Delving into the Mystery of Customer Satisfaction: A Toyota for the Retail Market?

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It started out as an academic puzzle of sorts. The researchers already knew that in the airline industry, customers and employees revere Southwest Airlines. With computers, Dell stands out as superior in customer satisfaction. And Toyota remains the company to emulate in the automobile industry. But when it comes to the retail industry, what company sets the standards for customer and employee satisfaction?

"In pretty much any other industry segment, you can say, 'Here is a company that is the best at something,'" says Serguei Netessine, Wharton professor of operations and information management. "But in retailing, there is no clear company to follow. There is no Toyota in retailing."

Netessine, Marshall Fisher, Jayanth Krishnan and Daniel Corsten have begun two closely related projects to find out what drives success in the disparate world of retailing as measured by profitability and long-term growth. Fisher is co-director of Wharton's Fishman-Davidson Center for Service and Operations Management. Krishnan is a Wharton doctoral student and Corsten is vice director, Kuehne-Institute for Logistics, at the University of St. Gallen in Switzerland.

Their preliminary conclusions as to what drives success reflect a maxim long held in the service industry but only recently thought to pertain to the retail sector -- namely, customer satisfaction. While this finding alone is not a surprise, some unexpected results surfaced when the four operations experts decided to try and pinpoint exactly what promotes customer satisfaction and helps shoppers differentiate one retailer from another, a process that they feel has until now received little academic review. Among their conclusions:

· Customer satisfaction is partially driven by inventory availability, when shoppers actually find what they are looking for on the store shelf. "It seems trivial, but product availability -- in-stock and out-of-stock and on the shelf conditions -- is a much more complicated issue than previously thought," says Netessine. "Customer perception of out-of-stocks can differ greatly from retailers' own estimates."

· When it comes to solving the problem of inventory stock outs, less can be more. In other words, the conventional wisdom that more inventory leads to less stock outs does not hold true. Rather, inventory appears to reach a critical mass; when there is too much inventory and too large a "back room," stock outs actually begin to escalate because employees literally can't find products or often misplace the products they need to restock the shelves. Interestingly enough, the longer a store manager has been with the store, the lower the out-of-stocks.

· Satisfied customers reflect satisfied retail employees who are knowledgeable about the store and its contents, and able to pass along their insights and information to shoppers. As simple as this may sound, the Wharton experts noted that it is a difficult task to find, keep and motivate knowledgeable employees in retail positions that typically pay only minimum wages. One way to deal with this problem is to

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develop fool-proof policies that are easy to implement and explain.

· Satisfied customers not only enhance retail customer retention and drive up purchases but also attract new customers through word of mouth. Together, retention and expansion drive the financial performance of the retailer. Consequently, measuring customer satisfaction through regular surveys is as important in retailing as in many service industries.

"It seems like there is a threshold of performance that is acceptable," says Fisher, referring in part to some previous Wharton studies on a computer manufacturer that linked customer satisfaction scores to subsequent product recommendations. "As long as you are above that, it doesn't really matter if you are very good or excellent. In either case, your customers are satisfied and that's enough."

For each retailing segment, finding that optimal level of performance is often difficult, Fisher acknowledges. "Basically, how do you know what the threshold is? You need to correlate customer satisfaction numbers with the business result you are interested in, and with customer retention. For example, research on retention rates for customers of a major telecommunications firm found that they flattened out at 75% -- even as customer satisfaction continued to increase. So you should think of customer satisfaction as a threshold."

Employees: Both Revenue and Cost Centers

In order to examine what drives customer satisfaction, the four experts have adopted two different but complementary approaches. Fisher, Netessine and Krishnan are in the process of recruiting major retailers for a research project designed to find out what store operating policies drive outstanding store execution, customer experience and financial performance.

Research on store operating policies will focus on payroll, square footage, size of back room, assortment breadth, management tenure, employee retention and training. Store execution concerns include in stock, out of stock and inventory record accuracy ("You can't improve what you can't measure," says Fisher), along with customer-friendly layouts, integration of add-on services and accuracy of signage and price. Questions about the customer experience will examine the benefits of a helpful, friendly staff, a well organized store and a hassle-free check out, but will primarily focus on one simple question: Do customers find what they are looking for?

"There is an anonymous quote -- Retail is Detail,'" says Krishnan, who recently spent several days working in a major convenience chain store to gather information about customer satisfaction. "Which details contribute most to revenues, and which contribute more to cost? At (the convenience chain), profit depended more upon the minimum wage employee doing things correctly in the store. The employee is the revenue center and the cost center. Anecdotally, we have evidence that shrink (store theft) is most often caused by employees, not customers. And employee morale does affect shrink at a store."

In a separate but parallel study, Corsten is working with retailers to focus on out-of-stock (OOS) issues and how they influence shoppers' experiences. "Intuitively, you would argue that this has an impact on customer satisfaction," says Corsten. "But we also have hard evidence across more than a dozen categories that almost half of customers respond to out of stocks by substituting with another brand or size, and a third of customers respond by walking out of the stores."

Quoting earlier studies, Corsten notes that the average out of stock for retail stores is 8.3%, a significant number. In his 2002 report to the Grocery Manufacturers of America, Corsten suggested that "retailers can boost earnings per share up to 5% by addressing their out of stock issues."

The causes for the stock outs turned out not to be supply chain management errors, purchasing or external distribution factors, says Corsten. The majority of out of stock causes could be found right in the store -- through wrong forecasting, lost or misplaced inventory, poor shelving or storage systems, and inadequate

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or erroneous stock measurement.

"When we looked into the reasons why out of stock was such an issue, we learned that 72% of the root causes could be found in the store," he notes. "So it doesn't take long to figure out that the best place to start to correct the problem should be within the store. While it's important to focus on all sorts of other things -- managing distribution systems, expanding internationally, going into Internet retailing -- it just seems that some of the retailers haven't done their best in their own back yard or, rather, front yard, first. It's amazing how long retailing has been around and you think about how poor the performance is. You wonder why someone hasn't tackled this before. That's why we are currently recruiting retailers for a follow-up study on how out of stocks can be lowered sustainably."

"Shooting the Holes"

Through his group's research, Fisher notes some interesting findings about how companies audit their inventory for stock outs. One major consumer electronics retailer, for instance, actually hired an outside company to "shoot the holes" -- retail jargon for walking the aisles at the end of the day, looking for stock outs and scanning the bar tags on any item that was out of stock. The finding was quite a surprise. "Nearly 30% of the time, the computer said there was a positive inventory but somehow the store couldn't find that inventory," says Fisher. "There was a clear store execution problem."

And how do the out of stocks affect customers? When he reviewed a worldwide study of more than 71,000 consumers in 20 countries, Corsten found five major responses: Customers buy the item at another store (store switch); delay purchase (buy later at the same store); substitute a different size or type but buy the same brand; substitute a different brand; or do not purchase the item (lost sale). And while consumers will tolerate some degree of stock outs, their toleration level depends on just how immediately they need to use the product, and how attached the consumer is to a particular brand.

As Corsten writes: "When the opportunity cost of not being able to immediately consume the product is high (for example, when one runs out of diapers) the consumer will either substitute or find the item at another store. Alternatively, a low-opportunity cost will lead to either purchase delay or cancellation. When the substitution cost of using a less preferred brand is high (for example in the case of feminine hygiene and laundry), the consumer will take any action except to substitute another brand. When the transaction cost is high, i.e., involving time and effort to purchase later or elsewhere, the consumer will either substitute or cancel purchase. This perspective shows that consumers switch more in some categories than others."

Interestingly enough, consumer satisfaction as it relates to stock outs is apparently geographically driven. Corsten discovered that European consumers are "almost 50% more likely to switch to a competing brand when faced with an out of stock on the desired item" but are "least likely to switch stores" due to out of stock items. Alternatively, U.S. consumers are "more likely to substitute a different package size or variation within their preferred brand." But if stock outs of preferred brands occur two or three times in a row, U.S. shoppers are more inclined than Europeans to switch stores.

The challenge of figuring out what drives customer satisfaction, Netessine believes, stems from the need to combine two processes at the same time. "In the service industry, you have to take care of customers," he says. "In manufacturing, your main focus is streamlining the manufacturing process. In retailing, you have a flow of customers you have to take care of, at this moment, while making sure that you have a flow of products at the right place, right time, in the right quantities, with the right employees to enable customer and product flow. In retailing, the two processes meet at the same time, and this seems to be one of the things that makes retailing particularly hard to figure out."

The ongoing studies, these experts predict, will look at all aspects of retailing, and ultimately identify best practices from various retail segments. "That could be the goal of this research," said

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Fisher, "to help create a Toyota for the retail market."

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