SATMETRIX®

The Power Behind a Single Number

Growing Your Business with Net Promoter®

A Satmetrix Systems® White Paper

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Many companies recognize the power of loyalty and its impact on financial performance.[1] Not only is the notion of loyalty intuitively appealing, but a growing body of empirical evidence also suggests that companies who choose to ignore it may risk precarious footing on the ladder to financial success.[2] Given the link between loyalty and certain financial benefits, such as increased market share, higher revenue and reduced costs, companies are wisely investing time and resources into developing loyalty programs which seek to measure, manage and improve loyalty performance.

Misdirected Measurement

Despite the growing popularity of loyalty programs, the true value of such programs often goes unrealized due to ambiguous or ill-defined measurement systems. In fact, an informal meta-analysis performed on existing research shows that a standardized metric that accurately measures loyalty remains elusive. What has become clear, however, is that measuring satisfaction is simply not enough (Reichheld, 2003). Moreover, researchers and practitioners alike are grappling with identifying the right loyalty metric that consistently links to a company's bottom line.

Establishing a Standard

To begin the path towards standardization, Satmetrix Systems, in close consultation with Frederick Reichheld, founder of the Loyalty practice at Bain and Company and author of Loyalty Rules! (Harvard Business School Press, 2001), embarked on an independent research project to understand both the micro- and macroeconomics of customer loyalty. At the micro-level, research objectives included finding the 'right' loyalty question that best predicts customers' short-term purchase and referral behaviors (see Figure 1A). At the macro-level, research objectives involved validating this aforementioned metric (i.e., the 'right' loyalty question) by linking it to longer-term corporate financial indicators across industry-specific companies (see Figure 1B).

1 For the purposes of this paper, the term 'loyalty' refers to self-reported attitudinal loyalty
2 See References

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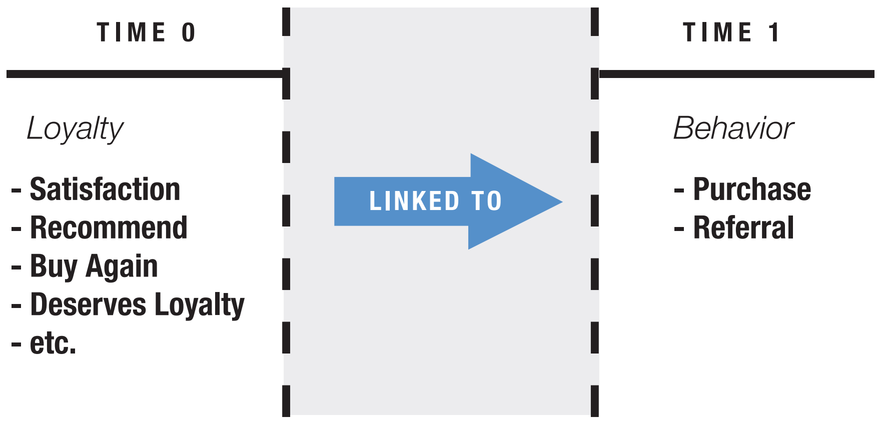
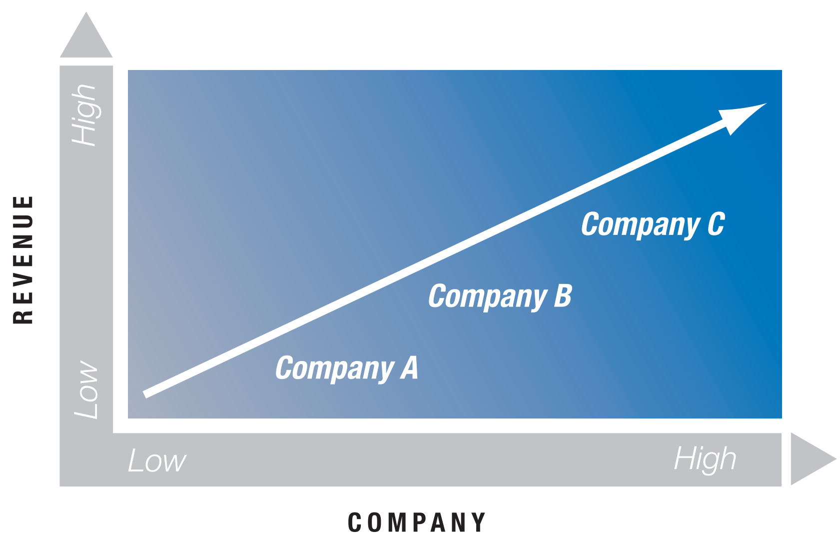
When studying customers of a given company, which loyalty question shows the strongest link to short-term future purchase and referral patterns?

Figure 1A. Microeconomics of Loyalty



Does the loyalty question identified above also link to longer-term corporate financial indicators when studying companies within a given industry?

Figure 1B. Microeconomics of Loyalty



Finding the 'Right' Loyalty Questions

Data Collection

To identify the 'right' loyalty question that links to real behaviors (i.e., purchases and referrals made), survey data was collected from customers of targeted companies within six industries, including financial services, cable and telephony, ecommerce, auto insurance, Internet service providers and computer hardware. Specifically, data was collected using the Web, with customer participation solicited through email invitations sent to addresses purchased from publicly available, opt-in email lists.

Although each survey was customized to address industry-specific customer attitudes and behaviors, all questionnaires asked respondents to provide information related to satisfaction and loyalty to a particular company, as well as individual purchase histories and actual referrals made. Follow-up surveys were then sent to these

White Paper

same individuals within a six to 12 month timeframe in order to evaluate the lag effect between selfreported loyalty and future behaviors. Overall, approximately 4000 customers were sampled for participation in this specialized study, resulting in large enough sample sizes per industry to perform various statistical tests.

Analysis

To evaluate the relationships between loyalty questions and customer behavior, survey questions and response options were designed with quantitative analysis in mind. As such, response options for the loyalty questions consisted of a 0-to-10 point rating scale, with '0' representing the extreme negative end and '10' representing the extreme positive end. Response options for the behavioral questions were also numerically scaled, and consisted of a set of rank-ordered categorical choices.

Using these scaled responses, correlations were computed for each paired loyalty and behavioral combination for each of the different industries. Correlation coefficients were then examined in terms of absolute magnitude and level of significance to find the loyalty question that most strongly and consistently linked to short-term customer behaviors. Below is a listing of the primary questions and behaviors that were linked within each industry.

LOYALTY QUESTIONS

- Satisfaction with company's overall performance
- Likelihood to recommend company to friend or colleague
- Likelihood to continue buying products/services from company
- Likelihood to choose again as if for the first time
- Belief that company deserves his/her loyalty
- Belief that company sets standard for excellence in its industry
- Belief that company creates innovative solutions
- Belief that company makes it easy to do business with

LINKED TO

CUSTOMER BEHAVIOR

- Purchase
- Referral

Results

Because different industries generally foster distinct types of customer-to-company relationships, one of the presumed hypotheses in this micro-level analysis was that each industry would yield a unique answer. In other words, a different question would prove to be the 'right' loyalty metric for each industry under consideration.

What the results showed, however, was that a single loyalty question may be sufficient to gauge individual customer purchase and referral patterns across seemingly disparate industries.

Specifically, of the correlations studied across the different industries, the 'likelihood to recommend' question proved to be the top correlate to actual customer behavior 80% of the time (see Figure 2). More explicitly, if customers reported that they were likely to recommend a particular company to a friend or colleague, then these same customers were also likely to actually repurchase from the company, as well as generate new business by referring the company via word-of mouth. Conversely, if customers reported that they were not likely to recommend a company, they were also less likely to engage in actual repurchase or referral behaviors.

1. Reichheld, Frederick F., "The One Number You Need to Grow," Harvard Business Review (Dec. 2003)
2. Ibid.

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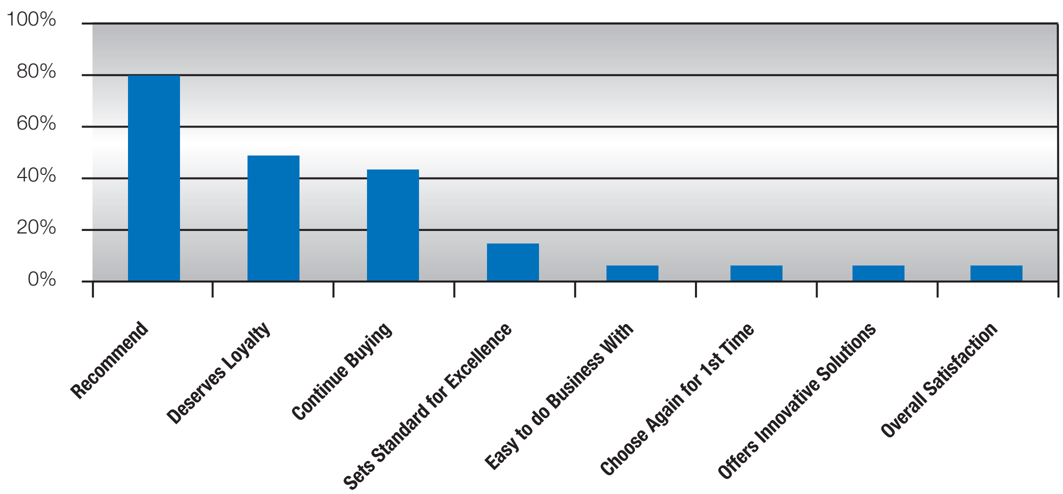
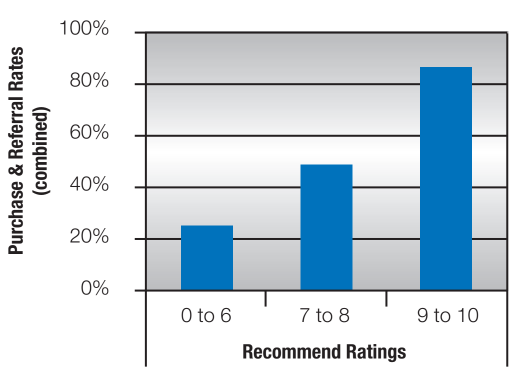
Figure 2 illustrates the frequency with which each of the different loyalty questions emerged as the top correlate to actual customer behavior when testing these links across the six different industries.

Figure 2. Top Ranking Correlates to Customer Behavior



Results of this analysis also led to the discovery of a customer classification scheme, whereby customers can be grouped according to their joint loyalty and behavioral profiles. For example, Figure 3 shows the co-varying distributions for customers within the cable and telephony industry. As seen below, customers were segmented into three categories based on their 'recommend' ratings and their combined purchase and referral rates. Using these groupings, customers can be characterized in terms of their joint profile of 'what they say' and 'what they will actually do'.

Figure 3. Joint Distribution of 'Recommend' and Behavior for Cable and Telephony Customers



1) Promoters – customers who were highly likely to recommend a company (i.e., ratings of 9 or 10) and exhibited the highest rates of purchase and referral behaviors

(2) Passive – customers who were somewhat likely to recommend a company (i.e., ratings of 7 or 8) and exhibited moderate rates of purchase and referral behaviors

(3) Detractors – customers who were less likely to recommend a company (i.e., ratings of 0 thru 6) and exhibited the lowest rates of purchase and referral behaviors

[When generalizing the results described above, please note that the 'recommend' question may not be as effective in measuring customer loyalty for monopolistic companies who have very few if no competitors. Because such companies dominate a certain industry, customers may purchase or refer simply out of necessity and lack of choice rather than true customer loyalty (Reichheld, 2003).]

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Linking 'Recommend' to Long-Term Corporate Growth

Although results from the micro-level analysis proved to be robust at the individual customer level, could they also be substantiated at the macro-level? In other words, could the 'recommend' approach to measuring customer loyalty also predict longer-term corporate financial growth when comparing companies within competitive industries?

Data Collection

To investigate this question, loyalty data in the form of 'recommend' ratings was first gathered from Satmetrix Systems' independent benchmarking database. For nearly three years, Satmetrix Systems has provided its clients with competitive data compiled from over 150,000 opt-in survey responses from customers of over 400 companies across numerous industries. By accessing this database, which is updated on a quarterly basis, clients are able to track their own loyalty performance relative to competitors within the same industry or market segment, as well analyze trends across time.

Within the benchmarking database, customer loyalty scores are collected and stored at the individual respondent level. These scores are then aggregated and represented at the company level, either in terms of averages or percentages. In order to qualify for inclusion in the analysis, each company under consideration had to have a sufficient number of opt-in survey respondents to ensure accuracy and stability of their aggregated loyalty scores. In total, over 50 companies were included across a dozen targeted industries, such as airlines, package delivery and life insurance.

Analysis

To test whether the 'recommend' question would still link to financial indicators beyond the individual customer level, company data gathered from the benchmarking database was aggregated in terms of two types of loyalty percentages:

- %Promoter – the percentage of respondents indicating a 'recommend' rating of 9 or 10
- %Net Promoter – the percentage of respondents indicating a 'recommend' rating of 9 or 10 minus the percentage of respondents indicating a 'recommend' rating of 0 thru 6

Using these percentages, correlations were computed tying %Promoter and %Net Promoter to each company's revenue growth rate for each targeted industry. 33 Correlation coefficients were then examined in terms of absolute magnitude and level of significance to determine whether either of the two types of loyalty percentages links to corporate financial growth.

Results

In general, results of this macro-level analysis revealed significant correlations for a majority of the targeted industries, ranging anywhere from 0.70 or higher. These high correlations led to the interpretation that the 'recommend' question, when expressed in terms of %Promoter or %Net Promoter, does indeed suffice as an aggregate loyalty metric for companies to track when gauging long-term corporate growth.

Furthermore, results also indicated that the %Net Promoter expression of the 'recommend' question, rather than simply the %Promoter, maintains a stronger link to revenue growth rate for most industries.

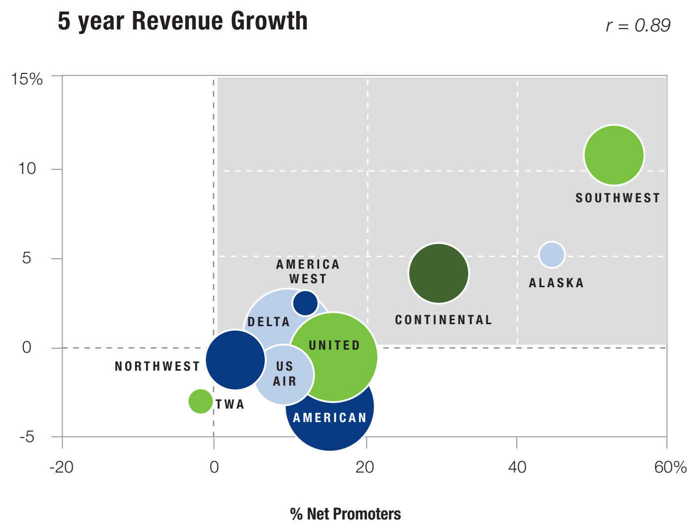
As an example, Figure 4 below plots %Net Promoter scores against five-year revenue growth rates for major companies within the airline industry. As seen from the chart, the correlation coefficient of 0.89 indicates a relatively strong relationship between loyalty and growth. This correlation coefficient of 0.89, when squared, indicates that 79% of the variance in revenue

White Paper

growth rates can be explained by the %Net Promoter loyalty scores. In other words, companies that maintain higher %Net Promoter scores also demonstrate higher growth rates, whereas companies that maintain lower %Net Promoter scores also demonstrate lower growth rates.

The correlation coefficient of 0.89 indicates that firms who have higher %Net Promoter scores also enjoy higher long-term growth rates (e.g., Southwest), whereas firms who have lower %Net Promoter scores also suffer from lower long-term growth rates (e.g., TWA).

Figure 4. %Net Promoter vs. 5-year Revenue Growth Rate for US Airline Companies



** Bubble size represents 2001 domestic revenue*

Discussion of Results

Although today's companies are quickly heeding the call for customer loyalty programs, incongruities exist around the actual methods used to measure loyalty itself. Specifically, many companies are employing a variety of loyalty measurement methods that may be unnecessarily complicated or even misguided, leading to inaccurate metrics, unrealized value and potentially wasted resources.

To answer this need for measurement standardization, Satmetrix Systems devoted nearly one year to analyzing and understanding the linkages between loyalty and actual customer behavior and long-term corporate growth. What the results of this undertaking revealed was really fairly simple—an individual's propensity for recommending a company to friends or colleagues may be the most direct gauge of customer loyalty and ultimately, financial success.

Although this finding was borne out by statistical tests, it also makes intuitive sense. When customers are truly loyal, their relationship with a particular company surpasses the basic model of economic exchange, where money is simply spent for products acquired or services rendered. Not only do these customers remain committed to the company despite price increases and occasional errors, they also actively recruit new customers through positive word-of-mouth marketing. And it is exactly through this act of recommendation that customers may be viewed as truly loyal, since they are willing to risk their own character, trustworthiness and overall reputation with virtually no reward beyond the positive regard and thanks of others.

Furthermore, it also makes sense that the %Net Promoter metric demonstrated the strongest link to long-term corporate growth. Specifically, results from the macro-level portion of this study showed that %Net Promoter accurately measures the net effect of 'viral marketing'. In other words, the reason why %Net Promoter is such a powerful metric for gauging long-term growth is because it takes into account both the increased growth achieved through positive word-of-mouth marketing, as well as the lost potential for growth caused by the repellant effects of negative word-of-mouth marketing.

Ongoing Research

Satmetrix Systems continues to analyze the links between %Net Promoter and other indicators of long-term growth, as well as expand these analyses into other industries and market segments. In addition, the Net Promoter Database will be available within the Satmetrix Systems core product for clients who wish to track their own %Net Promoter score in comparison to relevant competitors within their own industry or market segment.

By tracking loyalty performance in relation to competitors, clients may interpret improvements or declines in performance within the context of marketplace fluctuations.

Although other factors can certainly influence any company's growth potential, companies would be well advised to begin looking at loyalty through the eyes of customers who are 'likely to recommend'. By measuring and tracking this propensity, as well as the net effect of customers who 'promote' over customers who 'detract', companies can confirm the appropriateness of the %Net Promoter metric for their own organization. Over the course of time, and with repeated validation, %Net Promoter may indeed prove to be a firm's loyalty metric of choice for gauging both short-term and longterm financial success.

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About Satmetrix Systems

Satmetrix Systems is a leading software and services company focused on customer experience management. Satmetrix provides the only solution that integrates cuttingedge research methodology with a complete customer experience system to move from analysis to action to visible financial results. Satmetrix has recently introduced Satmetrix Net Promoter®, which enables companies to act with the highest impact on the one number they need to grow.

Global leaders who have driven profitable results from their customer experience such as BearingPoint, Hewlett-Packard, Lucent Technologies, Nokia and Oracle rely on Satmetrix. Headquartered in Foster City, CA, Satmetrix Systems has sales and service offices in New York and Europe. For news, product demos, and other company information, visit www.satmetrix.com. For more information on Net Promoter, visit www.netpromoter.com.

White Paper

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