SATMETRIX
THE NET PROMOTER COMPANY

*White Paper*

# The Power Behind a Single Number

*Net Promoter: The New Standard for Measuring Customer Loyalty*

*Many companies recognize the power of loyalty and its impact on financial performance. Not only is the notion of loyalty intuitively appealing, but a growing body of empirical evidence suggests that companies that choose to ignore loyalty may find themselves on precarious footing as they attempt to ascend the ladder of financial success. Given the link between loyalty and financial benefits, such as increased market share, higher revenue, and lower costs, companies are wisely investing time and resources into developing loyalty programs that seek to measure, manage and improve loyalty performance.*

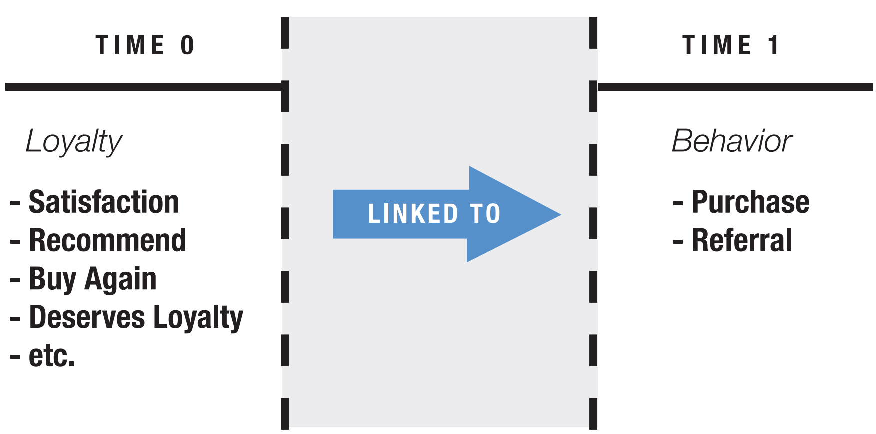
## Establishing a Standard

Despite the growing popularity of loyalty programs, the true value of such programs is not often realized due to ambiguous or ill-defined measurement systems. An informal meta-analysis, performed in 2003, showed that a standardized metric that accurately measures loyalty was difficult to find. Moreover, it became quite obvious that measuring customer satisfaction was simply not enough (Reichheld, 2003). And yet, researchers and practitioners alike were still trying to identify a customer metric that consistently linked to a company's bottom line.

To begin the path towards standardization, Satmetrix, in close consultation with Frederick Reichheld, founder of the Loyalty practice at Bain & Company, embarked on an independent research project in 2003. Our objective was to better understand the micro- and macro-economics of customer loyalty. At the micro-level, our research focused on finding a loyalty question that could consistently predict short-term purchase and referral behaviors (see Figure 1A). At the macro-level, we sought to validate this metric by linking it to long-term corporate financial indicators across industry-specific companies (see Figure 1B).

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

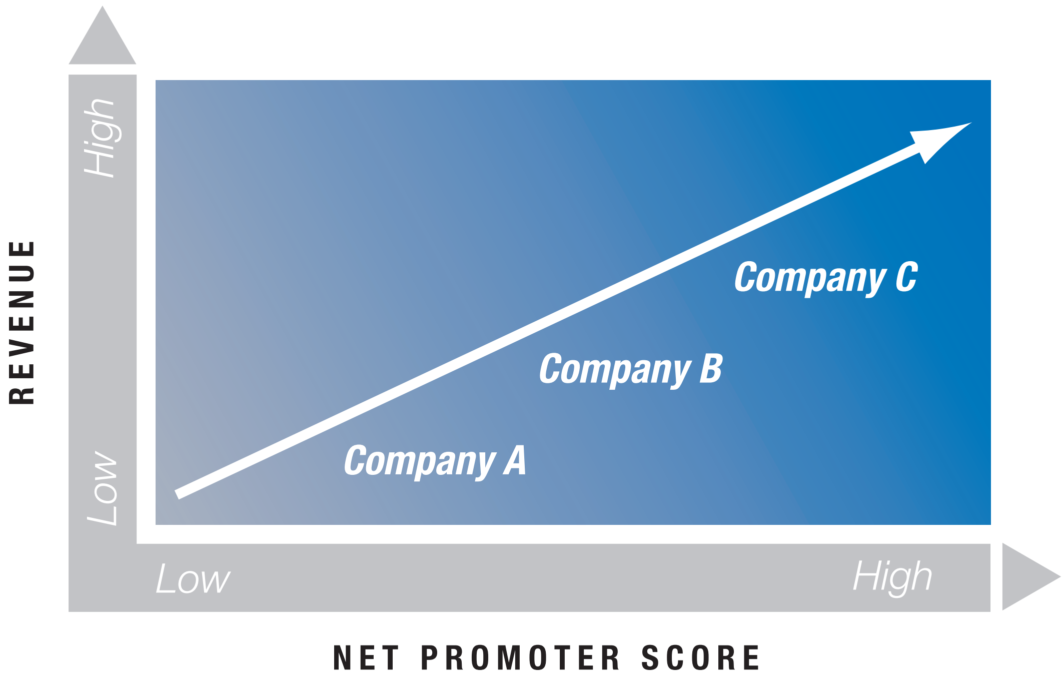
*Figure 1A. The Microeconomics of Loyalty*




[1] For the purposes of this paper, the term 'loyalty' refers to self-reported attitudinal loyalty.
[2] Reichheld, Frederick F., "The One Number You Need to Grow," Harvard Business Review (Dec. 2003).

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

*Figure 1B. The Macroeconomics of Loyalty*




The results of this investigation were compelling. Not only did we discover the most effective question for accurately measuring customer loyalty, but we also identified "Net Promoter" as a valuable tool for assessing long-term corporate growth. Since then, ongoing research has continued to strengthen the efficacy of Net Promoter. For example, Reichheld's book The Ultimate Question (2006) presents many cases documenting the power behind Net Promoter. Extensive analyses conducted by Satmetrix, along with independent researchers such as Marsden et. al. (2005) and Ritson (2006) are increasing Net Promoter's validity by producing convergent results.

The growing acceptance of Net Promoter is not limited to academics and researchers. Through vehicles such as netpromoter.com and conferences held in North America and Europe, Net Promoter is quickly gaining widespread industry adoption. During Forrester Research's 2007 Marketing Forum, Forrester Chairman and CEO George F. Colony said "Net Promoter is becoming a driving force within organizations."

In the remainder of this paper, we will describe the ground breaking research that has positioned Net Promoter as today's standard for measuring customer loyalty.

# Finding the ‘Right’ Loyalty Questions

## Data Collection

To identify a loyalty question that links to real behaviors (i.e., purchases and referrals), we collected survey data from customers in six industries: financial services, cable and telephony, e-commerce, auto insurance, Internet service providers and computer hardware. We collected data via the Web, and solicited customer participation via email invitations (addresses were purchased from publicly available, opt-in email lists.) Although each survey was customized to address industry-specific attitudes and behaviors, all questionnaires asked respondents to provide information related to satisfaction and loyalty to a particular company, as well as to individual purchase-histories and actual referrals made.

We then sent follow-up surveys to these same individuals within a six to 12 month timeframe in order to evaluate the lag effect between self-reported loyalty and future behavior. We gathered information from approximately 4,000 customers in this specialized study, resulting in large enough sample sizes to perform meaningful statistical tests in each industry.

## Analysis

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

Using these scaled responses, we correlated each paired loyalty and behavioral combination for each of the different industries. Next we examined correlation coefficients 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 | | CUSTOMER BEHAVIOR |
|---|---|---|
| **- Satisfaction with company’s overall performance**<br>**- Likelihood to recommend company to friend or colleague**<br>**- Likelihood to continue buying products/services from company**<br>**- Likelihood to choose again as if for the first time**<br>**- Belief that company deserves his/her loyalty**<br>**- Belief that company sets standard for excellence in its industry**<br>**- Belief that company creates innovative solutions**<br>**- Belief that company makes it easy to do business with** | LINKED TO | **- Purchase**<br>**- Referral** |

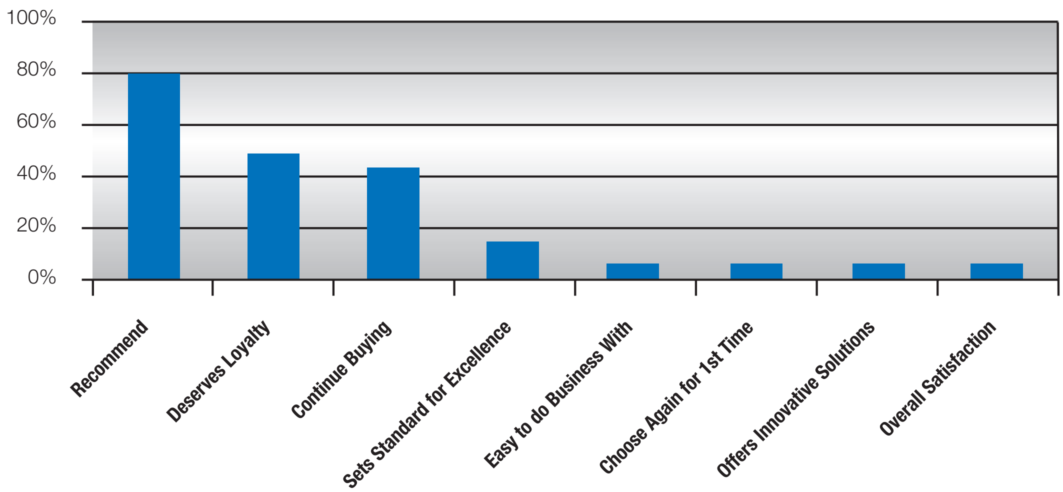
## Results

Because different industries 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, we assumed a different question would prove to be the ‘right’ loyalty metric for each industry.

However, the results were otherwise: a single loyalty question is in fact sufficient to gauge 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 first or second 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.

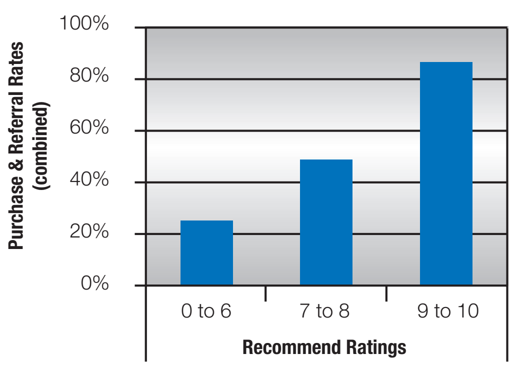
Figure 2 illustrates the frequency with which each of the different loyalty questions emerged as the top correlate to actual customer behavior when testing these links across six different industries.

*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 that have few or no competitors. Because such companies dominate their industries, their customers may purchase or refer out of necessity rather than true loyalty (Reichheld, 2003).

# Linking 'Recommend' to Long-Term Corporate Growth

Although the micro-level analysis proved to be robust at the individual customer level, could the results also be substantiated at the macro-level? In other words, could the 'recommend' approach to measuring customer loyalty also indicate 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's independent benchmarking database. This data included more than 150,000 opt-in survey responses from customers at more than 400 companies across numerous industries.

The benchmarking database included customer loyalty scores at the individual respondent level. These scores were also 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 its aggregated loyalty scores. More than 50 companies across a dozen targeted industries met these requirements, including airlines, package delivery and life insurance.

## Analysis

To test whether the 'recommend' question would still link to financial indicators beyond the individual customer level, we aggregated company data from the benchmarking database to calculate 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 (hereafter, Net Promoter®)

Using these percentages, we correlated %Promoter and Net Promoter to each company's growth rate for each targeted industry. We examined 33 correlation coefficients, in terms of absolute magnitude and level of significance, to determine whether either of the two types of loyalty percentages linked to corporate financial growth.

[1]Reichheld, 2003 (op. cit.)

## Results

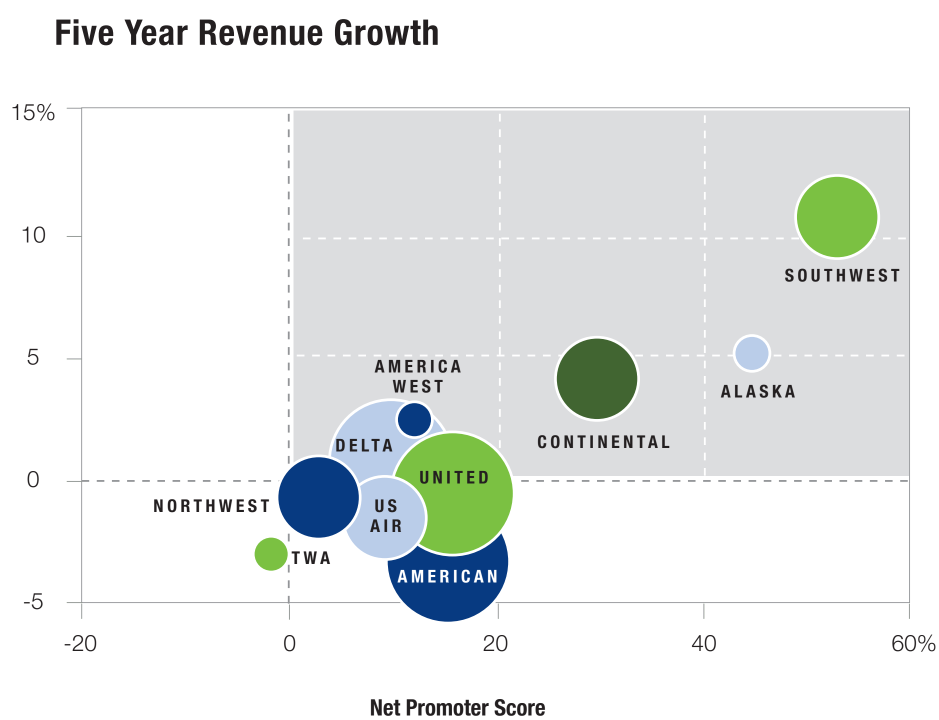
This macro-level analysis revealed significant correlations (0.70 or higher) for a majority of the targeted industries. These high correlations led to the interpretation that the 'recommend' question, when expressed in terms of %Promoter or Net Promoter, does indeed suffice as an aggregate loyalty metric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

These results also indicated that the Net Promoter expression of the 'recommend' question, rather than simply the %Promoter metric, more strongly links to revenue growth rate for most industries.

Figure 4 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. In other words, companies that maintain higher Net Promoter scores also demonstrate higher growth rates, whereas companies that maintain lower Net Promoter scores demonstrate lower growth rates

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

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



# Discussion of Results

This comprehensive undertaking revealed unequivocal results: an individual's propensity to recommend a company to friends and 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. These recommendations indicate true loyalty, since they reveal customers who are willing to risk their character, trustworthiness and reputation with virtually no reward beyond the positive regard and thanks of others.

Furthermore, it also makes sense that the Net Promoter metric demonstrates the strongest link to long-term corporate growth. Results from the macro-level portion of this study revealed that Net Promoter accurately measures the net effect of word-of-mouth. 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 referrals, as well as the lost potential for growth caused by the effects of negative word-of-mouth.

# Ongoing Research

While existing research positions Net Promoter as a straightforward metric that links customer loyalty to purchase behavior and long-term growth, there is always a need for ongoing validation. To this end, Satmetrix continues to analyze the links between Net Promoter and other indicators of long-term growth, as well as to expand these analyses into other industries, market segments and countries. For example, Satmetrix currently provides cross-cultural benchmark data to compare Net Promoter scores in different regions and countries, as published in the Satmetrix white paper, “Neutralizing Cultural Response Bias on Customer Loyalty Surveys.”

Although other factors can certainly influence a 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 in their own specific circumstances. Over the course of time, and with repeated validation, Net Promoter is becoming the loyalty metric of choice for gauging both short-term and long-term financial success.

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**About Satmetrix**

Satmetrix is the leading global provider of on-demand software applications and consulting services to measurably improve customer loyalty and link these results to financial benefits. As the co-developer of Net Promoter®, the company's solutions enable companies to monitor the customer experience at key touch points, measure loyalty of customers, partners and employees, identify performance gaps, and engage customers in a continuous dialog through online communities. The company has deployed more than 700 enterprise solutions in 40 languages.



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