ROI Calculations Toolkit

Excerpted from Chapter 9 of Customer Experience Leadership: How to Chart a Course and Deliver Outstanding Results by Brad Cleveland (Kogan Page, London, 2021).

Build a cost-benefit toolkit with returns on improvements

My main recommendation is to build a "toolkit" (repertoire if you prefer) of methods you can use to quantify returns and costs. There are two categories you'll want to include in your financial analysis toolkit: the returns you realize when making improvements to customer experience, and the risk and costs of doing nothing. (I encourage you to read through the calculations—but skimming is fine; they'll be here when you need them.)

FIGURE 9.3 Returns on customer experience improvements

Returns on improvements	Costs of inaction
• Customer loyalty • Brand promotion • Operational improvements • Product and service innovation • Employee engagement	

Let's begin with the good stuff. These are five potential returns that come back to you as you make improvements to customer experience.

Customer loyalty

Loyal customers bring enormous benefits to organizations. There are many ways to measure loyalty: customer lifetime value, wallet share, repurchase ratio, retention rate, customer sentiment, and others. Each has advantages and disadvantages.

Customer lifetime value (CLV) is a common approach. It measures how valuable a customer is to your organization over time rather than just one purchase. CLV can be used in any organization that sells products or services, and in non-profits supported by donors. I like it, especially for its educational value.

This is how I walk teams through CLV. Let's use a relatively simple example—say, you run a small chain of several delis. The first step is to calculate the amount of an average sale. With 300,000 transactions and $4.5 million in annual revenue, you determine your average sale to be $15 (4,500,000/300,000).

Average sale amounts vary widely from one organization to the next. It might be $38,000 for a car, or $4 for ice cream. In large organizations, you may have to work with colleagues to piece together a customer's transactions with different divisions. But the underlying approach is the same.

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Second, you determine the frequency of customer purchases by dividing the number of purchases by the number of unique customers. Let's say your deli chain had 10,000 unique customers (this number can come from data on accounts, payment methods, or point of sale information). The purchase frequency would be 30 (300,000/10,000) per year. If you sell big ticket products or services, sales may happen once every few years. And that's fine, you'll still want to look at them over a customer's lifetime of business with you.

Third, estimate customer life expectancy (CLE). Some healthcare providers have members most of their lives. A daycare center might have customers for a few years. Some executives push back here, predicting the business might not even exist in 20 or 30 years. That's fine, make an estimate that's comfortable. Let's go with 10 years for your deli. So, your customer spends an average of $15, she comes in 30 times per year, and she'll be with you an estimated 10 years. Put these figures together to determine Customer Lifetime Revenue. And, wow, over a lifetime, she spends $4,500 ($15 × 30 × 10) with you!

Customer lifetime value subtracts your average direct costs for serving the customer over those years. Let's say they are estimated to be $1,000. That would leave you with a CLV of $3,500 ($4,500 − $1,000).

Most employees are pretty amazed at these numbers. I heard one comment, "Just look at how much is at stake if a customer has a bad experience. Not $15. $3,500 in gross profits!" Yep, that's the thing to remember. I encourage you to use your own numbers. Then, ensure your employees understand the principle at work.

Brand promotion (word of mouth)

The better the customer experience you provide, the more likely you are to create brand advocates who promote for you. Brand advocates drive business to your organization, through word-of-mouth referrals to friends and family, and through posts and reviews.

So, how do you quantify brand promotion? First, you need to know how new customers find you. There are many technology options that can help, from customer management systems to point-of-sale terminals. Get your employees (and systems) in the habit of asking, "Have you shopped here before? How did you hear about us?" Explore ways you can capture that insight, and begin as soon as possible. If you don't have a reliable tracking system, samples of customers can be a good start.

Next, calculate the value of brand promotion by multiplying the number of customers generated through brand promotion by customer lifetime value (CLV). Let's say you estimate that 400 new customers last year came from brand promotion. If CLV is $3,500, the value of brand promotion is $1.4 million (400 × $3,500). The value doesn't stop there. You now have an additional 400 customers who may also promote your brand and create even more customers.

Now, a common objection here is that some of those customers may have found you without a referral. That's a reasonable assumption, so you can discount that number to a level that is comfortable. I encourage you to show where your numbers come from, so your team can make adjustments as you get better data and estimates.

The final step is to estimate the role that good customer experience plays in brand promotion. You might broadly and reasonably assume that any referral is due to customer experience. However, if your product is completely unique, it's possible customers refer others even if other aspects of the experience are just okay. In that case, let's say you attribute half of the value of brand promotion to efforts you're making to improve customer experiences beyond the product itself. That would still be $700,000.

Your brand advocates are generating business for you. Ask your customers to provide reviews. Share this insight with colleagues. And ensure that your organization understands the impact of customer experience on brand promotion.

Operational improvements

Improvements in customer experience often involve improvements to operations—customer service, inventory, shipping, technical support, or others. The range of possibilities is endless. So, let's look here at two different examples, one for a retailer and one for a government agency.

Shoppers with an online retailer were unhappy with the amount of time it took to receive products. The customer service team identified that 25 percent of potential orders were canceled just after shoppers learned the estimated delivery date. With 15,000 abandoned carts and an average purchase amount of $100, the service director estimated that $1.5 million (15,000 × $100) in potential sales were being abandoned annually.

The problem, she discovered, wasn't shipping time, but the time it took to customize products. She and her team worked with others in the organization to simplify and streamline customization options. This work was based on what they were hearing customers really wanted. They ended up cutting delivery time by two-thirds and, as a result, retaining 70 percent of abandons. By multiplying lost revenue by 70 percent, they found that this added over a million dollars in annual revenue ($1,500,000 × 70% = $1,050,000).

Here's another example of an operational improvement. A governmental agency learned from frontline service employees that constituents (customers) were sharing information in a different way than the system was capturing it. Constituents were also complaining about the need to repeat information. The customer service team worked with IT to redesign the screens and data fields used during interactions. This cut the average time to handle interactions by 3 percent. At an average contact cost of $9, that 3 percent amounted to 27 cents per contact—that sure didn't sound like much. But their perspective changed when they put a pencil to the overall impact. They estimated their savings by multiplying the efficiency percent, by cost per contact, by contact volume. With 620,000 annual contacts, the value of this improvement was $167,400 (3% × $9 × 620,000) per year. That saving of 27 cents exceeded $1 million in less than six years.

Product and service innovation

Product and service innovation is another valuation approach you'll want to have in your toolkit. Here, think about a range of questions: How many non-value-added customer contacts are avoided? How are customer reviews and referrals influenced by improvements? What is the financial impact of new or improved products?

One example of a product innovation is a consumer products company that discovered problems with the child-proof cap on a line of cleaning products. As customers forced the hard-to-turn cap, they would often damage the spray nozzle. Upon learning this, the customer service team worked with their packaging supplier to redesign the cap. That eliminated those interactions and prevented problems for many future customers. Assume there were 5,900 contacts prevented annually, at $7 each. That's an annual savings of $41,300 (5,900 × $7), without even considering a better product and happier customers.

In a more dramatic example, that same team later prompted the organization to launch a new line of products. Customers had been asking if they had cleaning options for use on materials that were highly valuable—the upholstery and surfaces of antique cars, and others. The customer service team saw the opportunity for a new niche product. That new line eventually contributed over $2 million annually to gross profit.

There's no one report for these benefits. You'll want to focus on specific examples of improvements, and estimates of their value. As you develop this area, you'll be taking the conversation around the value of customer experience to a whole new level.

Employee engagement

Improvements to customer experience almost always boost employee engagement (and vice versa). Three important components to consider when calculating the value of employee engagement are attendance, retention and productivity. Attendance rates can be tracked through your workforce management or payroll systems. Divide the number of hours worked by the number of hours scheduled. If you scheduled employees for 2,000 hours, and they worked 1,900 hours, then your attendance rate would be 95 percent (1,900 / 2,000).

The value of increased attendance can be calculated by multiplying the difference in attendance rates by your scheduled hours and by your average pay rate. Let's say you have a new knowledge management system that has noticeably improved both customer and employee satisfaction. So much so that your annual attendance rate has improved from 83 percent to 87 percent. Assuming 100,000 scheduled hours at an hourly rate of $20, that four-point increase has a value of $80,000 (4% × 100,000 × $20).

Let's look also at retention. Say you had five fewer employees leave this year. Multiply the number of additional positions retained by your staff replacement costs. For example, if your cost to replace an employee is $20,000, then the value of increased engagement is $100,000 (5 × $20,000).

Productivity is another consideration when you improve customer experience. Let's say engaged employees are now spending 30 hours more each year with customers. Multiply these additional hours by the number of employees and their average hourly rate. In this case, 30 hours times 100 employees at $20 is $60,000 (30 × 100 × $20).

Some go further, and put a value on the better and more creative work engaged employees produce. If you have data that demonstrates this, use it. Now, no employee is going to say, "Hey, I'm going to show up more and be more productive if you make improvements." But the research is without dispute: the more engaged employees are, the stronger their contributions will be.

Add risks and costs of inaction to your cost-benefit toolkit

Let's now explore the second category in your cost-benefit toolkit: the risks and costs of inaction. Laura Grimes, co-founder of Harrington Consulting Group, Inc., is a financial aficionado who has worked with me on a number of CX projects. She often reminds leaders: "Use the cost of inaction to spur others in your organization to action. This is particularly important when the benefits of an initiative do not increase revenue."

FIGURE 9.4 Costs of inaction

Returns on improvements	Costs of inaction
	• Customer defection • Brand damage • Recurring problems • Compliance, safety, legal • Employee dissatisfaction

This is the bad stuff. These are five potential costs that you'll incur if you don't make needed improvements.

Customer defection

While attracting customers is important, retaining them is imperative. Fred Reichheld (creator of the Net Promoter Score) finds that increasing customer retention rates by 5 percent increases profits anywhere from 25 to 95 percent. What's the cost of customer attrition?

You may know how many customers you lose; it may even be a report that is readily available. Alternatively, you may have surveys, point of sale data, a loyalty program, or subscription-based services. If no data is available from these or other sources, you can calculate customer attrition this way. First, take the number of customers you have at the end of the year. Subtract from it the number of customers you had at the beginning and new customers. Let's say your credit union ended the year with 160,000 members. You began with 150,000 members and added 20,000 new customers during the year. This shows you lost 10,000 (160,000 − 150,000 − 20,000) customers during the year.

You can then multiply the number of lost customers by customer lifetime value to see the longer-term impact. If the average CLV is $500 then the combined value lost over the lifetime of those customers is $5 million (−10,000 × $500). To get your customer attrition rate, divide the number of lost customers by the beginning number of customers. Here, it's 6.7 percent (10,000/150,000).

Not all customer defections are due to poor customer experiences. Your customers may, for example, move away from the area you serve. You will want to analyze a sample of customer feedback to identify the reasons. Get hard data if at all possible. You can then estimate the portion of defections that you have the opportunity to impact through better customer experiences.

Brand damage

Customers who speak poorly about your products, services or organization represent a considerable business risk. But how do you estimate the cost of bad reviews? After all, rarely will someone reach out and say, "Hey, I thought about buying your product, but I heard negative things and went elsewhere."

Google, Yelp, Tripadvisor and other sources can often provide these analytics on reviews. And if you enable customers to leave reviews on your own site, you can track insight yourself as well. Estimate the average number of lost customers from a bad review and multiply it by customer lifetime value. So if CLV is $2,000 and your research estimates you lose 30 customers for each bad review, then your loss from a bad review is $60,000 (30 × $2,000). Use your estimates to discuss how customer experience is important to preventing brand damage.

Recurring problems

I recently traveled to several countries in Asia, with different airlines involved. Somehow, the travel agency that helped me had my passport expiration date wrong by one digit. It resulted in hours of explanations to airlines and immigration officials. And it required lots of additional help from the agency. All from one simple mistake that would have taken 15 seconds to prevent.

Poor service or even simple product glitches cost time and money. Let's look at two examples of how you might quantify these issues. One common problem is with process or technology shortcomings. I recently observed customer service interactions with a government agency. One part of the process required a laborious effort to gather information from multiple systems and then do manual calculations—this routine added two minutes to the average time needed to support those customers. The organization handles around 30,000 interactions per month, and their cost to serve customers is $1 per minute. This routine in question was required about a third (33 percent) of the time. The formula they used is interactions per month × minutes used on the issue × frequency × cost per minute. That revealed the cost of the problem. So, 30,000 monthly contacts × 2 minutes × 33% × $1 per minute amounted to a monthly cost of $20,000 (30,000 × 2 × 33% × $1). That's an annual cost of $240,000 (20,000 × 12). The IT department had done some research and estimated the cost of automating this process (essentially removing the need for that time) would approach a quarter

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million dollars, $250,000. Too expensive, they assumed. But by looking at the costs of not fixing, they realized they would break even in about a year. Then, the savings would be ongoing.

Another common opportunity is in communication with customers. An organization that provides travel insurance was able to prevent thousands of customer questions per month—often occurring within several weeks of a claim—by better communicating that payments happen within 30 days. An investment company is preventing unnecessary inquiries by better communicating when tax documents will be ready. While these opportunities can seem obvious in hindsight, too many go unaddressed because the cost to handle and cost to fix them come out of different budgets.

Compliance, safety and legal costs

When I think of the role of customer experience in safety and legal issues, several cases come to mind. In one, a food company once distributed a product in Europe that was tainted and making people sick. The problem began at the start of a weekend, and customer inquiries to the company sat unanswered because the customer service department was closed. The problem quickly escalated through the weekend. The company later estimated that the direct legal costs, payouts, and damage to their brand could have funded weekend hours in customer service for over 100 years.

In a more positive example, a utility I'm familiar with has made robust investments that enable them to more quickly detect and address potential risks in their grid—power lines that pose fire risks and other things. They estimate that problems avoided have saved them millions of dollars over other utilities that have struggled with tragedies that were unnecessary or became far worse because they went undetected.

Effective customer service in particular is an early warning system for potential regulatory, compliance, safety and legal troubles caused by product defects, security weaknesses, inaccuracies in communication, and dangers to people or property. To calculate risks, you'll need to identify possible scenarios. Consider:

- fines
- lawsuits
- suspensions
- brand damage
- bankruptcy

A provider of baby food products worked with authorities to quickly find and catch a person making counterfeit labels; their first clue was a call from a concerned mother. Something just didn't look right. They later estimated the cost of what could have happened had they not acted quickly, a minimum of $7 million. A life is priceless. But in dollars, that was two and a half times the annual budget of their customer service operations. Talk about a great case for maintaining good customer access.

General Motors has often been cited as a negative business case—but GM is making great strides. Some years ago, the ignition switch in some small cars interfered with airbags. GM's slow response in fixing the problem led to 124 deaths; and while you can't put a value on a life, the direct costs alone exceeded $2.5 billion. Here's the rest of the story. Under new leadership, GM is today harnessing customer service for early detection. These efforts have reduced risk, caught problems early, and helped to create loyal brand advocates.

You can explore the likelihood and magnitude of these costs by looking at what has happened to other organizations and especially by working with your colleagues in finance and marketing to think through possible scenarios. Assessing risks and defining the role of customer experience in detecting and avoiding those risks will save you time, grief and money.

Employee dissatisfaction

Many organizations are unaware of the extent to which poor customer experience contributes to employee dissatisfaction. When I ask employees what gets in the way of great customer experiences, they often cite the following:

- policies
- lack of authority to complete the job
- constant unanticipated change
- conflicting goals
- technology that doesn't work well
- process or communication barriers

Dissatisfied employees over time become increasingly disengaged. Good employees will eventually leave your organization. Apathetic employees may stay but not provide results that are as good. Studies also show they are more likely to avoid work, come in late and not work as effectively.

One of the things I encourage you to calculate is the cost of attrition due to disengagement. When employees leave, ask them why. Those that are leaving because they felt they didn't have growth opportunities are often really telling you they felt limited in improving customer experiences. Multiply new hire cost by the number of employees leaving the organization per year and the disengagement percentage. Let's assume that the cost to hire and train a new employee is $25,000, you replace 100 employees each year and your exit interviews show that 35 percent left due to disengagement. Your disengagement turnover cost is $875,000 ($25,000 × 100 × 35%). That is a lot of money that could be used to keep employees engaged!

Another cost to consider is disengagement while on the clock. McLean & Company, an HR research firm, estimates that a disengaged employee costs $3,400 for every $10,000 in annual wages. Let's use that assumption here. If your employees earn $60,000 annually, then the cost of a disengaged employee is $20,400 (($60,000/$10,000) × $3,400). If you have 100 FTEs, and learn that 14 percent of them are disengaged, the total cost of disengagement exceeds $285,600 ($20,400 × 100 FTEs × 14%). This is money you are already spending. Wouldn't it be much more satisfying to get value from it?

FIGURE 9.5 Complete cost-benefit toolkit

Returns on improvements	Costs of inaction
• Customer loyalty	• Customer defection
• Brand promotion	• Brand damage
• Operational improvements	• Recurring problems
• Product and service innovation	• Compliance, safety, legal
• Employee engagement	• Employee dissatisfaction

You've now rounded out your toolkit. You now have a full complement of tools to assess both the returns on improvements and the costs of inaction.