Complaint management profitability: what do complaint managers know?

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Abstract
Despite the great impact of complaint handling on customer retention and the beneficial usage of complaint information for quality improvements, most companies have great difficulty calculating the profitability of their complaint management. As a consequence of this knowledge deficit, complaint management is often not regarded as a profit centre but as a cost centre, which makes it a probable victim for cost reductions by cutting back its activities. Hence, there is a huge challenge to develop methods and to address this issue. This work contributes to this. It is shown how complaint management profitability (CMP) can be conceptualized and several types of benefits and costs are presented. On this basis several propositions about the current practice of CMP calculation are developed. To test these propositions a comprehensive empirical study was conducted among complaint managers of major German companies in the business-to-consumer market. The collected information shows that the assumed CMP knowledge deficit is even higher than expected. To reduce this deficit this article provides an approach to calculate CMP on basis of the repurchase benefit.

Introduction
Customer care managers and complaint managers face a strategic dilemma. On the one hand, there is an increasing understanding that complaint management is of strategic relevance, particularly because it has proved itself as an effective customer retention instrument (Brown et al., 1996; Smith and Bolton, 1998; Smith et al., 1999; de Ruyter and Wetzel, 2000; Levesque and McDougall, 2000; McCollough et al., 2000; Maxham, 2001; Johnston and Mehr, 2002; Stauss and Seidel, 2004). On the other hand, the actual importance of complaint management within companies does not reflect this strategic relevance. On the contrary, most of the times customer care and complaint management departments are considered as operative units that only have to handle the customer dialogue but who are not involved in strategic planning processes. Besides, they are mainly seen as a cost factor and not as a potential source of profit. This perspective leads – especially in tough economic times – to a continuous pressure to reduce costs by cutting back its activities. Complaint managers can only escape this strategic dilemma by proving the contribution of complaint management to the company’s value creation. Thus, they are confronted with the task of proving the profitability of their domain.

This is a huge challenge in practice, but also an immense challenge for academic research. The latter has mostly ignored this issue and an integrated approach to complaint management profitability is still missing. Johnston (2001) belongs to the very few authors who considered this problem. In his pioneer work he proves a correlation between the financial performance of a company and complaint management. This is an important indication of the economic benefit of complaint management, but up to now many questions remain unanswered:

- On the conceptual basis it is not clear what the costs of complaint management are.
- It has to be settled what actual benefits result from professional complaint management activities.
- In addition to that, the question has to be answered how these benefits can be operationalized and measured on a monetary basis.
- There is no empirical evidence how complaint managers proceed here in practice. It is totally unknown whether they calculate the profitability of their complaint management at all, which calculation scheme they apply and whether they assess their complaint management as profitable or not.
The aim of this work is to give answers to these questions. For this reason a conceptual approach to complaint management profitability (CMP) is defined. It examines which types of costs and benefits are related with complaint management. Afterwards the current practice of cost/benefit calculation is discussed. First, propositions concerning the measurement of CMP are developed. Then the results of a comprehensive empirical study among complaint managers of the biggest German business-to-consumer companies are presented with respect to these propositions. The results show considerable knowledge deficits, not only regarding CMP, but also concerning the methodical approaches for its calculation. The next part will then introduce a method to calculate CMP. Here the repurchase benefit will serve as an example to show how to calculate the monetary value of saved customer relationships. At the end of the paper a summary presents managerial implications and open research questions.

Defining complaint management profitability

Complaint management profitability (CMP) represents the economic efficiency of the processes and instruments of complaint management systems. CMP is calculated by relating the invested capital to the profit of complaint management. The profit of complaint management is calculated by deducting its costs from its benefits. The invested capital equals the costs of complaint management activities within a period.

However, in order to calculate CMP sufficient data are necessary. Furthermore, it has to be discussed which costs and benefits to include in this calculation, how to measure the costs, and how to express the benefits monetarily.

Regarding the costs of complaint management, various types can be identified in the context of complaint management. These are described in the following (Stauss and Seidel, 2004):

1. **Personnel costs** arise from human resources that are directly concerned with complaint management processes (e.g. staff of a complaint management department).
2. **Administration costs** are generated by expenditures for, e.g. office space and office equipment.
3. **Communication costs** are all costs that are associated with necessary communication processes to solve the customer’s problem (e.g. phone costs or postage).
4. **Response costs** are all costs that arise in the context of the problem solution. Here three types of response costs can be differentiated:
   - compensation costs emerge from volunteer amends for the customer who experienced a problem (e.g. costs for gifts or vouchers);
   - warranty costs cover all expenditures for performances due to contractual claims (e.g. activated guarantees); and
   - costs for gestures of goodwill emerge from volunteer performances which are not covered by guarantees.

Regarding the benefits of complaint management, four distinct types can be identified on the basis of literature analyses and expert interviews (Stauss and Seidel, 2004):

1. The **information benefit** represents the value that is generated by using information from customer complaints to improve products, to enhance efficiency and to reduce failure costs.
2. The **attitude benefit** comprehends the positive attitude changes of the customer due to achieved complaint satisfaction.
3. The **repurchase benefit** arises when a complaining customer remains with a company instead of switching to a competitor.
4. **Communication benefits** describe the oral effect of complaint management. They are generated when complaints are solved and satisfied customers are engaging in positive word-of-mouth, that is, recommending the company and by that supporting the acquisition of new customers.

To calculate CMP it is necessary to operationalize the four types of benefits and to value them monetarily. The sum of the benefits less the measured costs equals the profit of complaint management. To calculate the return on complaint management (RoCM), see Figure 1), which is the key indicator for complaint management profitability; the profit of complaint management is set against the complaint management investments (costs).

The development of this RoCM concept is based on conceptual considerations without integrating knowledge on the current calculation practice of complaint managers. To identify the current practice of CMP calculation and the role of the various cost and benefit types, an empirical study was conducted.

Figure 1: Calculating the return on complaint management

<table>
<thead>
<tr>
<th>Return on complaint management = Complaint management profit</th>
<th>Investments in complaint management</th>
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Knowledge of complaint management profitability in companies

With regard to the actual CMP calculation practice in companies there is a huge knowledge deficit. It is totally unknown:

- whether complaint managers calculate the profitability of their complaint management at all;
- which calculation scheme complaint managers apply;
- whether complaint managers have all information necessary for the calculation at hand; and
- whether complaint managers assess their complaint management as profitable or not.

In order to receive answers to these questions a comprehensive empirical study was conducted among complaint managers of the largest German companies in business-to-consumer markets. Based on literature analyses and explorative interviews, a number of propositions with respect to CMP calculation were developed.

A comprehensive cost calculation by capturing all types of costs demands two prerequisites. On the one hand, all complaint-handling processes have to be defined clearly. On the other hand, detailed activity-based-costing must be implemented for a systematic association of cost rates with handling processes.

Many companies do not fulfil these conditions. Not all complaint reception and handling processes are defined in detail and monitored continuously by a complaint management system. Especially, processing of and reaction to rarely occurring problems, which need the assistance of other internal departments or which demand complex internal investigations, are often defined incompletely. In addition to that, activity-based-costing is not yet implemented in all companies consequently. Hence, one can expect that not all types of costs are recorded on a regular basis. This leads to proposition 1:

**P1.** The majority of companies only calculate a single part of the actual costs and therefore have only very limited knowledge about the real costs of complaint management.

The purpose of internal cost calculation is not only to measure the return on complaint management, but also to serve internal cost control. So, it can be highly important to reduce the occurrence of certain problems by charging the responsible department with the costs of complaint handling. However, despite these rational considerations it can not be expected that this is always implemented in practice. One the one hand, it can be assumed that necessary data are not available (see P1). One the other hand, the cause of a problem is often difficult and ambiguous to assign to the responsibility of a certain department. Hence, proposition 2 reads:

**P2.** Most of the times costs are not allocated within the company according to the responsible unit.

In spite of the deficit of cost transparency in complaint management which is assumed here, much indicates that this knowledge is still much better for the costs than for the benefits of complaint management. The conventional system of cost calculation in companies does not provide corresponding data for benefit calculation. Of course further developments, e.g. the balanced scorecard, contain some satisfaction and complaint management related figures but there is no attempt to value them monetarily. One major reason for this is that there are no clear conceptions on various benefit types or methods for their monetary valuation, neither in complaint management, nor in controlling. This leads to proposition 3:

**P3.** The majority of complaint managers do not calculate complaint management benefits.

When companies deal with the challenge of measuring the benefits of complaint management, it can not be expected that all types of benefits are considered equally. The essential objectives of complaint management are to prevent dissatisfied customers from exiting the relationship and to use the information that is contained in customer complaints within the company. If complaint managers want to control whether these objectives are met, they have to estimate the repurchase and information benefit of complaint management. Compared with attitude and communication benefit, the information basis is much better here and methodical difficulties are less hindering. Furthermore, it can be expected that at least some companies have information on the retention effects of their complaint management activities from customer surveys or customer data analysis. Equally, figures based on experience of the usage of complaint information for innovation and failure reduction can be expected. These considerations result in proposition 4:

**P4.** If benefit calculation is done, rather repurchase and information benefits are calculated than attitude and communication benefits.

If the above-developed propositions hold true it is hardly possible for complaint managers to give an accurate predication of CMP. Nevertheless, they mostly know by long experience the external and internal effects of complaint management. For that reason it can be assumed that complaint
managers are able to estimate roughly the economic performance of their complaint management. This is summarized in proposition 5: P5. Most complaint managers do not know the profitability of their complaint management exactly, but are able to give a rough profitability estimation.

The empirical study and its results

The above-presented propositions were tested by a comprehensive empirical study on the state-of-the-art of complaint management in Germany. The study was carried out among complaint managers of major German companies in the business-to-consumer market across various industries. A written questionnaire was developed, submitted to a pre-test and modified after the analysis. Altogether, 430 companies were contacted in a multi-stage process. A questionnaire was sent to 260 complaint managers; 149 completed questionnaires were returned, which equals a response rate of 34.6 per cent with respect to the original sample.

The collected information of the empirical study now allows the drawing of a comprehensive picture of complaint management practice and profitability. With regard to the above-presented propositions the results are discussed in the following.

On the cost side of complaint management it can be shown that a comprehensive cost calculation is not a rule but more an exception. Furthermore, various cost types are included differently in the cost calculation efforts of complaint managers. However, only a minority of 17.5 per cent of all companies are not calculating any costs of complaint management at all. Most frequently, costs for gestures of goodwill (46.2 per cent), direct personnel costs (44.1 per cent), warranty costs (44 per cent), and costs for small gifts (41.8 per cent) are measured. However, only 35.4 per cent are calculating administration costs and only 18.9 per cent are calculating the cost of communication. A very small minority of 6.3 per cent are calculating the personnel costs for human resources of other departments of the company who are involved in the complaint resolution process (see Figure 2).

Due to this knowledge deficit more than 70 per cent of all companies that participated in this study do not know the complete costs of their complaint management. Hence, they are not able to quantify the costs per complaint. Because of this there is an impressive confirmation of P1.

Concerning the internal settlement of complaint costs, clear results can be seen, too (see Figure 3). The majority of companies (59.7 per cent) do not settle costs of complaint management internally due to responsible departments. The minority of companies which pass on costs to responsible units within their organizations proceed differently with regard to the different types of costs. To a considerable extent only costs for gestures of goodwill (36.8 per cent), warranty costs (28.5 per cent), and costs for small gifts (20.1 per cent) are passed on (see Figure 3). This supports strongly P2.

Hence, a first result of the study is that in most cases cost calculation of complaint management activities is neglected. An assessment of the current practice of the measurement of complaint management benefits uncovers significant deficits, too. A narrow majority of 55.7 per cent state they calculate at least one type of complaint management benefit. Accordingly, P3 does not hold true (Figure 4). However, comprehensive benefit calculation (measurement of at least three benefit types) is only done by little more than 12 per cent. Hence, the majority of companies have no detailed picture of the benefits of their complaint management. To understand what exactly complaint managers know about the benefits of their work, more insight into the benefit calculation is needed.

Figure 5 provides more details into the current benefit calculation.

The four types of benefits are included differently by those companies that carry out a benefit calculation. Little more than half of all respondents (51.7 per cent) state that they calculate the information benefit of complaint management. The second most calculated benefit is the repurchase benefit. However, it is calculated by less than 20 per cent. Attitude and communication benefits are calculated by even fewer respondents. Hence, P4 holds true, especially for the information benefit. The amount of companies that calculate the repurchase benefit only differs a little from those who calculate attitude and communication benefits.

As a consequence of the above shown knowledge deficits, most companies do not measure CMP (see Figure 6). Almost 70 per cent state that they do not carry out any calculation. Little more than 21 per cent state that they pursue sporadic CMP calculations. A systematic cost-benefit-analysis and calculation of CMP needs a permanent recording of all relevant figures and its continuous monitoring. Only a minority of companies are able to do so: 9.5 per cent of all respondents measure CMP on a continuous basis.
For that reason the knowledge deficit which is part of P5 was in fact confirmed.

Despite this knowledge gap, which makes it impossible for complaint managers to really prove their contribution to the overall business profitability, many have – as also assumed in P5 – a rough estimation whether their complaint management is profitable or not. A majority (89 per cent) of them are able to judge the level of their CMP on a scale from 1 (low CMP) to 5 (high CMP). The total average of 3.55 demonstrates that complaint managers are convinced of the
profitability of their activities. Interestingly, the estimated CMP level differs whether complaint managers actually calculate CMP or not. Those companies that in fact measure CMP on a regular basis state a higher profitability (4.28) than those who do not calculate CMP (3.43) or calculate it sporadically (3.55). This shows that companies that calculate CMP systematically, predominantly have a more positive result, which supports the evidence that complaint management actually contributes to the overall profit of a company (see Figure 7).

One of the most considerable results of this study is that only a minority of companies actually try to measure CMP and – with exception of the information benefit – do not calculate the benefits of complaint management. The latter is also true for the repurchase benefit, which is of most important relevance for complaint management in the context of customer retention management.

Our empirical study provides clear hints to the reasons of this neglect: 78 per cent of all respondents consider the measurement as difficult and therefore do not calculate the repurchase benefit. Hence, a need for practicable methods to calculate it is given. For that reason a basic approach to repurchase benefit calculation is presented. Furthermore this serves as an example of how to calculate the return on complaint management as key indicator of CMP.

**An approach to calculating the return on complaint management**

A calculation of the return on complaint management that seeks the highest possible extent demands data on all relevant costs and benefits. In regard to the costs, the following example is based on the condition that information about relevant cost types can in fact be gained.

First attempts to calculate the benefits have recently been made by Stauss and Seidel (2004). Regarding the information benefit, one must make out the cases in which a monetary benefit basically is possible. If the benefit can be calculated monetarily, either the cost comparison or the sales comparison method is applied. The cost comparison method compares the costs of the previous process and the processes that have been altered on the basis of complaint information. The information benefit corresponds with the cost savings resulting from the process changes. The sales comparison method compares the sales of previous products/services and the sales of changed products/services. The information benefit corresponds with the sales increase resulting from the use of complaint information. If the benefit cannot be calculated monetarily, the value of information is assessed in terms of importance and degree of improvement using a scoring model. The economic assessment is then performed by assigning an estimated monetary value to each scoring point (Stauss and Seidel, 2004).
The attitude effect comes from the improvement of attitude values of complainants. The customer attitude after the resolution of a complaint case is compared to the attitude after the original occurrence of the problem. The difference represents the quantification of the attitude effect. A direct monetary assessment of this type of benefit is not possible, but can be estimated by analysing the costs of the attempt to reach a corresponding improvement of attitude by means of marketing strategies (e.g. advertising) (Stauss and Seidel, 2004).

The essential part of the communication effect lies in the fact that complainants engage in positive word-of-mouth communication about their complaint experiences and thereby recommend the company and its products/services to other customers. For the economic calculation of this effect two types of data are necessary: the number of people who are addressed by customers who are delighted or very satisfied by the company’s reaction to their complaints, and an influence rate. The latter is the share of addressed people who actually became buyers as a result of the positive depiction or buying recommendation. These data can be obtained by market research. The absolute number of customer relationships initiated by word-of-mouth can be multiplied by the average customer profit on a yearly basis or under consideration of the average duration of customer relationship (Stauss and Seidel, 2004).

While the calculation approach for information benefit, attitude benefit and communication benefit have been characterized only shortly, a simple approach for the calculation of the repurchase benefit is explained to a greater extent, as it is essential regarding the objective to retain customers.

The repurchase benefit of complaint management is achieved when previously dissatisfied customers, who otherwise would have migrated, remain loyal to the company as a result of complaint management activities. There are different approaches to calculate this effect. For example, a calculation on the basis of individual customer data concerning customer value is possible, or, if these data are not available, on the basis of the corresponding average. The following example is based on average data. The repurchase benefit is basically calculated in a way that the number of customers who remain loyal because of their experience with the complaint management is determined. This number is then weighted with a customer’s average profitability.

To be able to do this calculation, the following data are necessary:

- the total number of customers (customer base);
- the number of complainants;
- the share of convinced and satisfied complainants;
- their loyalty quota; and
- the percentage of complainants whose actual loyalty can be directly traced to complaint handling.

The investigation of these data is rather easy. The volume of the customer base must be available in the marketing or controlling department, the number of complainants is known to the complaint department. The share of convinced and satisfied complainants, their willingness to keep loyal and the decisive factor of complaint experience for this loyalty can be investigated in the course of a complaint satisfaction survey.

Figure 8 shows the basic model for this calculation (Stauss and Seidel, 2004). The starting point is a customer base of 100,000 customers, 24,000 of whom turn to the company with a complaint. The complaint satisfaction survey shows that complaint management managed to
convince 30 per cent of the complainants and satisfy 25 per cent. At the same time the results show that 95 per cent of the convinced and 65 per cent of the satisfied customers are willing to stick to the relationship. The reason for the loyalty of the convinced customers is for 65 per cent the positive complaint experience, of the satisfied customers it is 15 per cent. Resulting from that, 5,031 customers were actually retained due to complaint management.

It is now possible to calculate the secured profit per year from the periodic average sales per customer and the average return on sales. An example for this calculation is shown in Figure 9: with a monthly revenue per customer of $200.00 and an 8 per cent rate of return, the secured profit per year equals $965,952.00.

When the average duration of customer relationships is considered and not only one period is taken into account, the secured profit increases significantly. Assuming an average customer relationship lasts for 20 months instead of one year, then the secured profit contribution for the remaining duration of an average relationship rises to $1,609,920 (see Figure 10).

The above-introduced approach to calculate the profit of complaint management has several advantages. It makes a realistic calculation possible by building on those relationships that were secured for a company due to complaint management activities. In addition to that it is easy and practicable as the relevant data are already available in the marketing, controlling or complaint management department, or can be collected by means of complaint satisfaction surveys.

If a company has insight into the costs of complaint management and information about
monetarily valued benefits (e.g. the repurchase benefit), the (minimum) return on complaint management can be calculated.

The repurchase benefit less the costs of complaint management equals the profit of complaint management (see Figure 11). After that the return on complaint management (RoCM) is calculated by setting the profit of complaint management against the complaint management investments, which are the measured costs. In Figure 12 the RoCM equals 312.8 per cent.

Managerial implications

Complaint managers face a strategic dilemma. On the one hand, it is unquestionable that complaint management is of particular strategic importance in the context of CRM and retention management. On the other hand, the actual importance of customer care and complaint management departments does not reflect this strategic relevance. On the contrary, since it is mostly perceived as just cost producing units without a measurable contribution to the company’s value creation, complaint managers are under continuous pressure to justify their activities and are confronted with a permanent danger of budget reductions. One major solution to this strategic dilemma is to prove credibly the contribution of complaint management to the overall profit, and by that strengthening the internal position of customer care.

Figure 11 Basic model to calculate the profit of complaint management

<table>
<thead>
<tr>
<th>Cost/Benefit Position</th>
<th>Cost/Benefit</th>
</tr>
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<tbody>
<tr>
<td>Realized Repurchase Benefit</td>
<td>1,609,920 $</td>
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<tr>
<td>+ ......</td>
<td>......</td>
</tr>
<tr>
<td>= Market Success of complaint management</td>
<td>1,609,920 $</td>
</tr>
<tr>
<td>- Personnel costs</td>
<td>153,000 $</td>
</tr>
<tr>
<td>= Gross profit of complaint management</td>
<td>1,456,920 $</td>
</tr>
<tr>
<td>- Administration costs</td>
<td>75,500 $</td>
</tr>
<tr>
<td>- Communication costs</td>
<td>21,500 $</td>
</tr>
<tr>
<td>- Response costs</td>
<td>140,000 $</td>
</tr>
<tr>
<td>= Profit of complaint management</td>
<td>1,219,920 $</td>
</tr>
</tbody>
</table>


Figure 12 Basic model to calculate the return on complaint management

\[
\text{Return on complaint management} = \frac{\text{Complaint management profit}}{\text{Investments in complaint management}} = \frac{1,219,920 \text{ $}}{390,000 \text{ $}} = 312.8\%
\]


Limitations and directions of future research

Considering the results of the empirical study on the complaint managers’ knowledge of complaint management profitability, two major limitations have to be taken into account. First, the study is restricted to customer care managers from German companies, and second, it focuses on the business-to-consumer market only. In future research the scope should be extended to an international context and to business-to-business companies as well.
Furthermore, research should focus more on the neglected field of costs and benefits of complaint management:

- Regarding the cost aspects there are several open questions. Among those are the determination of all relevant cost elements, the development of methods to gather the required cost information, and systematic considerations on the allocation of complaint management costs within the company according to the responsible units.

- With respect to the repurchase benefit of complaint management, it is necessary to complement the calculation based on average sales data by calculation concepts on the basis of individual customer values. Here the information about customer complaint behaviour and complaint (dis)satisfaction recorded in a customer database, on the one hand, and the information about individual customer value, on the other hand, have to be connected. Only then is it possible to calculate the repurchase benefit correctly on the basis of the individual customer lifetime value.

- With regard to the information, attitude and communication benefits, the challenges for research are even greater. Although first calculations concepts for these benefits are already available, no reports exist on experiences with these approaches and a comprehensive assessment of these methods is missing.

Here a broad and relevant field for research emerges in the related area of services marketing and controlling. Now it is necessary to test, to assess and to further develop the existing calculation approaches, and when necessary, to develop useful alternatives.

References


Further reading