

Profit-Driven Customer Service

Tuning and Exploiting a Necessary Function
So It Multiplies Profit

Randy MacLean



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Why Did I Write This Book?

I left home when I was seventeen, working away from home in the summer before college. From that point forward, I was responsible for every aspect of my life, and suffered the full consequences of my mistakes, and the benefits of successes of myself and others.

I worked to pay my way when I was in college, and had the very great fortune to be mentored by exceptional businessmen who hired me for those jobs, and to learn from the wisdom of my investors, and especially that of the best of my customers.

Through four decades of working in businesses, many of them my own, I learned how vital serving customers is to any kind of success.

I owe entrepreneurs and businessmen like Mel Broadhurst, Cliff Schmidt, Al Fairbrass, Del Vopni, Ed Rieger and countless others for what they taught me about serving customers.

Ten years ago, I partnered with Bruce Merrifield, a brilliant thinker with more than four decades of experience in distribution profit performance, and perhaps one of the first to discern and articulate the underlying profit dynamics that define profit performance in this sector of industry.

For the past decade, we've literally lived in, and thought of nothing else than, the cost and profit numbers in

approaching \$100 billion in product sales from wholesale distribution companies ranging from under ten million to over a billion in annual revenue.

The software system our company developed – WayPoint Analytics – has confirmed and quantified what, exactly, makes the top companies so very profitable. (I'm very proud that distributors that use WayPoint are amongst of the most profitable in the world.)

In my role as analyst and advisor to these companies, I've seen that strategic customer service is one of the primary factors in profit leadership.

Unfortunately, few companies have recognized just how customer service can be instrumental to the strategies that drive profit rates, and both short-term and long-term success.

This book collects everything I've learned from the practices of the best companies and from examining the quantified cost and profit dynamics for both successes and failures in the market.

My hope is that it will add new perspectives to your understanding of customer service, and how it affects and drives profit rates. If something somewhere in this book triggers a change that increases your company's success, I'll feel the book is a complete success.



Why This Matters

Why This Matters

Customer service – in its remedial sense – often directly correlates with issues in your operations that adversely affects profit and cash-flow. How you organize and handle customer service will increase or reduce profits and growth.

At WayPoint, we use the world's most capable costing system to see – exactly – where money is made and lost in each of our clients' businesses.

Using the system, our clients can see the profits or losses in every invoice, territory, account, product, demographic, and more. Armed with information they can't get from their other systems, our clients are among the most profitable in the world, with average profit rates ranging three to eight times industry average.

We can see precisely where companies make and lose money, producing unexpected insights into the underlying profit dynamics that really drive profits, cash-flow and growth.

Using what we can see in WayPoint, we've discovered how significantly the direct costs of customer service issues cut into profits made on sales. We also see where strategic second-level customer service returns many times its costs in new profits.

This means that the market as a whole, and companies individually have a remarkable opportunity to spur profits,

cash-flow and growth by developing strategic second-level customer service, and its related underlying dynamic – core competence.

Core Competence

The core competence of a wholesale distribution company is sourcing and moving product to customers.

This has evolved from simple buying, warehousing and sales using paper and ledgers, to sophisticated robotic systems supported by advanced computing and algorithms.

In the age of Amazon, even small companies are investing in automation and analytics to stay with – or ahead of – the market.

Your company's mastery of core competence directly affects your profits, customer satisfaction, and your reputation.

This, because failures in core competence increase the costs of customer service and of remedial activities, while increasing customer frustration and costs, ultimately affecting customer loyalty and your reputation.

To quantify the significance of the competence issue, I looked at roughly ten billion in recent revenue, and evaluated returns which would include remedial corrections for errors. We found the financial drag due to returns on \$9.7B in sales drove up expenses by 2.1% or \$204M, and reduced the net profit rate from 5.1% to 3.4%, producing a whopping 37.4% drop!

Although there are clearly other reasons for returns, errors are a significant contributor to what is a very big factor in the profit and cash-flow challenges many companies are experiencing.

This number is an average, and includes companies that have much-lower rates, so there are companies that potentially could increase net profits by 50% or more by addressing the errors and returns issue.

Takeaway: Customer service is directly impacted by core competence, and its structure and operation significantly affects company profit performance and growth.

Profit Value of Customer Groups

The number one dynamic in company profits and growth – bar none – is customer mix.

I can't stress this enough.

The typical company has a compliment of high-profit accounts – those that generate high levels of operating cash (op cash) at low expense rates. These super-profitable customers typically generate profit rates exceeding the total bottom line of the company.

The typical company will also have a similar compliment of high-volume, money-losing accounts that represent losses equal to half or three-quarters of the profit made by the high-profit accounts.

These two customer groups largely represent a profit transfer from the good to the bad. The best subsidizes the worst. This unhealthy dynamic has most of the profits you've already made bypassing your bottom line.

Companies that understand and manage this dynamic stop the transfer, diverting the profits to more productive uses – like aggressive pricing and superb customer service and, especially, to a bigger bottom line.

This is accomplished by shifting the balance between the two customer groups, using pricing and second-tier customer service as the levers to effect the change in customer mix.

Stated simply, you shift price advantage and high-level customer service toward the high-profit accounts, and away from the money-losers.

Owning and serving most or all of the high-profit customers in your market, and few or none of the money-losers, will give you top profit rates, and make the very existence of competitors financially impossible.

Having a two-tier customer service structure directly supports this critical strategy.

The intent is to provide regular problem-rectification service to any customer that needs it, and specialized extra-value service for only the handful of high-profit accounts you work with.

Second-Tier Customer Service

Designing and implementing a second-tier customer service capability exclusively for high-profit customers is your most important tool for acquiring and keeping all of the high-profit accounts in your market.

We know this from our clients' experiences, and from WayPoint analysis.

The WayPoint system has a sophisticated customer segmentation capability, grouping accounts by profit-value – the best segmentation method – so high-volume, high-efficiency, high-profit customers can be identified.

Accounts in this group typically represent 5-10% of a company's customer base, and all of the profits. All of the other accounts net out, the losers draining as much profits as the profitable ones make.

For this reason, the high-profit accounts need to be protected at all costs. Specialized second-tier customer service addresses irritants to the relationship, and provides a differentiated customer experience that builds loyalty.

Accounts in this group are the most important accounts for growth because they add revenue, operating cash, and profits faster than they add expenses. Adding new accounts with characteristics and logistical requirements similar to accounts in this group fuels rapid growth, while delaying infrastructure and personnel investments longer than with an undifferentiated new customer group. Second-tier customer service is an important tool for the sales force to attract these accounts.

Finally, it's vital to restrict your top-tier service to only high-profit accounts. This ensures that costs are both limited and matched to the accounts providing profit rates to fund them.

Otherwise, offering high-level service to all customers will quickly attract low-value small accounts that increase infrastructure costs faster than cash-flow, hurting profits and diverting service attention from high-profit accounts.

Takeaway: Two-tier customer service delivers very important profit and growth advantages, and can directly contribute to increased profit rates.

State of the Market

As of this writing, the market is in a significant state of transition. The maturing and encroachment of Amazon,

adoption of analytics, growing importance of social media, emergence of new transportation options, and explosion of foreign suppliers in nearly every sector are all changing the landscape faster than ever before.

Companies fighting to maintain the structures of even the recent past are losing relevance, while the innovators and early adopters of the newest models are taking their customers.

Every aspect of your business is being impacted by these changes, and customer service represents one of your best opportunities to meet and lead the market. The hesitance of your competition to move quickly affords you major opportunity for a lasting market advantage.

Takeaway: The market isn't very good at customer service because most companies haven't realized either the importance, nor the opportunity new customer service models afford.

Customer Service Has Been Pulled Out of Sales

You may have noticed the world is changing. Emerging economies are producing higher-quality products at lower costs. Ever-expanding transport options are bringing those products to our markets. Customers have access to information unimaginable just ten years ago.

The traditional advantages in quality, availability and information have nearly vanished, and will soon be completely gone.

Most of the traditional activities and functions of the sales team have also been replaced. Product information, order collection, and customer relations are now primarily out of the sales rep's hands.

Customers expect to look to different elements of your business for a much higher level of customer service.

This has not only changed how leading companies approach customer service, it has also affected how sales teams are structured.

Takeaway: Much of what sales used to handle has now become the specialized responsibility of the customer service group.

Being the Best

With most products becoming commodities and competition squeezing margins, differentiated customer service represents the best opportunity to stand out.

Being the company that delivers a truly different and better customer experience, and extra benefits helps the sales team win important accounts, and makes it much more difficult for competitors to poach them.

Takeaway: In an environment with relatively low standards, it takes a lot less effort and investment to exceed expectations. This represents one of the best opportunities to reap early benefits from an initiative that can be refined and improved over time.

So, Finally – Why This Matters

A well-planned and well-structured two-tier customer service capability serves all customers, while delivering differentiated service to desirable high-profit accounts.

It prevents the destructive accumulation of money-losing small accounts, by restricting access, and can serve as a motivation for customers to attain high-profit status.

It's a powerful tool for the sales team, providing a business reason to switch to your company, and is also an exit barrier for customers who may not want to lose the special service they get from you.

It can help track and drive improvements in core competence, which will affect both profit rates and market reputation.

All of this is available in a market context where advantages are rare, yet competitors are unlikely to match you before you've built and exploited a long-term lead.

Takeaway: Excelling in real and differentiated customer service represents perhaps the best opportunity for a company to increase growth, profits, and market share.

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