

# Employee Satisfaction Lead to Better Customer Management

White Paper



---

© 2004 Ibhar Technologies Private Limited. All rights reserved.

The information contained in this document represents the current view of Ibhar on the issues discussed as of the date of publication. Because Ibhar must respond to changing market conditions, it should not be interpreted to be a commitment on the part of Ibhar and Ibhar cannot guarantee the accuracy of any information presented after the date of publication.

This document is for informational purposes only.

IBHAR MAKES NO WARRANTIES, EXPRESS OR IMPLIED, IN THIS DOCUMENT.

Companies, names, and/or other data used in screens and sample output are fictitious, unless otherwise noted. Other product or company names may be the trademarks of their respective owners.

---

## Introduction

Over a decade ago Schneider wrote: "What is surprising is that (1) researchers and businessmen have concentrated far more on how to attract consumers to products and services than on how to retain customers, (2) there is almost no published research on the retention of service consumers". Despite the passing of years, there is still very little published research on the area of retention marketing. Certainly little rigorous work is evident in the area of the relationship between employee satisfaction and customer retention.

The specific objectives of this section are:

1. To review and provide a critique on the literature on customer retention and employee satisfaction
2. To consider appropriate strategies for improving customer retention
3. To examine the relationship between customer retention and employee satisfaction
4. To identify major potential areas for future research

## Literature Review

The concepts of relationship marketing and interactive marketing are receiving increasing attention as marketers focus on how to maintain and enhance customer relationships with existing customers rather than attract new customers.

According to Gronroos 'the traditional view of marketing as a function for specialists planning and executing a marketing mix may not be altogether true where services are concerned.' The marketing mix approach is frequently too limited and does not cover all the activities that appear in customer relationships at various stages of the customer relationship lifecycle.

Instead of this narrow transactional view of marketing, marketing is now increasingly seen as being concerned with relationships. Whilst some relationships do not involve any social relationship or interaction, other relationships may involve many interactions between customers and employees and evolve over long periods of time.

Berry introduced the concept of relationship marketing to describe a longer-term approach to marketing. According to Gummesson (1987) long-term relationships with customers are especially important in services, where relationships with customers can be more expensive to establish. The emphasis on relationships is also important in industrial markets. This does not mean that short-term sales are not desirable. In fact, they may be very profitable. However, if close and long-term relationships can be achieved, this will lead to increased profitability for the company and reduced costs and make market entry or share gain difficult for competitors.

According to Berry (1983): 'Relationship marketing is applicable when there is an ongoing and periodic desire for the service and when the customer controls the selection of a service supplier and has alternatives from which to choose.'

---

Customer service is a key ingredient in relationship marketing and therefore in customer retention. However, Lewis (1989) points out that emphasizing service is one thing; delivering it is another. In fact, he considers that emphasizing service is not the most appropriate approach to adopt. His basic idea is that emphasis should be placed on the customer and that focusing on the customer renders marketing and service inseparable.

Thus management policies that enhance customer-based service often prove to be a firm's best marketing strategy. Christopher, Payne and Ballantyne (1991) go further than this to describe a new synthesis between quality, customer service and marketing. They argue that quality is also a key linkage in the exchange relationship between the organization and its customer. They maintain that 'unless management can bring these activities together with new forms of collaboration and cross-functional coordination, there can be no sustainable competitive advantage.' Relationship marketing can therefore be seen as a focal point for integrating customer service and quality with a marketing orientation.

Much of the literature on retention marketing draws on the philosophy of relationship marketing and focuses primarily on the impact of retention marketing on company profitability and various strategies and plans to improve customer retention rates.

Buchanan and Gillies (1980), Dawkins and Reichheld (1990), Berry (1983), DeSouza (1992) and others argue that service firms devote most of their resources to attracting new customers, but few take equal trouble to retain existing customers. Bain and Co maintain that 'one of the key elements of business success and profitability is customer satisfaction, the more satisfied the customer, the more durable the relationship. And the longer this lasts, the more money the company stands to make.'

The effect of longevity on profits can be explained by several factors:

Acquiring a new customer costs more than retaining an existing one. The costs of acquiring a new customer are incurred only at the beginning of the relationship, thus the longer the relationship, the longer the amortized cost of acquisition.

Retaining customers means that account maintenance costs as a percentage of income tend to decline over the life of the relationship leading to increased revenues.

Long-time customers tend to be less price sensitive, permitting higher prices to be charged.

Long-time, satisfied customers are likely to provide free, word of mouth advertising referrals

Long-time customers are likely to purchase additional products/services

Retaining customers makes it difficult for competitors to enter a market or increase share

---

Regular customers tend to place frequent, consistent orders and therefore, usually cost less to serve

Improved customer retention can also lead to an increased employee retention that feeds back into even greater customer longevity

Bain and Co have developed approaches for measuring customer retention and linking it to company profitability. The customer retention rate is the rate at which customers are kept and is expressed as the percentage of customers at the beginning of the year that still remain at the end of the year. Therefore, the average life of a customer relationship doubles from five to ten years as a company's retention rate goes from 80 to 90 per cent.

Bain and Co has also quantified the potential impact of improving customer retention for several banks and many other service businesses. They conclude that a five-point improvement in customer retention can lead to profit swings of 25 per cent to 80 per cent.

## **Strategies for Improving Customer Retention**

There are a number of core ideas relating to customer retention strategies that can be identified:

Companies must measure customer retention rates over time and by line of business and in each of the areas that the company does business. This information and its importance must then be communicated to the employees.

It is then essential to analyze the root causes of customer defections, because it is only by understanding why customers are leaving the company that the company can begin to implement a customer retention programme to increase satisfaction and thereby improve customer retention and profitability.

A further strategy involves focusing attention on internal marketing and particularly for front-line employees to ensure that they are offering service quality that consistently meets the requirements of the target market. These employees can often make or break service organizations.

Best demonstrated practice is also recommended as a technique for improving customer retention rates.

Other suggested strategies include: senior management commitment; customer focused culture and incentive schemes; building value-managed relationships; focusing attention on the most profitable customers and setting clear targets and measuring results; and identifying switching barriers. The prevailing idea behind retaining customers has been maintaining quality. However, research undertaken in the financial services sector by Temple, Barker and Sloan, a US firm of management and economic consultants, indicates that quality programmes no longer have the power to keep customers satisfied.

Their work suggests that quality is not always the major determinant of customer turnover for which there are four primary causes - rate increases

---

competitive solicitation, service deficiency and poor reputation. According to Temple, Barker and Sloan, the initial step for implementing a sound customer retention plan is to determine price volatility and service intensity for particular products. The findings from their research found that quality is important but insufficient when it comes to high service, high volatility products such as car insurance, and that for low volatility and high service intensity products, quality is the key driver. The research suggests that financial service firms must effect a comprehensive retention strategy composed of quality, strategy and tactical programmes.

In the same way that Christopher, Payne and Ballantyne (1991) describe relationship marketing as a focal point for integrating quality and customer service with a marketing orientation, many of the strategies/plans for improving customer retention as described above, integrate concepts from marketing, quality management and customer service and apply them specifically to keeping customers.

## **Customer retention and employee satisfaction**

Little evidence has emerged in the literature of research into the relationship between employee satisfaction and customer retention. However, the work undertaken by Bain and Co suggests a strong link between these two variables. (Figure 2.2) They maintain that high customer retention will lead to dealing with satisfied customers rather than dissatisfied customers. As a result, employees will stay longer with the company. 'Higher retention of the right caliber of employees creates a stable and experienced labor force that delivers higher service quality at lower cost... this leads to higher customer retention' and of course increased profitability.

The advantages of long-term employees is that they are often able to form personal relationships with customers, understand their needs, and possibly are able to pre-empt dissatisfied customers leaving the company. Reichheld maintains that there are: powerful insights available from probing into root causes of customer and employee defections. This is the most powerful pool of untapped insight in any business. It clarifies what is and what is not working in the business system and this is the first step toward a meaningful and measurable improvement programme. In intensive organizations the quality of service is determined mostly by the skills and attitudes of the people producing the services. All employees are part of the process, which connects with the customer at the point of sale. Employees remain the key to success at these service encounters or 'moments of truth'.

The extent therefore, to which these organizations can attract, keep and motivate quality personnel will influence their capability to offer quality services to their customers. Consistently offering services that match the requirements of the external customer will be an important factor in building strong long-lasting customer relationships. The concept of internal marketing emerged in the literature in the last 15 years as a way of enabling companies to get, motivate and retain customer-conscious employees, and was then described more widely in the services management literature. The aims of internal marketing are to improve internal marketing relationships, quality and customer service in order to satisfy internal and external customer needs (Helman and Payne, 1991).

---

Schneider and Bowen (1985) have found that when employees identify with the norms and values of an organization, they are less inclined to leave and, furthermore, customers are likely to be more satisfied with the service.

In addition to this '...when employee turnover is minimized, service values and norms are more transmitted to newcomers and successive generations of service employees' (Bowen and Schneider, 1988). Employee satisfaction in internal markets is therefore a prerequisite to customer satisfaction in external markets. The basic philosophy is that if management wants its employees to do a great job with customers, then it must be prepared to do a great job with its employees (George, 1990). Unhappy employees will make for unhappy customers so unless employees can be successfully taken care of, the success of the organization in its ultimate, external markets, will be jeopardized.

Internal marketing therefore involves creating, developing, and maintaining an organizational service culture that will lead to the right service personnel performing in the right way. It tells employees how to respond to new, unforeseen and even awkward situations (Schneider, 1986). The service culture has a vital impact on how service-oriented employees act and thus how well they perform their tasks as 'part-time marketers' (Bowen and Schneider, 1988). 'When internal customers perform, the likelihood of external customers continuing to buy is increased' (Berry, 1981). Lewis (1989) argues that the success of the internal marketing concept ultimately lies with management. It is unreasonable to expect lower level employees to be customer oriented if management is not customer-oriented.

## Conclusions

Because of the implications for profitability and growth, customer retention is potentially one of the most powerful weapons that companies can employ in their fight to gain a strategic advantage and survive in today's ever-increasing competitive environment. It is vital that we understand the issues and mechanisms behind customer and employee retention and the role that retention marketing can play in formulating strategies and plans. However, in order to do that, much more research needs to be undertaken to provide us with the relevant information on which to base management decisions.

There are three major areas for research in this field: an evaluation of current practice; an examination of factors affecting customer retention rates and a consideration of retention management strategies. The key current questions relating to each of these areas are listed below.

### Current practice

To what extent are service businesses measuring customer retention? Is it measured in aggregate or is it broken down to measure retention rates by market segment

To what extent have service companies implemented customer retention programmes?

What have been the results of customer retention programmes

---

Do successful companies factor customer retention into performance measures, job evaluation and career advancement?

### Factors affecting customer retention rates

What are the factors that affect customer retention rates?

Why do some companies have high retention rates and other companies have low retention rates?

Why do some regions/branches with the same company have higher retention rates than others?

Is there a strong link between employee satisfaction and customer retention? What are the key factors to determine this?

To what extent do satisfied employees tend to be long-service employees?

What is the impact of the company's culture on customer and employee retention rates?

Are referred customers retained longer than customers who are not referred?

### Retention marketing strategies

What frameworks and structures can be formulated in order to explain the theory of retention marketing?

How can organizations create, develop and maintain an effective service culture? What are the critical success factors and what are the barriers, which must be broken down in order to achieve this goal?

What retention marketing strategies can be adopted to build an organizational climate which will encourage quality customer conscious employees to stay with the company and at the same time ensure that the company maintains long-lasting relationships with its customers?

What are the most effective organizational structures, which will facilitate building a customer-oriented culture?

The second of these - factors affecting customer retention rates - represents an especially interesting area for research. It would be particularly appropriate to examine the different performance amongst branch activities in the same company within organizations such as banks and building societies, for example, since these provide an opportunity to explore best-demonstrated practice on a competitive basis. It also provides the opportunity to examine linkages between employee retention and customer satisfaction.

Within this, the key to customer satisfaction, it can be argued, is based upon the extent to which an appropriate climate can be engendered whereby employees see as their major priority the retention of

---

customers. Some preliminary evidence has been provided on the possible linkages between the internal customer service climate and its impact upon employee retention and customer satisfaction. A critical research issue, therefore, lies in establishing the major determinants of employee satisfaction and hence the willingness of employees to work as part of a team that feels itself empowered to create an atmosphere in which customers willingly commit themselves to a continued relationship with that organization.