



The Business Case for Good Complaints Handling in Legal Services

Report for the Legal Ombudsman

November 2013



Document contents

1. Executive Summary	4
2. Introduction	8
2.1. Introduction to our study	9
2.2. Background context	9
2.2.1. Defining good complaints handling.....	9
2.2.2. Evidence on the scope for improvement	10
2.3. Key objectives and aims of our study	11
3. Our methodology and approach	12
3.1. Conceptual framework for developing a business case	13
3.1.1. Overview of framework	13
3.1.2. Application of our framework	13
3.2. Our methodology for developing the Business Case	14
3.2.1. Description of the financial model.....	14
3.2.2. Stylised law firms.....	15
3.2.2.1. Pen portraits of stylised firms	15
3.2.2.2. Base case data for stylised firms.....	16
3.3. Developing modelling scenarios	17
3.3.1. Central case scenarios.....	17
3.3.1.1. Sole practitioner	17
3.3.1.2. Small sized firm.....	17
3.3.1.3. Medium sized firm	18
3.3.1.4. Sensitivity analysis	18
3.3.2. Review of existing studies and evidence.....	18
3.3.3. Qualitative interviews with law firms	18
4. The Business Case.....	19
4.1. Review of existing evidence and analysis	20
4.1.1. Evidence on key sources of financial costs and benefits	20
4.1.2. How the costs and benefits can vary.....	20
4.1.3. Methodologies for estimating costs and benefits of complaints handling.....	21
4.1.4. Existing quantitative evidence	22
4.1.5. Codification of papers reviewed.....	22
4.2. Expert opinion of Dr Andrew Mell	23
4.3. Key findings from our qualitative interviews	23
4.4. Results of modelling analysis – central scenarios	24
4.4.1. Sole practitioner results.....	24
4.4.2. Small sized firm results	25
4.4.3. Medium sized firm results.....	25
4.4.4. Summary of results and sensitivity analysis	26

4.4.5. Net benefits relating to tier two complaints.....	27
4.5. Qualitative assessment of impact for barristers and ABSs	27
4.6. Consideration of wider industry impacts	27
4.6.1. Approach to scaling up	28
4.6.1.1. Differentiating between competitive effects and wider market impacts.....	28
4.6.1.2. Uncertainty as to the number of firms that would make the assumed improvement.....	29
4.6.2. Industry wide benefits.....	29
5. Conclusions and key findings	31
5.1. Economic theory and evidence	32
5.2. Economic Insight financial modelling	32
5.3. Potential for wider benefits	32
Annex A - Literature review	33
Annex B – Dr Andrew Mell opinion	60
Annex C – summary of complaint data.....	63
Annex D – retention effect modelling	65



1. Executive Summary

This report sets out the commercial business case for good complaints handling in the legal services industry; and provides a quantification of the likely financial impact both for law firms, and across the industry more widely.

In summary, our study – undertaken on behalf of the Legal Ombudsman – finds that:

- (i) ***There is a robust business case for good complaints handling in the legal services industry.*** In particular, law firm profitability could increase by between 2% and 3%.
- (ii) ***Although subject to uncertainty, there could also be a wider net financial gain across the industry as a whole.*** This could be up to £80m – in net present value terms over 10 years, where this benefit would be shared between firms and consumers.
- (iii) ***Our findings are based on a range of evidence,*** including: existing academic and empirical studies, a range of financial data; and interviews with providers of legal services.

This report sets out the business case for good complaints handling in the legal services industry

It is well established that reputation or brand value can generate increased profitability for firms across a range of markets. Consequently, to the extent that how firms manage customer complaints can impact their reputation, then clearly one would expect there to be natural commercial incentives to have complaints handling processes that meet customer needs. Furthermore, given the importance of 'reputation' with respect to the provision of legal advice, one might expect these incentives to be particularly relevant to legal services.

However, research by the Legal Ombudsman published in 2012¹ found that there is significant scope to improve complaints handling within the industry (although it is important to note that the study also found examples of good practice). In particular, the Ombudsman's study found that many of the issues that led consumers to complain in the first place were themselves features of the complaints handling process.

Given that there are good 'in principle' reasons to believe that the commercial incentives exist for law firms (and other legal advice providers) to have good complaints handling, it is important to consider why this has not been universally implemented across the industry. One possible explanation is that some firms may underestimate the extent of these commercial incentives, because they do not appreciate the importance that customers attach to complaints handling.

It is therefore important to: (i) seek to understand what the business case for good complaints handling might be, from a law firm's perspective; and (ii) communicate that business case so that the scope for providers underestimating the potential benefits is reduced.

In the above context, The Legal Ombudsman commissioned Economic Insight to undertake an analysis to determine the business case for good complaints handling in the legal services industry. This report sets out the results of our findings, and addresses in turn:

- » The background context to our work.
- » The methodology and approach we have applied in order to develop the business case.
- » The results of our analysis (including a quantification of the potential benefits of improved complaints handling).

We have applied a commercial approach to developing the business case

Given that the primary issue that our study seeks to address relates to the commercial incentives faced by the providers of legal advice, the approach we have taken is to develop the business case from a 'commercial perspective.'

That is to say, we have sought to identify – and then quantify – the potential financial impacts (both costs and benefits) *on law firms* of developing good complaints handling processes. The objective of this is to ensure that the business case for improving complaints handling is evaluated in the same way that law firms would evaluate any business opportunity in the real world.

To implement this approach in practice, we developed a forward looking financial model that estimates the profitability and cash flows of 'stylised law firm types' both under a base case, and for a scenario in which we assume improvements are made to firms' complaint handling process. Our modelling has been informed by: (i) existing academic research and studies; (ii) analysis of a range of financial data; and (ii) a series of qualitative interviews with legal advice providers.

The stylised law firms we have modelled are not intended to represent any individual firm, nor an 'average' of all firms. Rather, they are designed to be broadly representative of the different 'types' of firms that operate in the market, to reflect the diversity of legal services providers that exist (and recognising that the impact of improved complaints handling is likely to vary across firm types). We have modelled the financial impact of improved complaints handling for:

- » ***A sole practitioner*** – likely to have a turnover of <£100k pa, with a relatively narrow service offer, operating in a town or village high street.
- » ***A small firm*** – likely to have up to 5 fee earners with a turnover of between £600k to £800k pa, with a somewhat broader service offering, operating in a town centre or high street.
- » ***A medium sized firm*** – likely to have between 30 and 40 fee earners with a turnover of between £5m and £6m pa, with a broad service offer (including material commercial and corporate work).

Our modelling shows that improving tier one complaints handling can increase law firm profitability

For each of the three stylised law firm types identified in our study, we modelled a scenario

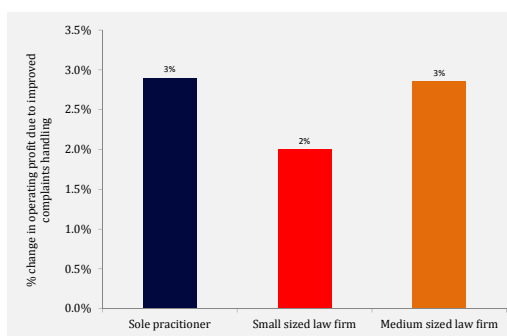
¹ 'Consumer experiences of complaint handling in the legal services market – first-tier complainants.' Legal Ombudsman (2012).

whereby they are assumed to make improvements to their complaints handling process. The scenario modelled varies across the law firm types to reflect what we consider to be 'credible' and 'reasonable' ways in which the firms could make improvements (recognising that these are unlikely to be uniform across all firms).

Our model then calculates the expected financial costs (consisting of: foregone fee income, increased administrative staff cost, client reimbursements, and any initial set up and investment costs) and benefits (consisting of: improved customer retention, acquisition and potential cost efficiencies).

Based on our central scenarios, we estimate that law firm profitability could increase by between 2% and 3% as a result of having good complaints handling processes, as summarised in the figure below.

Figure 1: Projected % increase in operating profit by law firm type



Source: Economic Insight

In practice, because there is an absence of detailed empirical studies relating to the impact of complaints handling on firm financials *specifically relating to legal services*, the above analysis is subject to uncertainty. We cannot, therefore, comment on the likelihood of these results in a statistical sense.

To recognise this uncertainty, however, we have undertaken sensitivity analysis. This indicates that having good complaints handling processes could increase operating profits by between 1% to 4% across our stylised firm types. This range is consistent with studies regarding financial impacts in other industries.

It should further be noted that the scenarios we have developed implicitly capture the net financial benefit to firms in relation to tier 1 complaints. In reality, there may be some additional benefit in relation to tier 2 complaints (i.e. complaints that are referred onto the Legal Ombudsman). This could arise if the improvement in complaints handling at tier 1 either: (i) reduced the number of complaints that were subsequently referred; and/or (ii) reduced the resource required at tier 2 (where in relation to both, potentially both firm and Legal Ombudsman costs would be avoided). However, we do include an approximation of Tier

2 net benefits in our overall industry results, as described subsequently.

The wider net benefit of improved complaints handling across the industry could be material.

Although our modelling has focused on understanding the financial business case for good complaints handling, primarily from the perspective of law firms, it is possible to 'scale up' the estimated net benefits in order to get a sense of the potential wider net benefit to firms and consumers across the industry.

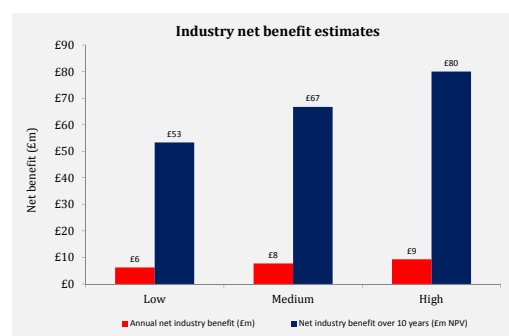
There are two key uncertainties regarding the above, which need to be taken into consideration:

- » Firstly, not all of the identified cost and benefit factors are 100% scalable, as some relate to the benefits for – or costs to – firms arising from competition with their rivals (e.g. acquiring a customer from a rival).
- » Secondly, if all of the estimated net benefit figures were 'scaled up,' it would imply that all law firms could or would make the improvements we have assumed regarding complaints handling. This would clearly not be appropriate, as some law firms will already have good complaints handling processes.

In addition, whilst our firm level analysis focused only on Tier 1, our industry estimate has been up-scaled to include potential benefits relating to Tier 2 complaints. This has been done in line with the proportion of Tier 2 to Tier 1 complaints.

Consistent with the above, we have undertaken an analysis that seeks to 'scale' the estimated firm net benefits taking into account the two key uncertainties (by estimating a low, medium and high case). Based on this, the potential wider gains to industry could be between £53m and £80m in present value terms over 10 years, as shown in the figure below. These benefits would be shared between firms and consumers – but if the gain is expressed as a % of total industry profit, it would equate to 1.1% (using the upper estimate).

Figure 2: Potential wider net benefit of good complaints handling in the legal services industry



Source: Economic Insight

Our results are consistent with existing economic theory and evidence, which is supportive of there being a business case

Within the scope of our work, we have undertaken a review of the existing evidence base. Here we find that economic theory sets out a strong rationale for there being a business case for improved complaints handling. In particular, there is a well-established framework that is consistent with firms being able to generate increased profits as a result of them investing in their reputation. Consequently, to the extent that improved complaints handling can enhance firm reputation and brand, clearly a commercial incentive exists to provide good complaints handling.

Our review of evidence is supported by the opinion of Dr Andrew Mell, an economist and fellow at Corpus Christi College Oxford with expertise in the economics of reputation. Dr Mell's opinion is that there are strong grounds to believe that law firms can benefit commercially by investing in their reputation through having a good complaints handling process.

In summary, we conclude that there is likely to be a robust commercial business case for good complaints handling

Based on economic theory, the existing literature and empirical studies – and our own modelling analysis – our view is that law firms can generate increased profits as a result of having good complaints handling processes.

Whilst the extent of the net financial benefit is subject to uncertainty, we find that the expected impact is positive across a range of scenarios.

At an individual firm level, the positive impact is likely to be modest, which is consistent with the existing studies and our qualitative interviews with law firms and other providers of legal advice. For example, one firm told us: *"There is a positive effect on profit... [but it]... is not massive."* However, across the industry as a whole, our analysis shows that there are potentially material net benefits to firms and consumers.



2. Introduction

The Legal Ombudsman commissioned Economic Insight to take forward a study examining the business case for good complaints handling in the legal services industry.

This introductory section of our Final Report:

- (i) ***Provides an overview of the structure and content of our Report***, including a breakdown of the main sections and annexes.
- (ii) ***Describes the relevant background context to our work***, including a description of the rationale for developing a business case for improved complaints handling.
- (iii) ***Sets out the key objectives and aims of our study***, which includes a quantification of the commercial business case for having a good complaints handling process.

2.1. Introduction to our study

The Legal Ombudsman commissioned Economic Insight to undertake an analysis to determine the business case for good complaints handling in the legal services industry.

This report sets out the results of our study, and is structured as follows:

- » The remainder of this section sets out the background context to our work – and its key aims and objectives.
- » Section 3 addresses the methodology and approach we have applied in order to develop the business case.
- » Section 4 sets out the results of our analysis and provides a quantification of the potential benefits of improved complaints handling.
- » Section 5 contains our key findings and conclusions.
- » Separate annexes contain: details of our literature review; the expert opinion of Dr Andrew Mell (an economist specialising in the impact of reputation on firm financial performance); a summary of complaint data; and our modelling of customer retention effects.

2.2. Background context

In many industries, complaints handling is one dimension of a firm's quality of service and, relatedly, its overall customer proposition. Consequently, there is a natural commercial incentive for firms to ensure that, as for all elements of proposition design, their complaints handling processes adequately meet customer needs (as firms that do not meet customer needs will struggle to attract and retain customers). In service industries, such as the provision of legal advice, customer relationships can be a particularly important part of the overall proposition, which can further

accentuate these incentives. We discuss these issues further in Sections 3 and 4.

In practice, however, it is possible that (as in any industry) *some* providers of legal advice may not have complaints handling processes that fully meet customer needs. This could occur either because those providers of legal advice:

- » Underestimate the importance and value that customers attach to having good complaints handling processes (and so they do not believe that there is a commercial incentive to improve their complaints handling process); and / or
- » Do not fully understand the *nature* of customers' requirements relating to complaints handling (and so, even if their intention was to develop a complaints handling process that meets customer needs, they may fail to achieve this objective).

If one believed that either of the above issues arose (to some degree) in the legal services industry, then there would be merit in helping to identify and communicate the potential commercial benefits of improved complaints handling. This, then, provides the underlying rationale for why, *in principle*, the Legal Ombudsman is concerned with understanding the business case for improved complaints handling.

The *in practice* rationale turns on the extent to which the evidence suggests the industry is adequately meeting customer needs in relation to complaints handling at present. This requires an understanding of both:

- what 'good' complaints handling looks like (i.e. what customers want); and
- what level / quality of complaints handling is currently being provided.

Importantly, the extent to which the above factors result in a 'sub-optimal' quality of complaints handling could vary across firm types. In particular, the largest corporate law firms often tend to have separate commercial management functions. This resource advantage may mean that they are better placed to evaluate the financial costs and benefits associated with complaints handling than much smaller firms.

2.2.1. Defining good complaints handling

With regard to understanding customer needs relating to complaints handling, the Legal Ombudsman has previously commissioned research that addresses this. In particular, the Legal Ombudsman's research examined the attitudes and experiences consumers have in relation to first-tier complaints; and what typifies both good and bad complaints processes.²



"The *in practice* rationale for examining the business case for good complaints handling turns on the extent to which the evidence suggests the industry is adequately meeting customer needs in relation to complaints handling at present."

² 'Consumer experiences of complaint handling in the legal services market – first-tier complainants,' Legal Ombudsman (2012).

This research suggested that a good complaints handling process should be:

- transparent;
- tailored to the nature and tone of the complaint (so that there is not a requirement to formalise the process);
- timely;
- clear and comprehensible;
- designed to involve another solicitor where appropriate; and
- provided in a way that gives consumers reassurance regarding the impact on any legal case of relevance.



"[Complaints handling processes] 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 activities." Stauss and Schoeler.

The Solicitors' Regulation Authority's (SRA) Code of Conduct (2011) requires that all practices have some process for addressing client complaints.³ Relatedly, the Law Society's 'Practice Note'⁴ for complaints handling indicates that a 'good practice' approach should incorporate:

- an appropriate person being identified to handle the complaint;
- care and time is taken to understand the client's complaint;
- the complaint is formally acknowledged;
- the complaint is investigated in an 'open minded' manner;
- the final response is appropriate; and
- the complaint is recorded and documented.

2.2.2. Evidence on the scope for improvement

The Legal Ombudsman's research found that there is significant scope to improve complaints handling across the legal services profession – and that many of the issues that led consumers to complain in the first place, were themselves features of the complaints handling process.

³ 'SRA Code of Conduct.' (2011). See outcomes 1.9, 1.10, 1.11. Note, the SRA does not formally require practices to have a written complaints process, although this is listed as an Indicative Behaviour.

⁴ 'Handling Complaints.' Law Society Practice Note (2013).

Particular issues identified by the Legal Ombudsman research included:

- » A lack of clarity regarding the complaints handling process itself.
- » Lack of clarity regarding the nature of communications (e.g. language used in responding to complaints can be confusing).
- » Delays in providing an initial response to the complaint.
- » Instances of defensive and / or threatening responses by legal services providers.

A study by YouGov on behalf of the Legal Services Board (LSB) in 2011 also found that: *"there is a clear gap between what is expected to happen under the regulatory framework and what is actually happening."*⁵ In commenting on the gap between customer / regulatory expectations and industry practice relating to complaints handling, the LSB identified similar themes to those addressed in the more recent Legal Ombudsman research. These included:

- » Delays to the complaints handling process.
- » Lack of communication regarding the complaints process and – relatedly – cost implications (for example, only 13% of respondents to the study reported being told about the internal complaints handling process).

- » Use of confusing legal language or 'jargon.'

It is important, however, to emphasise that the Legal Ombudsman study also found examples of good practice across the industry. It would therefore be erroneous to suggest that the above issues apply indiscriminately across the legal services sector.

Nonetheless, we suggest that existing research and evidence is sufficient to indicate that there are a proportion of legal service providers who are not currently meeting customer needs with regards to complaints handling. Indeed – as noted by the LSB – it should be recalled that: *"a perception of poor complaints handling by the legal profession was one of the primary drivers for the Legal Services Act 2007."*⁶

The fact that there appears to be some evidence of a gap between customer expectations and current quality of service levels regarding complaints handling could (as noted previously) be due to a

⁵ 'First-tier Complaints Handling.' YouGov / Legal Services Board (2011). Page 7.

⁶ 'First-tier Complaints Handling.' YouGov / Legal Services Board (2011). Page 4.

number of factors, but in particular, it could be that providers underestimate the commercial incentive to have good complaints handling processes.

Consistent with the above, within the relevant academic literature (summarised subsequently) there is evidence that firms more generally do not think about the profitability impact of complaints handling. In particular, Stauss and Schoeler reported that complaints management processes: *“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 activities.”*⁷

In the above context, therefore, it is logical to examine the commercial business case for good complaints handling – which is the primary focus of our study.

regarding complaints handling in the legal services industry.

Rather – and consistent with the preceding discussion – our work is primarily focused on understanding the *commercial* incentives that exist for firms to provide a good complaints handling process. Here the objective to communicate those commercial incentives clearly to the industry, so as to mitigate the scope for legal services providers to underestimate them; as this may be contributing to the existing ‘gap’ between customer needs and current quality of provision.

2.3. Key objectives and aims of our study

The primary objective of this study is to develop a robust business case, which quantifies the value of good complaints handling to both businesses and consumers.

In addition to this, our work addresses:

- » A review of existing research and evidence relating to whether good complaints handling: delivers wider benefits; provides added value to consumers; and can increase a firm’s reputation and profitability (particularly in relation to the providers of legal services).
- » The potential impact of improving complaint handling early on in the customer journey – e.g. say through early interventions.
- » The identification and quantification of the financial costs and benefits of good complaint handling.
- » A consideration of the risks associated with any adverse effect that poor complaint handling might have on a firms’ reputation – and therefore profitability.

It is important to understand that the purpose of this work is not to undertake a cost benefit analysis. This is because such an analysis is primarily appropriate in circumstances where there is a specific policy proposal or (publically funded) intervention that requires evaluation. In this case, no such proposal is being put forward by the Legal Ombudsman (or any other body)

⁷ *‘Complaint Management Profitability: what do complaint managers know?’ Stauss and Schoeler, Managing Service Quality (2004).*



3. Our methodology and approach

Here we set out the detail of our methodology and approach. Our focus is on developing an analysis that provides a robust quantification of the potential financial impacts of making improvements to complaints handling from the perspective of law firms and other providers of legal services.

Our methodology and approach is underpinned by three core elements:

- (i) ***A clear conceptual framework that focuses on developing a business case from the perspective of how law firms*** and other providers would make decisions relating to complaints handling in the real world.
- (ii) ***The use of financial modelling to apply the framework***, which seeks to provide a robust quantification of the likely financial impacts of having good complaints handling processes.
- (iii) ***A range of both qualitative and quantitative evidence, which is used to inform the modelling***, including: a review of existing research, the expert opinion of economist Dr Andrew Mell, and qualitative interviews with legal services providers.

3.1. Conceptual framework for developing a business case

3.1.1. Overview of framework

Before describing the detail of our methodology and approach for developing the business case for good complaints handling, we first set out the wider conceptual framework that we have applied in addressing this issue.

Our starting point for this study is that the appropriate way to develop a business case for complaints handling is to consider the question from a 'commercial perspective'. That is to say, we have considered how law firms and other legal services providers might weigh up the relative pros and cons associated with investing in improvements to their complaints handling processes.

We believe that this approach is appropriate because, as noted in the introductory section, we are not evaluating a proposed (publically funded) policy initiative to improve complaints handling. Rather, the question of primary interest to this study is whether – absent any such policy intervention – there might nonetheless be a net benefit to providers of legal advice associated with having a good complaints handling processes. In order to understand this, it is necessary to therefore identify and quantify the potential financial impacts on the providers of legal services.

In identifying the potential financial impacts from the perspective of law firms, it is important to recognise that no improvement in complaints handling is costless. For example, improving complaints handling may result in firms incurring costs associated with:

- a reduction in utilisation rates, as internal fee-earning staff have to spend more time handling complaints processes;
- a re-allocation of resource away from other commercially useful activities such as marketing;
- incremental resource costs if the improvement in complaints handling is sufficiently material to demand dedicated resource; and
- up-front set-up and training related costs associated with designing and implementing a more robust approach to complaints handling.

The potential commercial benefits are linked to how important customers see a complaints handling process within the overall 'brand' and 'reputation' of the firm and the role that such factors play in their choice of which legal services provider to use. In principle, however, the financial benefits could be:

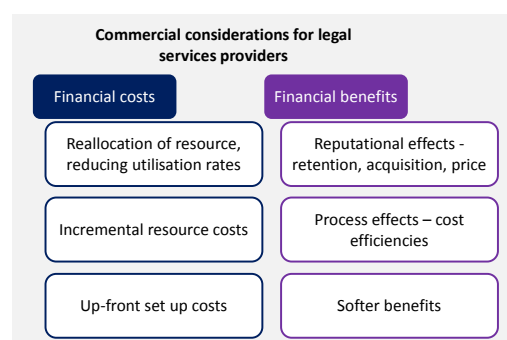
- increased customer loyalty and retention;
- increased customer acquisition; and

- ability to sustain a price premium over rivals.

In addition to the above, there may also be cost efficiencies associated with improved complaints handling; and also softer benefits associated with firm values that positively impact staff retention and motivation.

Ultimately, our view as to what the potential 'cost' and 'revenue' impacts are likely to be has been informed by our review of the existing theory and evidence base; and our qualitative interviews with legal services providers. This is set out further in Section 4 of this report. However, the above gives an indication of *types* of factors that could be considered from the perspective of providers. Relatedly, our overall framework is illustrated in Figure 3 below.

Figure 3: Illustration of conceptual framework



Source: Economic Insight

3.1.2. Application of our framework

Having determined that the appropriate framework for developing the business case is one based on the 'commercial perspective' that a provider of legal services would have, we then had to identify the correct approach to applying that framework in practice.

Here our view is that the most suitable analytical technique is one of financial modelling. Our rationale is that, if we are seeking to consider the commercial case for good complaints handling, then we should evaluate that case just as a firm would evaluate any potential investment opportunity. Here we note that:

- » From an economic and finance theory perspective, there are well established best practice principles for evaluating investment opportunities using financial modelling tools (specifically discounted cash flow models are generally accepted to be the best practice technique for appraising investment opportunities).
- » In the real world, firms apply financial modelling in order to make decisions. Here it is important to note that the detail and extent of any financial analysis can vary materially and is

usually proportionate to the issue under consideration. For example, for large-scale investment opportunities and business decisions, relatively detailed analysis might be undertaken; whereas for more minor business decisions, a simple quantification of likely costs and returns might be deemed sufficient.

Put simply, once we had determined that we should evaluate the business case from the perspective of legal services providers, our view was that – in order for that business case to be robust and credible – the analysis used to develop it should: (i) reflect best business practice; and (ii) be reflective of how firms evaluate cases in the real world.

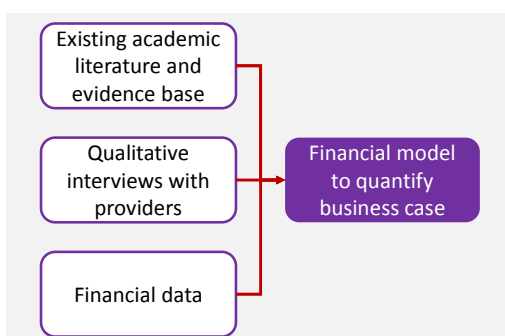
3.2. Our methodology for developing the Business Case

As noted above, our methodology for applying our conceptual framework in practice is based on the development of a financial model. We use this model to assess the potential impact of improved complaints handling through a number of potential ‘scenario’ or ‘what if’ analyses.

In order to develop the financial model in the first instance, however (and in order to design the scenarios we proceeded to test) we firstly had to collect input data and evidence. As illustrated below, this came from three primary sources:

- law firm financial data from Companies House;
- review of existing studies and evidence relating to the financial impact of complaints handling; and
- qualitative interviews with 14 law firms.

Figure 4: Illustration of our methodology for developing the business case



Source: Economic Insight

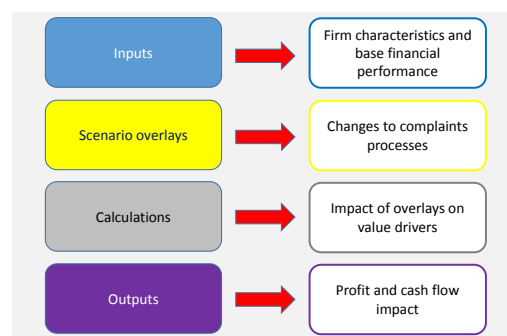
3.2.1. Description of the financial model

In order to apply our framework in practice, we developed a forward looking financial model, which projects the financial performance of ‘stylised’ law firm types over time. The key purpose of this is to allow us to examine projected profits and cash flows under a ‘base case’ and compare these to projected profits under a range of ‘scenarios’ whereby improvements are made to complaints handling.⁸

The model has been developed on a ‘bottom up’ basis, so that the projected costs and revenues of the stylised law firms are linked back to their underlying value drivers. For example, projected revenues are a function of: overall demand for the law firms’ services (which includes assumptions regarding customer retention and acquisition), the number of fee earners, their fee rates; and their utilisation. Similarly, costs are a function of: the size of overheads, staff salaries (including partner remuneration from the profit pool where appropriate) and any incremental costs associated with complaint handling.

Developing the model on a ‘bottom up’ basis is essential, as it allows us to accurately calculate the impact of changes to underlying value drivers – such as law firm utilisation rates – on their expected profitability over time. This, in turn, is what allows us to develop robust quantifications regarding our scenarios for improving complaints handling. Figure 5 below shows a schematic of the financial model we developed.

Figure 5: Schematic of financial model



Source: Economic Insight

⁸ Our profit measure is EBIT and cash flows are free cash flows (before tax), which are discounted at an assumed nominal pre-tax discount rate of 10%.

3.2.2. Stylised law firms

As noted above, our model is designed to calculate the expected profitability of 'stylised' law firm types. By this we mean that the data we use in our model is intended to be reflective of the financials for a 'typical' or 'representative' law firm(s). This is important to ensure that the base case position is rooted in the real world.

Related to the above, we understand that, in practice, there is considerable diversity across the providers of legal services, ranging from single independent practitioners and barristers through to large ABS structures. Consequently, basing our modelling purely on a 'single' firm, or type of firm, would risk omitting valuable information. For this reason our modelling addresses three stylised types of law firms, as summarised in the table below. A 'pen portrait' of each type is provided subsequently.

Table 1 Stylised law firm types

Stylised firm	Number of fee earners	Turnover range (£k pa)
Sole practitioner	1	<£100
Small firm	3 – 5	£600-£800
Medium firm	30 - 40	£5,000-£6,000

Source: *Economic Insight*

3.2.2.1. Pen portraits of stylised firms

Sole practitioner

Assumed to be a sole fee earner with a turnover of <£100k pa. These could be individual solicitors, typically operating in a town or village high street – or potentially from a home office.

We would expect such sole practitioners to primarily focus on core areas of legal advice of relevance to individual consumers, including: criminal law; family law; immigration; probate; and residential property. A material proportion of sole practitioners may well specialise in just one or two of the above areas.

Consistent with this level of turnover, we would typically expect such sole practitioners to have fee and productivity rates somewhat below overall industry averages. However, they are able to operate with minimal overhead costs and little / no administrative support costs, which makes this model viable.

The *Time of Change* study indicates that sole practitioners represent a material proportion of all law firms in England and Wales.⁹ We therefore consider this to be a particularly important 'firm type' to consider. Relatedly - and consistent with our pen portrait - the *Time of Change* study further found that: (i) the breadth of practice is related to firm size – and thus sole practitioners would have a relatively narrow service offer; and (ii) that there is a relationship between 'revenue per fee earner' and 'firm size', consistent with the relatively low assumed turnover figure here.¹⁰

Finally, we note that as direct access to barristers becomes more commonplace, the commercial considerations regarding complaints handling will become increasingly relevant to this segment of the wider industry. Therefore, we suggest that our findings with respect to 'sole practitioners' can also be used to draw inferences regarding the likely financial benefits to barristers (operating under direct access) of having good complaints handling processes.

With regard to their prevailing approach to complaints handling, we would not typically expect sole practitioners to have very detailed formalised 'policies' or customer relationship management (CRM) systems. Rather, due to the importance of 'personal relationships', complaints handling is likely to be managed in a less formulaic way.

Small sized firm

Assumed to be a firm with between 3 and 5 fee earners (and 1 to 2 administrative support staff) with a turnover between £600k and £800k pa. These would typically be operating in a small office located in a town centre.

We would expect these firms to have a somewhat wider service offer than sole practitioners. Their core offer will most likely relate to the areas of: criminal law; family law; immigration; probate and residential property. But, unlike sole practitioners, they are less likely to focus on just one or two of these fields. In addition, they might also offer advice relating to: employment; personal injury; and limited corporate / commercial work.

Firms of this size will require permanent office space and a degree of administrative support, which means that their productivity / fee rates must be somewhat higher than those for sole practitioners (and relatively close to industry norms for medium sized firms) in order to be viable.

The *Time of Change* data indicates that firms of this size also account for a material proportion of

⁹ See Table 2 in: '*A Time of Change: Solicitors' Firms in England and Wales.*' Pleasence, Balmer and Moorhead (2012). This shows that 33% of firms had a single fee earner.

¹⁰ The study reported a mean productivity (income per fee earner) of £243,129; with a median of £85,000. With

regard to the relationship between size of firm and productivity, the study reported that: "fee earners and fee earners per client only [equated] to around a 30% higher productivity per 100 fee earners." (Page 30).

the overall base of law firms,¹¹ and consequently we believe that it is important to consider them within the scope of our work.

Firms of this size are more likely to have somewhat more detailed, formal complaints handling policies, due in part to their access to administrative support. It is still unlikely that such firms would have detailed CRM systems, but some more limited client management systems and software may be used.

Medium sized firm

Assumed to be a firm with between 30 – 40 fee earners (and up to 20 administrative support staff) with a turnover of £5m to £6m pa. These would typically be located in larger town centres (and in some cases, such firms may have more than one town centre location).

Firms of this size would tend to offer the full suite of legal advisory services – and would undertake materially more commercial and corporate work relative to small sized firms.¹²

Due to the level of overhead and administrative support typically required to sustain firms of this size, fee and productivity rates need to be in line with industry averages in order to be viable (for example, our analysis suggests that overheads alone can typically be in the range of 30% to 40% of turnover for these firms).

Firms of this size represent a much smaller proportion of the overall base of law firms than small firms or sole practitioners.¹³ However, the higher fee and productivity rates of such firms means that they will account for a higher proportion of legal services provided in value terms.

With regards to their existing approach to complaints handling, we would generally expect more detailed, formalised, policies to be more commonplace amongst these firms. In addition, due to the higher volume of work (and relatedly greater number of clients) served relative to smaller firms, it seems likely that such firms may have some form of CRM or other customer database tool, which could be utilised to support complaint management.

Barristers and ABS's

In addition to the above, we believe that there is merit in considering the potential impact of improved complaints handling for both barristers and ABSs. In order to limit the total number of scenarios to a manageable level, however, our

assessment of these is more 'qualitative' in nature and is set out in Section 4 of this report.

When defining our stylised firms we assessed a range of data and evidence 'in the round.' In particular, we had regard to a number of factors, such as:

- their share of the population of law firms in England and Wales;
- their share of complaints;
- the likely areas of law they would advise on (and relatedly, how likely it is that complaints would be brought relating to those areas of law); and
- a range of qualitative factors, such as views as to the scope for improving complaints handling processes.

3.2.2.2. Base case data for stylised firms

In order to establish the 'base case' financial position of each of our stylised law firm types we made use of a range of data and evidence.

In particular, for our 'medium' sized firm, to inform our assumptions regarding turnover, fee rates, productivity and overheads, we primarily made use of accounting data as filed by law firms at Companies House.¹⁴ In particular, we collected accounting data for 21 actual firms that had characteristics consistent with our 'stylised' medium firm. Here it is important to note that:

- » The selection of firm data was random – other than seeking to ensure that each of the firms had characteristics consistent with the 'medium sized stylised firm.'
- » The purpose of the exercise was not to create a large, statistically significant sample. Rather, it was just to ensure that our start point for financial performance for the firm 'type' was broadly representative of how such firms perform in reality.
- » As we are modelling 'stylised firm types', none of our analysis reflects any one actual firm, and all of the data we collated and subsequently averaged was anonymised.

Assumptions regarding likely staff costs were based on a combination of: the 2012 Annual Survey of Hours and Earnings (ASHE) as published by the ONS and the Private Practice Solicitors' Salaries Survey (2012) as published by the Law Society. These were cross checked against the accounting data we collected.

¹¹ Table 2 shows that firms with between 2-5 solicitors represent 42% of the overall population of firms.

¹² For example, Table 5 of 'A Time for Change' states that only 2% of firms of this size have a "narrow practice."

¹³ For example, Table 2 of 'A Time for Change' indicates that they make up c. 7% of the population of firms.

¹⁴ The notes to the statutory accounts typically provide breakdowns of staff numbers by partners, fee earners and other, which allow us to calculate implied productivity and fee rates.

For our 'small' sized firm, accounting data is not readily available.¹⁵ We therefore started from our 'medium' stylised firm and adjusted down fee and productivity rates so that the implied turnover was consistent with: (i) evidence from other sources; and (ii) the firm being able to recover its likely overheads and salary costs. As per our 'medium' type firm, assumed salary costs were based on a combination of ASHE and Law Society data.

Finally, for our 'sole practitioner', we set the assumed fee and productivity rates such that the implied turnover was slightly under £100k pa – consistent with the *Time For Change* study. We assumed zero administrative support costs and minimal overheads.

3.3. Developing modelling scenarios

For each of the above three stylised firm types, our financial model generates quantitative estimates of the financial impact of making changes to complaints handling, for the purpose of informing our business case assessment. This is based on overlaying 'scenarios' in which improvements are made to complaints handling, the impact of which can then be compared to the 'base case.'

The scenarios allow flexes to be made with regards to:

- the amount of ongoing time (effort) allocated to handling complaints;
- the initial time (effort) allocated to setting up an improved complaints handling process (and also external and internal training costs);
- the propensity to offer clients refunds;
- any upfront investment associated supporting complaints handling.

The model then calculates the associated financial cost and benefit impacts of these changes, where the latter relates to a 'customer retention effect' and 'efficiency savings'. The model also allows the benefit of an uplift to customer acquisition to be included. However, we have not been able to identify any sufficiently robust evidence that allows us to parameterise this benefit. Therefore, the financial gain from customer acquisition is based on 'what if' analysis, whereby the user can specify and assumed increase in customer acquisition rates.

It is important to note that the scenarios we have developed capture changes to firms' internal complaints handling processes, and therefore relate to tier one complaints (rather than tier two complaints, which relate to those that are subsequently referred to the Legal Ombudsman).

3.3.1. Central case scenarios

Ultimately, a wide variety of scenarios can be designed and tested using the financial model. For the purpose of our study, however, we have sought to define a scenario for each of our three stylised firm types that we believe represents a 'reasonable' central case (in the sense that the scenario inputs are chosen based on our assessment of the types of improvements such firms could plausibly consider).

3.3.1.1. Sole practitioner

The primary change we have modelled is an increase in ongoing resource (measured in terms of time) allocated to complaints handling. We have assumed a 50% uplift in this.

We have also assumed that some costs would be involved in establishing an improved complaints handling process (specifically, attending external training – including a course fee). However, we have assumed:

- Zero upfront capital investment (as we do not think it would be credible for a sole practitioner to contemplate a CRM investment);
- No change to client refund amounts or propensity (as the commercial rationale for this is primarily based on efficiency savings, which we consider would be negligible for a sole practitioner).

Finally, we assumed that customer acquisition would increase by 1% as a result of these changes (although given the uncertainty regarding this, we subsequently set out sensitivities in which no uplift in acquisition is included).

3.3.1.2. Small sized firm

As per the sole practitioner, we have modelled an increase in ongoing resource allocated to complaints handling of 50%.

We have also assumed set up costs associated with time spent at both external and internal training (including a course fee for the external training).

Unlike the sole practitioner, however, we have also assumed:

- That a modest upfront investment of £3,000 would be made to facilitate a proportion of CRM costs that we assume are attributable to complaints handling.
- An increase in the assumed amount and propensity of refunds offered to clients – designed to achieve efficiencies.

As per the sole practitioner, we have assumed a 1% uplift in customer acquisition in our central scenario.

¹⁵ Due to HMRC exemptions on the need to file full accounting data for firms below certain size thresholds.

3.3.1.3. Medium sized firm

As per the other firm types, we assume a 50% increase in the time allocated to complaints handling.

We also assume that staff attend internal and external training, and incur setup costs associated with improving the complaints handling process.

We further assume:

- An initial upfront investment of £10,000 is required to facilitate improvements in CRM attributable to complaints handling (the investment being proportionate to the greater size of firm).
- As per the small sized firm, an increase in the assumed amount and propensity of refunds offered to clients – designed to achieve process efficiencies.

As per the sole practitioner and small sized firm scenarios, we have assumed a 1% uplift in customer acquisition in our central scenario.

3.3.1.4. Sensitivity analysis

Whilst it has been possible to parameterise the financial benefits of improved customer retention and efficiency gains within our model, as noted previously, the impact on customer acquisition is more uncertain.

To address this, in addition to the central scenarios set out here, we have modelled the financial impact on our stylised firms assuming:

- Zero uplift in customer acquisition; and
- A 2% uplift in customer acquisition.

This is in order to provide a 'high' and 'low' case around our central scenarios.

3.3.2. Review of existing studies and evidence

Both in order to develop the input data for our financial model and to inform the design of the scenarios (described above) we undertook a detailed review of existing academic and commercial studies relevant to understanding the impact of complaints handling on financial performance. The scope of this review specifically included:

- published academic economics papers;
- published academic marketing and business papers; and
- other public domain papers – such as estimates from commercial and / or consultancy type reports.

A summary of the evidence we collated from this review is set out in Section 4 of this report – and a more detailed description is provided in Annex A.

3.3.3. Qualitative interviews with law firms

We conducted 14 qualitative interviews with a range of law firms (and other providers of legal services). These interviews represent an important source of evidence for our study as they helped inform our views as to:

- the range of complaints handling processes that we should assume within our 'base case' position;
- the types of improvements that providers thought could be made to their processes;
- the types of financial impacts that those improvements could have in principle (both costs and benefits); and
- the likely 'order of magnitude' of those impacts.

Providers of legal services were selected for qualitative interviews based on our discussions with the Legal Ombudsman. Again, it is important to understand that the purpose of these was not to develop statistically significant quantitative evidence; but, rather, to ensure that the types of impacts we were considering – and their likely scale – were based on real world experiences of legal service providers. Given the qualitative nature of the discussions, we have not listed the names of the providers we spoke to. However, the following table provides a categorisation of the types of firms we spoke to.

Table 2 Breakdown of firms for qualitative discussions

Category of provider	Number interviewed
Barrister	2
Sole practitioner	1
Small firms	1
Medium firms	9
ABs	1

Source: Economic Insight



4. The Business Case

In this section we set out our assessment of the Business Case for good complaints handling in the legal services industry – including a quantification of the potential financial impacts.

We examine a range of evidence and analysis to inform our assessment of the business case - we specifically find that

- (i) ***Existing theory, evidence and research suggests there are commercial benefits to improved complaints handling.*** These primarily relate to the impact on firm reputation and brand and, relatedly, its impact on customer retention.
- (ii) ***Our financial modelling provides quantitative evidence to suggest that firm profitability can increase*** as the result of improving complaints handling processes.
- (iii) ***A number of the identified benefits can be ‘scaled up’*** to provide an indication of the overall welfare gains to consumers and firms of good complaints handling.

4.1. Review of existing evidence and analysis

In order to inform both our understanding of how complaints handling might impact firm financial performance – and relatedly, the design of scenarios within our financial model – we have undertaken a review of the existing academic and other relevant literature and evidence. A full summary of the papers we have reviewed is set out in Annex A. In the remainder of this section we summarise the key findings of relevance to our study – and in particular, describe:

- the key *types* of financial costs and benefits identified in the literature;
- evidence as to how those costs and benefits can vary in key dimensions;
- what the evidence suggests regarding methodologies for estimating costs and benefits; and
- existing quantitative estimates regarding the potential financial impact of complaints handling processes.

4.1.1. Evidence on key sources of financial costs and benefits

Many papers discuss the potential sources of costs and benefits to firms that may arise from the implementation of a complaints handling process. Key categories of costs identified in the existing literature – see particularly Stauss and Schoeler (2004)¹⁶ – include:

- » **Personnel costs** – the incremental cost of employee time spent dealing with complaints (note, in the context of law firms and other providers of legal advice, this could include the ‘opportunity cost’ associated with the reallocation of staff time away from fee earning activities in order to handle complaints).
- » **Administration costs** – any administrative costs incurred through implementing a (or improving an existing) complaints process, for example, printing or training costs.
- » **Response costs** – these typically include compensation or goodwill expenses.

The source of potential benefits arising from making improvements to complaint handling is also widely discussed. Key potential benefits specifically listed in the literature – in particular see: Mitchell and Critchlow (1993)¹⁷, Gilly and

Hansen (1985)¹⁸, and Stauss and Schoeler (2004)¹⁹, include:

- » **Customer retention effects** – adequately resolving a customer complaint may increase their likelihood of seeking the services of the firm again.
- » **Acquisition effect** – word-of-mouth is a powerful acquisition tool, and an effective complaint handling process can lead to positive recommendations.
- » **Internal firm processes effect** – an effective complaints handling process can be a valuable source of management information to firms, which in turn can underpin improved financial performance. In particular, complaints can be a source of information regarding areas that a firm is weak in; and so where there is scope for improvements to be made, resulting in either enhanced revenues or cost efficiencies.
- » **Firm reputational effect** – a strong complaints handling process may help enhance the overall reputation of a firm, so enhancing its ‘brand value’. There is a well-established evidence base that shows that investment in brand and reputation can lead to increased returns for companies. The mechanism for this could come through enhanced acquisition / retention or through the ability to maintain a price premium.
- » **Indirect benefit through lower staff costs** – providing a fair and just complaints handling process can increase the alignment between firm and employee values, subsequently increasing employee retention and reducing staff turnover costs. More generally, there is a considerable economics literature that shows that strong internal staff values can allow firms to acquire and retain staff at lower cost.

4.1.2. How the costs and benefits can vary

The above sets out the potential *types* of costs and benefits associated with implementing an effective complaints handling process. However, the literature and existing evidence base suggests that the scale of these costs and benefits can vary depending on factors such as: (i) how a complaints handling process is implemented in practice; and / or (ii) the specific characteristics of the firm and customers in question. Therefore, whether in practice it is commercially beneficial for providers to improve their complaints handling process will, to some extent, turn on factors such as these.

¹⁶ ‘Complaint Management Profitability: what do complaint managers know?’ Stauss and Schoeler, *Managing Service Quality* (2004).

¹⁷ ‘Dealing with Complaints,’ Mitchell and Critchlow, *International Journal of Retail and Distribution Management* (1993).

¹⁸ ‘Consumer Complaint Handling as a Strategic Marketing Tool,’ Gilly and Hansen. *Journal of Consumer Marketing* (1985).

¹⁹ ‘Complaint Management Profitability: what do complaint managers know?’ Stauss and Schoeler, *Managing Service Quality* (2004).

Below we provide some examples of why this might be the case.

As noted previously, one potential benefit of improved complaints handling is the scope for an uplift in customer acquisition. Consequently, a determinant of whether an improvement in complaints handling is likely to be profitable could be the firm's expected costs of acquiring new customers. This, in turn, could be a function of switching barriers within an industry – see Estelami (1999).²⁰ The higher the costs for a consumer to switch providers, the greater the incentive has to be to invoke switching, and therefore the more costly it is for the firm. In the context of a legal services firm, this could mean that to attract customers from further afield, and to therefore overcome the additional travelling costs, they would need to implement a very effective complaints handling process to generate such positive word-of-mouth recommendations to convince prospective clients of the value. Consequently, a firm in a rural area *could* experience higher acquisition costs - and so a complaints handling process might be less profitable for them.

Estelami (1999) discusses two further issues that could give rise to variations in the expected financial impact of complaints handling across firms or customers: the cost of resolving a complaint; and the existing level of customer loyalty. Clearly the cost of resolving complaints could, in principle, vary across firms or customer types. In cases where the cost of resolving a complaint is too high, then the benefits (e.g. retention) may not be enough to justify the costs. Relatedly, existing levels of customer loyalty can also vary across firms. In principle, some firms may have customers that are so loyal that they will not switch even if they are dissatisfied. In such cases, investing in complaint handling becomes less profitable.

Relating to how complaints handling processes are implemented in practice (and the impact of this on expected financial performance) Smart and Martin (1992)²¹, Tax, Brown and Chandrashekar (1998)²²; and Johnston and Mehra (2002)²³ highlight the importance of conducting the complaints process with a human

touch and conveying commitment to ensure the customer feels valued.

Regarding customer characteristics, Homburg, Fürst and Koschate (2010)²⁴ demonstrate that the effectiveness of a complaints handling process will depend on customer characteristics, such as perceived level of importance of the problem and socio-demographics.

4.1.3. Methodologies for estimating costs and benefits of complaints handling

As discussed above, the existing literature identifies a range of potential financial costs and benefits associated with complaints handling processes - and the factors that can cause these to vary. Estimating the monetary impact of these (which is of particular relevance to our study) can, however, be challenging. The main techniques used for this purpose, as outlined in the literature, are summarised below.

- » With regard to the overall framework to be used when estimating financial impacts, Gilly and Hansen (1985)²⁵ advocate that any such evaluation should be made in a manner consistent with how firms make any other business decision. We note that this principle has guided our overall framework and approach, as outlined in Section 3 of this report.
- » A number of authors propose the use of customer surveys to identify and estimate the specific parameter values for cost and benefit impacts – e.g. Stauss and Schoeler (2004).²⁶ These can be particularly helpful with regard to the estimation of reputational effects and their impact on customer acquisition and retention (say, via word-of-mouth effects). Although a large-scale customer survey is not within the scope of our work, our analysis has been informed by qualitative interviews with providers of legal advice.
- » Another technique that can be used is one of profitability analysis. In particular, one could seek to identify statistical relationships between firm profitability (or firm value

²⁰ 'The Profit Impact of Consumer Complaint Solicitation Across Market Conditions.' Estelami, *Journal of Professional Services Marketing* (1999).

²¹ 'Manufacturer Responsiveness to Consumer Correspondence: An Empirical Investigation of Consumer Perceptions.' Smart and Martin. *The Journal of Consumer Affairs* (1992).

²² 'Customer Evaluations of Service Complaint Experiences: Implications for Relationship Marketing.' Tax, Brown and Chandrashekar. *Journal of Marketing* (1998).

²³ 'Best Practice Complaint Management.' Johnston and Mehra. *Academy of Management Executive* (2002).

²⁴ 'On the Importance of Complaint Handling Design: A Multi-level Analysis of the Impact in Specific Complaint Solutions.' Homburg, Fürst and Koschate. *Journal of Marketing Science* (2010).

²⁵ 'Consumer Complaint Handling as a Strategic Marketing Tool.' Gilly and Hansen. *Journal of Consumer Marketing* (1985).

²⁶ *Complaint Management Profitability: what do complaint managers know?* Stauss and Schoeler, *Managing Service Quality* (2004).

drivers that link to revenues and costs) and the quality of firm complaint handling processes.

4.1.4. Existing quantitative evidence

In order to ensure that our scenario modelling of improvements to complaints handling is robust, we need to identify parameter values that allow us to simulate the impact of these improvements on firm costs and revenues. Consequently, we have reviewed the existing evidence base relating to complaints handling to determine whether any such parameter values have previously been estimated.

Based on our review, we do not believe that any previous study has specifically sought to estimate the financial impact of complaints handling processes *in the legal services industry*. Consequently, it is necessary to review quantitative estimates relating to potential financial impacts in other industries, then seek to make inferences regarding their impact with respect to legal services. Below we set out the key quantitative financial impact estimates we consider to be of most relevance to our work.

With regard to understanding the potential uplift in customer retention that can arise from making improvements to complaint handling, a particularly relevant paper is that of Johnston (2001).²⁷ This empirical study measures correlations between 'scores' (on a scale of 1-5) for complaints processes and key value drivers, such as customer satisfaction and retention – based on survey responses from 40 UK businesses. The results of the study imply that a 10% improvement in complaint processes could translate to a 2% increase in customer retention.²⁸ We have therefore used this to estimate the potential customer retention benefit associated with making improvements to complaints handling within our financial model.

Consistent with the above, Ang and Buttle (2006)²⁹ investigate the relationship between customer retention and complaints handling processes. Among Australian companies across all major industries, they find a correlation of 0.28 between having a documented complaints handling process and the company exceeding its retention expectations.³⁰

As discussed previously, Estelami (2013)³¹ undertook a Monte Carlo analysis based on a

probabilistic framework, which sought to identify the potential profit uplifts associated with (i) increased solicitation; and (ii) increased resolution of complaints. The author found the potential for modest profit uplifts.

Finally, a range of studies provide quantitative estimates of the link between financial performance and firms' reputations. For example, using dynamic econometric models, Roberts and Dowling (2002)³² find a strong relationship between sustained financial performance and firm reputation. However, whilst such studies are relevant to our work, it is difficult to make use of their findings directly, as one would need to statistically identify the link between complaints handling and firm reputation in the first instance.

4.1.5. Codification of papers reviewed

For completeness, we have 'codified' the 25 papers we reviewed as part of this study according to whether they are:

- » **Theoretical.** These relate to the theory of what effects complaints handling will have on the performance of a firm, or the behaviours of customers.
- » **Empirical – Operational.** These papers use evidence from either surveys or actual market data to demonstrate the link between complaints handling and operational measures, such as retention. All papers reviewed are supportive of the positive effects of complaints handling on operational performance.
- » **Empirical – Financial.** These papers use actual market evidence, sometimes coupled with survey data, to show the relationship between complaints handling and financial performance. All papers are supportive of the positive relationship between the two.

A summary of this is shown in the following figure.

²⁷ 'Linking complaint management to profit,' Robert Johnston. Warwick Business School (2001).

²⁸ The study reported a correlation coefficient of 0.58 between complaint process score and customer satisfaction; and a correlation coefficient of 0.41 between customer satisfaction and customer retention. The product of these is 0.23, implying that a 10% improvement in complaints processes equates to a 2% increase in customer retention.

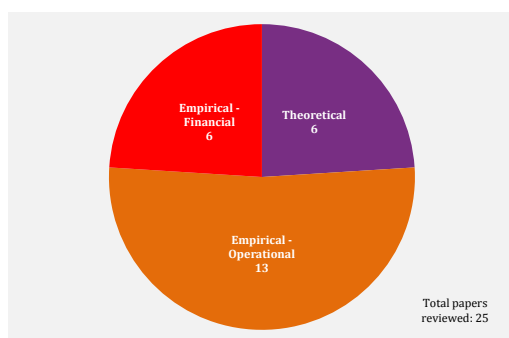
²⁹ 'Customer Management Processes: A Quantitative Study,' Ang and Buttle, *European Journal of Marketing* (2006).

³⁰ Although the study does not allow us to translate this into a quantifiable uplift in retention.

³¹ 'The Profit Impact of Consumer Complaint Solicitation Across Market Conditions,' Estelami, *Journal of Professional Services Marketing* (2013).

³² 'Corporate Reputation and Sustained Superior Financial Performance,' Roberts and Dowling, *Strategic Management Journal*, (2002).

Figure 6: Classification of papers



Source: Economic Insight

4.2. Expert opinion of Dr Andrew Mell

Dr Andrew Mell is an academic economist and a fellow at Corpus Christi College, Oxford. He is an expert in the economics of reputation, and so we asked him to provide an opinion as to the likely business case for complaints handling in the legal services industry from a theoretical perspective.



"A good system for handling complaints from customers can help a law firm to ensure that more of their customers now and in the future are satisfied customers. This will improve the firm's reputation and lead to more repeat business from those customers who frequently find themselves in need of legal advice." Dr Andrew Mell

His opinion is set out in full within Annex B to this report, but the key points raised by Dr Mell are as follows:

- » Economic theory suggests that there is likely to be a good business case for law firms investing to improve their complaints handling.
- » This is because complaints handling can enhance reputation and brand, which should be regarded as an 'asset' to law firms, on which they would be expected to earn a return.
- » The most direct route for a good complaint handling system to improve a firm's reputation would be by turning customers who would otherwise have been unsatisfied into satisfied customers.

4.3. Key findings from our qualitative interviews

As set out in the methodology section of this report, we conducted 14 qualitative telephone interviews with a range of law firms. This was, in part, to help ensure that the assumptions we made in our modelling analysis were based on how firms currently manage complaint handling in practice. In addition, however, the interviews also provided a number of helpful insights in of themselves. As we spoke to firms on a non-attributable basis, we have summarised what we consider to be some of the key messages below, without any reference to specific firm names.

- » The amount of complaints received varied considerably across the firms we spoke to. There was no particularly common view as to what factors affected the volume of complaints received, although there was general acceptance that service quality was a key driver. In addition, some respondents commented that they felt more complaints were being raised on cost grounds. Relatedly, a small number of firms said that, in some cases, clients lodged complaints about the cost purely as an attempt to lower the final bill, rather than actually being dissatisfied with the service received.
- » The reported amount of time spent handling an average complaint also varied largely across the firms we spoke to. Respondents estimated spending between 2 and 12 hours per complaint (although most were in the range of 2-5 hours). The type of people within a firm responsible for complaint handlings also varied. In some instances, for example, a non-lawyer member of staff conducts most of the handling, and in one case the firm outsourced some of the complaint handling altogether, as this was more cost effective than allocating internal staff time.

"Complaints are a huge drain on time, so we hire an external consultant to help with them."

- » In certain cases there was a sense that some firms think about complaints handling primarily from the perspective of the costs it creates for the business, rather than to take a more holistic perspective as to its potential positive impact on profit.

"Every hour spent dealing with complaints is an hour of billable time lost, but we need to do it."

- » Where a complaint is upheld, the standard amount of compensation that firms offer tends to range between £100 and £500. There were a few reports of having to give a full refund, worth £1-3k. One respondent was able to give the precise figure of discounts given.

- » The time spent setting up the complaints handling process was generally considered to be quite small, with the largest part being time spent in meetings informing all colleagues of the process.
- » Most firms use a case management system, typically either Riliance or Proclaim, which they can log complaints in. However, complaints management represents just one element of what the software is used for, and so is not always the most important factor in the purchase decision.
- » Firms tend not to engage in, or monitor, social media as a means of encouraging pro-active client feedback. However, one firm said that they did have a twitter account, used primarily for corporate social responsibility communications; and also had a blog.
- » Respondents wanted to prevent complaints going to the Legal Ombudsman, due to the additional cost of time spent dealing with the complaint along with the potential case admin fee. There was, therefore, general agreement that there were benefits to having good first tier handling processes, which resolved complaints early on in the process.

“It’s good to nip it in the bud as soon as possible.”

- » Respondents generally recognised the commercial gains that could arise from having good complaints handling (although many wished to highlight the fact that they were, in any case, now required to have a complaints handling process). Respondents suggested that an effective complaints handling process was likely to have a small, but positive, impact on firm profits.

“There is a positive effect on profit... [but it]... is not massive.”

4.4. Results of modelling analysis – central scenarios

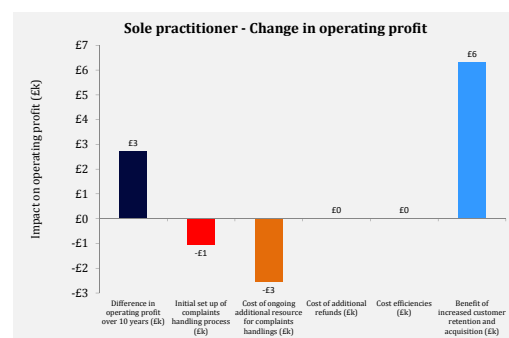
In the following we set out the results of our modelling analysis for the ‘central case’ scenarios described earlier.

As these are primarily assumption driven, it is important to note that these do not represent the ‘most likely’ outcomes in a statistical sense. Rather, they show the financial impacts given a set of parameters that we believe are ‘reasonable’ based on the evidence we have reviewed. In turn we set out the results for our three types of stylised firm. The scenario results that follow reflect assumed improvements in relation to first tier complaints handling.

4.4.1. Sole practitioner results

The following figure shows the overall impact on projected operating profit (over ten years) in absolute terms, based on our central scenario for the sole practitioner improving his / her complaints handling process. The chart splits the overall change in profit into its component parts.

Figure 7: 10 year profit impact by key driver

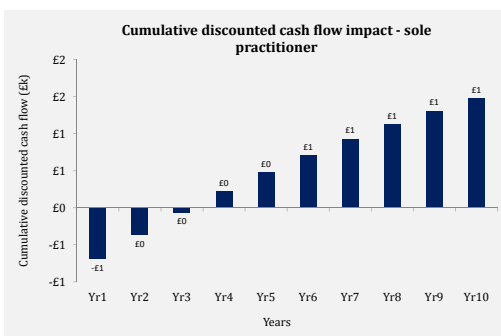


Source: Economic Insight

The above analysis shows that a sole practitioner could expect to earn £3k additional profit over a 10 year period, which translates to a 3% increase relative to the base case (note that profits are stated after the sole practitioner’s salary is deducted). Consistent with our description of the scenario, we have not assumed any change in client refunds or efficiency gains for the sole practitioner. Therefore, the totality of the change is driven by: (i) the ongoing and initial costs primarily associated with the additional time required to improve complaints handling; versus (ii) the financial benefit of improved customer retention and acquisition.

Figure 8 shows the corresponding impact on the projected cumulative discounted cash flows of the sole practitioner.

Figure 8: Discounted cash flow impact



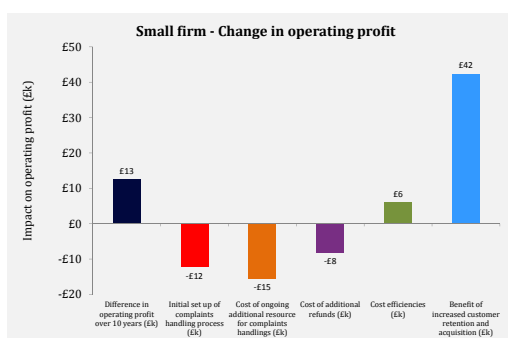
Source: Economic Insight

The above analysis shows that there is a small initial negative cash flow impact, due to the setup costs outweighing the initial revenue gains. However, after three years this cost has paid back.

4.4.2. Small sized firm results

Figure 9 sets out the overall operating profit impact over ten years in absolute terms, based on our central scenario for our 'small sized' stylised firm. The key differences relative to the sole practitioner scenario are that we assume: (i) the firm pays increased client refunds in the expectation of making efficiency savings; and (ii) incurs a modest up-front investment cost associated with CRM. The chart splits the overall profit impact into its constituent elements.

Figure 9: 10 year profit impact by key driver

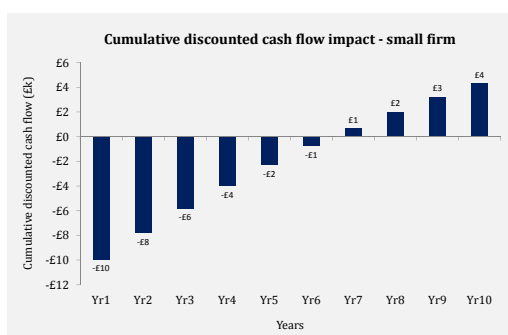


Source: Economic Insight

Our analysis indicates that the 'small sized' firm would improve its operating profit by £13k over a 10 year period. This translates to an increase of 2% in percentage terms, relative to the base position. The profit gain is primarily driven by improved customer acquisition and retention, which drives increased profits of £42k over the period.

Figure 10 shows the impact on the 'small sized' firm's projected discounted cash flows. Note, due to the modest upfront investment, the cash flow impact is initially negative, but has paid back by year 7.

Figure 10: Discounted cash flow impact



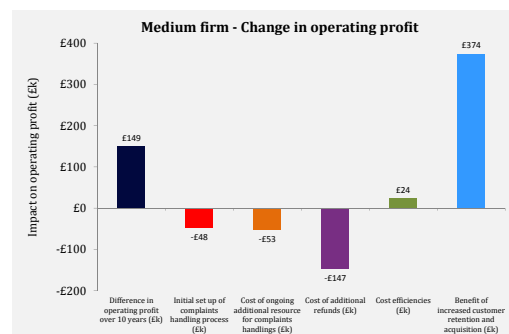
Source: Economic Insight

The overall impact of making the improvement to complaints handling is cash flow positive for the 'small sized' firm.

4.4.3. Medium sized firm results

Figure 11 shows the impact on profits based on our central case scenario for our 'medium sized' stylised firm. Here we assume a more substantial initial investment in CRM may be required, and also an increase in customer refunds.

Figure 11: 10 year profit impact by key driver

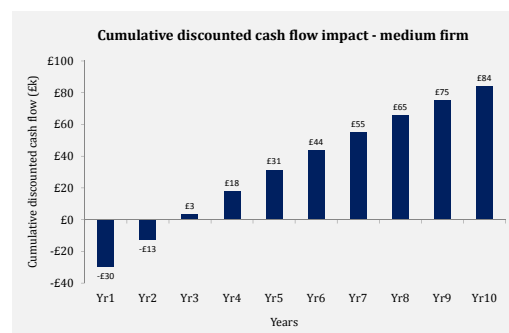


Source: Economic Insight

In totality, we find that a medium sized firm might expect its profitability to increase by up to £149k over 10 years (an increase of 3% in percentage terms relative to the base case). The higher value of cases managed by larger firms means that the cost impact of increased refunds is greater. However, the expected uplift in customer retention and acquisition is substantial, at £374k over ten years, more than sufficient to offset the costs of making the improvement.

The following chart shows the corresponding expected impact on the firm's discounted future cash flows.

Figure 12: Discounted cash flow impact



Source: Economic Insight

Interestingly, although the medium sized firm is assumed to require a greater initial investment than the small sized firm, the investment pays back quicker (by year 4). This is because the expected value of the increase in customer acquisition and retention is greater, due to the higher average value of cases handled by the medium sized firm.

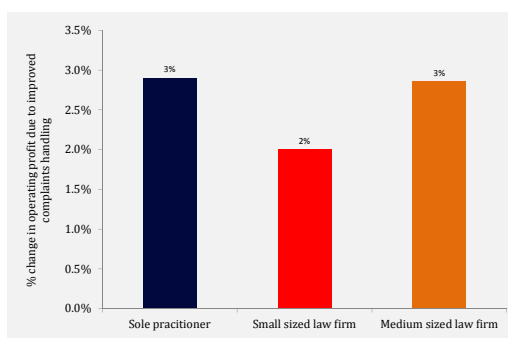
4.4.4. Summary of results and sensitivity analysis

Across all three stylised firm types, we find that the impact of our central scenarios regarding improvement to complaints handling is:

- expected to increase operating profitability; and
- is strongly cash flow positive.

The chart below provides a summary of the expected percentage increase in operating profit across the three firm types. It shows that, based on our central case, law firms might expect their operating profits to increase be between 2% and 3% as a result of having good complaints handling processes.

Figure 13: Expected % profit impact of improving complaints handling



Source: Economic Insight

As set out above, the slightly larger profit benefit to medium sized firms in our scenarios arises because they have somewhat higher fee and productivity rates than smaller firms (and so the absolute value of additional customers is higher).

Under our scenarios, small law firms are expected to benefit slightly less than sole practitioners (in percentage terms). This is due to our assumption that small firms might need to incur some modest up-front investment to facilitate the improvement in complaints handling.

As described previously, the results presented here are subject to a relatively high degree of uncertainty. This is primarily because, to date, there has been no empirical academic study or survey that specifically seeks to assess the impact of complaints handling on key value drivers specifically in the legal industry. Our analysis, therefore, has been constructed around a series of 'what if' scenarios, that make best use of available data relating to other industries.

To reflect the above uncertainty, we recalculated the expected % change in profit that would arise from an improvement in complaints handling assuming: (i) that there would be no increase in

customer acquisition are a result (our low case); and (ii) that customer acquisition would increase by 2% as a result (our high case). The results of this sensitivity analysis are shown in the following table.

Table 3 Sensitivity analysis

Scenario	% increase in operating profit
Sole Practitioner	
High	4%
Central	3%
Low	2%
Small sized firm	
High	3%
Central	2%
Low	1%
Medium sized firm	
High	4%
Central	3%
Low	1%

Source: Economic Insight

Our sensitivity analysis indicates that the range of potential profit impacts lies between 1% and 4%. We consider this range to be relatively robust, based on the input assumptions made. Further, it should be recalled that complaints handling is just one driver of overall law firm financial performance – and importantly, it is a much less direct driver than: fee rates, utilisation, recovery, staff costs and overheads. Given this, it is doubtful that one could credibly suggest that the likely profitability impact of improved complaints handling could be *materially higher* than the range set out here.

Relatedly, we note that using a probabilistic modelling approach based on making changes to the probability of complaint solicitation and resolution, Estelami (2013) reported that: “*profits do not seem to shift a great deal—only by about 1%. This suggests that while complaint handling does contribute to profits, the effect may, on average, be small.*”³³ However, under sensitivity analysis that allowed for customer switching, the author found profits could vary by up to 5%.

³³ ‘The Profit Impact of Consumer Complaint Solicitation Across Market Conditions.’ Estelami, *Journal of Professional Services Marketing* (2013). Page 18.

4.4.5. Net benefits relating to tier two complaints

As noted in Section 3 of this report, our scenario analysis relates to changes in firms' internal processes regarding how they deal with the complaints they receive. As such, our analysis implicitly relates to the financial impact with respect to first tier complaints. In practice, however, improvements in how firms handle tier one complaints may have an impact on the cost of second tier complaints, either because: (i) they reduce the number of complaints that are referred onto the Legal Ombudsman in the first place – and so there are less tier two complaints in totality; and / or (ii) they reduce the total resource requirements at the tier two stage.

For the purpose of our study, we have, however, included an approximation of the potential net benefits at the Tier 2 level in our calculation of the overall net benefits to the industry, and this is set out subsequently.

4.5. Qualitative assessment of impact for barristers and ABSs

We have not undertaken any quantitative modelling specifically in relation to the impact of improved complaints handling on barristers and ABS's. However, we have given some qualitative consideration as to the likely relevant issues relating to both, which are as follows:

» **In relation to barristers**, as set out earlier, we consider that the nature of the impacts identified for our sole practitioner stylised firm are likely to be broadly applicable, at least in instances where there is direct client access to the barrister (i.e. as per a sole practitioner, we do not believe it likely that individual barristers would consider investing in CRM, or would actively seek to monitor process efficiencies). However, a key differentiating feature is that, by virtue of being part of a Chambers, barristers often have access to *some* level of administrative support – which, in principle, could impact that nature of complaint management. A further differentiator is that both the expected turnover and cost structures / levels earned or incurred by barristers are likely to be somewhat different from those for our styled sole practitioner, where we assumed a very low level of turnover, with little overhead. Notwithstanding the above, however, because the same 'in principle factors that drive the expected benefits of improved complaints handling would still seem to apply, intuitively our view is that there is likely to be a business case for barristers also having a good complaints handling processes.

» **Alternative Business Structures (ABS)** refer to firms that provide legal advice where a non-

lawyer is either: (i) a manager of the firm; or (ii) has an ownership interest in the firm. A firm can also be an ABS where another body: (a) is a manager of the firm; or (b) has an ownership interest in the firm. With regards to the likely business case for complaints handling, we have a number of observations in relation to ABS:

- ABS may find it easier to raise capital than traditional law firm structures, due to the ability to raise equity from a broader base. Consequently, to the extent that improvements to complaints handling require investment (which is more likely to be true for larger providers, as CRM systems are likely to be more relevant) it could be that, in some instances, ABS are better able to realise those benefits.
- Because ABS are able to operate as a broader 'one stop shop,' to the extent that some complaints handling resource can be shared (e.g. central administrative costs, shared CRM costs), then they may benefit from economies of scope with regard to complaints handling. This may, therefore strengthen the business case for improved complaints handling.
- On the other hand, there are risks associated with the 'broader portfolio' of services that ABS offer. In particular, an approach to complaints handling that is suitable for, say, financial services, may not be appropriate for legal services. Consequently, were ABS to seek to leverage existing complaints handling practices across into legal services, they might incur various cost inefficiencies and / or fail to meet customer needs appropriately.

4.6. Consideration of wider industry impacts

In addition to developing a quantified Business Case for complaints handling (set out previously) within the scope of our work we have given some consideration to *wider* industry impacts. In particular, we have sought to determine which of the financial costs and benefits identified in our analysis could be 'scaled up' to provide an indication of the potential 'industry' benefit of good complaints handling.

Here it is important to note that, in economic terms, by total industry benefit we are specifically referring to the impact of good complaints handling on *total welfare*, which captures both the net benefit to firms and consumers. Put another way, once net benefits are scaled to an industry level, in practice those benefits would be shared between firms and consumers (but quite how they would be shared is difficult to determine robustly).

In considering whether particular costs and benefits should be ‘scaled up’ in order to form part of our measure of total industry welfare, it is important to distinguish between:

- » Costs and benefits that are associated with generating increased value across the industry as a whole (e.g. incremental growth in demand or sector wide cost efficiencies); versus
- » Costs and benefits that arise because of intra-firm rivalry (e.g. firms competing for customers) which could benefit any individual firm or set of firms, but clearly would leave total industry value – and therefore welfare – unchanged.

In practice, it can be difficult to distinguish between the above affects with certainty.

4.6.1. Approach to scaling up

4.6.1.1. Differentiating between competitive effects and wider market impacts

To ensure we calculate the net benefit to the industry appropriately, we consider each source of cost and benefit separately.

Set up costs identified at the firm level will be experienced by each firm in the industry that improves their complaint handling; and so represent a cost to industry welfare. The estimate for the industry cost associated with setting up improved complaints handling processes are therefore calculated as the upfront cost to an individual firm multiplied by the number of firms that are assumed to make the improvement. The absolute number of firms in the industry has been sourced from the SRA, and the proportions between our stylised firms has been sourced from the report: ‘*A time of change.*’

In a similar fashion, the ongoing incremental costs to firms of improving complaints handling (and any related cost efficiencies) will be realised by every firm that improves their complaint handling and have therefore been scaled in the same way as set up costs.

The identified increase in demand for legal services at a firm level (both improved customer retention and acquisition) will be a consequence of both: (i) gains from rival firms through competition; and (ii) gains from market growth resulting from improved complaints handling. Specifically, being better at complaints handling could both help a firm retain a customer from a rival, but could also help retain a customer who might otherwise have left the market for legal services. For example, a customer’s future decision regarding whether to have a will written might in part be a function of their previous experience with a law firm. Therefore, a positive experience of complaint handling in relation to a prior legal matter might increase the likelihood of that customer purchasing a will. Conversely, a poor complaint handling experience might lead

the customer not to purchase a will, meaning that this ‘value’ is lost from the market.

Given the above, it is clearly appropriate only to scale a *proportion* of the customer acquisition and retention benefit to the industry level (i.e. we need to exclude the benefits associated with intra-firm rivalry). Our estimate of this proportion is based around a plausible implied market price elasticity for legal services. We do this as follows:

- » **First**, we first assume that the increase in complaints handling quality assumed in our scenarios has the same welfare effect as a decrease in price of equivalent value. This means we can calculate the % change in the cost of our stylised firms that is due to the improvement in complaints handling and interpret it as a % change in price.
- » **Second**, we then calculate the % increase in demand under our scenarios as being the difference in billable hours between the base case and the scenario (but where we only include a proportion of the increase in demand, where that proportion reflects our view as to demand uplift that is not due to competitive rivalry).
- » **Third**, by dividing the % change in demand by the % change in price (or quality) we can observe the implied market elasticity for legal services.
- » **Finally**, we can then vary the proportion of the demand effect we assume related to market growth so that the implied market elasticity in step three is plausible.

We have not been able to identify any published estimates of the market price elasticity for legal services. However, given the nature of legal services, we expect that the industry level demand is relatively inelastic – that is, a small percentage change in price will lead to an even smaller percentage change in demand (in economic terms, this implies a market elasticity of less than 1). This is because the purchase of most legal services often a necessity, rather than being a discretionary ‘nice to have’, and so demand is unlikely to be particularly sensitive to price at the total market level. This is consistent with recent research identified by the Legal Services Board, which has

shown that price is not the primary driver of purchasing legal services.³⁴

As points of reference, an empirical study has shown that the price elasticity of food and beverage ranged from 0.27 to 0.81;³⁵ and another that the price elasticity of municipal water ranged between 0.41 and 0.63.³⁶ We have therefore only scaled up a proportion of the estimated acquisition and retention benefit, consistent with the implied market elasticity being less than 1.³⁷

It is important to emphasise that the identification of the benefit of increased demand between 'intra-firm competition' and 'market demand' is subject

to material uncertainty. Whilst we consider the approach we have deployed to be reasonable given the available evidence, it is heavily reliant on a number of simplifying assumptions, which may not hold in practice.

Finally, the scaling of the cost to firms of additional refunds also needs to take account of the amount of growth coming from outside the sector. We have therefore scaled this cost based on the same proportion we assume for

the benefit of increased demand.

4.6.1.2. Uncertainty as to the number of firms that would make the assumed improvement

A further uncertainty in determining the total industry welfare gain is the number of firms by which the identified costs and benefits should be multiplied over.

This is because in practice, it would be inappropriate to assume that all firms in the legal services industry would make the improvements to complaints handling that we have assumed in our individual 'stylised firm' scenarios. This is for two reasons:

- First, some firms will already have good complaints handling processes, which may be at or above the quality assumed in our scenarios; and

- Second, some firms might be unsuccessful in improving their complaints handling processes.

In practice there is no data or evidence that we can draw upon to robustly determine by what proportion of firms our costs and benefits should be scaled by. We have therefore undertaken a sensitivity analysis, whereby we assume that: 40%, 50% and 60% of firms make the improvement (to provide a low, central and high case for our estimates).

4.6.1.3. Scaling to allow for net benefits at Tier 2

Finally, although as noted previously, our firm level analysis focused on Tier 1 complaints, it is clear that there would be net benefits in relation to Tier 2 complaints. Therefore, in estimating the overall net benefit to the industry as a whole, we have up-scaled our Tier 1 results by the proportion of Tier 2 complaints as reported by the Legal Services Board to Tier 1 complaints (20%).³⁸ In other words, we assume that the impact of improved complaints handling at Tier 2 is proportionate to the volume of Tier 2 complaints. Clearly in practice, the actual Tier 2 related net benefit could be higher or lower than this amount.

4.6.2. Industry wide benefits

Based on the approach described above, we have calculated the wider industry net benefit of good complaints handling for a low, medium, and high case. The chart below shows both:

- Our estimated annual net benefit for the industry in pure £m terms (the red bars); and
- Our estimated net benefit for the industry in net present value (NPV) terms over 10 years (this is the measure typically used by government when making policy decisions).³⁹



"Our findings are consistent with there being material benefits to the industry arising from good complaints handling. Importantly, these benefits would be shared between consumers and providers."

³⁴ <https://research.legalservicesboard.org.uk/wp-content/media/Map-of-Legal-Services-Part-2-Demand-October-20111.pdf>

³⁵ 'The Impact of Food Prices on Consumption: A Systematic Review of Research on the Price Elasticity of Demand for Food,' Andreyeva et al (2009), American Journal of Public Health

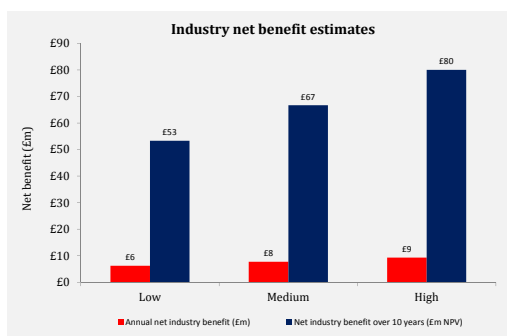
³⁶ 'Price elasticity of demand for municipal water: A case study of Tucson, Arizona,' Young (2010), Water Resources Research

³⁷ This implies that up to 80% of the demand effect could be scaled up to industry level.

³⁸ 'Market impacts of the Legal Services Act 2007 - Baseline Report (Final),' LSB (2012)

³⁹ Discounted net benefits were calculated using the recommended social discount rate of 3.5% as published by HM Treasury in the Green Book.

Figure 14: Expected % profit impact of improving complaints handling



Source: Economic Insight

In summary, we find that the annual net benefit to the industry from good complaints handling could range from £6m to £9m pa, and that in NPV terms the net benefit could be between £53m and £80m (the upper end of which translates to an increase in overall industry profitability of 1.1%). As noted, both the individual firm level analysis and the industry scaling is subject to considerable uncertainty – and so we cannot comment on the statistical likelihood of these results. Nonetheless, our findings are consistent with there being material benefits to the industry arising from good complaints handling. Importantly, these benefits would be shared between consumers and providers.



5. Conclusions and key findings

This final section of our Report brings together the evidence and analysis set out in the preceding sections in order to summarise our key findings.

Our key conclusions regarding the business case for good complaints handling in the legal services industry are as follows.

- (i) ***Economic theory and evidence provides strong grounds to believe that there is a Business Case for improved complaints handling in the legal services industry.*** In particular, theory points to enhanced reputational and firm process related financial benefits, and empirical evidence is consistent with profitability being enhanced.
- (ii) ***Our financial modelling analysis shows that, with a reasonable set of input assumptions, the profitability of law firms can increase*** as the result of improved complaints handling. The scale of financial gain is somewhat uncertain, but could be around a 2% to 3% increase in operating profit.
- (iii) Illustrative analysis of the potential wider gains from good complaints handling indicates that ***the total net benefit to consumers and firms could be up to £80m in present value terms across the industry as a whole.***

5.1. Economic theory and evidence

As noted in Section 3 of this report, economic theory provides a strong basis to suppose that there is a business case for good complaints handling in the legal services industry.

Specifically, investing to make improvements in complaints handling can improve a firms' reputation and brand, which in turn can allow it to outperform rivals, boosting customer retention and acquisition.

In addition, the literature also shows that complaints handling can itself be a powerful source of management information to firms, which can allow them to improve their operational performance (e.g. achieve cost efficiencies).

There are also a number of empirical studies that examine the links between firm reputation / complaints handling and financial performance. However, we have not identified any that *specifically relate to legal services*. Nonetheless, due to the central role that solicitor / client relationships play in the legal advice sector, the importance of reputation and brand (and therefore complaints handling) is likely to be particularly important in this industry. This view is supported by Dr Andrew Mell, an economist with expertise in the economics of reputational effects.

5.2. Economic Insight financial modelling

We developed a forward looking financial model, which calculates the projected profit and cash flows of stylised law firm types for both: (a) a base case; and (b) scenarios whereby improvements are made to complaints handling.

The scenario analysis is 'assumption driven' and therefore is subject to uncertainty. Nonetheless, based on a reasonable set of assumptions as to how firms might improve their complaints handling process, our model shows that:

- Improvements to complaints handling can improve the profitability of law firms by between 2% and 3%; and
- That investment in improving complaints handling is strongly cash flow positive and can pay back quickly.

Whilst the nature and scale of the potential financial benefits is likely to vary across different types of law firms, the above findings are true across all three stylised law firm types that we examined within the scope of our work.

Due to the lack of existing empirical studies and survey evidence that relates specifically to legal services, we cannot comment on the likelihood of the scenarios we have developed here. However, our modelling is sufficient to conclude that

improvements to complaints handling can demonstrably increase the profitability of firms.

5.3. Potential for wider benefits

With regard to the financial costs and benefits identified in our modelling analysis, we consider that these can be 'scaled up' to provide an indication of the wider costs and benefits.

At an industry level, it is important to note that the total net benefit would in practice be shared by consumers and firms (but it is ambiguous as to how exactly these net benefits would be shared).

The extent to which the costs and benefits we estimate at firm level should be scaled is subject to uncertainty because:

- One should not scale benefits or costs that arise from intra-firm rivalry; and
- It is not clear what proportion of law firms would make the improvements to complaints handling assumed in our scenarios.

To reflect the above uncertainties, we have developed low, medium and high case estimates of the total net industry benefit. Based on this we find that total industry benefits could be between £53m and £80m in present value terms over 10 years.

Annex A - Literature review

This annex provides a detailed review of the relevant literature relating to the potential financial impact of complaints handling. We have reviewed and summarised papers that seek to address the following issues:

- what the sources of the financial costs and benefits of a complaint handling process may be;
- how the costs and benefits may vary depending on implementation, and firm and customer characteristics;
- how the costs and benefits can be estimated; and
- what evidence exists as to the size of these financial costs and benefits.

A summary of the key evidence and implications of the literature is provided in the main body of this report (see Section 4). In the remainder of the annex, each of the papers we have reviewed is summarised in turn.

Title: An Economic Theory of Customer Complaint Management
Author: Liang
Date: 2009
Journal: -
Areas of theory covered: • Complaint handling • Game theory • Defensive marketing strategy
Coding: Theoretical
Implications for legal services: The level of complaint handling undertaken by a firm will depend on the firm's reputation, the variety of quality in the market, and the competitive environment. Legal services firms will set the level of complaints handling that maximises their profits, assuming perfect information.
Synopsis: This paper sets out a game theory model to examine the optimal behaviour of firms in relation to complaint handling. The customer chooses whether to complain, keep quiet or switch providers and the revenue maximising firm chooses whether to take corrective action based on the customers' actions. The paper studies the Bayesian-Nash equilibrium of the game and compares different response strategies.
Main arguments / ideas: Marketing research identifies two common objectives of complaint handling: (1) restoring customer satisfaction; and (2) providing management with valuable information. There are also two broad courses of action that can be taken to achieve these objectives. First is to minimise the number of complaints, and the second to maximise the number of dissatisfied customers that complain. Based on the theoretical model that they build, they identify that a firm's reputation, the variance of quality and the competitive environment can determine the approach that the firm takes to complaint handling. The model shows that, particularly low reputation firms, will set a barrier to complaints that is too high from a social perspective.
Evidence and data sources: The theoretical model includes one firm and two identical customers. There are two time periods ($t=1,2$) in which there can be a good state or a bad state for each customer (G =good, B =bad). In the first period each customer draws a state which can be interpreted as a satisfied customer or unsatisfied customer. There are therefore four possible combinations in the first period (BB, BG, GB, GG). Upon learning the initial state the customers then choose either to exit (E), complain (C), or keep silent (K). Complaining incurs a cost D , which is set by the firm. The payoff of exiting is higher in the first period compared to the second. In the second period all customers who have not exited receive a good or bad state again. If they receive a good state they stay and realise the associated payoff, if they receive the bad state they leave and receive the payoff for exiting in the second period. The firm can choose to incur F to undertake corrective action and ensure that the good state is realised in the second period. If no corrective action is taken the state from the first period is realised in the second period. The firm's revenue is a product of the customers it still has at the end of period two. At the beginning of the game, the firm announces its policy with regard to customer actions (E, C , or K), and sets the cost D of a complaint. In period one the customer learns the initial state and decides on an action. In period two the firm undertakes corrective action according to their policy and the final states are realised. In period one only the customer knows their own state, and in period two all players learn the final states. The author uses this theoretical model to draw the conclusions noted above.

Title: The Effects of Satisfaction and Complaining Behaviour on Consumer Repurchase Intentions	
Author: Halstead and Page	
Date: 1992	
Journal: Journal of Consumer Satisfaction, Dissatisfaction and Complaining Behaviour	
Areas of theory covered: - Complaint handling - Customer satisfaction - Retention - Defensive marketing strategy	
Coding: Empirical - Operational	
Implications for legal services: Effective complaints handling can be a powerful tool in increasing a dissatisfied customer's likelihood to purchase the services of a firm again. In certain cases it can be that effective resolution of a complaint increases repurchase intentions more than if the customer was satisfied and did not complain.	
Synopsis: This paper investigates the brand repurchase intentions of carpet consumers. It is well understood that product satisfaction is positively related to repurchase intention, but there is also evidence of a positive relationship between a consumer actually complaining if they are unhappy and repurchase intention. The paper examines the effects of product satisfaction, complaining behaviour and complaint resolution satisfaction on consumer repurchase intentions.	
Main arguments / ideas: Complaining helps relieve the dissonance created by product dissatisfaction, which then leads to higher repurchase intention (Oliver 1987). Also, Beard and Oliver (1985) argued that increased incidence of public complaining allows firms the opportunity to provide satisfactory redress, which can lead to higher purchase intention. These relationships present a paradox, given the inverse relation between consumer satisfaction and complaints. On the one hand satisfaction leads to higher repurchase intention and dissatisfaction leads to lower repurchase intention. On the other hand dissatisfaction can also lead to complaints, which can in turn lead to higher repurchase intent. Day (1983) show than consumer dissatisfaction is not a sufficient condition for complaining to occur. Conditions including causal attributions and perceived costs and benefits affect complaining. Jacoby and Jaccard (1981) argue that dissatisfaction may not even be a necessary condition for complaining to occur. They present some evidence that complainers perceive benefits, some fraudulently, to complaining to a supplier. In addition some customers who are generally happy may complain about minor issues, particularly if the organisation has a reputation of settling complaints. Oliver's (1987) two-by-two matrix categorises consumers by whether they are satisfied with the product or not, and whether they complain or not. The authors extend this matrix to break out those that are satisfied (SAT/CR) and dissatisfied (DIS/CR) with the complaint resolution, as outlined opposite. Using evidence explained in the section below, the paper found that: - Contrary to the authors' hypothesis, the repurchase intention of complainers was significantly lower than that of non-complainers. This contradicts previous research (TARP 1979) that found those that complained were more likely to repurchase than those that did not complain – for reasons explained above. - Post-complaint satisfaction did not significantly affect repurchase intentions among complainers who were originally satisfied with the product. - For complainers who were dissatisfied with the product, satisfaction with the complaint resolution significantly increases their repurchase intentions.	
Evidence and data sources: The empirical analysis was based on new owners of a nationally advertised carpet brand who had purchased their carpeting prior to November 1987. Respondents were interviewed by phone by an independent market research company. The total sample size was 399 which was based on a stratified random sampling technique, which in turn was based on the return of warranty card to the manufacturer. Only 25% of customers return warranty cards and this could create a source of bias. Also the specifics of the market in question may limit the results generalisation. T-tests and ANOVA statistics were used to determine if differences between groups were significant.	

		Complainers	Non-complainers
Satisfied	SAT/CR		
	DIS/CR		
Dissatisfied	SAT/CR		
	DIS/CR		

Title: Defensive Marketing Strategy by Customer Complaint Management: A Theoretical Analysis
Author: Fornell and Wernerfelt
Date: 1987
Journal: Journal of Marketing Research
Areas of theory covered: • Complaint handling • Defensive marketing strategy • Retention
Coding: Theoretical
Implications for legal services: Encouraging complaints from customers can create a valuable source of competitive advantage through persuading existing customers to stay and reducing the cost of offensive marketing.
Synopsis: This paper presents an economic model of defensive marketing strategy based on complaint management. The authors use Hirschman's exit-voice theory to show that, under certain conditions, complaints should be maximised.
Main arguments / ideas: Strategies designed to obtain additional customers, encourage switching and increase purchase frequency can be defined as offensive marketing strategies. Defensive marketing strategies are concerned with reducing customer exits and switching. The first step that a firm must take to prevent exit or switching is to identify the buyers who are dissatisfied. The second step is to persuade those buyers to remain loyal. The author's analysis shows that, under cost constraints, it is in the best interests of the firm to maximise the number of complaints. The paper uses the exit-voice framework set out in Hirschman (1970). Management discovers its failures through two feedback mechanisms: exit or voice. Exit implies that the customer has stopped buying from the firm, and voice is the customer making a complaint. Their model demonstrates that when the revenue loss of a customer leaving is greater than the cost of handling and encouraging complaints, complaints should be encouraged if a sufficiently large proportion of complaining customers can be persuaded to stay. Defensive marketing can lower total marketing expenditure by substantially reducing the cost of offensive marketing. The offensive marketing savings can be large enough to offset the additional costs associated with compensating complaining customers.
Evidence and data sources: The paper uses a theoretical market share attraction model applied to both duopoly and n-firm cases. Their base case is where no firm has a defensive strategy, and they examine situations where only one firm encourages complaints and where they all do. The authors warn about generalising their results and note that the optimal strategy depends on how many customers are dissatisfied, the proportion who currently voice their opinion, the fraction of dissatisfied customers who don't switch and the compensation given to a customer who complains. Under certain values of these parameters, complaint management will not be an attractive strategy for a firm.

Title: Satisfaction, Complaint, and the Stock Value Gap
Author: Luo and Homburg
Date: 2008
Journal: Journal of Marketing
Areas of theory covered: • Complaint handling • Competitive advantage
Coding: Empirical - Financial
Implications for legal services: This paper is further evidence of the financial returns to investing in complaints handling processes.
Synopsis: This paper looks at empirical evidence to determine the relationship between customer satisfaction and complaint with stock market value. They use a statistical benchmarking methodology to determine the stock value gap and show that it has a negative relationship with satisfaction, and a positive relationship with complaints.
Main arguments / ideas: Stock value gap is the difference between the actual stock market value of a company and its optimal market value. As not all firms are equal in seizing their opportunities and translating them into stock performance, a curve can be traced out that represents the optimal stock value given the opportunity sets, differences in firm characteristics and the trade-off between operating characteristics. The resultant curve – efficient frontier – is the optimal stock value benchmark that consists of hypothetical best-performing competitors. The distance a firm sits from this frontier is the stock value gap. Intuitively, the authors show that higher customer satisfaction leads to a lower stock value gap, and a higher level of customer complaint leads to a higher stock value gap. Negative word of mouth can influence both existing customers (into leaving) and potential customers (by lessening the chance of becoming a customer or making acquisition more expensive), and the use of online channels can exacerbate this. Psychologists explain that negative information appears more useful to the receiver than positive information (Taylor 1992). This is “a greater weighting of negative as compared with equally positive information in the formation of evaluative judgement” (Ahluwalia 2002). Anderson and Mittal (2000) suggest that negative experiences can produce an impact that is “twice as strong on [return on investment]” as positive experiences (Gupta and Zeithaml 2006). Furthermore, Chevalier and Mayzlin (2006) find that negative book reviews have a stronger impact on relative sales than positive book reviews. The authors’ analysis supports these ideas, and shows that customer complaint has a relatively stronger impact than customer satisfaction on a firm’s stock value gap. The authors also demonstrate that working capital and firm specialisation can interact with the effects of satisfaction and complaint. They show that greater working capital can increase the effect of satisfaction and dampen that of complaints. With higher resources available a firm can more easily communicate satisfaction to customers, potential customers and investors. They are also more able to respond to complaints to rectify the matter. Their analysis also shows that more specialised firms benefit more from customer satisfaction. This is because a more focused firm is able to transfer customer satisfaction into valuable loyalty and brand equity over time.
Evidence and data sources: The paper uses cross-sectional time-series data pertaining to the US airline industry. Stock market gap is measured using the stochastic frontier methodology (SFM), which estimates the best-performance frontier after accounting for random stochastic error. There are three advantages of SFM over the traditional ordinary least squares approach: (1) it constructs the benchmark with best performers, rather than average performers; (2) it can account for outliers and the random stochastic nature of business; and (3) it can handle heterogeneity with random parameter modelling.

Title: The Profit Impact of Consumer Complaint Solicitation Across Market Conditions
Author: Estelami
Date: 1999
Journal: Journal of Professional Services Marketing
Areas of theory covered: • Complaint handling • Retention • Loyalty • Acquisition
Coding: Empirical - Financial
Implications for legal services: This paper identifies four factors which will impact a legal services firm's decision whether to invest in complaints handling or not. These are switching barriers, acquisition costs, complaint resolution costs, and customer loyalty.
Synopsis: This paper looks at the different market characteristic that are likely to make investment in complaints handling profitable or not. The author does this in two stages. In the first, a model is created of the customer dissatisfaction and complaints process which is defined by a set of parameters and interactions. Through Monte Carlo simulations the parameters which affect profits most can be identified. In the second stage, a survey of positive and negative complaint experiences are used to determine the validity of the findings from the first stage.
Main arguments / ideas: Effective complaint handling is characterised by initiatives which encourage consumers to voice their concerns, and processes which facilitate the resolution of those concerns. The use of free phone numbers, surveys of the customer base, and training and motivating employees to properly receive consumer complaints are common approaches. Previous research has shown that, across a wide range of industries, the return on investment of complaint management departments typically exceeds 100 percent (TARP 1986). In addition to retaining existing consumers, satisfactory resolution of consumer complaints may increase consumers' loyalty levels, lower their price sensitivity, and can also be used as a guide for improving product quality (Halstead and Page, 1992; Mitchell, 1993; Reichheld and Sasser, 1990). While some firms will significantly benefit from enhanced complaint handling, others will find the costs outweigh the benefits. The authors highlight areas which will affect the profitability of an improved complaint handling process: the frequency of dissatisfied customer; customer loyalty; switching barriers; and the cost of complaint resolution and customer acquisition. The model design by the authors includes seven variables related to these areas, these are: • The probability of a consumer being dissatisfied with the product or service they receive • The probability that a dissatisfied customer will make a complaint • The probability that a complaint will be resolved • The probability that a customer will leave if they are dissatisfied • The probability of a customer remaining loyal to the firm • The cost of acquiring new customers • The cost of resolving a complaint The analysis shows that there are four factors which significantly change the commercial incentive to invest in complaints handling: • Consumer switching barriers significantly decrease a firm's incentives to solicit consumer complaints • Complaint solicitation is more beneficial to firms facing high new consumer acquisition costs • High complaint resolution costs will reduce a firm's incentives to solicit consumer complaints • Firms with high consumer loyalty levels will witness more profit gains as a result of proactive complaint solicitation than those which face low loyalty levels
Evidence and data sources: The paper's findings are based on two stages of analysis. In the first, a model of the dissatisfaction and complaints process is constructed. The variables described above are modelled using different distribution functions and the outcomes modelled through Monte Carlo simulations. This allows those variables which most affect profit to be identified. The second stage of analysis was based on a survey of MBA students. Each student was asked to describe the best and worst complaints experiences they had. The 158 responses were used to validate the identified market characteristics from the initial stage. For example, respondents reported good complaints handling in industries where there are low switching barriers (e.g. clothing and shoes, soft drinks), and poor complaints handling where there are high switching barriers (e.g. airlines, local telephone services).

Title: A transaction cost approach to consumer dissatisfaction and complaint actions
Author: Gronhaug and Gilly
Date: 1990
Journal: Journal of Economic Psychology
Areas of theory covered: • Transaction costs
Coding: Empirical - Operational
Implications for legal services: This paper demonstrates that the source of dissatisfaction can arise from consumers' expectations not being met – because the terms of the transaction were not fully stipulated in the contract. A clearly set out and communicated complaints handling process should increase complaint resolution satisfaction and increase the commercial benefits of legal services providers investing in complaints management.
Synopsis: Transactions, the exchanges of goods or services for money, involve uncertainty and are subject to contracts (explicit or implicit agreements). This paper applies the theory of transaction costs to dissatisfaction and complaints.
Main arguments / ideas: The author makes a distinction between transactions and contracts. Transactions consist of the exchange of a good or service for money. A transaction is governed by a contract which sets out the rights and obligations of each party in the transaction. Most contracts are incomplete as there is an element of uncertainty as the future is unclear. Consumer dissatisfaction and complaints can arise from expectations of a transaction not being met – because the contract isn't complete.
Evidence and data sources: The authors demonstrate their point of view using data from previous research pertaining to the source of dissatisfaction experienced by consumers. They show that many of the sources of dissatisfaction arise from issues outside the contractual agreement and can therefore be classified as transactional costs.

Title: Corporate Reputation and Sustained Superior Financial Performance
Author: Roberts and Dowling
Date: 2002
Journal: Strategic Management Journal
Areas of theory covered: • Reputation • Competitive advantage
Coding: Empirical - Financial
Implications for legal services: This paper demonstrates that the returns that a firm makes from investing in complaints handling, which in turn will positively affect their reputation, can have positive implications for profitability over time.
Synopsis: This paper complements evidence, of the relationship between reputation and financial performance, by showing that firms with relatively good reputations are better able to sustain superior profit outcomes over time. Previous research has showed the positive relationship between reputation in one time period and financial performance. This paper goes further and looks at the impact of corporate reputation on the path of future financial performance.
Main arguments / ideas: Firms with assets that are valuable and rare possess a competitive advantage and may expect to earn superior returns. Those whose assets are also difficult to imitate may achieve sustained superior financial performance. Within this line of reasoning, intangible assets—such as good reputations—are critical because of their potential for value creation, but also because their intangible character makes replication by competing firms considerably more difficult. The authors' analysis suggests that superior-performing firms have a greater chance of sustaining superior performance over time if they also possess relatively good reputations. A firm's financial reputation has a consistently strong impact on profit persistence. This suggests an important self-reinforcing dynamic. Some of the things that firms do to improve profitability also enhance their reputations. This reputation enhancement, in turn, makes it easier for firms to sustain superior performance outcomes over time.
Evidence and data sources: The authors use two complementary dynamic models: one an autoregressive approach and the other a proportional hazards regression. These methods are applied to data from Fortune on both profitability and firm reputation.

Title: Manufacturer Responsiveness to Consumer Correspondence: An Empirical Investigation of Consumer Perceptions
Author: Smart and Martin
Date: 1992
Journal: The Journal of Consumer Affairs
Areas of theory covered: • Complaint handling • Customer satisfaction
Coding: Empirical - Operational
Implications for legal services: This paper highlights that responding to customer complaints, or compliments, in a personal and appreciative manner can increase customer satisfaction.
Synopsis: This paper examines the reaction of consumers to manufacturers correspondence in relation to both complaint and compliment letters. The discussion focuses on understanding the components of consumer satisfaction to manufacturers' responses and provides suggestions to businesses to increase that satisfaction level.
Main arguments / ideas: The authors identify three main areas in which a business can increase the satisfaction level of customers when communicating with them regarding a complaint or compliment. Firstly, thanking the customer for their input, in terms of time to write and purchasing their brand, is appreciated. Secondly, customers prefer a personalised response, rather than something that feels like a generic response. And thirdly, a gift, token or refund is welcomed.
Evidence and data sources: The researchers identified 50 consumer packaged goods providers, sent each one a complaint letter and one praise letter, and got 300 consumers to analyse the responses received from the manufacturers.

Title: Customer Management Processes: A Quantitative Study
Author: Ang and Buttle
Date: 2006
Journal: European Journal of Marketing
Areas of theory covered: - Retention - Complaints handling
Coding: Empirical - Operational
Implications for legal services: The importance of a retention plan, assigning budget and an individual responsibility to it are overshadowed by having a documented complaints process. For legal firms concerned with retention, a documented complaints process may present the highest returns.
Synopsis: This research investigates the associations between customer retention outcomes and a number of management processes including customer retention planning, budgeting and accountability and the presence of a documented complaints-handling process.
Main arguments / ideas: The authors have four hypothesis that they test using a quantitative survey. These are: - Companies that excel at customer retention have an explicit, documented customer retention plan. - Companies that excel at customer retention have budget dedicated to customer retention activities. - Companies that excel at customer retention have nominated a particular person or group to be responsible for customer retention. - Companies that excel at customer retention have a documented process for handling customer complaints. They rationalise this finding in two ways. First, companies with a documented complaints process are better placed to resolve the particular complainant's problem and retain that customer's residual value. Second, they can begin to identify problems that are systemic or repetitive and therefore can develop solutions to those problems. If companies can use complaints data to understand the reasons for customer churn they are better placed to identify root causes and fix the problems. They report a correlation of 0.28 between having a documented complaints process and the company exceeding its retention expectations.
Evidence and data sources: The authors conducted a quantitative survey of 170 companies in Australia across all major industry classification codes. The authors express two potential limitations of generalising these results. First, it was conducted in one geographic areas and may not be representative of another, and secondly, the analysis relies on self-reported data.

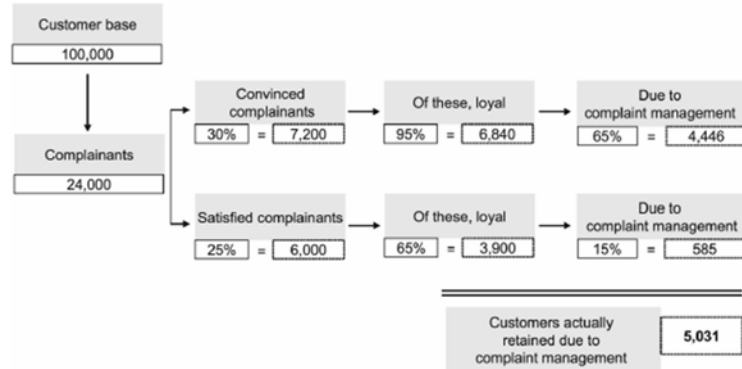
Title: Dealing with Complaints
Author: Mitchell and Critchlow
Date: 1993
Journal: International Journal of Retail and Distribution Management
Areas of theory covered: • Complaint handling • Competitive advantage • Retention • Reputation
Coding: Theoretical
Implications for legal services: This paper highlights many advantages of a complaints handling processes that could be realised in the legal services market.
Synopsis: This paper highlights the advantages of an effective complaints handling process to UK grocery suppliers and assess the current state of the market.
Main arguments / ideas: The paper details the advantages of an effective complaints handling process to UK grocery suppliers, these are: • Competitive advantage. In a mature market non priced-based competition is attractive and effective complaints handling offers a potential source of competitive advantage. • Prevention of legal proceedings. Good complaints handling can reduce the number of dissatisfied customers taking their grievance to court. • Increase brand loyalty. Effective resolution of a customer's complaint can increase brand loyalty. • Improved production. Complaints can be a vital source of identifying deficiencies in current production processes. • Marketing and R&D. Communication with a customer provides a marketing opportunity. Also, feedback can be used to improve or develop new products. • Reduce consumer risk. By having an effective complaints system, customers know that if they have a problem they can obtain redress. Purchasing then becomes less risky. • Reduce negative word-of-mouth. Good complaint handling will reduce negative word-of-mouth, which can have a bigger impact than positive word-of-mouth. • Company image. An effective complaints system can improve company image both to consumers and employees.
Evidence and data sources: The paper details the results of a survey of UK grocery suppliers. In documents the state of the market but doesn't draw further conclusions.

Title: Consumer Complaint Handling as a Strategic Marketing Tool
Author: Gilly and Hansen
Date: 1985
Journal: Journal of Consumer Marketing
Areas of theory covered: • Complaint handling • Retention • Acquisition
Coding: Theoretical
Implications for legal services: Decisions about complaint handling should be taken like any other business decision, assessing the costs and benefits. The paper outlines the considerations that should be taken into account.
Synopsis: This paper sets out various strategies towards complaints handling and identifies the considerations that should be taken into account when making strategic decisions about the level of complaints handling to provide.
Main arguments / ideas: Planning a complaint handling strategy should involve the same planning process as any other aspect of company strategy. The paper identifies three potential complaint handling strategies: • Over-benefitting would represent a strategy aimed at long-term profits rather than cost control. The customer would be better off after having made the complaint than they were before they purchased the product. This strategy is used by a company that sees consumers as an investment worth expending resource on. • An equity approach will return the customer to the position that they were in before they purchased the product. This is a strategy used when companies see customers as potential litigants. • The under-benefitting approach represents an attempt to minimise company expenditure, and at the extreme involved ignoring the complaint. This strategy is adopted by companies that see their customers as expendable. The following consequences should be evaluated before making a decision about complaint handling strategy: • Effect on demand of person who complained • Effect on demand on of others (resulting for example from word-of-mouth) • Potential expense of litigation • Cost of complaint handling
Evidence and data sources: The paper uses anecdotal evidence to support their theory.

Title: Firms' Complaint Handling Policies and Consumer Complaint Voicing
Author: Huppertz
Date: 2007
Journal: Journal of Consumer Marketing
Areas of theory covered: • Complaint handling • Customer satisfaction
Coding: Empirical - Operational
Implications for legal services: Consumers evaluate the costs and benefits before making a complaint. Increasing the benefits may be a stronger driver than reducing the costs, when trying to encourage customers to complain.
Synopsis: Many papers highlight the importance of encouraging complaints, this paper looks into what mechanisms can be used to do this practically. It concludes that the probability of getting a refund is a more powerful driver of complaints than reducing the cost of complaining.
Main arguments / ideas: Many studies have shown that customers are reluctant to make a complaint when they are dissatisfied. TARP (1996) show that over 70 percent of customers experiencing service failures did not complain, The Retail Customer Dissatisfaction Study (2006) reported that only 6 percent of customers who experienced a problem told the firm about it, and Andreassen (2001) found that 68 percent of dissatisfied customers did not complain. Cost-benefit theory suggests that customers make the judgement that complaining is not worthwhile for them. They make an assessment of the probability that they will get redress, the effort required to complain, and the value of the product involved. If complaining was easier, or redress more likely, consumers would be more likely to complain. The findings strongly suggest that firms should establish lenient refund policies and make them known to customers. Lenient refund policies drive consumers' expectations of successful redress and their likelihood of voicing complaints. Furthermore, improving benefits of complaining are more powerful than reducing costs.
Evidence and data sources: A panel of 338 US consumers were shown written scenario descriptions of a product that failed and the associated complaints process. The authors highlight that the evidence is from a retail environment where a refund may dominate the consumers' decision to make a complaint. Therefore generalisation outside of the retail industry may not be sensible.

Title: Complaint Management Profitability: What Do Complaint Managers Know?
Author: Stauss and Schoeler
Date: 2004
Journal: Managing Service Quality
Areas of theory covered: • Complaint handling • Retention
Coding: Empirical - Financial
Implications for legal services: This paper provides a framework to estimate the profitability of a complaint handling process.
Synopsis: This paper assesses how, and whether, companies assess the potential profitability of a complaints handling process. They detail a framework to estimate the profitability.
Main arguments / ideas: The paper introduces the concept of complaint management profitability (CMP), which is the difference between the costs and benefits of a complaints management process. They identify four sources of cost: • Personnel costs arise from human resources (e.g. staff of a complaint management department). • Administration costs are generated by expenditures, for example office space and office equipment. • Communication costs are all costs that are associated with necessary communication processes to solve the customer's problem (e.g. phone costs or postage). • Response costs are all costs that arise in the context of the problem solution. Three types of response costs can be differentiated: - o compensation costs (e.g. costs for gifts or vouchers); - o warranty costs cover all expenditures for performances due to contractual claims (e.g. activated guarantees); and - o costs for gestures of goodwill emerge from volunteer performances which are not covered by guarantees. And four sources of benefits: • 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. • The attitude benefit comprehends the positive attitude changes of the customer due to achieved complaint satisfaction. • The repurchase benefit arises when a complaining customer remains with a company instead of switching to a competitor. • Communication benefits describe the oral effect of complaint management (e.g. positive word-of-mouth). The author presents an approach to estimating the above benefits of complaints management. The information benefit can be calculated as a reduction in production costs or an increase in sales. If the monetary value cannot be calculated directly, a scoring model can be created and monetary values assigned to each scoring point. A direct monetary assessment of the attitude effect is not possible but can be estimated by analysing the costs of achieving a corresponding increase resulting from, for example, advertising. To estimate the communication effect, two data points are needed: the number of people who are told about the positive experience of complaints handling; and the influence rate. The repurchase benefit is the main focus of the paper. 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. 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. Parameters not available can be attained through a customer survey. The general model is presented below:

Figure 8 Basic model to calculate retained customers due to complaint management



Source: Stauss and Seidel (2004)

Evidence and data sources:

The paper uses an empirical study of 149 German business-to-consumer companies to assess the prevalence of CMP estimation in making strategic decisions.

Title: How Organisations can Learn from Complaints
Author: Vos and Huitema
Date: 2008
Journal: The TQM Journal
Areas of theory covered: • Complaint handling • Learning from complaints
Coding: Theoretical
Implications for legal services: This paper provides a framework to consider how law firms can learn from complaints.
Synopsis: This paper augments the general model of organisational learning to include complaint management.
Main arguments / ideas: Stauss and Seidel (2005) make the distinction between complaints handling and complaints management. Complaints handling refers to the process directly aimed at helping customers resolve their complaints. Whereas complaints management refers to the overall process which includes complaints handling, analysis of complaints and learning from them. Organisational learning can be described on the basis of at least three elements. Firstly, there is a trigger that sets off the process of learning (e.g. a complaint). Secondly, is the processing and development of that idea. And on the far end of the spectrum is the outcome – the result of learning. The paper further considers the difference between informational learning and interactive learning. Informational learning concentrates on the formal and quantitative registration and analysis of complaints and their sources. With interactive learning, a dialogue between individuals is essential for developing new ideas and processes.
Evidence and data sources: The paper discusses their framework in the context of six Dutch service organisations.

Title: Negative Word-of-Mouth by Dissatisfied Consumers: A Pilot Study
Author: Richins
Date: 1983
Journal: Journal of Marketing
Areas of theory covered: • Reputation
Coding: Empirical - Operational
Implications for legal services: Given that legal services are important and have can have significant consequences, the change of negative word-of-mouth resulting from dissatisfaction is increased. If consumers perceive that responsiveness to complaints is low, negative word-of-mouth may increase.
Synopsis: This paper investigates the drivers of negative word-of-mouth caused by dissatisfaction. In particular it looks at the severity of the problem, the allocation of blame, and the perceptions of responsiveness to complaints.
Main arguments / ideas: Potential responses to dissatisfaction include switching brands, making a complaint, or engaging in negative word-of-mouth (WOM). Data from Diener and Greyser (1978) indicated that 34% of those dissatisfied with a personal care product told others about their dissatisfaction. This paper presents evidence of three drivers of negative WOM: • The more sever a problem the more likely a consumer will engage in negative WOM • The greater the blame for dissatisfaction placed on the company the more likely the customer will engage in negative WOM • The more negative the perception of retailer responsiveness the more likely negative WOM is
Evidence and data sources: Correlations were calculated based on a survey of 214 consumers of appliances and clothing.

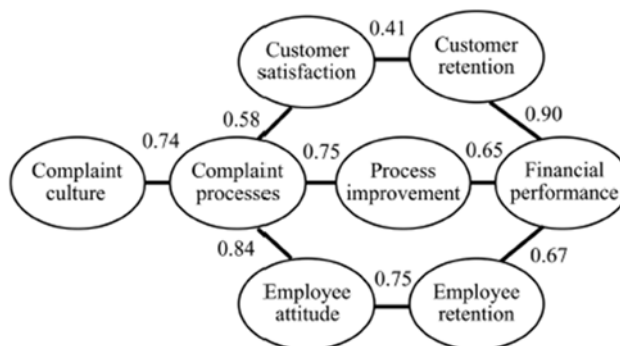
Title: Firms Reap What They Sow: The Effects of Shared Values and Perceived Organizational Justice on Customers' Evaluations of Complaint Handling
Author: Maxham and Netemeyer
Date: 2003
Journal: Journal of Marketing
Areas of theory covered: • Complaint handling • Reputation
Coding: Empirical - Operational
Implications for legal services: Implementing a fair and just complaints handling process can improve employee perceptions, which in turn can improve customer perceptions and intentions to repurchase or recommend.
Synopsis: This paper examines how employee's' perceptions of shared values and organisational justice affect the complaints handling process. They also investigate how this affects customer perceptions and purchase intent.
Main arguments / ideas: The authors' analysis shows that employees perceptions of shared values and organisational justice affect the degree to which they are prepared to go the extra mile (extra-role behaviours) when dealing with customer complaints. When the values of an employee and the values of the firm align, as well as customers believing that their organisation is being fair, they are willing to put in extra effort when dealing with complaints. Furthermore, employee extra-role behaviours have a significant effects on customers' perceptions of justice, which in turn affect satisfaction with complaint recovery, overall satisfaction, purchase intent and word-of-mouth.
Evidence and data sources: The paper's results are based on a study of online customers who registered telephone complaints about the electronics equipment purchased from a well-established electronics retailers.

Title: Customer Satisfaction, Market Share, and Profitability: Findings from Sweden
Author: Anderson, Fornell and Lehmann
Date: 1994
Journal: Journal of Marketing
Areas of theory covered: • Customer satisfaction
Coding: Empirical - Financial
Implications for legal services: Increases in customer satisfaction can lead to high economic returns.
Synopsis: The authors investigate the nature and strength of the link between customer satisfaction and economic returns. They discuss how expectations, quality, and price should affect customer satisfaction and why customer satisfaction, in turn, should affect profitability.
Main arguments / ideas: In general, high customer satisfaction should indicate increased loyalty for current customers, reduced price elasticities, insulation of current customers from competitive efforts, lower costs of future transactions, reduced failure costs, lower costs of attracting new customers, and an enhanced reputation for the firm. All these factors should increase the ability of the firm to make a profit.
Evidence and data sources: The paper uses data on 77 Swedish firms that are all major competitors in a wide variety of industries, including: airlines, auto, banking, travel, retail, insurance, computers and supermarkets. They find that an annual one-point increase in customer satisfaction has a net present value of \$7.48 million over five years for a typical firm in Sweden. Given the sample's average net income of \$65 million, this represents a cumulative increase of 11.5%.

Title: Customer Evaluations of Service Complaint Experiences: Implications for Relationship Marketing
Author: Tax, Brown and Chandrashekar
Date: 1998
Journal: Journal of Marketing
Areas of theory covered: Complaint handling
Coding: Empirical - Operational
Implications for legal services: The effectiveness of a complaints handling process will depend on the trust and commitment conveyed through the process.
Synopsis: This paper looks at how customers evaluate their experience of making a complaint. Using justice theory, the authors also demonstrate that customers evaluate complaint incidents in terms of the outcomes they receive, the procedures used to arrive at the outcomes, and the nature of the interpersonal treatment during the process.
Main arguments / ideas: Complaint handling satisfaction is significantly and strongly associated with both trust and commitment. Customers who choose to complain are offering firms the opportunity to demonstrate their trustworthiness and that the resolution process drives customers' subsequent attitudes and behaviour. The results indicate that a firm's favourable actions during episodes of conflict demonstrate its reliability and trustworthiness and imply that investments in complaint handling can improve evaluations of service quality, strengthen customer relationships, and build customer commitment.
Evidence and data sources: The paper uses results from a survey of consumers' evaluation of their most recent service related complaint, providing it was made in the last six months. The authors note there is a limitation of their finding because they are based on self-reported results.

Title: Best-practice Compliant Management
Author: Johnston and Mehra
Date: 2002
Journal: Academy of Management Executive
Areas of theory covered: Complaint handling
Coding: Empirical - Operational
Implications for legal services: This paper provides a set of conditions that could be used to create a best practice approach to complaints handling.
Synopsis: This paper identifies 12 insights into what constitutes an effective complaints management process.
Main arguments / ideas: The paper identifies the following 12 factors: - Speed but with a human face – this commonly involves acknowledging a complaint within 24 with a telephone call to establish a human connection - Tease out complaints appropriately – encouraging customers to overcome the complaint barriers and make a complaint so the situation can be improved - No-blame culture – establishing within a firm that mistakes do happen so blame isn't placed for complaints - Proactive top-level involvement – involvement of senior members of staff in the complaints process - Complaint management should be a strategic issue - Complaint management is a mix of centralised and decentralised – individual departments deal with their own complaints, with overall responsibility going to the head office - Communication and improvement – data on complaints should be shared internally and discussed - Internal complaints system – employees themselves are a valuable source of complaints - Surveying customers with a focus on problems and resolutions - Focus staff attention through knowledge of the benefits of complaints - Focus senior management attention through the costs and savings from complaints
Evidence and data sources: The authors conducted interviews at five organisations that they identified as having a strong complaints process and strong financial performance based on previous research (Johnston 2001).

Title: Linking Complaint Management to Profit
Author: Johnston
Date: 2001
Journal: International Journal of Service Industry Management
Areas of theory covered: Complaint handling
Coding: Empirical - Financial
Implications for legal services: This paper provides evidence that there is a link between effective complaints handling and financial performance, and could therefore be worthwhile for legal firms. It also indicates that there are returns from improving employee relations through the complaints process.
Synopsis: This paper looks at the relationship between complaints management and financial performance.
Main arguments / ideas: The underlying hypothesis of the paper is that good complaint processes generate financial benefits. Several factors have been highlighted as to what 'good' complaint management consists of, these include: having clear procedures; providing a speedy response; the reliability (consistency) of response; having a single point of contact; ease of access; ease of use; keeping the client informed; staff understanding of the procedure; complaints taken seriously; employees trained to handle complaints; follow up procedure; using the data to engineer-out the problems; and using measures based on cause reduction rather than complaint volume reduction. Based on their analysis, the authors suggest that financial performance may be more likely improved by focusing on process improvements and making sure the complaint process is staff-friendly, rather than customer satisfaction specifically.
Evidence and data sources: The analysis is based on a survey of 40 senior managers responsible for the customer service department. Response options were based on a 1-5 scale and questions were aggregated to (unweighted) to form an index. The correlation between complaint process and financial performance was 0.56, other correlations are shown below:



Title: Understanding the Role of Complaint Handling on Consumer Loyalty in Service Relationships
Author: Rothenberger, Grewal and Iyer
Date: 2008
Journal: Journal of Relationship Marketing
Areas of theory covered: • Complaint handling • Customer satisfaction • Retention
Coding: Empirical - Operational
Implications for legal services: This paper highlights the importance of complaint handling on word-of-mouth and recommendations. Effective complaints handling will impact the buying behaviour of the individual customer, as well as whether they tell others about the service or product.
Synopsis: The authors explore the impact of customer usage level, pricing, quality, membership in a loyalty scheme and satisfaction with complaint handling on loyalty.
Main arguments / ideas: The authors find that quality and pricing are the two more important drivers of customer loyalty. They also find that effective handling of complaints affects consumers' recommendation intentions, but not their reuse intentions. They hypothesise that this is because of limited alternatives, rather than not wanting to switch.
Evidence and data sources: A survey of 1,001 airline passengers was conducted and multiple regression models run to determine the impact of factors on measures of likelihood to recommend and likelihood to reuse. Their analysis suggests that an increase of one point on the scale of satisfaction of handling a complaint increases likelihood to recommend by 0.13 (on a scale).

Title: Premiums for High Quality Products as Returns to Reputations
Author: Shapiro
Date: 1983
Journal: Quarterly Journal of Economics
Areas of theory covered: • Reputation
Coding: Theoretical
Implications for legal services: This paper demonstrates that when there is imperfect information, like in the legal services market, reputation in reputation to signal quality will earn a positive return through a price premium. Such a reputational investment could be made through a complaint handling system.
Synopsis: This paper builds a model that explores the implications of firm-specific reputations in a perfectly competitive environment. The equilibrium is derived under conditions of perfect competition but imperfect information.
Main arguments / ideas: If product attributes were perfectly observable prior to purchase, then previous production of high quality items would not enter into consumers' evaluations of a firm's product quality. Instead, quality beliefs could be derived solely from inspection. The equilibrium involves a gap between price and cost for high quality items. This premium can be viewed either as a return to reputation or as an incentive payment to induce quality maintenance. Without premiums for high quality items, sellers would find that a fly-by-night strategy of quality reduction would be profit maximizing. Since positive profits can be earned via the fly-by-night strategy, it would always dominate, unless positive profits could also be earned via the faithful strategy of quality maintenance.
Evidence and data sources: The author constructs a theoretical model to demonstrate the price premium for reputation.

Title: How Organisational Complaint Handling Drives Customer Loyalty: An Analysis of the Mechanistic and Organic Approach
Author: Homburg and Fürst
Date: 2005
Journal: Journal of Marketing
Areas of theory covered: - Complaint handling - Customer satisfaction
Coding: Empirical - Operational
Implications for legal services: A combination of explicit procedures and teaching employees to make their own decisions should be used to maximise the impact of complaints management. The paper also highlights the importance of complaints handling as loyalty depends on satisfaction with the complaints procedure rather than initial satisfaction.
Synopsis: This article addresses how an organization's complaint management affects customer justice evaluations and, in turn, customer satisfaction and loyalty. The authors distinguish between a mechanistic and organic approach to complaint handling, and find that they are complementary approaches.
Main arguments / ideas: Companies can influence employee behaviour by developing guidelines and procedures for specific activities. This approach is referred to as the mechanistic approach and is closely linked to the 'organisation as a machine' paradigm. Additionally, firms can influence employee behaviour by focusing on training and motivating employees by providing them with shared values and norms. Rather than developing specific guidelines on how to behave it aims to establish in the employee a state of mind that leads them to reach the decision that is advantageous for the firm. This approach is referred to as the organic approach and is rooted in the 'organisation as organism' paradigm. In general it is accepted that firms can use both approaches simultaneously, and this is supported by the authors' analysis. They also find that: - The mechanistic approach is a stronger driver of complaint satisfaction. - The mechanistic approach is more important in B2C than the B2B, and more important to service firms than manufacturing firms. - Complaint satisfaction has a strong impact on customer loyalty, but the impact of overall customer satisfaction on customer loyalty was not significant. Therefore, after a complaint, loyalty depends on how well the complaint was handled, rather than on initial satisfaction.
Evidence and data sources: The authors surveyed both firms and customers who had complained, and collected complete data relating to 110 firms. Questions used were asked on a scale of 1-5 or 1-7. The authors point out some limitations of their analysis, notably, that their sample was relatively small and may not be fully representative.

Title: Modelling Customer Perceptions of Complaint Handling Over Time: The Effects of Perceived Justice on Satisfaction and Intent

Author: Maxham and Netemeyer

Date: 2002

Journal: Journal of Retailing

Areas of theory covered:

- Complaint handling
- Customer satisfaction

Coding: Empirical – Operational

Implications for legal services:

Satisfaction with a complaint resolution is a significant driver of whether a customer spreads positive word-of-mouth, which is an important driver of acquisition in the legal services market. This paper finds though, that overall satisfaction is a more important driver of purchase intent than satisfaction with the recovery process.

Synopsis:

This paper proposes a model of the effects of perceived justice on customer satisfaction and intent following a service or product failure and a recovery attempt.

Main arguments / ideas:

The authors put forward a model in which there are three perceived justices that contribute to complaint resolution satisfaction and overall firm satisfaction, which in turn contribute to word-of-mouth intent and purchase intent. These three justices are: distributive; procedural; and interactional. The model is set out below.

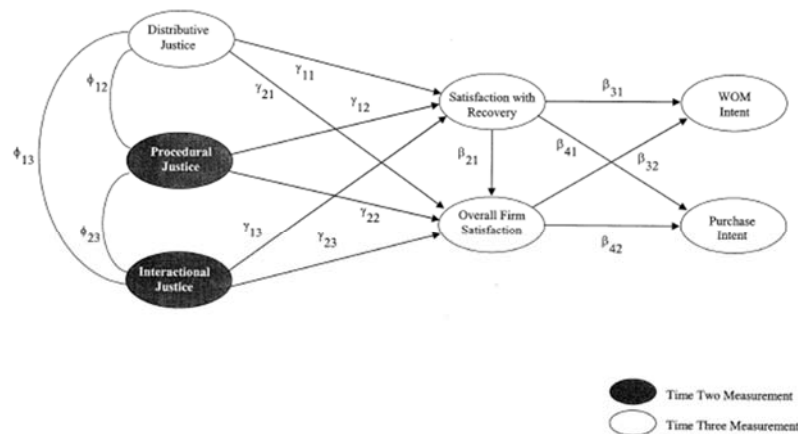


Fig. 1. Hypothesized model.

The authors find that:

- Procedural and interactional justice are more influential in forming overall firm satisfaction than distributive justice
- Satisfaction with recovery was a stronger predictor of the likelihood of spreading positive word-of-mouth than overall firm satisfaction
- Overall firm satisfaction was a stronger predictor of purchase intent than satisfaction with recovery

Evidence and data sources:

The paper is based on two studies. The first was a survey of customers who complained about their banking service for the first time. The second was a survey of new homebuilder customers who experienced construction defects.

Title: On the Importance of Complaint Handling Design: A Multi-level Analysis of the Impact in Specific Complaint Solutions
Author: Homburg, Fürst and Koschate
Date: 2010
Journal: Journal of Academy of Marketing Science
Areas of theory covered: Complaint handling
Coding: Empirical – Operational
Implications for legal services: The effectiveness of a complaints handling process will in part be determined by the characteristics of customers, which legal services providers will need to take into account when making decisions about investing in complaints handling processes.
Synopsis: This paper looks at the implications of firm and customer characteristics on customers' perceived level of fairness of the complaint handling.
Main arguments / ideas: The paper sets out a number of variables that could affect a consumer's perception of fairness of the complaints handling process. These are: - The quality of the complaint handling process - Problem-related customer characteristics – perceived severity of the problem, perceived importance of the product, attribution of responsibility to company - Relationship-related customer characteristics – perceived intensity of business relationship - Psychographic customer characteristics – propensity to complain, appreciation of quality - Sociodemographic customer characteristics – age, education level, gender They find that the impact of a company's complaint handling design varies significantly depending on the characteristics of the complaining customers with which the firm has to deal.
Evidence and data sources: The paper uses data relating to companies with at least 200 employees and annual revenues of \$50m or more. Regression models were built to determine the impact of different variables on the level of perceived fairness of the complaint handling process.

Annex B – Dr Andrew Mell

opinion

Profile of Dr Andrew Mell

This Annex was written by Dr Andrew Mell; Fellow in Economics at Corpus Christi College, University of Oxford. Dr Mell is an academic whose expertise and research is focused on understanding the impact of reputation on markets and agents.

Overview

This annex sets out my opinion as to why it would make good business sense for law firms of all shapes and sizes to expend resources on handling complaints by their customers. The basis of this opinion is that good handling of customers' complaints offers an excellent way for law firms to invest in their reputation, and this is an investment that offers a good return.

The returns to reputation come directly via more satisfied customers being more likely to remain as customers. However, in many areas of law there may be few opportunities for repeat business; for example criminal law will (hopefully) present few opportunities for repeat business with the same client. Even in cases such as this, satisfied customers are more likely to recommend the firms they purchased from than dissatisfied customers. Indeed, dissatisfied customers could actively dissuade people from approaching firms where they had unsatisfactory experiences. The effect of such negative word of mouth on reputation was highlighted by Luo & Homberg (2008).

Good complaints handling will also allow a firm to learn from any mistakes and ensure that there are more satisfied customers in the future. So, even if the complaints handling process fails to turn a dissatisfied customer into a satisfied customer, it is possible for a firm to derive benefits from the process itself.

Why is Reputation Important?

The traditional economic model of a market sees perfectly informed consumers purchasing goods from perfectly informed firms. Efficiency is achieved because the consumers never pay more money for a good than their valuations and firms only make goods if the price they receive is greater than the cost of making them.

It was George Akerlof who showed in his seminal 1970 article (for which he was awarded the Nobel

Prize in Economics in 2001) what happens if consumers are uncertain about the quality of the particular product they are being offered. Akerlof used the economic parable of the used car market where good cars are referred to as "peaches" and bad cars are called "lemons". He showed how as a result of consumers' uncertainty over whether the particular car they are buying is a lemon or a peach, peaches are withdrawn from the market and it is only possible to buy or sell lemons. The problem is that it is only really possible to tell the difference between a lemon and a peach after driving the car around for a few weeks. So, it is not possible to write a contract that specifies that a car is a lemon or a peach - no court would be able to later verify whether that was the case or not. The presence of lemons then reduces buyer's willingness to pay for second hand cars, potentially to the point where peach owners no longer wish to sell.

Legal advice suffers from a similar problem to the used car market in that some lawyers will offer very high quality legal advice while other lawyers will simply meet the minimum quality requirements. Prior to purchase, a customer would, most likely, be unable to tell whether a lawyer whose advice they are seeking will be one or the other. While a person might have a shrewd idea of the quality of legal services they received after using a particular law firm, it is not something they would be able to prove after the fact. Quality consists of too many different dimensions, which are not susceptible of numerical measurement. For example, the clarity of explanation of the legal issues and the "bedside manner" of the lawyer might all be relevant quality variables, but there is no way to measure them or define them in a contract.

The result is that customers would be unwilling to pay any premium for higher quality services as it is very difficult to reassure them that that is what they will get. But if customers are not willing to pay a premium for high quality services, there will be no incentive for law firms to provide such high quality services. The result could be all law firms providing the lowest level of service.

Market Institutions

However things are not as bleak as this. In reality there is a used car market and there are law firms who provide a quality of service which goes above and beyond the legal minimums. This is because, as George Akerlof pointed out in his paper, market mechanisms for assuring quality have sprung up

to allow trade in the high quality goods and services that people want. In Akerlof's example of the used car market, this came from the ability of car sellers to offer a guarantee that they would pay for any repairs the car required in the first e.g. six months. In other markets, including legal services, firms can acquire a *reputation* for providing high quality legal advice.

For a law firm, the benefits of acquiring such a reputation include:

- That those customers who frequently need legal advice are more likely to stay.
- That it becomes easier to attract more customers thanks to word of mouth recommendations, or at least the absence of word of mouth condemnation.
- That all customers will be willing to pay a premium for the higher quality of service.

The idea of a reputation is that the extra profits a firm can make with a good reputation provide them with an incentive to develop and maintain such a reputation. In order to ensure that firms do indeed have an incentive to maintain their reputations, it must be that they are able to charge a price premium for high quality products which is greater than the cost premium of producing this higher quality. If that were not the case, a firm with a good reputation would be unable to resist the temptation to make a profit by selling low quality outputs at the high quality price - indeed this would be the only way for a firm to make a profit. So any reputational mechanism used to ensure the provision of high quality must allow for a price premium of high quality above and beyond the extra cost of providing high quality.

Reputation as an Asset

However, this price premium leads to another problem. Such a price premium implies that the firm is making very high profits. This is inconsistent with these goods being provided in a competitive market, where there should be no profits.

This seeming paradox was resolved in articles published by Carl Shapiro in 1983 and by Benjamin Klein & Keith Leffler in 1981. Their insight was to view reputation as an asset which involved some up-front cost and which would pay out over the future life of the firm. The excess of revenues over and above the cost of providing high quality services constitutes a return on that initial investment in reputation. This return survives the conditions of a competitive market because free entry occurs up until the return on the initial investment in reputation represents a normal rate of return.

A key difference between the two papers concerns the form of the initial investment. Klein & Leffler suggest that the investment in reputation takes the form of highly visible assets with no salvageable value if they were to be redeployed in

other industries, one example might be a celebrity endorsement of their services. To Shapiro, the initial investment takes the form of providing high quality services to consumers at low quality prices thus making a loss for as long as it takes to teach consumers that the product is high quality.

These ideas as to the form of initial investments in reputation are not mutually exclusive. A good system for handling customers' complaints is consistent with both of the suggested ways of thinking about the initial investment in reputation. A good system for handling customers' complaints in legal services can be thought of as an investment in the law firm's name by associating the name with high quality legal advice. As such, it is unlikely to have much salvageable value if deployed in other industries. One could also think of the practice of making goodwill payments to customers who have some justifiable complaint as effectively raising the quality of service they have received while lowering the price charged.

More generally speaking we should expect a good system for handling customers' complaints to improve a law firm's reputation through a number of ways. The common denominator however, as with all reputation improving mechanisms, will be that they raise the quality expectations of consumers - both those who have already purchased, and those who have yet to purchase.

How Does Complaint Handling Improve Reputation

The primary route through which good handling of complaints improves a firm's reputation is by increasing customer satisfaction, both by increasing the number of satisfied customers and how satisfied those customers are.

The most direct route for a good complaint handling system to improve a firm's reputation would be by turning customers who would otherwise have been unsatisfied into satisfied customers. Had these customers been left unsatisfied, they might have refused repeat business opportunities with firm, and / or failed to recommend the firm via word of mouth. They might even tarnish the firm's reputation during interactions with potential customers.

Although the initial evidence that a consumer whose complaint is satisfactorily resolved might be more likely to repurchase than one who had no cause for complaint in the first place has since been questioned, the theoretical underpinning for this idea is not unreasonable. Customers know that things go wrong from time to time, even in the best run firms. Nothing having gone wrong is a sign that the customer was lucky as much as it is a sign that the firm is well run. However if something goes wrong and the customer's complaint is well handled, then the customer learns much more about how well run the firm is

and can make better informed repurchase decisions and recommendations to friends.

However there is a more indirect route for a good complaints management system to lead to more satisfied customers, even if it fails to turn dissatisfied customers into satisfied customers. Good firms would also identify customers' complaints as learning opportunities, and use them to supplement their own management systems and improve their offering.

For example, suppose that a customer's complaint centres around having lost their case when it went to court. It may be that the complaint is groundless because the lawyer warned the client beforehand that their case rested on weak legal grounds. While it may be unlikely that any complaints procedure will convert such a customer from dissatisfied to satisfied, the complaint itself still offers the firm the opportunity to learn. For example, they could find out what form of words might have communicated to the customer the legal problems they faced in making their case, and might have discouraged them from taking the case as far as court.

If the right lessons are learned, the firm may be able to change the way in which it gives such advice and so have more satisfied customers in the future. This will improve their reputation and lead to more customer retention and more customer acquisition through word of mouth recommendations.

The discussion so far has been quite theoretical. In part, this is because the economic literature on reputation is quite theoretical; it is very difficult to measure a firm's reputation among all of their

customers and potential customers. Stuart Landon and Constance Smith came up with an innovative way of measuring reputation for wine producers in an article they published in 1998 in which they showed that producers' reputations do have a positive impact on demand and price. Since then, numerous economists have come up with ingenious uses of data from eBay and natural experiments using this online trading forum which, on the whole, show that reputation as measured by sellers' eBay ratings does have a positive impact on price.

Conclusion

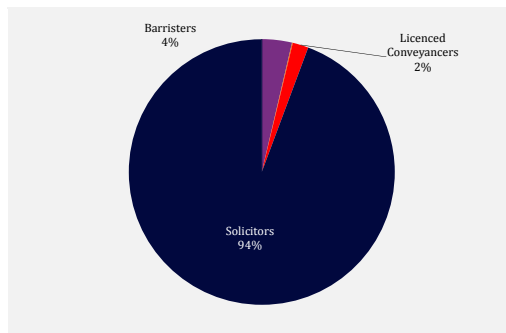
In conclusion, a good system for handling complaints from customers can help a law firm to ensure that more of their customers now and in the future are satisfied customers. This will improve the firm's reputation and lead to more repeat business from those customers who frequently find themselves in need of legal advice. It will also lead to more customers being acquired through word of mouth recommendations. We should also expect that the higher level of demand for legal advice from a firm with a good reputation should enable that firm to charge higher prices for their higher quality of service as a means of recouping their investment in their reputation.

Annex C – summary of complaint data

In order to help inform the definition of our stylised law firm types, the Legal Ombudsman provided us with a range of data relating to the nature of the complaints it adjudicates, and the characteristics of the law firms to which those complaints correspond. Whilst our analysis primarily focuses on developing the business case for complaints handling regarding *first tier complaints*, the features of complaints received by the Legal Ombudsman may nonetheless be informative in relation to a number of relevant issues, such as the areas of law that are most likely to receive complaints.

As can be seen from the figure below, the vast majority of complaints received by the Legal Ombudsman relate to firms of solicitors.⁴⁰ Our stylised firms are, therefore, modelled around these; but, as set out in Section 3, we also consider the implications of our findings for barristers and ABSs.

Figure 15: Sources of complaints

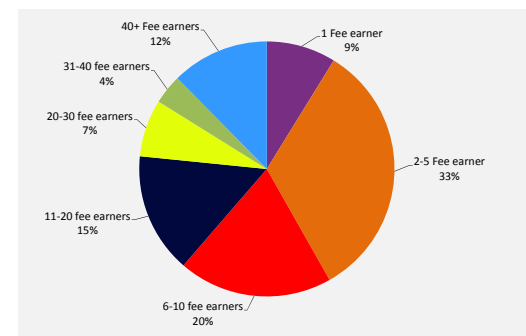


Source: Legal Ombudsman, 2012-2013 data

The next figure shows a breakdown of complaints by firm size (for solicitor firms only). Single fee earners make up roughly a tenth of all complaints received by the Legal Ombudsman. However, as noted in the main body of this report, such firms account for 33% of the total population of law firms in England and Wales, indicating that they *generate a disproportionately small number of complaints*. Firms with two to five fee earners make up a third of complaints, which is slightly below their share of the population of law firms (42%). Over half of complaints received relate to firms with more than six fee earners, although very few are associated with 'big city' law firms. This indicates that such firms generate a

disproportionately high number of complaints relative to their number.

Figure 16: Source of complaints by solicitor firm size



Source: Legal Ombudsman, 2012-20113 data

These data do not, however, necessarily imply that firms with more fee earners are more likely to have complaints brought against them than smaller firms. This is because a wide range of factors may, in practice, influence the probability of complaints being brought, such as: firm turnover, the average value of cases undertaken, or areas of law on which advice is provided. Furthermore, such factors may themselves be correlated with the number of fee earners within a firm.

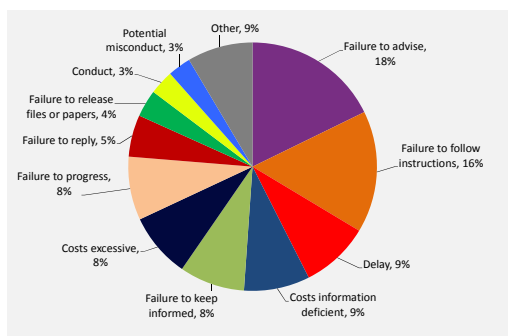
Of particular relevance to the above, average turnover per fee earner varies materially across firm size. So, although firm turnover is correlated with the number of fee earners, there is not a simple, linear relationship. For example, turnover per fee earner tends to be lower for single fee earners and smaller firms (perhaps reflecting that they have fee and utilisation rates that are somewhat below industry averages). The key implication of this is that, unless all of the relevant factors that could influence the likelihood of having a complaint brought are controlled for, only limited inferences can be drawn.

The data provided by the Legal Ombudsman also identifies the 'reasons for complaint.' This shows that the most common reasons to complain are: *'failure to advise'*; and *'failure to follow instructions'*. These were common among different sizes of solicitor firms. The following

⁴⁰ Specifically, firms regulated by the Solicitors' Regulation Authority.

figure shows the top five reasons for complaint regarding firms of solicitors.

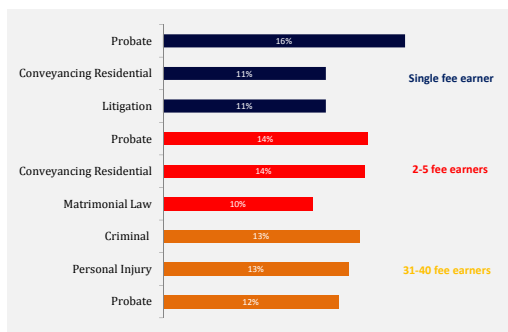
Figure 17: Reason for complaint



Source: Legal Ombudsman, 2012-2013 data

The area of law that a complaint resulted from varied by size of firm. Larger firms are more likely to practice criminal or commercial law; and as such, are more likely to receive complaints relating to these areas. As can be seen in the following chart, single fee earner and small firms are most likely to receive complaints about probate and residential conveyancing. A larger, 31-40 fee earner firm, is more likely to receive complaints about criminal or personal injury matters.

Figure 18: Complaints by area of law and size of firm (SRA)



Source: Legal Ombudsman, 2012-2013 data

When defining our stylised firms we assessed a range of data and evidence 'in the round.' As such, the data set out in this annex represents only one piece of information which we made use of. More widely, in defining stylised law firm types, we had regard to a number of factors, such as:

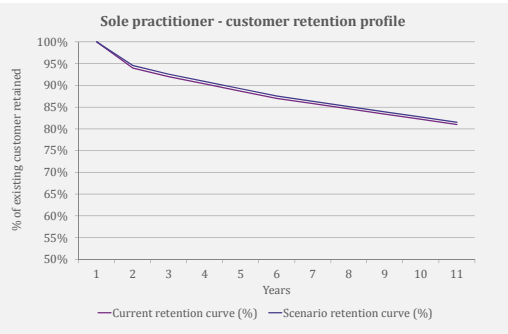
- Their share of the population of law firms in England and Wales;
- Their share of complaints;
- The likely areas of law they would advise on (and relatedly, how likely it is that complaints would be brought relating to those areas of law); and
- A range of qualitative factors, such as views as to the scope for improving complaints handling processes.

Annex D – retention effect modelling

As described in Section 3 of this report, an important calculation within our model is the increase in customer retention arising from the assumed increase in the quality of complaints handling.

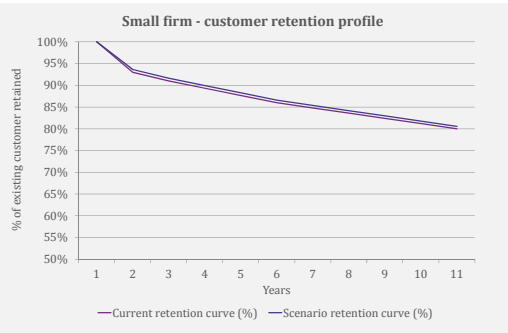
In this annex, we therefore show the modelled increase in customer retention across our three stylised firm types for our central scenario (see following three charts).

Figure 19: Sole practitioner – modelled increase in customer retention



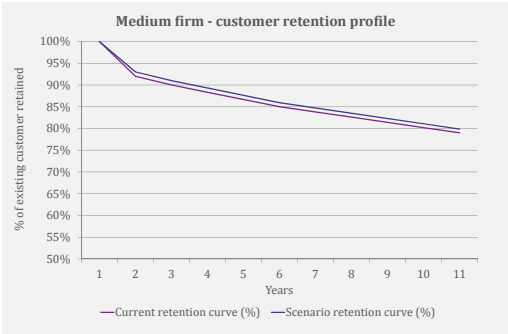
Source: Economic Insight

Figure 20: Small sized firm – modelled increase in customer retention



Source: Economic Insight

Figure 21: Medium sized firm – modelled increase in customer retention



Source: Economic Insight

As set out in the main body, our approach to modelling increased retention is to apply a ‘retention coefficient’ as estimated in an existing academic paper,⁴¹ and apply this to the assumed increase in complaint handling quality as modelled in our scenarios.

⁴¹ *‘Linking complaint management to profit.’ Robert Jonston. Warwick Business School (2001).*

Further information

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