intriguing relationships. For example, look at the impacts of food quality. Food-related items have the second biggest direct impact on guest satisfaction (behind service)—but the largest total effect! This is because perceptions of food affect perceptions of other aspects of the guest experience, particularly service pace and value. If the food is rated as having very high quality, customers' satisfaction with pace increases. Why? It's likely that great food makes customers more tolerant of pace issues. It's easier to forgive slow service when the food is exceptional than when food is simply mediocre.

OPTIMIZE CUSTOMER EXPERIENCE INVESTMENT

While customer experience is important, unlimited investments in customer experience doesn't make sense. At some point, there will be a law of diminishing returns, where the costs to improve customer experience outweigh the benefits. In the extreme, single-minded pursuit of satisfaction may lead to overspending and misallocation of resources. So how do corporations optimize their investments in customer experience, minimizing those with little return and maximizing those with clear financial gain?

First, it's important to acknowledge that store-level performance drives brand level results. The individual business operator's ability to drive incremental improvements will ultimately drive the success of the entire business. However, they need clarity on where they should focus their attention. Metrics collected in customer satisfaction and mystery shop programs cannot be reported with scorecards because they don't convey what is most important to satisfaction and sales. Operators who look at scorecards will have a dilemma: Should they attempt to move service pace scores from 89% to 93%? Or would financial results be better if they moved friendliness scores from 68% to 72%?

Complex models, like the one above, point out where investments matter most—but it's difficult and time-consuming to explain to operators unfamiliar with modeling—and frankly, they want very pragmatic tools. Operators need tangible information that help them manage their business so they can invest in the things that matter to customer satisfaction while controlling the expenses they incur.

Market Force has produced such a tool, called the Loyalty Lift Calculator[™]. It is a patent-pending decision support system for optimizing customer experience investments. It takes complex models (illustrated above) and makes the estimates and conclusions tangible. Business operators—from the corporate level to the individual store level—can estimate the financial impact of making specific customer experience improvements.

The Loyalty Lift Calculator:

- Allows business operators to create what-if scenarios measuring the effect of intended performance improvements on loyalty and financial performance;

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- Estimates lost revenue opportunity by measuring the risk of losing non-loyal customers;
- Estimates the financial impact of a 1% improvement in satisfaction based on improving a specific behavior on loyalty and financial metrics such as sales, conversion rates, or transaction size;
- Identifies the lag-time between drops in satisfaction and resulting financial metrics.

Market Force believes such tools are required to drive action at the store level. Operators don't act on theory. And often, they own the P&L for their particular stores—whether as managers for the corporation or as independent franchisees. We encourage the development throughout the customer experience industry of tools that help individual location managers better operate their businesses.

If you would like to discuss the ideas in this paper, please call Dr. Cheryl Flink, Vice President of Customer Experience Solutions, at: 303.402.6985 or email her at: cflink@marketforce.com. Your comments and questions are very welcome.

Business operators—from the corporate level to the individual store level—can estimate the financial impact of making specific customer experience improvements with the Loyalty Lift Calculator[™].