PART I

STRATEGIC COST MANAGEMENT

CHAPTER 1

SUPERIOR CUSTOMER SERVICE

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1.1 KNOWING CUSTOMERS' EXPECTATIONS

A medium-size professional association located in the Northeast has a national membership base and has experienced a steady, incremental increase in its membership over several years. However, a series of proposed legislative initiatives that are perceived as a threat to the profession have swelled the membership ranks recently. Even though the association endeavors to provide the same type and quality of service to its membership that it has in previous years, it is unable to do so in many areas. Growing increasingly frustrated, the association's top management commissioned an assessment of its membership base to determine its expectations in different areas. It had never conducted such an assessment before.

The study revealed that in one area in which the association was seeking to ship publications within 48 hours, members stated that the receipt of such materials within three to four weeks was acceptable. However, members expected the phones to be answered promptly and inquiries to be addressed accurately and efficiently. Armed with this information, the association was able to modify its service level in direct response to member expectations. The result was an increase in member satisfaction and a reduction in cost, despite the increase in the membership base.

Providing a product or service that customers perceive as excellent requires a company to know what its customers expect. This is the most critical component of delivering excellent customer service.

Virtually every company thinks it knows what its customers want. However, if a company is only slightly inaccurate about its assumptions, it could lose its customers' business to another company that has more accurately filled their needs.

Being only "slightly" inaccurate can lead an organization to spend money, time, and effort on things that are not important to customers. And in a worst-case scenario, it can mean not surviving in an intensely competitive environment.

(a) Expectation Gap At times a gap occurs between what customers expect and what management presumes they expect. This often happens because companies overlook or do not fully understand customers' perceptions and expectations. In spite of a strong commitment and sincere desire to provide quality service, many companies fall dramatically short of the mark, usually because they have an internally directed rather than externally directed focus. An internally directed focus assumes that the company knows what customers *should* want and delivers or produces that. This orientation often leads to providing products and services that do not match customers' expectations—important features and benefits may be left out and levels of performance may be inadequate.

In looking at several different types of organizations, common elements contribute to the gap between customer expectations and the product or service offered. The common elements are:

- Inadequate "bilateral" communication between front-line personnel and management.
- An absence of regular interaction between management and customers.
- An absence of a strong market research program.
- An absence of customer service accountability.

(b) Communicating with Front-Line Employees Front-line employees are in regular contact with customers. As a result, they know a great deal about customers' perceptions and expectations. This information must be regularly passed on to management. When channels of communication are closed or inadequate, managers cannot know about problems occurring in product and service delivery as well as critical information about changing customer expectations.

Communication between front-line employees and management can be enhanced in a number of ways:

- Formal types of communication (e.g., memos, suggestion cards, and open meetings).
- Informal communication (e.g., discussions over coffee, walking around the facility, going out into the field).

It is essential to assess customers' perceptions and expectations regularly, but it is also very important to assess whether managers understand the needs and expectations of front-line employees. Managers who communicate with front-line people not only build morale but also learn a tremendous amount about their customers, thereby reducing the expectation gap.

Some questions to ask concerning the communication between management and front-line employees in an organization are:

- How often do managers have direct contact with front-line employees?
- Do managers encourage suggestions from front-line employees concerning the quality of products or services?
- Are there too many levels of management, causing managers to be cut off from direct contact with and feedback from front-line employees?
- Are there formal or informal opportunities for front-line employees to communicate with management on a regular basis?

- Has management adequately determined and monitored the expectations of front-line employees?
- Do front-line employees feel strongly supported?

(c) Interaction between Management and Customers The larger a company is, the more difficult it is for managers to deal directly with customers. Consequently, managers have less information about customers' perceptions and expectations. However, in smaller companies, managers can receive more direct information concerning their customers.

Even when they are regularly given reports, managers readily lose the customer perspective if they do not have the opportunity for direct customer contact. Theoretical knowledge is a poor substitute for a face-to-face encounter.

To truly understand and appreciate customers' needs and expectations, managers should experience firsthand what really happens in the field—in stores or on the customer-service line—by answering the service line themselves or dealing with customers face to face. Managers can better empathize with employees if they have experienced some of what employees deal with on a regular basis. Here are some questions to consider concerning regular interaction between management and customers:

- Does the company have a program in which managers rotate to different service positions within the organization?
- Does top management make it a priority to get out in the field and see customers?
- Do managers randomly interact with customers (e.g., those waiting in line, browsing in the store, or calling the service desk)?

(d) Need for a Strong Market Research Program Because marketing research is an important tool in assessing customers' perceptions and expectations, a company that fails to regularly collect such information may be more likely to have a significant customer expectation gap.

To effectively deal with expectation versus performance issues, marketing research measurements should focus on product or service quality issues. These might include:

- Which features and benefits are most important to customers?
- How much do customers expect, at what price and in what time frame?
- What do customers think the company should do if problems occur in product or service delivery?

Determining what customers expect is essential to providing superior quality. Regardless of a company's size and resources, there are ways to obtain this kind of information. Questions to consider concerning a company's marketing research efforts include:

- Is research conducted on a regular basis to generate high-quality, reliable information about what customers want and expect?
- Does research focus on quality of service provided?
- Can research findings be readily understood and used by managers?
- Are the research findings integral to the company's strategic planning?
- Are research findings shared throughout the company when appropriate?

(e) Customer-Service Accountability Policies and procedures are important, but when they impede a firm's ability to meet customer needs, they are counterproductive. With many companies experiencing an increase in policies and procedures over the last several years, initiative has been stifled and employees are less willing to get involved.

For companies to compete effectively in an increasingly competitive marketplace, employees must be enabled to identify problems, resolve them, and share suggestions with management. They should not be allowed to withdraw into a bureaucratic environment and assume that someone else will take care of problems. All the while, customers may be migrating elsewhere. The following list provides questions to ask regarding customer service accountability:

- Are employees encouraged to "take ownership" of a problem, and are they supported in their efforts?
- Is the business unduly bureaucratic, and does it encourage an attitude of "someone else will take care of it"?
- Does the business empower its employees to find ways in which customers can be better served?

Any organization, regardless of size, can reduce customer expectation gaps if it improves communication between managers and front-line employees, increases interaction between management and customers, develops a strong market research program, and insists on accountability for customer service.

1.2 KEEPING CUSTOMERS

Jim has an impressive resume. He received excellent training while employed as a brand manager for a Fortune 500 company. For two years, he has been running a small sales-driven company in the Northeast. Because of his experience in a large company, Jim is relentless in his urgent call to employees to attract more customers. Those admonitions have been carefully heeded. More new customers have come to the company in Jim's two years than ever before in its history.

However, no measurable increase in revenues or profits has resulted during Jim's tenure. A customer-satisfaction assessment reveals that existing customers feel that the firm's objective is to get new customers. But existing customers do not feel well taken care of, and many choose to leave. When Jim receives this information, he immediately changes the focus of the firm, realizing that pursuing new customers at the expense of customer retention is unprofitable.

Within nine months, the number of new customers has fallen, but the number of customers staying with the firm has risen, as have monthly revenues and profits.

Customer retention is one of the most important strategic issues companies have faced in recent years. Retention is critical for increasing profits and remaining competitive. Studies show that a 5 percent change in the rate of customer retention can shift profits from 25 percent to 100 percent in either direction.

In manufacturing, measuring the number of defects is an important index of quality. In measuring service, the number of *defections* (customers going elsewhere) is important.

Many companies underestimate the cost of customer defections. Few companies track defections (otherwise known as *migration*) or invest in reducing them.

Companies should measure customer migration, and their goal should be customer retention. They must regularly evaluate and modify training programs, information systems, organizational structure, complaint handling procedures, hiring objectives, incentives, and even the company culture. Providing superior customer service is an effective strategy for increasing customer retention, which can lead to an increase in profits, because customers will beat a path to the company that provides superior customer service.

(a) High Cost of Migration Failure to realize the high cost of losing customers stems in part from aggressive selling and marketing. In many companies, the work involved in keeping customers is seen as dull and tedious. Selling is what is truly exciting. Many companies view unhappy customers as chronic complainers who are not worth the effort required to satisfy them.

It is true that some customers are habitual complainers, but too often companies apply this label to every customer who complains. If this attitude permeates a company, dissatisfied customers will probably receive poor treatment and their problems will remain unaddressed.

Prospective and first-time customers usually are treated well during the selling courtship. Many companies aggressively pursue new customers, but these customers go right out the door if service is poor. They come in with great expectations but leave with disappointment, frustration, and possibly resentment.

(b) Marketing: A Two-Part Process The marketing function should be viewed as a two-part process:

1. Getting customers.
2. Retaining customers.

The first part of the marketing process rarely has inadequate resources and seldom suffers from a lack of attention. Sales budgets, advertising campaigns, and promotional efforts usually take a significant percentage of a company's operating budget. However, retention marketing often has little or no budget at all. Research shows that, depending on the specific industry, it costs between five and seven times as much to get a new customer as it does to keep an existing one.

Most companies have little difficulty defending the significant costs of acquiring new customers. But what if the new customers are only replacements for dissatisfied customers? Such companies find themselves barely holding on to customers, or worse, they experience a net loss of customers. Companies that do strive to retain customers have return policies, customer complaint departments, and occasional customer mailings. But few companies engage in aggressive, well-constructed strategies of retention-oriented marketing that keep customers happy and mend relations with dissatisfied customers.

(c) Moment of Truth Every point of contact a customer has with a company (whether by phone, in person, or by mail) is a point at which service is delivered—or not delivered. It is a point at which the customer forms one more impression and makes one more judgment about the company. Some call it the "moment of truth."

Nordstrom's, a department store, operates by the following maxim: "Listen to the customer; the customer is always right. Do anything to satisfy the customer." Every time a company fails to live up to a promise to its customers, it loses some credibility.

Advertising, public relations, architectural design, and other high-profile efforts may create favorable impressions. But the critical difference in customer retention usually occurs in less glamorous areas. For example, customers may be impressed by the behavior and appearance of employees, the way phones are answered, the clarity and accuracy of billings, or the overall promptness and reliability in handling complaints. "Little things" are important, and companies must be vigilant and consistent in their attention to detail. Such vigilance may require redefining the role of marketing, rearranging priorities, and reallocating budgets.

(d) Obstacles to Superior Customer Service There are several obstacles to customer service that at one time or another affect most businesses.

(i) Attitude That Customers Are Replaceable The days of monopolistic enterprises and taking customers for granted have long since passed away. Customers should be considered valuable assets that are obtained only through hard work and at considerable expense. Although employees are often relieved when disgruntled customers leave, this is an unfortunate attitude for any employee or business to have.

(ii) Insensitive Managers The old expression that "no two people are alike" applies to both employees and customers. Problems develop when managers become insensitive to the characteristics or behavior of their employees and customers. Managing the human element is a considerable challenge in providing superior customer service.

Managers must continuously respond to changing situations. They must be able to make instantaneous decisions in an environment in which education, experience, skills, perceptions, values, and prejudices have a direct impact on transactions with employees and customers. Other concerns—such as divorce, financial trouble, or sick children—also affect employee–customer transactions. Given these human idiosyncrasies, companies must monitor, train, motivate, evaluate, and periodically retrain employees so that they are empowered to be of assistance to customers.

(iii) Budgetary Problems Some companies do not properly fund efforts to improve customer service. As a result, they end up with inconsistent customer-service strategies and poor implementation of programs to improve customer service. In a highly competitive economy, budgetary constraints can drive away frustrated customers who may be told, for example, that there are not enough qualified people, or that there simply are not enough people to catch up on back orders. In many companies, the financial resources required to meet customer needs exist, but they are allocated elsewhere. Insufficient funding inherently devalues the importance of customer service in the minds of frontline employees.

(iv) Lack of Strong Commitment In many cases, management lacks a strong commitment to superior customer service. Managers may claim to have a strong commitment, but in reality they pay only lip service to customer service. Unless management undertakes a full-scale effort and requires an intense commitment to superior customer service throughout the organization, the prospects of achieving superior customer service are seriously diminished.

(v) Inconsistency Customers usually measure a product or service by the satisfaction they expect and subsequently receive. If a customer is sold a product or service that fails

to live up to its promises, dissatisfaction is the result. Customers who are oversold or promised undeliverable levels of satisfaction usually forget the salesperson and concentrate instead on the product or service involved and the company behind it. Thus, companies must strive for consistency in the delivery of products and services, in representations made about product and service characteristics, and in the professionalism of all employees who deal with customers.

(vi) Lack of Listening Managers are typically concerned with the big picture, so they seldom have the time to get out and really listen to what customers need and think. Many managers are comfortable believing that if customers are not complaining, things must be going all right. But this can be a dangerous assumption. Managers must be available to both employees and customers. They must observe and listen purposefully and systematically. Most important, they must be open to discussion: They should not be defensive, closed-minded, or apprehensive about being proved incorrect.

(vii) Inertia Computer systems, policy guides, and procedures often take on a life of their own in many companies. Customers usually feel frustrated when they are told, "I'm sorry, but our policy is . . . ," or "There is nothing I can do about it." In some companies, the computer systems are often handy excuses for mistakes. Although computer systems, policies, and procedures are important, they can stifle a company's primary mission—to sell and serve customers—if they are not kept in check. Companies that excel in providing superior customer service focus on the customer and strive diligently not to allow "the system" to interfere with what is best for the customer.

(viii) Different Frames of Reference Words frequently used to describe customer service include "prompt," "reliable," "satisfaction," "courtesy," "professional," "timely," and "quality," along with such phrases as "quick response to customer complaints," "accuracy in billing," "prompt repairs," and "satisfaction guaranteed." For these words and phrases to have relevance, specific definitions, measurements, or other explicitly stated standards have to exist. For example, "quick response to customer complaints" might be defined to mean "within 24 hours," whereas "accuracy in billing" might mean that if errors are identified within seven days of receipt, a correction will be made. When definitions are clearly understood from the start, a company and its customers will have a common denominator for measuring the quality of service.

(ix) Lack of Perspective Providing high-quality customer service is not a program that can be bought and paid for in a short time. High-quality customer service cannot be effectively implemented and sustained through memos, short-lived promotional efforts, or advertising campaigns designed to boost sales.

Management must view high-quality customer service as an ongoing process. The "tyranny of the urgent" often prevents managers from taking steps that will keep customers the company worked so hard to get.

(e) How to Increase Customer Retention Just as there are frequently encountered obstacles to superior customer service, there are also several suggested ways to help a company successfully retain as many of your customers as possible.

(i) Reliability Customers want consistent performance most of all. To be reliable, a company should strive for the following:

- Do what you say you are going to do.
- Do it when you say you will.
- Do it right the first time.

(ii) Credibility Customers will go back to businesses that want to help them and have their best interests in mind. Customers do not want hidden agendas, fine print, hard-sell tactics, or extra charges. They want the products or services they buy to be free of danger, risk, and doubt.

(iii) Responsiveness We live in a time of instant gratification. When customers want service, they usually want it immediately. Being responsive requires being available, accessible, and willing to help customers whenever they have a problem.

(iv) Empathy Being empathetic means putting oneself in the position of a customer. Management must ask itself whether it would do business with the company. Every customer is unique and wants to be treated uniquely. To accomplish this, companies must ask the right questions, listen intently, and then design products or services to meet stated needs.

(v) Select Front-Line Employees Carefully Companies oriented toward customer service should have customer-friendly people in front-line positions. Such positions are not for everybody. Great care should be exercised in selecting prospective employees based on their personality traits and other skills. A psychological consulting firm has singled out the following attributes as especially helpful for employees in front-line positions:

- An ability to make sound judgments in a stressful setting.
- A problem-solving orientation.
- A desire to be liked.
- A naturally optimistic outlook.

(vi) Provide Sufficient Employee Training Customers want to be served by knowledgeable employees. Thus, employees should be well trained before interacting with customers. Employee training should not be viewed as a one-time entrance requirement. Regular training sessions are needed to keep employees updated on new policies and procedures, new product features and benefits, competition, customer needs, new programs, developments in other parts of the company, and core corporate goals.

(vii) Create a Sense of Belonging Employees also need a sense of their company's mission and their role within the company. They need to receive encouragement to enhance their roles while also receiving recognition for contributions made. Regardless of the methods used by different companies, employee recognition is an important motivator and a fundamental tool for nurturing an environment committed to customer service.

(viii) Avoid Premature Release of Products, Concepts, or Policies Taking a new product or service to market before it is ready, changing policies rapidly, or introducing a new computer system before all the bugs are worked out erode customer satisfaction levels. Companies must take great care not to sacrifice customers while trying to achieve progress. Customers want consistency and stability.

(ix) Make Things Easy for the Customer Making things easy for the customer requires careful planning, coordination, and diligence. When companies do not work at these fundamentals, customer service can suffer. Following are ways to make things easier for customers:

- Install a toll-free number.
- Provide adequate incoming phone lines.
- Hire enough employees to answer phones quickly.
- Use business-reply mail (postage-paid).
- Implement easy refund and exchange procedures.
- Provide prompt and accurate information.
- Do not assume that the customers have extensive knowledge about a product or service.
- Speak and write in plain English. Do not use highly technical terms or company jargon.
- Debrief customers who leave the company for competitors.

(x) If a Customer Leaves, Ask Why Whenever the company loses a customer, find out why. Few customers are more honest or candid than a dissatisfied customer.

1.3 INVESTING RESOURCES IN THE RIGHT PLACES

A regionally based accounting firm has grown at a steady rate over a 10-year period. Some of the growth has been fueled by acquiring other firms in the region. The managing partner has been proud of the fact that the firm also has added new services. However, in the last two years, the firm's revenues have been relatively flat. To help assess the situation, the managing partner commissions an assessment of customer satisfaction.

The assessment shows that two-thirds of the new services offered are valued highly but that the clients are not very committed to the remaining one-third. With this information, the managing partner cuts the services that customers do not value (thus eliminating the corresponding overhead) and reallocates resources to support the services customers do value. As a result, the firm's revenues and quarterly profits have increased due to the reduction in overhead and expenses associated with cutting one-third of the new services.

It is important that companies regularly assess their competitive positions. Such an assessment can help identify strengths and weaknesses vis-à-vis the competition, thereby enabling companies to focus on their strengths and eliminate weaknesses.

Few companies can effectively compete against all competitors on all fronts simultaneously. It is important, therefore, to identify key strategic points of difference so that a company can allocate its finite resources optimally. The key areas to evaluate include:

- Markets
- Customers and the products or services offered to them
- Personnel
- Operations, facilities, and technology
- Finances

To be valuable in the marketplace, companies must maximize the return on available and invested capital. They must regularly evaluate their allocation of resources to different areas.

(a) Markets Many companies make decisions about critical components of their operations as if they were in a vacuum: They show little sensitivity to, or awareness of, what other companies are doing in the market. To be effective, they should be asking questions such as:

- What are the trends in the market?
- In which direction is the market headed?
- What do the customers want (versus what they need)?
- Is the company aware of the difference?
- What is the size of other competitors in the market?

To have strategic significance, terms or units of measure should be used that enable companies to compare themselves to competitors. Statistics regarding the number of employees or customers a competitor has may have a marketing impact. Other information—such as the amount of capital invested, asset base, profits, inventory levels, the number of inventory turns, the number of support personnel, and the number of sales representatives—can help a company determine the investment required to compete effectively and identify areas that may not be well served.

(b) Customers and Products or Services Offered Why does a company offer the products or services it offers? Is there a rational process in place by which new products or services are added or deleted from a company's portfolio? Is there a threshold of revenue generation below which a product or service will no longer be carried or offered?

Too often companies offer products or services that management feels *should* be offered, or they continue to offer the products or services that they have historically offered, as opposed to what the market dictates. However, companies should periodically assess their offerings and determine whether customers and potential customers are aware of all the products or services in their portfolios.

Not long ago, a large, well-known law firm disclosed in a meeting that it had budgeted a significant sum toward practice development. Before launching the development campaign, the firm performed an assessment on existing clients to determine their awareness of the services offered. Much to the chagrin of the firm's partners, almost two-thirds of the clients used more than one law firm for their legal work. Further analysis revealed that none of those clients used other law firms because of dissatisfaction but, rather, because they did not realize all the other services available from the firm. Thus, the law firm realized that one of its biggest challenges was to increase the awareness of existing clients before spending significant funds on pursuing new clients.

In another case, a company offered 12 different kinds of services to its customers. Upon careful objective analysis of customer input, the company determined that the customers really had a viable interest in only 7 of the 12 services. At that point, the company had a choice to make: to pursue additional customers that may have an interest in the other services or drop the other services and the costs associated with offering them.

The key point in these examples is that by getting objective information from customers, both organizations could make decisions that enabled them to allocate re-

Dear Valued Client:

Our success at XYZ is built around our ability to meet the needs of our clients. Like any business, it is important that we ask ourselves the question, "How are we doing?"

We believe the best approach is to let our clients answer that question for us. By taking a few moments to complete this survey, you will help us evaluate our performance.

We have enclosed a postage-paid envelope for your convenience. To allow for timely processing, please return the questionnaire within seven days of receipt.

We appreciate your willingness to assist us. Thank you for taking the time to respond to our questions. We'll be listening.

Sincerely,

XYZ

Jane Doe

President

Please indicate your company's awareness of our products and services, utilization of our products and services (as well as products and services from other companies), and interest in the products or services. If you have used a particular product or service from our company, please also rate your level of satisfaction in the products or services. Additional space for comments on any or all of our products or services is provided at the bottom of this assessment.

A box that is not checked will be considered a "no" answer.

Rate Our Product/Service Quality (where applicable)

Products and Services	Aware of product or service	Have used this product or service from this company	Have used this product or service from another company	Have used this product or service	High	Medium	Low
Product or service A	Q	Q	Q	Q	H	M	L
Product or service B	Q	Q	Q	Q	H	M	L
Product or service C	Q	Q	Q	Q	H	M	L
And so on...	Q	Q	Q	Q	H	M	L

Additional space for comments:

Exhibit 1.1 Sample Survey of Customer Awareness, Utilization, and Interest in an Organization's Products or Services

sources where they could generate the greatest return. Without this information, both organizations would have continued operating in a manner that presumed business as usual and thus consumed resources inefficiently. A well-designed customer questionnaire can prove helpful in determining the awareness, utilization, and interest levels of customers. Exhibit 1.1 provides a sample customer questionnaire.

(c) Operations, Facilities, and Technology Companies should periodically assess competitive strategies utilized in terms of operations, facilities, and technology. Information concerning competitors in these key areas can provide important insight regarding their strategic direction. It is particularly helpful to consider how competitors compare in the following areas:

- Locations of branch offices, field offices, and the types of buildings used.
- Creative channels of distribution used.
- Databases, communication networks, and computers employed.
- Technology used downstream with customers, branch offices, field offices, and sales representatives.
- Facility management, overall appearance, and the integration of other offices or facilities.

Because many companies must increasingly compete based on how they allocate scarce capital, a company's ability to profitably compete will increasingly depend on the proper deployment and utilization of operational capabilities, facilities management, and technology. Customer input is a critically important tool in assessing these areas.

(d) Financial Allocation Decisions Customer satisfaction information is helpful in allocating the *financing* and *operating* responsibilities needed to manage a company. Financing responsibilities pertain to how a company obtains the capital needed to provide for assets. Operating responsibilities relate to how a company uses those assets once they have been obtained.

(i) Return on Total Assets One tool that is helpful in making financial allocation decisions is a calculation of the *return on total assets*. The formula for return on total assets can be used in assessing a product or service, overall financial performance, or the re-

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$$\frac{\text{Net income} + [\text{Interest expense} \times (1 - \text{tax rate})]}{\text{Average total assets}} = \text{Return on total assets}$$

Net income		$1,500,000
Addition of interest expense $625,000 × (1 – 0.40)		375,000
	Total	$1,875,000 (1)
Assets, beginning of year		$26,720,000
Assets, end of year		$29,000,000
	Total	$55,720,000

Average total assets: $55,720,000 / 2 = $27,860,000 **(2)**
Return on total assets: **(1)** / **(2)** = 6.7%

Note: This calculation can be done by product or service offering, division, office, the entire organization, etc.

Exhibit 1.2 Return on Total Assets Formula

Date: ___________ Product/Service/Organization: ______________________________

Information required:
Net income:
Interest expense:
Assets, beginning of year:
Assets, end of year:
Average total assets:

$$\frac{\text{Net income} + [\text{interest expense} \times (1 - \text{tax rate})]}{\text{Average total assets}} = \text{Return on total assets}$$

____ + [____ × (1 – ____)] = Return on total assets

Exhibit 1.3 Return on Total Assets Worksheet

turn on an individual customer. It is a measure of how well assets are utilized—that is, a measure of operating performance. Exhibit 1.2 and Exhibit 1.3 provide the formula and a worksheet for its calculation and analysis.

(ii) Cost-Benefit Analysis Another financial measurement, *cost-benefit* analysis, can prove helpful in allocating a company's financial resources. By carefully measuring specific levels of customer satisfaction on a product-by-product or service-by-service basis, a company can analyze how each element is faring from a customer's perspective.

(iii) Break-Even Analysis Break-even analysis is a tool that helps a company assess whether it should continue providing a particular product or service. Simply defined, the *break-even point* occurs when total sales revenue equals total expenses (whether variable or fixed). Break-even analysis helps a company determine whether to go forward in launching a new product or service or to continue offering an existing product or service.

The calculated break-even point, as illustrated in Exhibit 1.4, determines how many

Sales = Variable expenses + Fixed expenses + Profit

At the break-even point, profits will be zero. Thus, the break-even point can be calculated by finding the point where sales just equal the total of the variable expenses plus the fixed expenses.

Example:
Sales = Variable expenses + Fixed expenses + Profit
$250x = $150x + $35,000 + 0
100x = $35,000
x = 350 units

where:
x = break-even point in particular product or service units.
$250 = unit price
$150 = unit variable expenses
$35,000 = total fixed expenses

Note: This calculation can be done by product or service offering, division, office, the entire organization, etc.

Exhibit 1.4 Break-Even Formula

units (e.g., products, services, engagements, memberships, patients, or clients) must be successfully engaged for a company at least to cover its costs. While reviewing the numbers derived from a break-even analysis to assess the reasonableness or probability of attaining a particular profit level, a company can factor in valuable customer-based information gleaned from an assessment of awareness, utilization, and interest to aid in the process of determining whether such levels are also realistic in light of customer satisfaction.

1.4 PLANNING FOR THE FUTURE

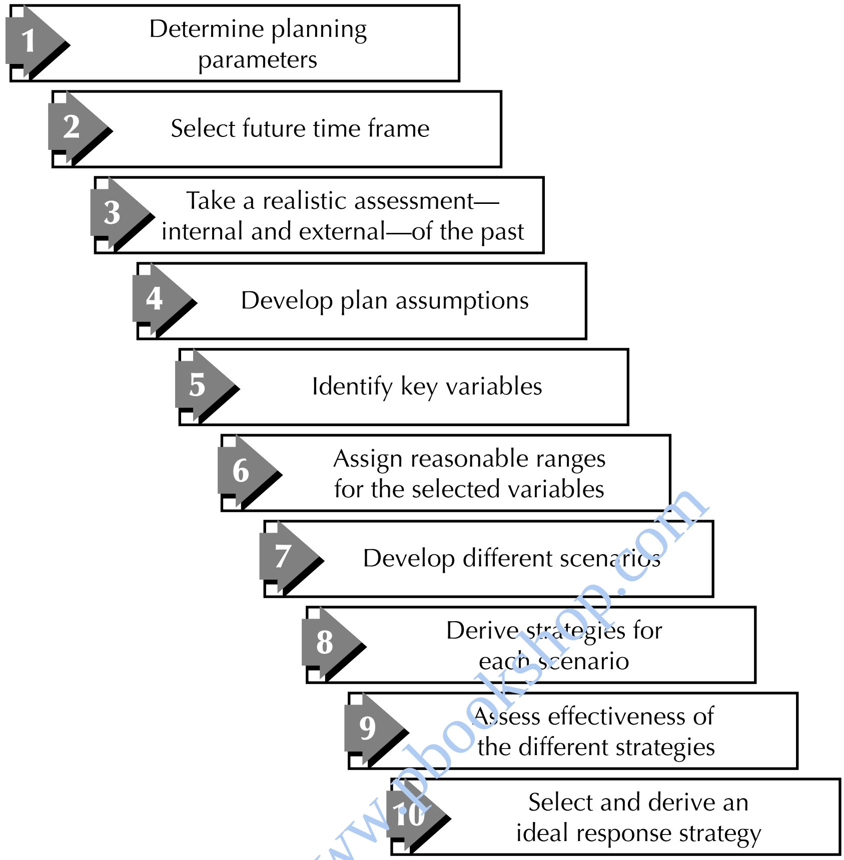
Although they compete in one of the most cyclical industries anywhere, Alex and his associates always seem to be well organized, in control, and leaders in sales and profitability. When asked to explain his relative calmness and that of his associates, Alex responds that it is because of an untiring commitment to planning the firm's direction—where it has been and where it wants to go—given the dynamics of the marketplace.

Planning for the future requires a thorough and realistic understanding of existing products, services, markets, margins, profits, return on allocated capital, and availability and skills of employees. When contemplating a company's specific mission, management must have a clear understanding of how well the company is doing today. As has been demonstrated, customer input and assessment of satisfaction can play an enormously important role in setting objectives.

(a) Prudent Planning Prudent planning helps a company, regardless of its size, focus on where it wants to be three to five years in the future. Too often, managers are focused only on short-term needs and prospects, largely because of their immediacy. As a result, long-term problems and opportunities are deferred or given only slight attention. Management must distinguish between current operating challenges and longer-term goals and plans. Some executives search for ways to increase the size, efficiency, and profitability of their company's operations. But if the forecasted performance of existing operations fails to produce expectations of profitable growth, many of them build on the operations that presently exist and accept the status quo.

(b) Strategic Planning Some executives are not satisfied with nominal growth rates into the future. Empowered with well-founded, customer-based information (e.g., measures of customer satisfaction; information about awareness and utilization of products and services; customer wants, needs, expectations; perceived strengths and weaknesses; and suggestions for improvement), they stretch the forecasts and establish new and challenging standards of performance for the future.

Increasingly, companies realize the importance of strategic planning. Several large companies go to the extreme of considering a range of plans that cover simultaneous possibilities across a wide set of assumptions. However, this involved approach usually requires a highly structured strategic planning process and a large planning staff. Although this type of intensive approach has considerable benefits, few companies can afford such a commitment. Smaller companies or larger companies without extensive strategic planning resources can use a simplified approach more effectively. The underlying assumption with this approach is that a person or group can only commit part-time efforts to the strategic planning process. Exhibit 1.5 graphically represents this ten-step process.



Note: Objectively obtained customer-based data play a critical role in each step of the process. Strategic planning will be seriously flawed if it does not draw extensively on customer satisfaction data when looking at an organization historically and planning for it prospectively.

Exhibit 1.5 Ten Steps for Business Strategic Planning

(c) Call to Action A management consultant recently wrote, "Future historians may well describe the 1980s and possibly the 1990s as the era of customer sovereignty. Perhaps 'customer rebellion' is more accurate."[1] To a large extent, which organizations will prosper in today's economy will depend on which organizations recognize the "customer rebellion" and make the preparations necessary to provide superior customer service.

Every organization must vigorously assess the status and quality of its relationships with both external customers (existing, potential, and past) and internal customers (employees). Where do we stand? What do we need to improve? How can we improve? In doing so, remember the following points:

- Customers, potential customers, and former customers perceive value in their own terms. If an organization wants to meet their needs, it must always look at products and services from *their* perspective.

- Customers, potential customers, and former customers think that an organization's reason for being in business is to meet *their* needs.
- If an organization sincerely desires to deal successfully with dissatisfied customers, employees must be empowered to focus on saving the customer, not the sale.
- An organization must strive to provide dissatisfied customers with a positive reason for dealing with the organization again.
- In all likelihood, an organization's employees will not treat customers or potential customers any better than they themselves are treated by the organization.
- Input from customers, potential customers, or past customers is invaluable. An organization should actively seek, appreciate, and review this input.
- The entire process by which an organization creates and delivers its products and services should exhibit superior customer service and support the creation of high levels of customer satisfaction.

Regardless of the size of an organization, it is increasingly difficult to compete primarily on the basis of price or product. In many cases, product differentiation is imperceptible. Thus, in the burgeoning battle for the customer, the key is usually not product superiority (or at least not for long) but service. The quality of service provided has rapidly become the standard by which organizations are judged. Thus, customer satisfaction—and continual improvement in customer satisfaction—has become a primary indication of sustainability.

In a world of increasing complexity and automation, the successful organization must find the means by which it can operate efficiently and profitably while maintaining a commitment to manage with integrity, compassion, intelligence, competitiveness, and an unwavering commitment to providing superior customer service and generating high levels of customer satisfaction. Although not on the balance sheet, customers are the greatest asset that any organization has. They need to be treated as treasured, long-term investments that, if properly nurtured and cultivated, will provide significant dividends.

How does a company know how it is doing with its customers, its prospective customers, and its employees? Are they satisfied? Do they perceive that the company has a strong commitment to providing superior service? The only way to know for certain is to ask—candidly, objectively, and following a good methodology. As Yogi Berra said so well, "The only way to begin is to begin."

Regardless of the type or size of an organization, management can seize the competitive advantage, provide superior customer service, and build high levels of customer satisfaction.

NOTE

1. *The Arthur Andersen Guide to Talking With Your Customers: What They Will Tell You About Your Business When You Ask the Right Questions* (Chicago: Dearborn Financial Publishing, 1993).