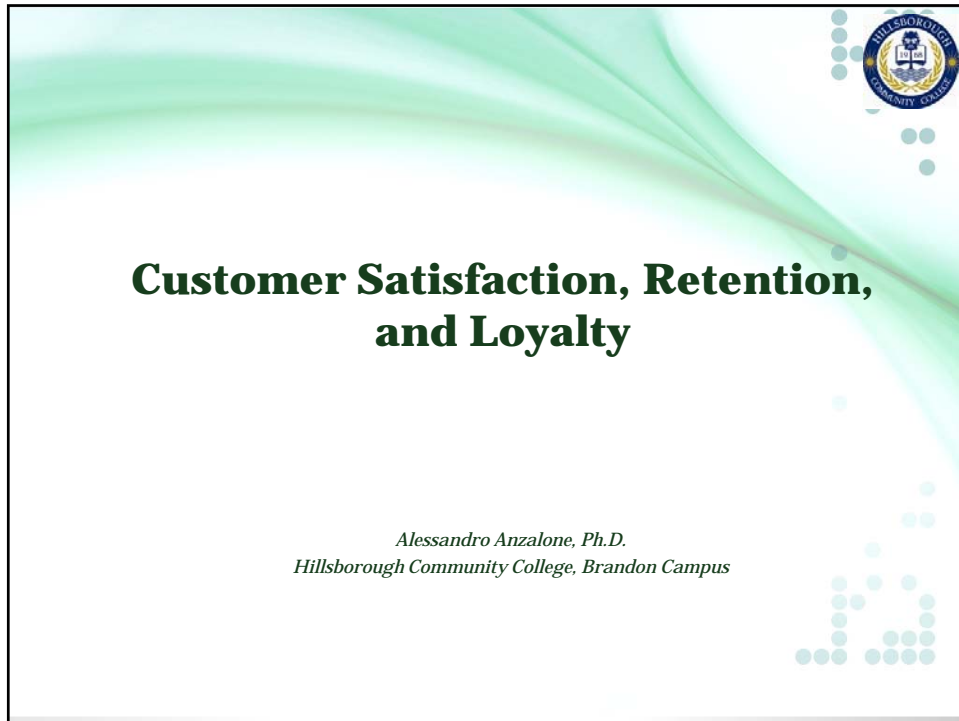# Customer Satisfaction, Retention, and Loyalty

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Agenda

1. Understanding Who Is a Customer
2. Understanding Customer-Defined Quality
3. Identifying External Customer Needs
4. Identifying Internal Customer Needs
5. Communicating with Customers
6. Using Customer Feedback to Make Design Improvements
7. Customer Satisfaction Process
8. Customer-Defined Value
9. Customer Value Analysis
10. Customer Retention
11. Establishing a Customer Focus
12. Recognizing the Customer-Driven Organization
13. Value Perception and Customer Loyalty
14. Customer Loyalty Model
15. Customer Loyalty versus Customer Profitability
16. Customers as Innovation Partners
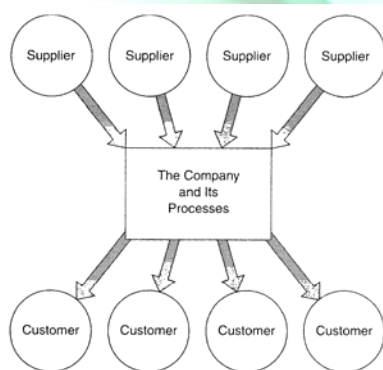17. References

Understanding Who Is a Customer

"The competitor to be feared is the one who never bothers about you at all but goes on making his own business better all the time."   Henry Ford Sr.

http://commons.wikimedia.org/wiki/File:Henry_Ford_%28Literary_Digest_1928-01-07_Interview%29.jpg

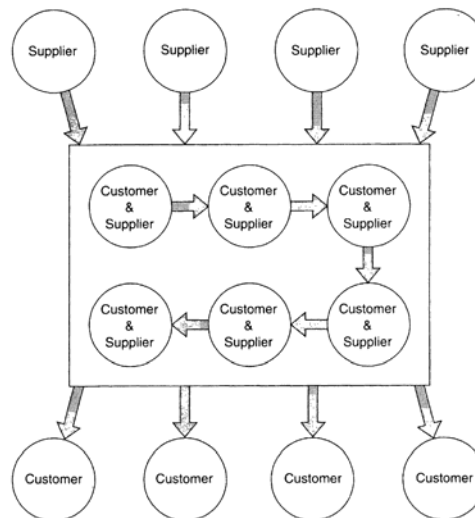## Understanding Who Is a Customer

Figure 7–1
Traditional View of Suppliers and Customers
Showing That Customers and Suppliers
Are Strictly External Entities

Understanding Who Is a Customer

In a total quality setting, customers and suppliers exist inside and outside the organization. Any employee whose work precedes that of another employee is a supplier for that employee. Correspondingly, any employee whose work follows that of another employee and is dependent on it in some way is a customer. For example, say Employee A attaches several components to a printed circuit board and then hands the board to Employee B to connect the components. In this relationship, Employee A is a supplier for Employee B, and Employee B is a customer of Employee A. Employee B cannot do her job correctly unless Employee has done his correctly. The quality of Employee A's work affects that of Employee B. This concept of dependency is critical in the supplier—customer relationship. A customer, whether internal or external, depends on suppliers to provide quality work and produce quality products.

Understanding Who Is a Customer

Figure 7–2
Contemporary View of Suppliers and Customers Showing That Employees Are Suppliers and Customers to Each Other

Understanding Customer-Defined Quality

In a total quality setting, quality is defined by the customer. In his book Total Manufacturing Management, Giorgio Merli makes the following points about customer-defined quality:
- The customer must be the organization's top priority. The organization's survival depends on the customer.
- Reliable customers are the most important customers. reliable customer is one who buys repeatedly from the same organization. Customers who are satisfied with the quality of their purchases from an organization become reliable customers. Therefore, customer satisfaction is essential.
- Customer satisfaction is ensured by producing high-quality products. It must be renewed with every new purchase. This cannot be accomplished if quality, even though it is high, is static. Satisfaction implies continual improvement. Continual improvement is the only way to keep customers satisfied and loyal.

Identifying External Customer Needs
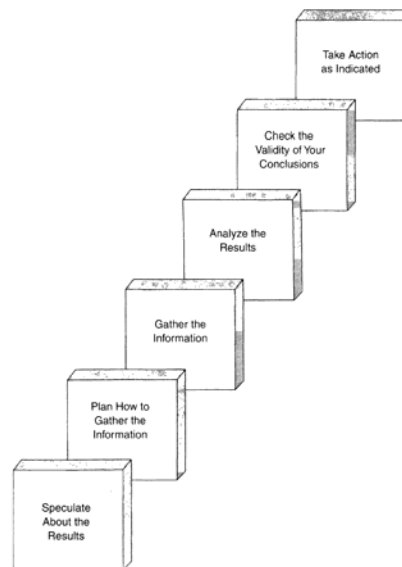
Take Action as Indicated

Check the Validity of Your Conclusions

Analyze the Results

Gather the Information

Plan How to Gather the Information

Speculate About the Results

Figure 7–3
Six-Step Strategy for Identifying Customer Needs

Identifying External Customer Needs

Power Pac Panels of Florida
19 Industrial Parkway, West
Fort Walton Beach, Florida 32548

- **Customers to Be Contacted**
Twenty manufacturers of low-voltage power supplies make up 90% of our business. These customers are located in five southeastern states. Feedback will be collected from all twenty of these customers.

- **What Information Will Be Sought?**
Each customer will be asked the following questions:
1. Rate the performance of our product from 1 to 10, with 10 representing a perfect score.
2. What specific problems do you have with our product?
3. What can we do to our product that would raise its performance score to a 10?
4. What is the priority ranking of your suggested improvements?

- **Information-Collection Method**
Half of the customers will be contacted in person and half by telephone.

- **Information Analysis**
Information collected will be analyzed by a team with representatives from the following departments: Design, Production, Quality, Marketing, and Accounting.

Figure 7–4
Information-Gathering Plan

Identifying Internal Customer Needs

Identifying the needs of internal customers is a matter of *ensuring that employees who depend on one another as individuals, as well as departments that depend on each other as units, communicate their needs to one another continually.* However, one should not assume that communication will just happen. As important as it is, communication rarely just happens in any setting. Rather, it must be encouraged and facilitated.

Quality circles, self-managed teams, cross-departmental teams, and improvement teams are all examples of mechanisms for improving communication and, in turn, quality. These mechanisms facilitate communication among internal customers and suppliers. However, they are not the only mechanisms available. Communication that occurs over a cup of coffee in the break room or during lunch can be equally effective. Training that promotes communication and helps improve communication skills is also important, as well as teamwork and how it can improve communication.

Communicating with Customers

Continual communication with customers is essential in a competitive marketplace. Establishing effective mechanisms for facilitating communication and using them are critical strategies in establishing a customer focus. One of the main reasons continual communication is required is that customer needs change, and at times, they can change rapidly.

Communication with customers must extend to both external and internal customers. What applies on the outside also applies within the organization.

Communicating with Customers

Communication with customers is sometimes misunderstood as one of the basic strategies used in a total quality setting. It does not mean asking customers what new products should be invented. Customers will not tell an organization what product to produce, but they will tell the organization what they think of its products.

All of the market research in the world won't spare the entrepreneur the anxiety of dealing with the inescapable element of risk. However, having taken the risk to produce a product, communicating with customers about that product can ensure that it gets the best possible reception in the marketplace and that it changes as the needs of customers change.

Communicating with Customers

Know Your Customer's Operations

1s a supplier to other companies (customers), it is important to know their operations. The more that is known about a customer's operations, the easier it will be to provide products that meet its needs.

What does the customer do with our product? How is it used? Is our product part of a larger assembly? Does the customer use our product in the way we expect or in some different way? Does the customer modify our product in any way? What processes does the customer use in working with our product? Knowing the answers to questions such as these can help a supplier improve customer satisfaction.

Communicating with Customers

The answers to these types of questions can lead to such benefits as the following:

- Product enhancements. By knowing a customer's operations, suppliers might be able to modify their products to better fit in with these operations. They might also be able to add attributes that will make the product even more attractive to the customer.
- Improved productivity. By knowing a customer's operations, suppliers might be able to propose process modifications that will improve its productivity.
- Internal improvements. By knowing a customer's operations, suppliers might learn facts that lead to internal improvements in quality, productivity, and design in their own organizations.

Using Customer Feedback to Make Design Improvements

It is important for organizations that compete in the global arena to collect customer input and feedback and use it to make continual improvements to the design of their products. Quality function deployment is an effective system for collecting customer input and factoring that input into the design process. Building affinity diagrams is an effective method for organizing customer feedback data so that it can be used to make ongoing design improvements.

Using Customer Feedback to Make Design Improvements

Quality Function Deployment and Design Improvements
It is important to know that a product will meet the needs of customers before you put it into production. This is the main reason for conducting the research necessary to identify customer needs and for communicating with internal and external customers. Quality function deployment (QFD) was developed with this in mind.
QFD is an integrated approach to product development and quality in all preproduction activities. It was introduced in the United States in 1983 by Professor Y. Akao of the University of Tamagawa as part of a paper he presented at a quality conference in Chicago. QFD is actually a model for incorporating customer input and feedback into product development. In effect, *it establishes an operational structure for the concept of building in quality*. The philosophy underlying QFD is that even a perfectly manufactured product may not satisfy the customer because it may be nothing more than a perfect example of what the customer doesn't want.

Using Customer Feedback to Make Design Improvements

QFD allows for the systematic incorporation of customer needs, production capabilities and capacity, and all other relevant parameters into product development. According to Merli, QFD consists of the following basic activities:
Deployment of customer requirements (quality needs)
Deployment of measurable quality characteristics
Determination of the correlation between quality needs and characteristics
Assignment of numerical values to each quality characteristic
Integration of quality characteristics into the product
Detailed design, production, and quality control of the product

Using Customer Feedback to Make Design Improvements

Affinity Diagrams and Design Improvements
Feedback from customers comes in many forms, and depending on the size of the organization, there can be vast amounts of it to deal with. However, if customer feedback can be collected, organized, and analyzed to identify patterns and trends, it can be an invaluable resource for making continual improvements in product design and the manufacturing process.
The affinity diagram is a useful tool for making sense out of large amounts of customer feedback that might come to an organization in any number of forms (e.g. , customer complaints, surveys, feedback or comment cards, focus groups, and telephone discussions).

Using Customer Feedback to Make Design Improvements

The steps in developing an affinity diagram are as follows:
1. Form a cross-functional team that includes representatives from all of the key functional areas in the organization (e.g. , engineering, marketing, accounting, and customer service).
2. Ask the team to investigate the following question: What do our customers dislike the most about our product?
3. Study the data from all of the various customer feedback sources and identify categories of complaints, comments, concerns, and issues expressed by customers.
4. Write all of the feedback categories identified on a flipchart and post them on a wall where everyone on the team can easily view them.
5. Sort all of the categories into related groups so that there are no duplicate categories.

Using Customer Feedback to Make Design Improvements

The steps in developing an affinity diagram are as follows:
6. Develop header cards for each of the categories remaining on the wall charts. Each card is headed by a sentence that accurately and succinctly describes the type of problems for that category. Examples of possible headers are as follows:
   a. Product is too difficult to assemble.
   b. Product does not provide sufficient operating information.
   c. Product wears out too quickly.

Using Customer Feedback to Make Design Improvements

The steps in developing an affinity diagram are as follows:
7. Using the header cards, draw an affinity diagram. The affinity diagram is simply a table consisting of each header, with the corresponding frequently given customer feedback for that header listed under it. For example, assume the product is a piece of home exercise equipment. Using the first header from above, one part of the affinity diagram might look like this:
    Product is too difficult to assemble:
    a. Assembly instructions are confusing.
    b. Fasteners require a special tool that is not provided.
    c. It takes at least three people to install the pulleys.

Customer Satisfaction Process

Customer focus is part of a process that leads to continual improvements in the organization that, in turn, result in customer satisfaction. Resources are limited; consequently, they must be applied where they will do the most to improve customer satisfaction and customer retention. The process described in the following list will help meet all these goals:
*   Determine who your customers are.
*   Determine what attributes of your product or service are most important to your customers.
*   Arrange these attributes in the order of importance indicated by your customers.
*   Determine your customers' level of satisfaction with each of these attributes.
*   Tie results of customer feedback to your processes.
*   Develop a set of metrics (measurements) that tell how you are performing and which areas within the process are having the greatest impact on performance.

Customer Satisfaction Process

- Implement measurements at the lowest possible level in the organization.
- Work on those processes that relate to attributes that have high importance but low customer satisfaction ratings.
- Work on those areas within the process that offer the greatest opportunity to improve.
- Update customer input and feedback on a continual basis. Then, as process improvements correspondingly increase customer satisfaction, move on to the process improvements that are next in importance.
- Maintain open, continual communication with all stakeholders on what is being done and why and on what results are expected and when.
- Aggregate metrics organization-wide into a format for management review on a continual basis. Adjust as necessary.

Customer-Defined Value

It is important for organizations to understand how customers define value. The value of a product or service is the sum of a customer's perceptions of the following factors:
- Product or service quality
- Service provided by the organization
- The organization's personnel
- The organization's image
- Selling price of the product or service
- Overall cost of the product or service

Whether customers are satisfied will depend on the sum of their perceptions relative to all of these factors. The issue of customer satisfaction is complicated even more by the fact that different customers place a different priority on these factors. That fact makes it even more critical that organizations maintain close, personal, and continual contact with their customers.

Customer-Defined Value

Customer-Defined Value at Federal Express
In order to capture customers' input in a meaningful and useful manner, Federal Express developed a system of Service Quality Indicators (SQIs). These indicators reflect the customers' views concerning their satisfaction with the performance of Federal Express. The list of SQIs is as follows:

1. Delivery on the right day but after the promised time
2. Delivery on the wrong day
3. Unsuccessful trace of a package
4. Customer complaints
5. Proof of performance is missing
6. Missed pickups from customers
7. Damaged packages
8. Lost packages
9. Unanswered calls from customers (not answered within 20 seconds)

Customer Value Analysis

What is it that customers want from our organization? What is it about our products or services that customers value? total quality organization must know the answers to these questions. Organizations that don't know what their customers value run the risk of wasting valuable resources improving the wrong things. The process used to determine what is important to customers is called customer value analysis (CVA).

Customer Value Analysis

The CVA process consists of the following five steps:
1. Determine what attributes customers value most.
2. Rate the relative importance of the attributes.
3. Assess your organization's performance relative to the prioritized list of attributes.
4. Ask customers to rate all attributes of your product or service against the same attributes of a competitor's product or service.
5. Repeat the process periodically.

Customer Retention

Customer satisfaction is a fundamental cornerstone of total quality. An organization develops a customer focus to be better able to satisfy its customers. Consequently, forward-looking organizations use customer satisfaction data to measure success. But measuring customer satisfaction alone is not enough. another important measure of success is customer retention.

Certainly, customer satisfaction is the critical component in customer retention, but the two factors are not necessarily synonymous. R customer satisfied is not always a customer retained. Frederick F. Reichheld makes the point that although " it may seem intuitive that increasing customer satisfaction will increase retention and therefore profits, the facts are contrary. Between 65 and 85 percent of customers who defect say they were satisfied or very satisfied with their former supplier." Reichheld's findings suggest that there is more to customer retention than just customer satisfaction.

Customer Retention

To retain customers over the long term, organizations must turn them into partners and proactively seek their input rather than waiting for and reacting to feedback provided after a problem has occurred.

Customer Retention

The following strategies can help organizations go beyond just satisfying customers to retaining them over the long term. These strategies will help organizations operationalize the philosophy of turning customers into partners.

- Be Proactive—Get Out in Front of Customer Complaints
- Collect Both Registered and Unregistered Complaints

Establishing a Customer Focus

Companies that have successfully established a customer focus share a number of common characteristics. In his book The Customer Driven Company, Richard C. Whitely suggests that these characteristics can be divided into seven clusters:

1. Vision, commitment, and climate.
2. Alignment with customers
3. Willingness to find and eliminate customers' problems
4. Use of customer information
5. Reaching out to customers
   a. Making it easy for customers to do business
   b. Encouraging employees to go beyond the normal call of duty to please customers
   c. Attempting to resolve all customer complaints
   d. Making it convenient and easy for customers to make their complaints known
6. Competence, capability, and empowerment of people
7. Continual improvement of products and processes

Recognizing the Customer-Driven Organization

Is a given organization customer driven? In today's competitive business environment, the answer to this question must be yes. Since this is the case, it is important for quality professionals to be able to recognize a customer-driven organization and to be able to articulate its distinguishing characteristics. According to Whitely, a customer-driven organization can be recognized by the following characteristics:

1. Reliability—an organization that dependably delivers what is promised on time every time
2. Assurance—an organization that is able to generate and convey trust and confidence
3. Tangibles—an organization that pays attention to the details in all aspects of its operations
4. Empathy—an organization that conveys a real interest in its customers
5. Responsiveness—an organization that is willingly attentive to customer needs

Recognizing the Customer-Driven Organization

In addition to these characteristics, Thomas Cartin and Donald Jacoby recommend that quality professionals look for the following management factors:

1. Internal support. Has the organization developed the right structure as well as management and employee skills (organizational development)?
2. Use of knowledge. Does the organization systematically collect customer feedback and continually assess changing customer expectations and needs?
3. Use of metrics. Has the organization established market-based performance measures that are tied to customer needs rather than internal factors?
4. Communication. Does the organization regularly communicate progress toward meeting customer needs to its employees?

Value Perception and Customer Loyalty

Companies work hard to build customer loyalty. Think of Coke and Pepsi, for example. The goal is to keep the customer on board for the long term. The theory is that a loyal customer is a customer forever. It is easy to see what drives the desire to create customer loyalty. Companies spend so much in marketing to attract customers that they must keep them for the long term to recoup their investments. Writing for the Harvard Business Review, Robert Blattberg and John Deighton cite the following example of why companies want to build customer loyalty:

"Lands' End, the second-largest clothing catalog retailer in the United States, operates with unusually high inventory levels. Its manager would rather inflate inventory than fail to fill an order and risk losing a customer. "If we don't keep the customer for several years, we don't make money," said the company's CEO We need a long-term payback for the expense of coming up with a buyer."

Customer Loyalty Model

Steve Hoisington and Earl Nauman have transformed the process of creating customer loyalty into a four-phase model that has the following components:

Business Performance

When evaluating the performance of an organization they do business with, customers consider a variety of factors, all of which fall into one of these categories:

- Product quality (e.g. , attributes, features, usability, compatibility, reliability)
- Service quality (e.g. , sales, after-purchase service, billing)
- Relationship quality (e.g. , communication, availability, responsiveness)
- Image strength (e.g. , when other performance indicators are equal, the organization's image can be an important consideration)
- Price perceptions (e.g., initial purchase price, cost of maintenance and repairs, cost of upgrades)

Customer Loyalty Model

Global Perceptions

Based on its evaluation of an organization, a customer will form global perceptions about that organization. There are many different types of perceptions that might be formed by a customer. For example, customers might form good or bad feelings about overall satisfaction, their willingness to recommend the organization to other potential customers, their willingness to do business with the organization again, their commitment to an ongoing relationship with the organization, the extent to which the organization met their needs, or the value they received for their money. If the perceptions formed by customers in these and other pertinent areas are positive, they can lead to loyalty behaviors on the part of those customers.

Customer Loyalty Model

Loyalty Behaviors

Customer loyalty is a behavioral concept, but it can be measured. For example, an organization can measure the defection rate of its customers—especially those that do business on a regular basis. Another factor that can be measured is the business volume of individual customers. Is the volume of business for the customer going up or down? A customer that stays with an organization but significantly decreases his or her volume of business is not a loyal customer. Consequently, it is important to measure both the defection rate and the business-volume-by-customer rate. When customers exhibit loyalty behaviors, the organization benefits in the critical area of financial outcomes.

Customer Loyalty Model

Financial Outcomes

Financial outcomes are affected by several key factors, including the following:

1. Market share—High customer loyalty leads to a larger market share, which, in turn, leads to better financial outcomes
2. Reduced costs—Repeat customers cost less to deal with than new customers, which means that customer loyalty decreases the cost of doing business
3. Employee attitudes—Positive employee attitudes promote positive customer relations
4. Profit—Increased market share can result in increased profits, provided the cost of doing business is held level or even decreased by customer loyalty
5. Shareholder value—Customer loyalty can result in higher profits, which, in turn, are a key driver of shareholder value

Customer Loyalty versus Customer Profitability

The key point that Reinartz and Kumar make in their study is that "When profitability and loyalty are considered at the same time, it becomes clear that different customers need to be treated in different ways." They go on to propose four strategies for dealing with customers based on an accurate segmentation of an organization's customers on the basis of their loyalty and profitability. They label customers according to where they fall in a customer loyalty/profitability matrix. High-profitability/short-term customers are called *butterflies*. High-profitability/long-term customers are called *true friends*. Low-profitability/short-term customers are called *strangers*. Low-profitability/long-term customers are called *barnacles*. The authors recommend strategies for each of these customer types.

Customers as Innovation Partners

According to Stefan Thomke and Eric von Hippel,

"In the course of studying product innovation across many industries, we have discovered that a number of companies have adopted an intriguing approach, which at first seems counterintuitive. Essentially, these companies have abandoned their efforts to understand exactly what products their customers want and have instead equipped them with tools to design and develop their own products, ranging from minor modifications to major new innovations. The user-friendly tools, often integrated into a package we call a "tool kit for customer innovation," deploy new technologies like computer simulation and rapid prototyping to make product development faster and less expensive."

Customers as Innovation Partners

According to Stefan Thomke and Eric von Hippel,

"A variety of industries use this approach. Bush Boake Allen (BBA), a global supplier of specialty flavors to companies like Nestlé, has built a tool kit that enables its customers to develop their own flavors, which BBA then manufactures. In the materials field, GE provides customers with web-based tools for designing better plastic products. In software, a number of companies let people add custom-designed modules to their standard products and then commercialize the best of those components. Indeed the trend toward customers as innovators has the power to completely transform industries. In the semi- conductor business, it has led to a custom-chip market that has grown to more than $ 15 billion."

Customers as Innovation Partners

Traditional Product Development Versus the Innovation Partnership Approach

With the traditional approach, the supplier was responsible for research and development, product design, and prototyping. Smart companies would involve customers at the testing phase to make sure the prototype developed actually satisfied their needs. Changes would then be made to the prototype design based on customer feedback. Once the design was revised, the product would go into production. With the innovation partnership approach, the supplier is still responsible for the research and development phase of product development. But the *design, prototyping, and testing phases are turned over to the customer*. This new approach tends to increase the pace of product change, which, in turn, requires manufacturers to be even more flexible, adaptable, and agile.

References

Quality Management for Organizational Excellence: Introduction to Total Quality, 6th Edition, David Goetsch and Stanley Davis, copyright 2010, Pearson, ISBN: 978-0-13-501967-2.