The Financial Impact of Bad Customer Service
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**Abstract**

Whether through bitter experience or good business sense, most companies have become well versed in the correlation between service and revenues. Happy customers spend more and are loyal. But this simplistic equation papers over a deeper problem caused by bad customer service. A problem which impacts Europe’s top 1,000 businesses’ profits by €14 billion a year and creates cash flow gap of €274 billion. Poor customer service creates unhappy customers. And the more unhappy a customer is, the more likely they are to delay or withhold payment (and in many cases, companies have no idea of the root service issue which is the source of a problem). This, in turn, inflates write-offs and bad debt, and impacts cash flow and working capital – ultimately destroying profits and shareholder value. Yet, much of this profit wastage is avoidable – if only the financial impact of disjointed customer service and poor collection practices could be measured and addressed in a holistic, cross-functional way.

Bad customer service is a headline grabbing issue. From personal financial data being sold by unscrupulous call centre agents to fines handed out by industry regulators, hardly a week goes by without another media exposé. A single high profile incident can cause irreparable damage to a brand’s reputation and trigger a collapse in revenues and share price.
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But this simplistic equation papers over a deeper problem caused by bad customer service. A problem which impacts Europe’s top 1,000 businesses’ profits by €14 billion a year and creates cash flow gap of €274 billion.

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Yet, much of this profit ‘wastage’ is avoidable – if only the financial impact of disjointed customer service and poor collection practices could be measured and addressed in a holistic, cross-functional way.

Customer service operations within large businesses are targeted with increasing customer revenues through cross- and up-selling, and enhancing loyalty by delivering a premium customer experience. These operations are typically measured on the quality of their service delivery using metrics such as average call waiting times, query handling and resolution, sales conversion rates, etc.

A well performing customer service operation is judged by its ability to meet or exceed service level targets. These metrics, however, skew a company’s understanding of its customer relationships.

There are many valuable methods to measure the overall financial value embedded within a customer relationship, with most focussing on predicted repeat business and profitability of orders.

The financial value of a single customer relationship also needs to be expressed as a function of its cash flows, administrative cost and service levels delivered. A company’s focus on revenues and loyalty, whilst of fundamental importance, belies the symbiotic relationship of service with the organisation’s ability to collect payments, improve cash flow and streamline the cost of administration and support. Having high revenue and high profit levels per order won’t deliver sustainable value if your customers cost the earth to support and/or are unhappy and withhold payment, or even defect to the competition.

The financial impact of poor customer service is therefore somewhat like an iceberg. Most organisations focus on the ‘visible’ impact of customer service – namely customer revenues and predicted repeat business. Yet, it is the ‘hidden’ nine tenths that has created a hole below the water line and is causing profits to sink and customer
retention to suffer.

A good illustration of the problem can be found in the Water Management report issued by the House of Lords Science and Technology Select Committee (Sub-Committee I) on 6 June 2006. Research undertaken on behalf of the Committee, chaired by Lord Selborne, revealed that 15% of UK householders do not pay their water bills:

“We discussed this issue with Margaret Devlin, Managing Director of South East Water. She noted that her company’s turnover was £100 million and that it had closed the year with £15 million outstanding as debt – a full 15% of turnover.”

Of the 15% of non-payers, the report suggested that one-third do not pay because of financial difficulties related to household income (for instance, pensioners, those on income support and other vulnerable groups). The remaining two-thirds, however, can afford to pay (according to their credit rating). Of the 10% that can afford to pay but do not, it is reasonable to assume a small proportion purposefully choose not to (and they know they legally cannot be cut off) or are ‘conscious objectors’, believing that water supply is a basic right.

Of the significant remainder, non-payment can only be due to poor payment collection practices, customer disputes and ‘unknown’ customer service issues that are preventing payment. The financial impact of this is massive:

“The 2004-5 figures show that the total amount of outstanding household revenue [related to domestic water supply and sewerage], including revenue written off, was £962 million – an increase of £38 million on 2003-04. This is an astonishing amount of debt which can only place pressure on companies’ finances and hence water bills. Moreover, pursuing non-payers and taking them to court adds further expense.”

And herein lies the crux of the problem. Customer service operates in a functional silo and has no way of seamlessly and effectively collaborating with other internal stakeholders in the customer relationship – most critically, the credit management team. Cross-functional sharing of information about customer-related activities, if it happens at all, is often nothing more than an exchange of bits of paper and spreadsheets – and issues simply fall through the cracks.

This means companies are unable to coordinate customer interactions to deliver an experience of optimal value to both parties. For example, how can one part of the organisation ask for payment of invoices if another part is resolving an administrative error that prevents payment?

Indeed, our own analysis of financial data from Europe’s top 1,000
publicly-quoted companies revealed they collectively have more than €274 billion of overdue debt outstanding due to disjointed customer service and poor collection practices.

Customer disputes due to poor service (involving problems related to products, pricing, invoicing, delivery or documentation) result in €103.3 billion in unpaid invoices. €82.6 billion of accounts receivable goes uncollected because of customer queries and service issues that have not yet been identified by suppliers because of poor account administration (such not properly recording change of address, amendments to service delivery requirements, etc). Failure to tackle this hidden problem results in €37.6 million lost profits every day, equating to a staggering €14 billion a year.

Our analysis also revealed that UK businesses have one of the worst performance records amongst Europe’s major economies, with an average wastage of 28% of accounts receivable (for instance, unpaid overdue invoices). Of the top eight economies, only German (32%) and Dutch (37%) companies have worse figures than the UK, and the best performers are French and Spanish firms (both averaging 18%). The most efficient country in Europe at cash collection and customer service is Austria (10%), and the worst is Norway (40%).

![Figure 1 – Accounts receivable wastage](image-url)
Collectively, the 245 UK companies in the top European 1,000 analysed were found to be leaking €59.5 billion per year in uncollected cash, of which:

1. €17.7 billion was due to customers withholding payments due to disputes;
2. €14.2 billion due to unresolved customer queries; and
3. €27.6 billion due to poor collection practices.

As a consequence, these businesses lost a combined profit opportunity of €2.6 billion.

The problem stems from the fact that constituent customer relationship stakeholders are spread across the organisation in various business units or functions (in particular, sales, customer service and finance), and use disparate systems. Each stakeholder manages an element of the customer relationship, but normally only from the perspective of the functional silo they are in (Accounts Receivable manages cash collection, sales closes transactions, etc, etc). And because of this incongruity, no single stakeholder group (including the board-level management team) can gain a complete joined-up picture of all customer activities.

From our experience of customer engagements, we typically find that CFOs have a reasonably good understanding of the size and scope of accounts receivable ‘wastage’ due to disjointed customer service and collection practices, but they do not have the tools or systems in place to resolve the underlying causes:

“… South East Water had undertaken analysis of its customers and found that around two-thirds of those who owed the company money had a credit rating of over 400 – in a range of 0 to 650 – which meant that they could afford to pay. Their non-payment added £10 to every other customer’s bill.”

The bottom line of all of this is that businesses cannot maximise asset productivity (for instance, the value of customer relationships) over the customer lifecycle. At best, potential process synergies and internal collaborative opportunities to enhance customer value slip by. At worst, companies risk damaging relationships resulting in unfulfilled revenue opportunities and higher churn. Companies have ended up putting the cart before the horse – business-driven customer relationships rather than customer-driven business.

As the cost of customer acquisition intensifies through greater competition, the need to maximise the value of existing customer relationships is becoming an absolute business imperative. This has driven the development of the concept of Customer Value, enabling CFOs to understand and act on what has historically been a management intangible.
Customer value can best be described as an asset based on the quality of the customer relationship, as experienced from both sides of the coin. Expressed in financial terms, it is a function of cash flow, profitability and customer service status.

By implementing effective Customer Value Management, businesses can create a virtuous cycle where the company invests in its customers and its customers invest in it. By doing so, a company will be able to maximise the value of its ‘customer assets’ and customers benefit from a positive, responsive organisation that is focused around them and their needs.

Addressing the three core denominators of customer value (cash (cash flow and payments), cost (administration and support) and service (sales & retention) in a fully integrated way, Customer Value Management enables businesses to optimise customer revenues, profitability and relationships through:

- Optimising cash flow to support value generation across the enterprise.
- Reducing the impact of bad debt and write-offs through enhanced credit risk management.
- Minimising the cost (and complexity) of managing and supporting customer relationships (including reducing interest cost charges).
- Reducing churn and minimising the cost of having to acquire replacement customers.
- Enhancing cross- and up-sell opportunities.
- Extending customer relationships to sustain revenue contribution.

Customer Value Management requires:

- Process & workflow automation.
- Resource optimisation.
- Management of activity cost of invoice-to-cash process.
- Enhanced collaboration and information sharing.
- Improved insight into customer profitability.
- Implementation of best practices.
Many organisations have attempted to build in-house solutions or re-purpose legacy systems to tackle elements of Customer Value Management (CVM), but with only partial success. The heterogeneous nature of systems used in most large organisations simply means that it is impossible to link processes, share common data sets, integrate workflows and processes, etc, across different functional silos. Customer Relationship Management (CRM) systems were never designed for ‘global’ asset management, and Phil from finance’s spreadsheet is hardly the most flexible or robust tool. Even with Enterprise Resource Planning (ERP) implementations, companies often end up running several different versions, making it an almost Herculean task build a robust solution in-house.

The demand for purpose-built solutions has driven the emergence of a new class of business process software over the last couple of years, and early implementations of Customer Value Management solutions by blue-chip multinationals have already generated hundreds of £millions of bottom-line value.

These solutions bridge the worlds of accounts receivable, customer service, and sales and marketing, enabling joined-up ‘asset management’ of customer relationships. They introduce a collaborative platform – including shared language, policies, processes, metrics & software tools – for the management and cultivation of sustainable customer relationships that grow in value over time.

Using Customer Value Management solutions, businesses can generate significant reductions in overdue and outstanding debt through more effective cash collection; cost savings through greater administration and process efficiency; and improved service levels and customer retention through enhanced communication and faster resolution of customer issues and transactions.

Designed to be implemented in a phased approach, Customer Value Management solutions enabling businesses to deliver strategic wins at each stage of the deployment – typically starting with working capital and automating accounts receivable processes including credit, collections and customer query/dispute management.

Customer Value Management enables businesses to gain an understanding of how to invest in customer relationships in order to deliver maximum impact on the bottom-line. They amplify the contribution of existing operations and infrastructure, and, because they occupy a new space in the enterprise/business software ecosystem, any organisation can derive significant benefits (as it’s effectively a Greenfield opportunity).

So what was a management intangible, is now an asset that can be measured, managed and maximised. For the first time, businesses can understand the symbiotic relationship they have with their...
customers. And, perhaps more importantly, they can gain a true understanding of the financial impact of poor customer service and attack the underlying causes from all areas of the business.

Reference

1 The research was undertaken by The Customer Value Group in May 2006 and was based on financial data from I dexec, Thomson Financials, other publicly available sources and data collected during client engagements. A detailed breakdown of the results, data sets and methodology is available on request by contacting The Customer Value Group at www.customervaluegroup.com.