



The Quarterly Quality Report
An ASQ Analysis of Quality & Customer Satisfaction
With Retail Trade, Finance & Insurance, and E-Commerce

*Commentary by Jack West, American Society for Quality
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Introduction

This report on quality is based on data from the American Customer Satisfaction Index (ACSI), a key economic indicator and the nation's leading measure of customer satisfaction. It offers further analysis and commentary by ASQ experts on the perceived quality component of ACSI.

QUALITY IN THE RETAILING, FINANCE & INSURANCE, AND E-COMMERCE SECTORS: HIGHLIGHTS FROM THE FOURTH QUARTER 2005 ACSI

Accepted wisdom states that with time, as organizations across a wide swath of the economy become savvier at applying quality methodologies, there should be a convergence toward quality practices and fewer opportunities for organizations to distinguish themselves from the crowd on the basis of quality. It's been called the commoditization of quality, as more organizations learn what it takes to stay in the quality game.

Yet the opposite seems to be happening to the perceived quality component in the sectors covered in the fourth quarter by the American Customer Satisfaction Index. This quarter's results show that some organizations are doing a clearly better job than others when it comes to their quality management approaches.

Companies that have more effective quality management systems improve the quality of their goods and services faster than those that do not—and the customers are taking notice of it. A handful of firms are outpacing their rivals at turning quality management technique into satisfied customers, which shows up in the widening gap revealed this quarter in the perceived quality of relatively well established companies.

In life insurance, Northwestern Mutual maintained its solid quality lead while rivals Metropolitan Life and Prudential experienced steep declines in quality ratings from their customers in the fourth quarter of 2005, compared to fourth quarter 2004 when the ratings were last compiled. It may be that Northwestern, as a mutual insurance company, is in a better position to concentrate on a long-term strategy grounded in

quality and customer satisfaction while its stock-company competitors are more driven by the pressure to generate quarterly results in line with investor expectations.

Among banks, top-ranked Wachovia extended its lead slightly, while Wells Fargo dropped even further behind with a significant decline in perceived quality.

In the specialty retail category, Lowe's Companies enjoyed significantly higher quality ratings from its customers, moving it to the top of the category alongside longtime leader Costco. Lowe's main competitor, Home Depot, took a big hit from its customers, dropping dramatically in customer-perceived quality and further widening the gap between the leader and the laggard in this category.

Among department and discount stores, there were no significant changes this quarter. However, since measurements began in 1994, two companies—Wal-Mart and Kmart—have been fighting it out in a race to the bottom of the category. Both have experienced significant declines in quality ratings from their customers.

A similar story has played out in the supermarkets category: No major changes in the current quarter, but big declines by another pair of companies (Albertson's and the Wal-Mart supermarket operation) since measures were first taken in 1994. They stand in marked contrast to the supermarket segment's quality leader, Publix.

In general, most of the industries measured during the fourth quarter enjoy perceived quality ratings that differ little from the overall national perceived quality index comprising all industries measured by the ACSI (see Table 1).

The exceptions are healthcare insurance, personal property insurance, and e-commerce. The healthcare insurance category, including measured companies Blue Cross Blue Shield, Aetna, and United Healthcare, is noticeably lower than the national perceived quality index. On the other hand, the personal property insurance category (including State Farm, GEICO, Allstate, Progressive, and Farmers) scores higher than the overall national perceived quality index for all companies and industries. The e-commerce segment is (one of) the highest scoring of all industry groups. This group is buoyed by perceived quality scores in the retail segment (with companies Barnes & Noble, Amazon, Buy.com, and 1-800 Flowers) but is dragged down by the brokerage segment, which includes Charles Schwab and E-Trade.

The differences noticeable in these insurance and e-commerce groups may be a reflection of barriers to switching. For example, it is easier to switch car insurance (usually a matter of personal choice) than it is to switch health care insurance (usually an employer choice), and there are usually more options available to consumers in choosing auto insurance as compared to health care insurance. The observation also applies to the very low cost of switching among e-commerce providers.

Table 1
ACSI Overall Perceived Quality

	Q4 '05	Q4 '04	% Change from last year	Q4 '94	% Change from 1st year
NATIONAL QUALITY INDEX (all industries)	78.9	79.1	(0.3)	80.2	(1.6)
FINANCE	78.5	78.7	(0.3)	79.3	(1.0)
Banks	77	77	0.0	77	0.0
Healthcare Insurance	74	73	1.4	74	0.0
Life Insurance	80	82	(2.4)	80	0.0
Personal Property Insurance	83	84	(1.2)	83	0.0
RETAIL	77.6	77.4	0.3	78.7	(1.4)
Department & Discount Stores	76	76	0.0	80	(5.0)
Gasoline Service Stations	79	79	0.0	85	(7.1)
Health & Personal Care Stores	80	n/a	n/a	n/a	n/a
Specialty Retail Stores	76	77	(1.3)	78	(2.6)
Supermarkets	78	78	0.0	79	(1.3)
E-COMMERCE	85.6	84.0	1.9	80.7	6.1
Auctions	80	80	0.0	76	5.3
Brokerage	77	76	1.3	80	(3.8)
Retail	89	87	2.3	87	2.3
Travel	81	80	1.3	82	(1.2)

Specialty Retail

In the specialty retail segment, home-improvement retailers Home Depot and Lowe's provide stark contrasts. While Lowe's experienced a significant gain in perceived quality, Home Depot suffered the largest decline among all companies measured this quarter.

Both companies have been enjoying solid financial performance lately, with Home Depot reporting record profit for the third quarter of 2005 and Lowe's racking up profits that handily beat analysts' estimates for the same period. Industry watchers are guardedly optimistic on prospects for both of these home-improvement giants in 2006. The home-improvement boom remains fairly strong in spite of rising interest rates and rising fuel prices that cut into consumers' discretionary spending. In terms of price that investors are willing to pay for a stream of earnings, the market is currently favoring Lowe's—a fact that tracks with the proven ACSI finding that the stock of companies with higher customer satisfaction scores outperforms the stock of companies in the same industry with lower customer satisfaction scores.

Both companies are also investing heavily in their businesses.

Lowe's is pouring billions into an ambitious plan to add new stores, concentrating on metropolitan areas where they will go store-to-store with existing Home Depot locations. The company added 140 new stores in 2004 and was on track to open 150 in 2005; new store openings have been a main contributor to its recent profit gains and market share gains.

Home Depot's spending has been focused on upgrading existing outlets, acquiring and building new outlets in Canada and Mexico, building up its supply businesses with acquisitions, and also investing in a major technology overhaul that includes a billion-dollar IT infrastructure modernization.

In the five years since Robert Nardelli took over the top job at Home Depot, the company's response to a flagging stock price and rejuvenated competition from Lowe's has been largely based on technology.

So far, however, Home Depot's big bet on technology has done more to please investors than it has to please customers.

The tech overhaul includes significant infrastructure projects and support for initiatives aimed at speeding up supply, reengineering business processes, and improving customer service. During this same time, however, Home Depot's model of customer service has changed from one based on a high level of employee/customer interaction to more of a customer self-help model. In fact, one of the major tech accomplishments touted by the company has been the installation of self-checkout stations, designed not only to hasten checkout time for the customer but also to redirect associates from customer checkout to the sales floor. Meanwhile, Home Depot's ratio of total employees to number of stores continues to decline.

In a recent announcement about new initiatives and long-term growth vision, the company stated that by 2010 it hopes its new operational initiatives will permit it to lead the industry by devoting 70% of operational hours to the selling floor.

Initiatives such as these, aimed at rationalizing Home Depot's internal systems for operational efficiency and productivity, are the types of things that customers do not see immediately, if ever directly. And once the effects do kick in, they can take a while to be reflected in perceived quality ratings, since customer perceptions can be slow to change.

Lowe's, on the other hand, is deliberately attempting to distinguish itself from Home Depot on the basis of a higher level of personal touch with the customer. The approach appears to be working.

Banks

When is the last time anyone got really delighted about his or her bank statement? Did you ever get a tingle of satisfaction knowing your check cleared promptly and without error? At a minimum, most customers expect high levels of performance from their banks on attributes such as promptness, accuracy, friendliness, or fairness. And all banks do a more than adequate job of satisfying the basics. But while banks have a hard time creating delight, they do have many opportunities to cause negative feelings for their customers, whether it's in denying a loan, changing rates on credit cards or deposit accounts, being hard to reach, or not answering questions correctly.

The large money center and super regional banks measured in the ACSI all face these challenges, and all provide a very similar array of services. Yet one of them—Wachovia—has been outshining the others on customer quality ratings while another—Wells Fargo—has been falling behind on this measure, punctuated by a rather steep decline in the current quarter.

In other respects, Wells Fargo enjoys a stellar reputation. It is one of only two banks worldwide and the only one in the United States holding a AAA rating from Moody's. It has been called the best managed company in U.S. banking and the world's most admired financial services company by leading business publications. It ranks 29th in revenue among all U.S. companies in all industries and is the 17th most profitable.

Both Wells Fargo and Wachovia have participated in the mergers and acquisitions activity that has been a prominent feature of the financial services environment in recent years. Even though 2005 was not a particularly active year, bank analysts are looking for 2006 to be a big year for financial mergers. And both Wells Fargo and Wachovia are mentioned as being ready to pursue deals.

Mergers are quality and customer satisfaction minefields owing to the disruptions they can cause and the stress involved in combining cultures, processes, information systems, and differing customer bases. Data from the ACSI demonstrate that satisfaction frequently declines when companies are involved in acquisitions.

Wachovia learned that lesson the hard way. Its predecessor institution, First Union, undertook a series of costly and disruptive acquisitions that drove away customers. But in the fourth quarter of 2005 Wachovia completed the integration of its \$14 billion 2004 acquisition of South Trust—on time and under budget, and without apparent major shocks to customers.

Another business policy that drove customers away from Wachovia was a retail strategy that steered customers toward automated systems and away from tellers. At one point the bank was losing more customers than it gained. Today, however, Wachovia gains 1.35 customers for every one it loses.

Wachovia’s customer service turnaround began in 2000 when its current chairman, G. Kennedy Thompson, became chairman and CEO at predecessor First Union. He initiated a \$100 million service improvement program that resulted in improvements in many things that customers readily notice—such as shorter teller lines and quicker telephone answering—as well as better service in the back office.

The customer service upgrade included beefing up the retail staff and providing them with enhanced training, installing a more customer-friendly telephone system, and adopting updated methods of handling customer inquiries. Wachovia also invested heavily in a customer-centric database framework to bring together customer information from disparate databases.

Focusing on core competencies, Wachovia sold its corporate trust and institutional custody businesses late in 2005. It had also sold off its credit card business, although it is planning to re-enter that business and become a direct issuer of cards once again later this year.

DIFFERENCES BETWEEN SERVICE QUALITY AND PRODUCT QUALITY

To better understand this quarter’s quality report results, it helps to have some insight into the differences between quality of services and quality of products.

Perceived quality for the service-based industries measured during the fourth quarter is noticeably lower than perceived quality for manufactured goods (see Table 2). Why is this?

Table 2
Customers Consistently Rate Service Quality Lower Than Product Quality

SERVICE	Perceived Quality Score	MANUFACTURING	Perceived Quality Score
Banks	77	Apparel	85
Health Insurance	74	Beverages	89
Life Insurance	80	Food Manufacturing	88
Dept & Discount Stores	76	Personal Care & Cleaning Products	89
Specialty Retail Stores	76	Automobiles	86
Supermarkets	78	Electronics	87
Online Retail	89	Major Appliances	88
Online Auctions	80		

Source: Perceived quality ratings from American Customer Satisfaction Index (ACSI)

One of the main enemies of quality is variation. Most products are produced by machines with highly defined and controlled processes. On the other hand, most services are the result of an interaction between two people. Since people are inherently more variable than machines there are more opportunities for defects to occur in the delivery of a service than in the production of a product.

Because of this variability, many service providers operate in a response mode. The conditions change constantly as the service transaction progresses. As a result, it is difficult to predict and script in advance all of the scenarios that may occur in this type of environment.

Furthermore, relatively few service organizations have employed advanced quality systems like Lean, Quality Function Deployment or Six Sigma--techniques that have been a mainstay in manufacturing for decades. Thus the typical manufacturing organization is far ahead of the typical service organization in the application of advanced quality practices.

Based on this reasoning, one would expect that those manufactured products that also have a service component will have a lower perceived quality score for the service component than for the manufactured component. This expectation is confirmed by the ACSI results for virtually all products that entail both manufactured and service components, such as automobiles and major appliances.

METHODOLOGY

This report on quality offers further analysis by ASQ experts and is based on a key economic indicator and the nation's leading measure of customer satisfaction, the American Customer Satisfaction Index. Produced by the University of Michigan in partnership with the American Society for Quality and CFI Group, the ACSI is produced quarterly, measuring more than 200 companies in 41 industries. The index has been issued and supported by the partnership for more than 10 years.

The ACSI uses two primary criteria to define the consumer's quality experience:

- 1.) customization, or the degree to which a product or service fulfills the customer's key requirements
- 2.) reliability, or how reliably these requirements are delivered.

ACSI data collection occurs through thousands of quarterly interviews with customers who have purchased and used specific products or services within defined time periods. It treats satisfaction with quality as a cumulative experience rather than a most-recent-transaction experience.

Customer interviews that formed the basis of the overall ACSI and its quality component occurred during the period of October-December of this year. Customers of companies in the retail, finance & insurance, and E-commerce sectors were interviewed.

Each quarter a different sector is measured, with the fresh data being used to update the national ACSI score quarterly on a rolling basis. ASQ plans to issue Quarterly Quality Reports, with analyses on these sectors, based on the latest ACSI scores.

Table 3
Data Collection and Sector Update Schedule

Sector	Consumer Interviews	Results Released
Utilities, Transportation, Information, Healthcare & Social Assistance, Accommodation & Food Services	January - March	May
Manufacturing/Durable Goods, E-Business	April - June	August
Manufacturing/Non-durable Goods	July - September	November
Retail Trade, Finance & Insurance, E-Commerce	October - December	February
Public Administration	Throughout the year	December

What Do Quality Scores Mean?

Even though determination of quality is a complex and subjective calculus involving the simultaneous processing of many factors inside the mind of the consumer, that does not mean it can't be quantified.

The ACSI relies on a tested methodology to help quantify the subjective evaluations of the goods and services acquired and consumed in the United States. Interviews with many customers probe multiple facets of quality such as product or service attributes, price, and market fit to measure the subjective evaluations of the goods and services acquired and consumed in the United States. Data derived from these interviews are used as inputs to the ACSI's econometric model, which combines numerous proxy measures (reflecting the consumer's overall consumption experience) to arrive at an index number on a 0 to 100 scale. This is not a percentage. Unlike the output of many familiar consumer surveys, an ACSI score of 80, for example, does not mean that 80% of consumers who were interviewed have high regard for the quality of the particular product or service in question.

The unique methodology used to calculate the ACSI and the quality component scores has the advantage of allowing for cross-industry and cross-company comparison. For example, it lets us say with assurance that consumers have higher regard for the quality of beer than they have for the quality of banking services, or that consumers think Heinz products have better quality than Dole products.

About the Author

Jack West is a past president of the American Society for Quality and a quality expert. A Six Sigma Master Black Belt instructor and consultant, West has held various engineering and management positions at Westinghouse Electric Corporation and Northrop Grumman. He holds a doctorate in business administration and a master's degree in management, both from The George Washington University. John Ryan, ASQ public policy analyst, also contributed to this report.

About the American Society for Quality (ASQ)

The American Society for Quality is the world's leading authority on quality. With more than 92,000 individual and organizational members, the professional association advances learning, quality improvement, and knowledge exchange to improve business results and to create better workplaces and communities worldwide. As champion of the quality movement, ASQ offers technologies, concepts, tools, and training to quality professionals, quality practitioners, and everyday consumers, encouraging all to Make Good Great™. ASQ has been the sole administrator of the prestigious Malcolm Baldrige National Quality Award since 1991. Headquartered in Milwaukee, WI, the 60-year-old organization is a founding partner of the American Customer Satisfaction Index (ACSI), a prominent quarterly economic indicator.

Other information about ASQ and the ACSI can be found on the following Web sites:

<http://www.asq.org/quality-report/index.html>

<http://www.theacsi.org/>

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