



# The Cost of Poor Quality or Service Delivery

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By Mac McIntire

**M**ost companies can quantify exactly how much money they spend to acquire new customers. Yet very few companies have any inkling of how much it costs when they *lose* a customer.

Although many companies complain about their labor costs, one of the biggest expenses your business may have is the revenue you lose when customers defect. Consequently, one of the best investments you can make is training your employees to reduce customer defections.

The following formula will help you calculate how much money your company loses when dissatisfied customers walk out the door because of bad products or poor customer service.

## The Cost of Lost Customers

To calculate the cost of lost customers, first, start with the **base numbers** of your company's (or department's) annual revenue, the total number of customers you typically serve in a year, and your yearly marketing expenses.

For example, let's assume XYZ Services Company has annual revenue of \$20 million, a total of 50,000 customers, and a yearly marketing budget of \$1.5 million.

The first step in determining the cost of poor service is to estimate the **number of customers dissatisfied with your products or services**. Usually between two and 15 percent of your customers will be dissatisfied with your company, depending on the quality of your

products and services. Sadly, some companies have a tendency to irritate much more than 15% of their customer base. Hopefully your company is not like that.

If only 5% of XYZ's customers are dissatisfied, this means 2,500 people are not happy with the company's services in a given year. But how many of the 2,500 will never do business again with XYZ?

Research shows between 80 to 90 percent of dissatisfied customers never return. If XYZ loses 80% of its dissatisfied customers, the **number of lost customers** would be 2,000 people.

By dividing the annual revenue by the number of yearly customers, we see that XYZ Company has an average revenue per customer of \$400. Consequently, the **lost revenue from poor service** is the equivalent of 2,000 people times the average revenue per customer. XYZ Company is losing \$800,000 in potential revenue each year because of the poor quality of its products and services.

However it gets worse. Dissatisfied customers have a tendency to tell others about their horrible experience with your company. Surveys show vocal dissatisfied customers tell between four and 20 other people about their dissatisfaction.

If each of the 2,000 disaffected customers of XYZ Company tell only *four* other people, XYZ will lose \$3.2 million in potential revenue (2000 x 4 x \$400). This represents 16% of their annual revenue.

But this is not all! XYZ Services Company spent \$1.5 million in marketing expenses during the year. By dividing the marketing costs by the total number of customers, we see XYZ spends \$30 in marketing costs per customer. The **lost marketing dollars** due to poor quality or bad service represents \$60,000 in wasted marketing expenses.

Now we know exactly how much poor service costs at XYZ Company. Here's how the numbers add up:

- \$800,000 lost potential revenue from lost customers
- \$3.2 million lost potential revenue from potential customers that won't be using XYZ's services because of what they've heard about the company.
- \$60,000 marketing expenses wasted when current customers left XYZ because of poor quality or service.

That's over \$4 million that could have gone to the bottom-line.

## Invest in Training

Business leaders must realize that not providing training to their employees could cost them far more than the training dollars required to engage their employees as business partners. Only a fool would allow \$4 million to walk out the door of their business. §

*Innovative Management Group* provides a variety of two-, four- and eight-hour customer service training programs for managers and employees. We show people how to increase revenue and reduce costs by providing consistent product and service delivery at every level of your company each and every day. Please call us to discuss how we can help you focus your employees on the things that matter most.

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