

COMPETITIVE ADVANTAGES THROUGH CUSTOMER SATISFACTION

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Customer Satisfaction can provide you with major competitive advantages, which can directly lead to increase in profitability and growth. They are : Repeat buying which will reduce cost of doing business; your products command higher prices leading to higher profits; gaining financial and moral support from satisfied customer in times of corporate crisis; word of mouth publicity from satisfied customers provides new market opportunities; satisfied customers buy other products and services; etc. Using real life examples the author illustrates these advantages.

INTRODUCTION

My own business experiences have led me to believe that the twin strategies of business success are: Employee Satisfaction and Customer Satisfaction. Productivity of corporate resources including people, money and machinery in all aspects of business operations ranging from research and development, manufacturing and operations, to sales and services depend on how employees and customers feel about the business.

I have also observed that in the early stages of a company's life cycle, its success depends heavily on employees and their soldier-like devotion and hard work. You see this in all startup businesses whether it is a retail restaurant, biogenetics or specialty chemicals or a high tech electronics company. We have all read and heard stories of successful entrepreneurs who succeeded against all odds because of extraordinary efforts by themselves and their employees.

Selecting the right employees, motivating them correctly, and rewarding them handsomely for their hard work becomes extremely important in the early stages of a company's life cycle. In the process, the company begins to be driven by its employees and internal operations and forgets that you also need satisfied customers to succeed in their business.

Furthermore, as business grows, so does its

bureaucratic structure, which further isolates the company from its customers. Indeed, it is not uncommon for the company's employees and procedures to feel that the customer is a bloody nuisance, who refuses to go along with their sales forecasts, who has the audacity to criticize and complain, and who wants to change them to suit his requirements !

Thus, when business grows and the company reaches the maturity stage of its life cycle, it is common to find satisfied employees but dissatisfied customers. Smart management, therefore, must focus on the external world of customers and their needs in addition to the internal world of employees and their operations. It must realize that the company now depends much more on its customers and not the other way around; that customers have other choices; and that customers are both technically sophisticated and financially capable to produce products and services rather than buy them from anyone in the market place.

Unless the company is willing to reorient its people and reorganize its operations to be customer driven, excellence in R&D, manufacturing, and marketing are unable to stop decline in market share, corporate growth and business profitability. It is not a question of doing it right, it is a question of doing the right thing ! Furthermore, it doesn't matter whether you are a big company or a small company, market leader or a niche player. Nor does it matter

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whether you are in agriculture, chemicals, consumer electronics, automobiles, financial services, health care or telecommunications. Lack of customer focus, especially at the maturity stage of the life cycle, creates a significant negative impact on the company's profits and growth performance.

And once you start losing profits, growth and market share, you also lose employee confidence, morale and productivity. Ultimately, excellent employees start to leave the company resulting in employee dissatisfaction. In other words, employee satisfaction also depends on customer satisfaction.

A number of excellent companies have recently learned this lesson the hard way. Fortunately, they were able to turn the corner before it was too late. Perhaps the best example is Ford Motor Company. It was losing significant market share, incurred record losses and was stagnant in its growth. However, what it had was strong employee loyalty. Before it became too late, they woke up and instituted changes in both corporate culture and operational structure to be customer driven. In less than ten years, the company has scored successive major new product victories across its product line and earned record profits. This includes Escort (small car), Thunderbird (personal car), Taurus (mid-size car), and more recently Lincoln Continental (luxury big car) as well as Probe (sporty car).

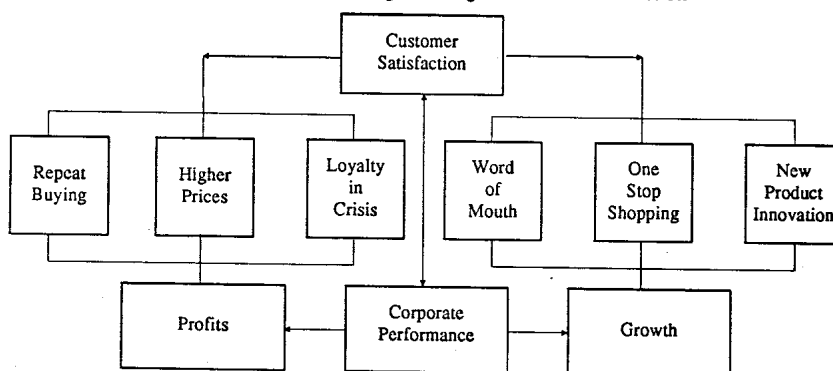
Similarly, after three to four years of flat sales and fluctuating profits, IBM has regained its leadership in the personal computer business as well as in the data processing business by refocusing on the customers.

Finally, AT&T and its divested Regional Holding Companies have survived the largest industry restructuring by the government because of their customer orientation even in a monopoly situation.

In this paper, I will discuss at least *six major competitive advantages* a company can gain through customer satisfaction. All of them contribute positively toward the dual financial objectives of profits and growth.

Figure 1 summarizes these six competitive advantages which contribute toward the corporate bottom line. A company's profit objectives are attained by the following three competitive advantages: (1) economy of sale through lower cost of doing repeat business; (2) higher prices commanded through differentiation; and (3) protection from satisfied customers in a crisis situation. Similarly, a company's growth objectives are attained by the other three competitive advantages; (4) product diversification growth through one stop shopping; (5) new market growth by word of mouth; and (6) new product development through lead users.

Figure 1
Six Competitive Advantages through Customer Satisfaction

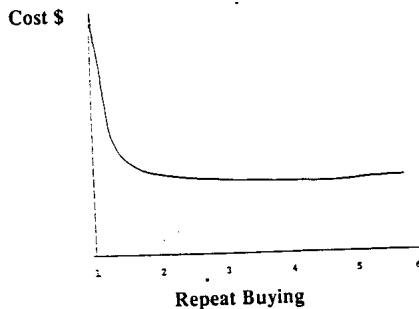


Let's now discuss each competitive advantage in some depth. The first three competitive advantages are directly relevant for profit improvement. The last three are directly relevant for growth improvement.

1. REPEAT BUYING RESULTS IN LOWER COSTS

In a mature market, perhaps the best competitive advantage a company can maintain is through retaining its customers since as much as 90 to 95 percent of total business comes from existing customers. Competitive strategies for retaining existing customers tend to be less costly than those for gaining new customers, especially in mature markets with entrenched competitors. We all know that with repeat purchase, the cost of doing business with satisfied customers goes down. However, what we often do not realize is that it goes down exponentially with a very sharp decline in costs in the early stages of repeat buying as demonstrated in Figure 2.

Figure 2.
Repeat Buying Results in Experience Curve



Underlying this simple concept are some powerful implications.

First, it demonstrates that the *economy of scale* advantages in manufacturing operations attained through volume and worker experience are equally appropriate concepts and consequences in the sales and service environment. In other words,

productivity of marketing-related activities goes up significantly with repeat buying by satisfied customers. And this is likely to become increasingly more important in the near future as we minimize manufacturing costs through just-in-time, quality assurance, and flexible manufacturing; and as we minimize management overheads through downsizing, office automation and reorganization. As both the manufacturing and management costs come down over time, marketing costs as a percent of total costs tend to rise. For example, it is estimated that manufacturing costs in the electronics industry are under 25 percent, management costs under 20 percent, and, therefore, as much as 55 percent of total costs in business are housed in sales, service and value add activities. Therefore, the next challenge of eliminating or minimizing business costs is likely to be in marketing. And the best way to lower costs is to increase satisfied customer base.

Second, we all know that *dissatisfied customers increase the cost of sale*. They slow down in their payments, elevate complaints to higher level management, and even engage their legal departments to fulfill their expectations. And, if the customers engage their legal departments, we must also engage our legal department, resulting in cost escalation.

It is estimated that *one dissatisfied customer takes the profitability out of five satisfied customers*. Unfortunately, this is hidden and dispersed throughout the organization, and therefore, not noticed by top management.

Third, it is impossible to satisfy all customers. Some customers have very unique requirements, their locations are too remote to serve them properly, and their user environments may not be conducive to proper product use. It is, therefore, important to *be extremely selective in your choice of customers*.

Unfortunately, customer selectivity as a concept is often contrary to sales incentives and the selling environment in general. We incentize our sales force on revenues and not on profits. Therefore, they generate both good sales and bad sales.

Someone in the company pays for the bad sales.

Finally, it is better to *prevent customer dissatisfaction* than to correct it after it is created. This is comparable to the zero defect concept in quality assurance : A bad component is likely to create more problems after the product is assembled, and it is a lot cheaper to institute front end preventive measures such as the zero defect. It is, therefore, extremely important not to create wrong customer expectations whether it is through advertising, product packaging, or sales presentations. The higher the expectations we create with aggressive sales and marketing tactics, the higher the cost of correcting them if customer expectations are not met by their product experience.

2. CUSTOMER SATISFACTION CREATES PRICE ADVANTAGE

Unless there is a strong incentive, satisfied customers are unlikely to switch suppliers. After all, they have invested significant amount of time, effort and expertise in searching and selecting the right vendors in the first place. There are minimal costs associated with switching vendors and in some cases they can be prohibitive. For example, once a customer is linked by computerized order entry systems it is very difficult for him to switch to another supplier.

Satisfied customers want the company to survive any crisis it experiences and they try to assist the company to ensure its survival. Customer satisfaction is probably the best source of insulation against corporate crises.

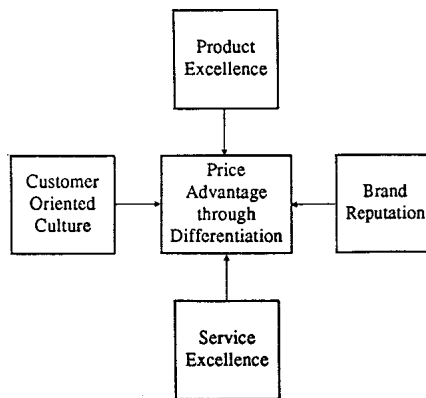
Therefore, if a competitor wants to capture your satisfied customers, it must provide significantly better value than you either by lowering prices for the same level of performance or by increasing performance levels at the same price. The larger the satisfied customer base you own, the greater the amount of entry barriers for your competitor. This was the experience of Air Borne and Emery against Federal Express in the overnight delivery business. Similarly, this has been the experience of most of the long distance telephone companies such as MCI

and U. S. Sprint as they try to capture AT&T's customer base. And of course, very few mainframe computer companies have succeeded in taking away the IBM share.

It is my estimate that a *minimum* of at least *five percent price advantage is generated through customer satisfaction* even in commodity businesses such as industrial chemicals, agricultural commodities, electronic components, and basic raw materials. Also, one would expect, at least theoretically, some maximum price advantages a company gains through satisfied customers. However, the maximum price advantages often tend to be outrageous, especially in highly specialized niche markets or for super premium products or services. In the majority of cases, my experiences have shown a maximum price advantage of around 30 percent in mass markets.

We refer to this price advantage as *Differentiation*. It is created through excellence in one or more specific sources of customer satisfaction. Figure 3 identifies four sources of differentiation : product excellence, service excellence, brand reputation, and customer oriented culture.

Figure 3
Sources of Differentiation Advantage



A very good example of price advantage toward *product excellence* is the 3M Company. It has several excellent products which have retained their performance superiority to command higher prices despite competition. These include the Scotch tapes, Post-it note pads, and 3M floppy disks.

On the other hand, IBM has maintained its price advantage primarily through *service excellence* especially in the mainframe business. It is not unusual for a large corporate customer to continue to pay at least 20 to 25 percent higher prices for IBM system of hardware, peripherals and software even with the knowledge that competitive products are at par or superior in performance.

A third source of price advantage through differentiation is *brand reputation*. In areas where quality varies significantly across competitors and the customer is unable to judge or control quality consistency, brand reputation becomes a significant price advantage. This is very true for McDonald's in the fast foods business, for Marriott in the hospitality business, and for Boeing in the commercial aircraft business. Brand reputation is even more critical in professional services such as health care (Mayo Clinic) consulting (McKinsey) and financial services (American Express).

A fourth source of price advantage through differentiation come from *customer oriented culture*. There are several American and foreign companies where customer satisfaction is part of the corporate creed and practice at the highest level of management. Customers experience this philosophy and develop an image that says : this company cares. Examples include Nordstrom in the department stores business, Singapore Airlines in the airlines business and IBM in all of its businesses.

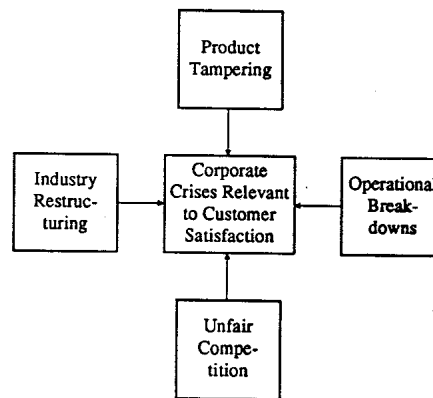
3. CUSTOMER SATISFACTION LIMITS CORPORATE CRISIS

A third major competitive advantage through customer satisfaction which is linked to profits is in the area of corporate crises. Satisfied customers want the company to survive any crisis it experiences and they try to assist the company to ensure its survival. Customer satisfaction is

probably the best source of insulation against corporate crises.

A company encounters crises from several sources, some external and others internal. Figure 4 identifies four major sources of crises which are directly relevant to customer satisfaction.

Figure 4
Corporate Crises and Customer Satisfaction



The first and probably the most relevant source of crisis is *product tampering*. Unfortunately, product tampering either at the factory or in the retail environment is becoming increasingly too common. A strong customer loyalty slows down what would otherwise be a precipitous decline in sales and a permanent loss of market share. This was clearly demonstrated to Johnson & Johnson when someone tampered with their Tylenol brand of analgesics. Not only was the company insulated by its loyal customers (patients, doctors, hospitals) in the short run, but it regained its market share after a short setback. A similar incident took place to SmithKline Beckman when its Contac brand of allergy products was tampered with in the marketplace.

And these examples are not limited to drug or food products but also present in the electronics industry. Tampering with the software programs and planting

"viruses" is also becoming increasingly too common.

The second source of corporate crises relevant to customer satisfaction is *unfair competition*. Loyal customers do not like unfair and often unethical business practices of competitors against a company they really like. For example, many vendors who try to compete against IBM or AT&T with unfair marketing or business practices are exposed by their loyal customers. It is not uncommon for a loyal customer to send copies of highly sensitive marketing plans of a competitor to IBM or AT&T.

Similarly, companies like McDonald's, Coca-Cola and Procter & Gamble are constant targets of rumors about their products. For example, not too long ago, it was rumored that McDonald's products contained spider webs, or that Coca-Cola is narcotic. Furthermore, often these companies are targets of social protests because of their high visibility. Loyal customers tend to ignore rumors and continue to patronize their products despite attempts to boycott them.

A third source of corporate crises relevant to customer satisfaction is *internal operational problems* created by sabotage, shortages or breakdowns. Right now, there seems to be a worldwide shortage of 256 chips which are used in building microcomputers. Companies that depend on critical components are tolerated more by their loyal customers to the extent they can wait or postpone purchases.

A fourth source of corporate crises relevant to customer satisfaction is *industry restructuring* either by government mandate or through industry consolidation. This is especially important in basic industries such as the oil industry or infrastructure industries such as telecommunications and airlines. The recent deregulation of the airlines industry has resulted in its massive restructuring. Airlines with strong customer loyalty have benefited from this whereas airlines with customer dissatisfaction have suffered. The best contrasting examples are Delta against Eastern Airlines and United against Continental Airlines. Similarly, the breakup of the Bell System by the government to create competition has succeeded only modestly especially

in long distance and local exchange services. Despite a significant restructuring and government encouragement of competition, it seems that the Bell Operating Companies have retained their customer franchise as has AT&T.

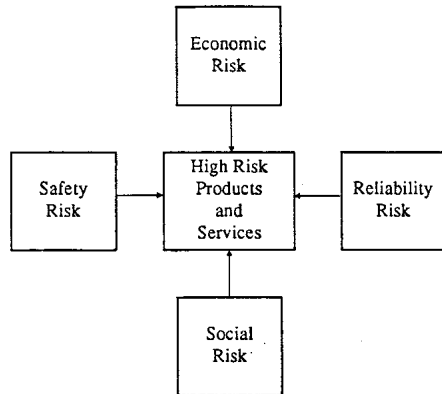
4. SATISFIED CUSTOMERS GENERATE NEW CUSTOMERS

The best way to grow business profitably is to gain new customers without significant investment of your product, marketing, and sales resources. This is possible through word of mouth communication. If you have satisfied customers they are more than willing to call or visit potential new customers. They are willing to put in their time and effort for several reasons. First, they want to share their appreciation for being treated well as customers. Second, it is in their self interest to drive out bad companies or inferior products from the market by promoting your products and your company. Finally, customers acquire market price if they concentrate their purchases from one or two vendors. This makes you more dependent on them and creates a balance of power between you and your customers.

Word of mouth communication is a very powerful form of communication and influence. It is more credible, goes through less perceptual filters and can enhance the product better than any sales communication. Indeed, a slight negative word of mouth can more than offset any amount of sales and advertising effort.

Research evidence shows that *satisfied customers talk to three other customers*. However, *dissatisfied customers talk to seven other customers*. Counting both positive and negative word of mouth communication suggests that one customer influences ten other customers. However, this average of the word of mouth communications goes up significantly more in all those purchase situations where the potential buyer perceives a high degree risk if he or she makes a wrong decision. In Figure 5, I have identified four areas of risk perceived by buyers. A product or service which has all four risk factors inherently present in it is, therefore, likely to totally depend on word of mouth communication.

Figure 5
Word of Mouth and Sources of Risk



The first common risk in most purchases is *economic risk*. It is inherent in major capital expenditures, in rapidly changing technologies, and in products or services with significantly high operating costs. Examples include homes, automobiles, machinery, factory automation and office automation.

The second area of high risk relates to products and services where it is difficult to deliver consistency and *reliability*. In other words, *performance uncertainty* is a common problem because of lack of standards, complexity of user interface, or because it is a radical innovation with no field experience. Example include drugs, biogenetics, software and most professional services. It is interesting to note, that service industries suffer more from this risk than product industries primarily due to lack of standards and consistency among providers of service.

A third area of high risk situations is in those products and services where there is a potential to threaten *personal safety* or safety of material possessions. Some products or services are inherently more dangerous than others. Examples include chemicals, electricity, and nature expeditions. Product safety is a major concern in all

advanced countries and in addition to strong word of mouth, there are efforts to establish legal and regulatory guidelines across virtually all industries.

The fourth area of risk is *social risk*. It refers to the risk of losing face, losing your job or losing the reputation of your department if you make a wrong choice. While there are obvious examples of social risks in personal care products and services, only recently have we recognized that social risk is significantly present in industrial buying behavior. It is often said that you don't get fired by buying IBM. Most MIS managers in a company hesitate to recommend a non-IBM solution because they fear that if any problems occur in the new computer system, everyone will blame him or her for making a wrong choice. His or her personal risk as well as the department's reputation and power are at stake.

There are numerous examples even in mass markets where market leaders have created billion plus dollar business by word of mouth advertising. These include Nestle Company in chocolates and The Limited in women's fashions. In fact, until recently, most certified professional services such as law and medicine were discouraged from advertising and therefore they relied solely on referrals.

5. CUSTOMER SATISFACTION ENCOURAGES ONE STOP SHOPPING

Satisfied customers not only generate growth of new business through word of mouth communication, they also buy other products and services from you. There are several reasons why customers prefer one stop shopping. First, it is more economical for the customer to place multiple orders with the same firm than to split the orders across several vendors. The customer gets volume discounts, favorable terms, better support service and more importantly, he saves significantly on procurement paperwork. Second, it is much more convenient for the customer. Procedures for ordering, delivery and payments are well known and routinized; supplier company people are familiar with all the tactical details related to his account; and there is a known person to call and place the order. This makes buying easy, convenient and probably faster. Finally, customers avoid the

uncertainty of doing business with an unknown vendor. As suggested earlier, customers encounter major risks in their purchase decisions. One way to reduce the risk is to buy all products and services from reliable and trustworthy vendors.

The one stop shopping preference by satisfied customers creates the competitive advantage of economy of scope. It enables the company to *expand its product line* and generate corporate growth without significant risk. For example, McDonald's has successfully broadened its product line from hamburgers to include salads, fish, chicken, and a full breakfast menu. It has virtually become a three meal place. It is reported that McDonald's is currently testing pizzas to add to its menu of meals. Similarly, IBM has successfully expanded its product line to offer a system solution including the CPU, peripherals, operating systems, software, customer training and financing.

The fundamental concept underlying the one stop shopping is life cycle revenues (LCR). It is comparable to life cycle costing (LCC) concept popular in engineering and manufacturing. It represents the net present value of all products and services a satisfied customer is likely to buy from you over his life. For example, in retailing, the life cycle revenue from a household account can be as high as \$500,000 over the life of that individual. Obviously, in industrial markets, the life cycle revenue of a corporate or government account is likely to be in the tens of millions of dollars.

The life cycle revenue concept provides several interesting implications. First, it enhances respect even for small accounts. In other words, no customer is too small so long as we can meet his expectations satisfactorily. Second, there is a significant amount of downstream revenues from value added services. For example, once you sell machinery, you can also sell insurance, financing, maintenance and repair services. In fact, the principle of the razor and the razor blades is fully anchored to the life cycle revenue concept.

Third, the customer puts his *trust* in the and, therefore, he expects comparable performance in value added services or other products he buys from

you. Unfortunately, most companies are not equally good across products and very likely not at all between products and services. This seems to be a problem currently experienced by Sears. As Sears expands its business into financial, healthcare and household services markets, there is a growing concern whether it will be able to maintain customer satisfaction so ably delivered in such great products as Craftsman tools and Kenmore application.

It seems that one stop shopping requires a high degree of consistency across diverse products and business units. This is often difficult to achieve across highly decentralized autonomous divisions.

6. CUSTOMER SATISFACTION ENCOURAGES SUCCESSFUL INNOVATIONS

Satisfied customers are more open to sharing their product use experiences. They not only allow but encourage suppliers to visit their facilities, talk to their employees and, in general, encourage learning about what they do with your products and services.

This open door communication and exchange is extremely important for new product innovations. It allows your R&D organisation to interface with the customer as they are developing new technologies. The customer input in the early stages of technology development has been recognised as one of the major reasons for the success of an innovation.

Indeed, in many industries, customer's engineering departments take the lead in new product development often resulting in worldwide patents. However, the customer does not want to diversify from his business operations and passes on the new discovery or the new design to a preferred vendor. This has been found to be true in process technologies, in material substitutions, as well as in support services.

CONCLUSIONS

In this paper, I have identified six major competitive advantages gained through customer

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satisfaction. Three of them are directly relevant for improving profitability of your organization. They are :

1. Repeat buying reduces cost of doing business if the customer is satisfied.
2. You command higher prices than your competition which increases your margins and, therefore, profits.
3. Satisfied customers provide both financial and moral support when your company faces a corporate crisis.

In addition, three additional competitive advantages through customer satisfaction are directly relevant for corporate growth opportunities. They are :

4. Word of mouth from satisfied customers provides new market opportunities at a very low cost. You don't need to invest as much in creating new customers.

5. Satisfied customers buy other products and services by practicing one stop shopping.

This provides you with significant product diversification opportunities and, therefore, economies of scope.

6. New product development becomes more productive as satisfied customers provide access to their facilities and people. Significant growth opportunities from new technologies are provided by leading users of your products and services.

Now the rest of the story : An unhappy customer is a terrorist ! He will hold you and your organisation hostage if you do not meet his expectations. ■

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