



May 30, 2008

## Case Study: PAETEC's Customer-Focused Strategy Captures US SMBs

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### EXECUTIVE SUMMARY

PAETEC, a US communications solution provider, often flies under the radar screen when compared with better-known wireline operators like AT&T and Verizon. This may be about to change — PAETEC recently acquired US LEC, Allworx, and McLeodUSA to expand its communications solutions and geographic reach throughout the US. PAETEC is among the top 10 US telecom companies, with more than 45,000 small and medium-size business (SMB) customers in 41 states. The company differentiates itself by providing communication solutions and superior customer service to SMB customers, relying primarily on word-of-mouth recommendations to generate new leads. PAETEC's intense customer service focus resonates throughout the company beginning with the CEO and extending to all levels of the organization. To reinforce the importance of customer service, 20% of employee bonuses are based on results from a customer service survey. PAETEC's success in the SMB market provides insight for other service providers and vendors seeking to address the needs of this increasingly important business segment.

### PAETEC RISES ABOVE THE COMMUNICATIONS SERVICE PROVIDER PACK

PAETEC is a hidden gem in the US telecommunications market — often overshadowed by larger carriers like AT&T and Verizon. Founded 10 years ago, PAETEC had \$1.04 billion in revenues during 2007, with virtually 100% of these revenues coming from the US. The company, which is based in Fairport, New York, provides more than 45,000 US small and midmarket customers with voice, Internet access service, security, and data center solutions. PAETEC supports more than 3.5 million access lines and is one of the top 10 US telecom service providers. The company differentiates itself by providing superior customer service, primarily to SMBs located in 82 of the top 100 Metropolitan Statistical Areas (MSAs) within 41 states.<sup>1</sup> PAETEC reports a 99.7% month-over-month customer retention rate. What is PAETEC's strategy?

- **Broaden product breadth and geographic reach through acquisitions.** A variety of recent acquisitions to accelerate new solutions and reach new geographic markets has facilitated PAETEC's momentum. In the past two years, PAETEC acquired US LEC, a provider of Internet Protocol (IP), data, and voice services to businesses in 16 Eastern states and Washington, D.C.; purchased Allworx a provider of voice over IP (VoIP) private branch exchange (PBX)/key systems and telephones; and merged with McLeodUSA, a provider of integrated communication services, which added 18 Western states to PAETEC's geographic reach.<sup>2</sup>

- **Leverage word-of-mouth recommendations and referrals to expand presence.** PAETEC shuns flashy TV ads and broad-reaching marketing campaigns. Instead, the company relies on word-of-mouth recommendations from existing customers to broaden SMB customer awareness. The company also implements a referral endorser program, which gives referral endorsers a 4% commission for each new customer referral. In addition, PAETEC builds on its customer relationships with companies that use its telecom expense management (TEM) solution, the PINNACLE Communications Management suite, to identify high-cost areas and save money. This helps PAETEC understand customer issues and gives the company the credibility it needs to expand solutions and services offered to customers — such as providing more managed service products.
- **Address customers with a particular profile or in specific vertical market segments.** PAETEC is strategic about identifying its potential customers. The ideal profile of a PAETEC customer has 250 employees (although organizations with up to 500 employees are common) and uses at least two T1s for access. Additionally, the typical customer company excels in specific industries like education, hospitality, healthcare, financial services, retail, and government. PAETEC has more than 350 universities and 3,500 hospitality customers. However, the company has no prepackaged bundles of services for particular vertical markets. Rather, PAETEC trains its account representatives to sell all of its voice, data, security, and data center solutions to all types of customers and trains them to help identify the unique needs of customers in each vertical industry.
- **Treat employees as critical corporate assets.** Core to PAETEC's corporate culture are the company's more than 4,000 employees. The company treats each employee as an important corporate asset. A key tenet of the corporate value system is the belief that satisfied employees will contribute to providing a high level of customer satisfaction. The link between happy employees providing exceptional service to make customers happy is particularly important because 20% of each employee's annual bonus is tied to how well PAETEC as a company does on customer satisfaction ratings and Net Promoter scores.

## CUSTOMER SERVICE COMMITMENT RESONATES THROUGHOUT PAETEC

At the center of PAETEC's corporate strategy is the customer — the company's goal is to “earn each customer's business.” PAETEC does not offer traditional off-the-shelf bundled services to customers. Instead, account representatives work with each customer to identify their communication service requirements and then create a customized solution to address each customer's needs. The company does not offer traditional cellular wireless capabilities to customers — it sticks to its core competency of primarily wireline-based communication services. PAETEC's focus on becoming a trusted advisor for SMB communication solution requirements and corporate commitment to delivering exceptional customer service is evident throughout all levels of the organization.

- **Extensive use of a highly trained direct sales force.** Sixty-five percent of PAETEC's revenue comes from more than 500 direct sales professionals.<sup>3</sup> Implementing a “feet on the street” sales channel as the primary means of reaching small and midsize organizations is an expensive strategy, so many communications service providers try to use less expensive channels such as customer service agents. PAETEC trains its direct sales reps to sell all products with a focus on creating customized solutions for each customer's unique needs. Former regional sales managers with extensive firsthand experience selling PAETEC's wide range of communications products conduct the training sessions. The direct sales force also uses an internally developed sales tool — Profit Assistant— to evaluate the overall profitability and long-term value of each customer relationship and help ensure focus on meaningful activities.<sup>4</sup> Another 20% of PAETEC's revenues come from more than 800 sales agents who receive incentives and commissions for selling PAETEC products and for providing customer referrals.<sup>5</sup> PAETEC's wholesale business brings in the remaining revenue. Sixteen sales professionals sell PAETEC's solutions to other carriers and resellers that can offer PAETEC's communication services under their own brand.
- **Proactive outreach and autonomy of customer service representatives (CSRs).** PAETEC carefully selects its CSRs, who complete rigorous training on how to address various customer service issues. Surprisingly, PAETEC does not use an interactive voice response system (IVR) to respond to customer calls. Instead, it relies on the personal touch of call center agents. That personal touch results in nearly 90% of incoming customer service calls being answered in 20 seconds or less, and approximately 35% of service issues are resolved during the first call. Agents also own the responsibility for following up with each customer on the issue resolution progress. For example, a CSR will proactively notify a customer that its T1 service is down. This same agent is responsible for providing the customer with periodic updates on the issue resolution process and timeline.
- **Direct interaction with customers through Customer Advisory Boards.** PAETEC maintains direct contact with customers through Customer Advisory Boards, which the company has established in more than 40 markets. Customer Advisory Board members include 10 to 15 representative customers from a particular geographic market. Senior PAETEC executives facilitate an open discussion on how PAETEC is doing in addressing member communication solution needs, identify opportunities for improvement, and discuss customer concerns. PAETEC documents customer concerns and suggestions in each meeting, and sends participants written comments and feedback identifying how it will address these issues within 90 days of the Customer Advisory Board session. PAETEC also brings agents and resellers together in separate advisory board sessions to help the company identify opportunities to improve relationships and better support participants in these important distribution channels.

- **Direct impact of customer satisfaction and Net Promoter scores on employee bonuses.** PAETEC implements various customer advocacy functions, including conducting customer satisfaction surveys after the installation, billing, and service process, as well as conducting Net Promoter surveys of customers. Twice a year, the company asks a representative sample of customers the following Net Promoter question: “How likely are you to refer PAETEC to friends and colleagues?” The goal for 2007 was a Net Promoter score of 20.2, and PAETEC exceeded this goal by achieving a score of 22.7. All employees at PAETEC are dedicated to ensuring customers are happy with PAETEC’s communications solutions and customer support because 20% of each employee’s bonus is tied to these Net Promoter scores. In addition, a dedicated PAETEC employee who is responsible for managing the company’s Net Promoter program and for meeting with a cross-functional PAETEC team to identify opportunities to continue to improve these Net Promoter ratings in the future continually monitors Net Promoter survey results.

### PAETEC'S CUSTOMERS VALIDATE THE COMPANY'S CUSTOMER SERVICE TENETS

A dedicated commitment to customer service has helped PAETEC differentiate itself from the communications service provider pack. To validate that customers themselves recognize this customer focus, Forrester interviewed a variety of PAETEC customers representing organizations in the education, financial service, hospitality, and real estate industries. While each interviewee noted that no service provider relationship is perfect, overall these customers are impressed by:

- **PAETEC's ability to listen to the customer and identify a solution to meet their needs.** Customers are consistently impressed by PAETEC's willingness to work with them to determine exactly what their communications service requirements are and then develop a communication solution to address these requirements. For example, the communications executive at a financial services company chose PAETEC because the company's sales rep conducted extensive research to determine what type of multiprotocol label switching (MPLS) solution would address their specific requirements. The sales rep was able to clearly articulate the benefits of this recommended solution and worked with the customer to ensure a smooth implementation process across all six locations.
- **Employee willingness to “go the extra mile” to help customers.** A consistent theme during customer interviews was the willingness of PAETEC employees to go out of their way to help customers. Customers state that PAETEC employees proactively try to help address any issue that arises, and they never hear the statement, “It’s not my job.” If an employee can’t help the customer directly, he or she proactively takes responsibility for identifying somebody who can work on the issue and then updates the customer on how the company is addressing the issue. This concept of going the extra mile reaches from the field technicians to the customer service reps who are “eager to help” and do not use “canned answers” when an issue arises.

- **Honest, quick response from PAETEC's corporate executives to customer issues.** Admitting to mistakes and working with customers to identify an acceptable solution resolution helps PAETEC retain customers. As with any service provider relationship, technical problem or billing issues will arise. However, customers mention that they quickly forgive these issues because PAETEC focuses on ensuring that it resolves the issue quickly and that it keeps the customer apprised of the issue resolution progress. A clear example of this issue response process is the case of a US LEC customer who lost her account manager as a result of PAETEC's acquisition, and she became dissatisfied with the customer service levels under the newly combined organization. The customer brought this issue up with her PAETEC account rep, and, one month later, service levels were up. PAETEC had sought out and rehired the operations manager who had been laid off as a result of the merger because of his ability to provide the customer with exceptional customer service.

### PAETEC MUST KEEP PUSHING FORWARD IN KEY AREAS

PAETEC has successfully established a corporate culture that is clearly focused on targeting the needs of small and midsize enterprises and ensuring that employees at all levels of the organization rally around the task of earning the customer's business. However, as the company continues to broaden its market reach through acquisitions and expansion, there are areas that it will need to address.

- **Lack of a cellular wireless strategy.** PAETEC's corporate executives have made a conscious choice not to offer cellular wireless service to customers, stating that offering wireless services is not a core competency of the organization. However, it is important to recognize that wireless displacement of traditional wireline access is occurring. Wireless initiatives are becoming an increasingly important component of SMB communications services spending and initiatives — and firms are starting to want to combine wireline and wireless billing.<sup>6</sup>
- **No clear communication service bundles or packages targeted to SMB customers.** PAETEC has developed or acquired a veritable buffet of communications service offerings ranging from voice, data, security, customer premise equipment (CPE), and telecom expense management software solutions. However, the company does not package or bundle these products and services in a manner that clearly addresses the needs of vertical market customers. Bundled service offerings and prepackaged solutions have broad appeal among small and midsize enterprise customers due to the price points and efficiencies associated with these bundles. To address SMBs' bundled service preference, PAETEC should consider creating prepackaged communications solutions that address the needs of particular vertical markets.
- **Inconsistent customer service approach across acquired organizations.** During the past two years, PAETEC made a variety of acquisitions (e.g., US LEC, Allworx, and McLeod) to expand its geographic reach and communication solution capabilities. As the company incorporates these new companies under one corporate umbrella, it is critical that it remain focused on

customers and customer service. PAETEC must make sure to train employees of these acquired organizations on the company's customer service mantra and approach to ensure that this key differentiator continues even as the company expands.

## ENDNOTES

- <sup>1</sup> Metropolitan Statistical Areas are geographic entities containing a core urban area of 50,000 or more population; they are defined by the U.S. Office of Management and Budget (OMB) for use by federal statistical agencies in collecting, tabulating, and publishing federal statistics. Source: "Metropolitan and Micropolitan Statistical Areas," U.S. Census Bureau (<http://www.census.gov/population/www/estimates/metroarea.html>).
- <sup>2</sup> PAETEC has acquired McLeodUSA (2008), Allworx (2007), and US LEC (2006). Source: "PAETEC Completes Acquisition of McLeodUSA," PAETEC press release, February 8, 2008 ([ftp://ftp.paetec.com/PDFS/News/2008%20releases/PAETEC\\_Close\\_020808.pdf](ftp://ftp.paetec.com/PDFS/News/2008%20releases/PAETEC_Close_020808.pdf)); "PAETEC Completes Acquisition of Allworx," PAETEC press release, November 1, 2007 ([ftp://ftp.paetec.com/PDFS/News/2007%20releases/PAETEC\\_AllworxClose\\_110107.pdf](ftp://ftp.paetec.com/PDFS/News/2007%20releases/PAETEC_AllworxClose_110107.pdf)); "PAETEC And US LEC To Combine In \$1.3 Billion Transaction," PAETEC press release, August 14, 2006 ([ftp://ftp.paetec.com/PDFS/News/PAETEC\\_USLEC.pdf](ftp://ftp.paetec.com/PDFS/News/PAETEC_USLEC.pdf)).
- <sup>3</sup> PAETEC's dedicated account reps focus on identifying business customers who spend between \$5,000 and \$50,000 per month on communications services.
- <sup>4</sup> The Profit Assistant sales tool tracks key drivers that impact the overall profitability of each account, including gross margin, net income, EBITDA, length of contract, and potential future value of the contract.
- <sup>5</sup> The agent channel is primarily used to target businesses that spend between \$2,500 and \$25,000 per month on communications solutions.
- <sup>6</sup> For additional information on enterprise demand for combined wireline and wireless billing, and the evolution of telecom expense and inventory management solution requirements see the September 14, 2007, "[Selecting A Telecom Expense And Inventory Management Supplier](#)."