

**The Loyalty Connection:
Measure What Matters and Create Customer Advocates**

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**customer
THINK**

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Executive Summary

Famed management consultant Peter Drucker once said, “There is only one valid definition of business purpose: to create a customer. ... It is the customer who determines what a business is.”

Far be it for me to correct such a legend, but I would suggest that as global competition increases and markets mature, it’s becoming much more important to also *keep* a customer. In fact, creating and keeping the *right* customers is the heart of successful customer management.

CustomerThink members agree. In a March 2007 survey, 77 percent of respondents rated “improve customer loyalty and retention” as a major expected benefit of CRM projects (top 2 box on a zero-to-7 scale). And, a more recent survey found that 76 percent rated customer loyalty as “extremely important” or “very important” to top management, similar to results from a survey almost three years earlier.

Yet, the 2007 study also found that only 43 percent of the respondents believe their company is doing a good or excellent job managing customer loyalty. That’s not much improvement from a similar survey conducted in 2004.

What *has* changed in the past three years is the rise of the “social web,” which allows customers to bypass conventional marketing channels and help each other. With more than 100 million blogs (according to Gartner) and social networking sites like Facebook and LinkedIn signing up millions of users, marketers have lost control of the message and will never get it back.

The current debate is not whether customer loyalty is important. Rather, the key issue is *how* to manage customer loyalty to achieve better business performance. And because management requires measurement, the central theme of this paper is that business leaders must develop effective ways to a) measure customer loyalty correctly and b) lead the organization to create more customer advocates. Effective customer loyalty management should result in better business performance.

Measuring customer’s attitudes and behaviors can be challenging, and there is no consensus about which metric is “best.” In fact, this paper will devote some time examining the Net Promoter Score®, which some have touted as a simple way to measure customer loyalty.

It’s encouraging that nearly 80 percent of respondents in our recent survey say they are conducting customer feedback surveys at least annually, up from 70 percent three years ago. Unfortunately, our survey also revealed that 42 percent of companies do not reward their people for their loyalty-building efforts, only a marginal improvement from the past survey.

In this white paper, an update to the first *Loyalty Connection* published in 2005, I will review once again why customer loyalty is so crucial to business success. But the primary focus this time will be on how to design customer feedback processes and employee rewards systems to make loyalty management an integral part of business performance management.

My major findings and conclusions are:

- Business managers continue to expect customer loyalty management to improve both top- and bottom-line performance.
- There is no “magic number” that correctly measures loyalty for all businesses, nor is there only one survey design that works best for all situations.
- Customer feedback systems can help capture and distribute loyalty indicators to the right people for timely action.
- Loyalty leaders are twice as likely to reward employees who help improve customer loyalty.

The Value of Loyalty Leadership

Loyalty experts generally agree that loyal customers stick around longer and buy more frequently. This *behavior* is driven by the customers' *attitudes*, demonstrating that they really want to continue to do business with the company. As a result, loyalty leaders enjoy a substantial advantage in revenue growth and profitability.

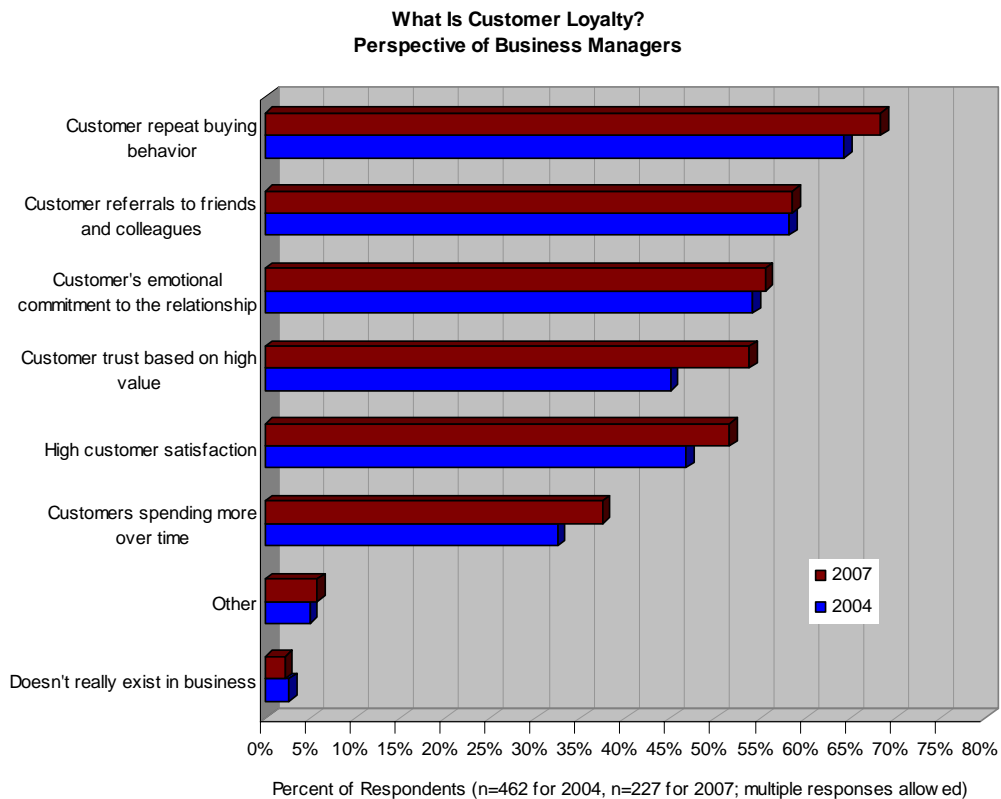
However, in the business world, there are still considerable differences of opinion about the specific elements of loyalty—and what actually causes customers to be loyal.

What Is Loyalty?

In a September 2007 CustomerThink survey, 68 percent defined loyalty as repeat buying behavior; 59 percent as a customer who makes referrals to friends and colleagues; and 56 percent as a customer's emotional commitment—results that are nearly identical to those from a 2004 survey.

The number of respondents who defined high customer satisfaction as loyalty increased from 47 percent to 52 percent, while the number of respondents who saw loyalty as customer trust based on high value saw the most significant change, increasing from 45 percent to 54 percent of respondents.

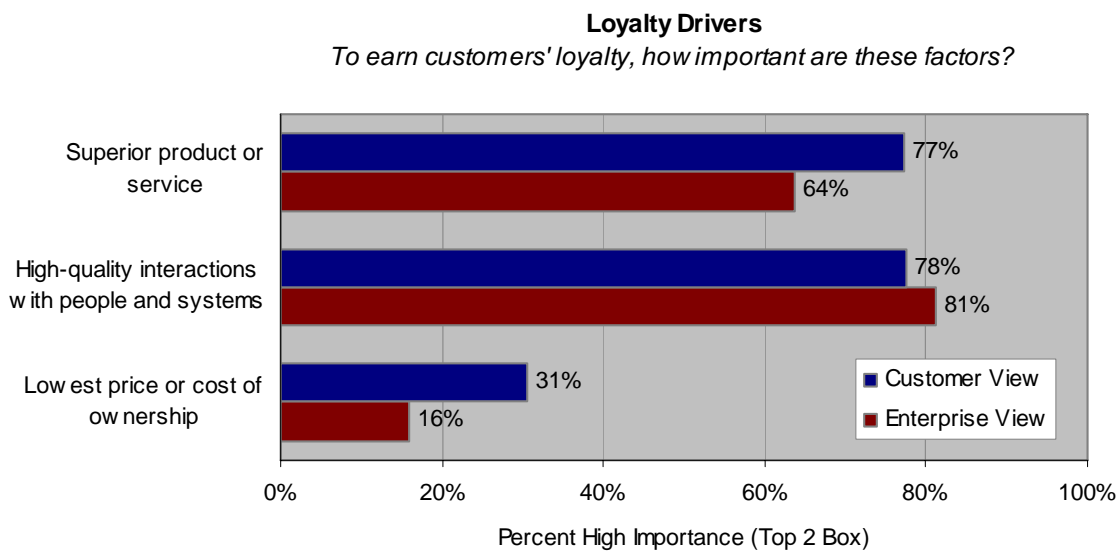
In 2004, only 32 percent of the respondents defined loyalty as a customer spending more over time, compared to 37 percent who agreed with that definition in 2007.



Customer satisfaction is not the same as loyalty, according to loyalty experts. Yet poor customer satisfaction can lead to customer defections and damaging word of mouth. Many business leaders ignore this fact and try to skip over customer satisfaction in a rush to build “raving fans.” Although customer satisfaction alone does not necessarily lead to customer loyalty (i.e. a positive attitude or such beneficial behavior as making referrals and increasing spending), customer satisfaction is still a required foundation. And some academic research indicates that overall or total customer satisfaction is linked to business performance improvements.

Loyalty Drivers

Customer loyalty is driven by customers’ perception of the *value* they receive. The core product or service is part of that value, of course. And let’s not forget that price is still a consideration. But increasingly, customer experiences are a substantial part of perceived value, too. In fact, in CustomerThink’s 2006 study of Customer Experience Management, customers ranked quality of experiences as equally important to earning their loyalty as the core product or service they purchased.



In that study, more than 600 customer respondents delivered 2,000 industry ratings based on their own experiences. Across 12 industries, nearly 80 percent of respondents give “high-quality interactions” and “superior product or service” high importance ratings (top 2 box on a 7-point scale, where 7 means “extremely important”). “Lowest price or cost of ownership” received only 31 percent of high importance ratings.

Enterprises give slightly lower importance ratings to the product and cost dimensions. This suggests that managers need to be careful not to overlook product/price fundamentals while searching for the next differentiator.

Of course, customer perceptions are influenced by other choices they have. You may sell a flawless product or service at a low price, but you won’t get kudos or generate much loyalty if customers can easily find three other suppliers offering the same solution at similar prices. Creating a total value proposition that is significantly better than competitive options is crucial.

The Business Case for Customer Loyalty

Why should you care about customer loyalty? It’s more than touchy-feely; loyal customers can pay off on your bottom line. The most elemental stage of loyalty—customer satisfaction—has been found to make a significant difference in whether a company performs well. The American Customer Satisfaction Index (ACSI) has been collecting data since 1994 across a wide range of industries for companies in the United

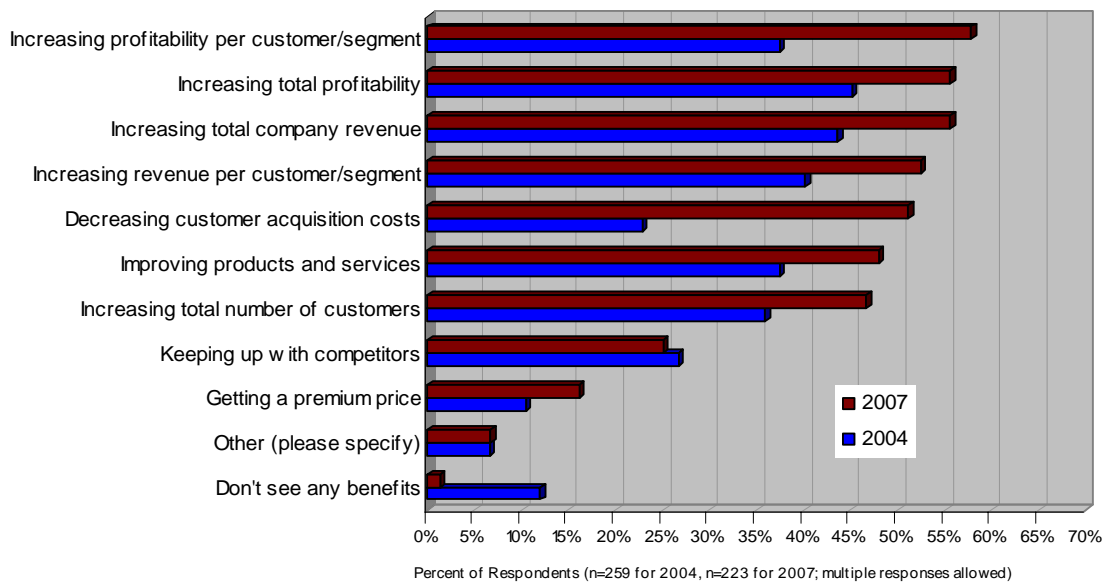
States. This “index” attempts to relate customers’ perceived quality, expectations and value to a composite measure of overall customer satisfaction (ACSI), which, in turn, is linked to loyalty (primarily repurchase likelihood). ACSI’s statistical analysis has revealed that ACSI scoring leaders tend to perform better and that ACSI scores are related to consumer spending, stock market growth and revenue and earnings growth.

In the age of social media, earning genuine customer loyalty is harder than ever and yet more valuable. Online buzz can help or hurt a brand, what with (according to Gartner) 100 million blogs now available for venting. In 2001, before the blogosphere existed, McKinsey found that 13 percent of the U.S. economy is largely driven by buzz and another 54 percent is partially driven by buzz. Unless you’re leading a monopoly or a utility, it pays to have happy customers. Even if they, themselves, don’t buy a lot, they can influence others.

So it’s important to have a loyalty program. By that, I’m not referring to a frequent buyer “points” or rewards program (although these can add some value to the customer) but, rather, a program intended to keep customers coming back, recommending and raving about your company, product or service.

In our 2007 survey, the top benefit expected from customer loyalty programs was increasing profitability per customer/segment, with increasing total profitability and total company revenue just marginally behind. Other key benefits included increasing revenue by segment, decreasing customer acquisition costs and improving products and services.

Expected Benefits of Customer Loyalty



Keeping up with competitors and getting a premium price were rated considerably lower.

Compared to the 2004 survey, when we worded the question somewhat differently, these results suggest that, three years later, managers have higher expectations for loyalty in general and continue to believe that improving customer loyalty will have an impact on the top and bottom line.

Counting What Counts

Managing a business is like flying an airplane. You need a good pilot and equipment to take off and keep it flying to the right destination. During flight, the pilot has a dashboard of instruments to monitor what's important: speed, height, direction, rate of ascent/descent, fuel, engine status.

In business, the equivalent of that cockpit is the Balanced Scorecard, developed in the late 1990s by Robert Kaplan (Harvard Business School) and David Norton. The idea was to provide a balanced measurement of company performance using a combination of financial, customer, process and employee perspectives.

Measuring financial performance is straightforward. There are accounting standards for gauging revenue and costs. But measuring customer satisfaction and loyalty is a bit more complicated.

Is There a “Best” Loyalty Metric?

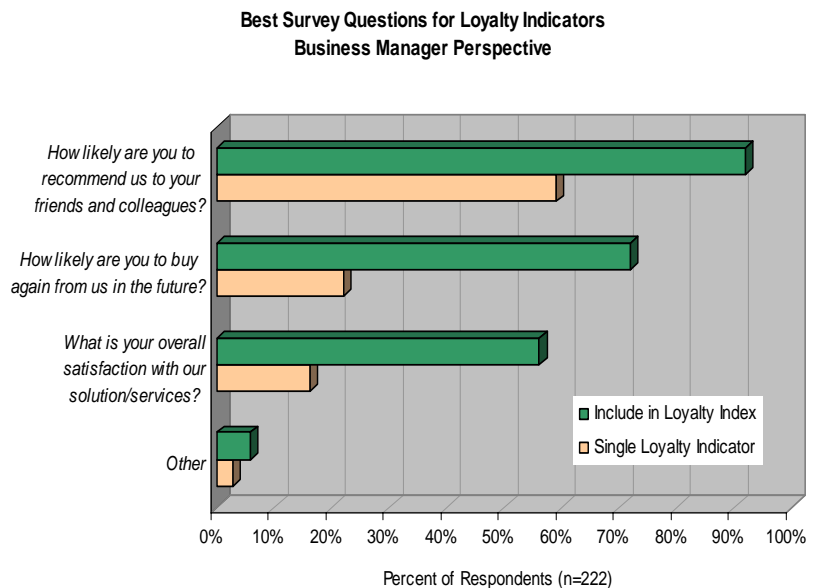
The key issue is *how* to measure customer loyalty. Is it possible to have one metric that works well for all companies?

Fred Reichheld thinks so. In 2006, his book, *The Ultimate Question* (Harvard Business School Press), proposed a simple method to measure loyalty, called the Net Promoter® Score. (Note: Net Promoter is a registered trademark of Satmetrix, Bain and Reichheld). Based on responses on a zero- to 10-point scale, customers are grouped into promoters (9 or 10), passives (7 or 8) and detractors (0 to 6). Subtract the percentage of detractors from promoters, and, voilà, you’ve got a Net Promoter Score (NPS).

With that, Reichheld asserts, you can get rid of those long surveys and expensive loyalty researchers. Just focus on improving your NPS, and your company will grow.

NPS has gained a lot of attention. In CustomerThink’s 2007 survey, about 30 percent of respondents said they were familiar with NPS, and a similar portion agreed that “higher Net Promoter scores would lead to higher revenue growth.” By contrast, respondents were slightly less familiar with ACSI, but only 20 percent agreed that “higher ACSI scores lead to increased earnings and stock price.” In a very short time, NPS has picked up considerable support in the business community, while ACSI remains more credible with academics and loyalty researchers.

The good thing about NPS is that it’s simple to calculate and easy to understand. The idea of “net promoter” is appealing to business managers. And NPS is based on a fundamental willingness-to-recommend (WTR) question, one of three key questions that come up repeatedly in loyalty research. The other two gauge overall satisfaction and willingness to buy again. Our recent survey revealed strong business manager support for WTR as a single-question loyalty metric (59 percent of responses) or as part of a multi-question loyalty indicator (92 percent of responses).



The trouble is, there is no solid evidence that NPS is the single best customer feedback metric for all companies or that it's even a *valid* metric in all situations. Even Reichheld noted in a July 2006 blog post that NPS “does not provide proof of a causal connection between NPS and growth” and that some of the original collected data was “imperfect.”

Michael Lowenstein of Harris Interactive, an expert in advocacy, defines customer loyalty as a complex combination of a “state of mind” and a “set of behaviors.” Can one metric encompass all of that? A growing cast of NPS critics says no, arguing that Reichheld has created an overly simplistic measurement. The concern is that managers, in a rush to get a loyalty program in place, will miss more important factors relating to customer loyalty.

“Make everything as simple as possible, but not simpler.”
—Albert Einstein

Recent independent research suggests that, at best, NPS is not the “best” metric and can't be applied in all industries. At worst, it's just plain wrong and will lead managers astray. Timothy Keiningham of IPSOS Loyalty and his academic colleagues attempted to replicate Reichheld's comparison of NPS and ACSI, where he claimed that there was no correlation between ACSI and growth. The new study, published in the July 2007 *Journal of Marketing*, found that the ACSI and NPS actually offer similar predictive capability using Reichheld's own data.

Larry Freed, president and CEO of ForeSee Results, which supports the ACSI, found in an online retail study of 8,400 consumers that NPS doesn't cause growth but, rather, is “spuriously” correlated to growth, while the real growth “driver” was good old-fashioned customer satisfaction. Freed and other loyalty researchers point out that NPS has statistical flaws. Why go to the trouble of asking people for a zero-to-10 rating, then “throw away” information by categorizing into three buckets? A simple mean (average) score would be more reliable (less statistical error).

Respected academics find little support for NPS in independent research. In the paper, *The Value of Different Customer Satisfaction and Loyalty Metrics in Predicting Business Performance*, Neil Morgan, a professor at Indiana University, and Lop Leotte do Rego, a professor at the University of Iowa, found that “metrics based on recommendation intentions (net promoters) and behaviors (average number of recommendations) have little or no predictive value.” The most effective measurement? Average satisfaction scores.

The danger is assuming that WTR (or NPS, which is just a derivative) is the *only* question worth asking. The same goes for any one customer feedback measurement. Researchers have not been able to prove that WTR is a good predictor of business performance for all industries. Even the conventional wisdom that it's better for B2C, has been disputed by some academics.

Also keep in mind that while NPS proponents claim a link to revenue growth, that isn't the only important business objective. Improving gross margins, net operating cash flow, shareholder return and market share were other business objectives that ranked high in our recent CustomerThink survey. Jeff Marr of Walker Information points out that in some business models, the key to growth may hinge on *prospects*, not necessarily existing customers.

In short, you should implement a single-question customer feedback approach, however appealing it might be, only after testing at least the three core questions to validate in a specific business or industry. Your metric should link to business performance *you* care about.

Effective Customer Feedback

There are many paths to success with customer loyalty management, including the choice of your metrics. Here is how four successful businesses approached loyalty measurement.

Intuit, one of the most customer-centric companies around, is a Net Promoter advocate. To understand why customers are promoters versus detractors, Intuit analyzes survey write-in comments instead of asking more structured questions. With millions of comments, sophisticated analytics software is required to classify responses. But this shows that a short survey can be both simple and provide effective diagnostic capability.

FileNet, a content management vendor acquired by IBM in 2006, has more than five years of experience with customer loyalty programs, under the direction of Suhail Khan, head of Worldwide Customer Loyalty. FileNet used to calculate a “loyalty index” but switched to NPS a couple of years ago and found it to be “easier to digest” for the organization and a “great tool to drive change.” What’s more, Khan says FileNet can link NPS improvements to revenue growth.

Some companies, initially drawn to the simplicity of NPS, are changing it to suit their unique business needs. Thermo Fisher Scientific is a good example. Tricia Rakiey, Global Customer Allegiance leader, says that the company liked the NPS concept but wanted more questions to add diagnostic abilities. Surveys can run 20 to 30 questions long, with critical questions covering overall customer satisfaction, ease of doing business, likelihood to repurchase and likelihood to recommend. Rakiey says that the company’s composite Customer Allegiance Score has helped to rally people to work on customer issues.

Egg, a European provider of digital banking and financial services, doesn’t use NPS, and hasn’t found the underlying likelihood-to-recommend question to be very useful, either. According to John Jennick, head of Customer Experience and Action, Egg has used a “test and learn” approach to find the best questions. Egg found that asking if an interaction with Egg “made me feel my time was well spent” was more effective in helping managers make better decisions on corrective action needed.

Considering these examples, along with input from numerous loyalty experts, I have developed three best practices for customer feedback management.

Best Practices for Customer Feedback Management

- **Determine the right question, or questions, that link to your desired business performance.** One size does not fit all and popularity does not mean validity for your business. According to Randy Brandt of Maritz Research, the right questions will “depend on market conditions, rules of competition and buying patterns.”
- **Develop a survey that has an appropriate number of questions.** Infrequent “relationship” surveys should be longer than “experience” surveys delivered immediately after an interaction. Most experts agree that experience surveys should be kept to fewer than 10 questions.
- **Systematically collect and distribute customer feedback data.** Summarize and tailor it to the needs of each group, from top management to frontline workers. More importantly, *use* the data to take action to correct customer issues quickly.

Getting Your Whole Company on Board

Customer loyalty programs must be built on a solid understanding of customer drivers, synchronized with the company business strategy and supported with measurement systems. But there's still one element missing. People must be encouraged to do the right things, so linking measurements to *rewards* is critical.

Our December 2004 survey found more than 70 percent of respondents self-classified as leaders (doing an "excellent" job with loyalty programs) said their company gives both tangible and intangible rewards. For all other respondents, only 46 percent gave rewards of any kind. Our 2007 survey found that figure increased to 83 percent.

That's nearly double the average for all respondents, where 42 percent said their organization *did not give rewards of any kind for helping to improve customer loyalty*.

Of those who said their organizations did give rewards, the highest rated factor in determining rewards was customer retention rate. Repurchase and referral activity, along with customer feedback metrics, were also very important (top 2 box) factors.

Rewards are important, but industry experts warn against making employee benefits driven by numbers alone. Management judgment, although the lowest ranked factor in our survey, is crucial to ensure rewards are administered fairly. To avoid "gaming" behavior—unnatural acts by employees to boost their "scores"—experts also advise that loyalty bonuses should not affect more than 20 percent of variable compensation. It's also important to recognize employees as part of teams because most cannot influence customer loyalty by their individual performances.

And it's worth mentioning that a "reward" does not have to be financial or even a job promotion. As we've learned from Maslow's Hierarchy of Needs, employees can also be motivated by a feeling of additional responsibility and accountability. Or personal growth, as they build new skills.

It never hurts for leaders to give a "pat on the back." Shaun Smith and Joe Wheeler, authors of the 2002 book, *Managing the Customer Experience* (FT Prentice Hall), recommend public praise. "Let high-performing employees know you are proud of them," they say. "Create tangible, short-term milestones for your employees that they can achieve and which contribute to the overall commitment to customers."



If you're serious about customer loyalty, you'll find a way to not only measure it but also reward the people who make it happen, day in and day out.

Recommendations

In September 2007, a *BusinessWeek* reader wrote to Jack and Suzy Welch, complaining that, despite investments in new facilities, innovative packaging, high quality and aggressive pricing, a few major accounts defected anyway. The reader wanted to know: “Is customer loyalty dead?”

The Welch's responded that it's not time to bury customer loyalty yet. But rather, they explained, it needs to be redefined from a transaction to a “two-way street,” so you “don't have a deal as much as you have mutual dedication.” As the seller, you have to go beyond just delivering on price, quality and service and strive to give your customer a “comprehensive, inimitable way to win.”

That's sound advice: If you want your customers to be committed to you, you have to demonstrate you're committed to your customers. Establishing effective customer feedback processes is critical to assess whether your efforts are on paying off.

As tempting as it might be to “just try something” that a guru recommends, if you truly care about loyalty, you'll need to invest some time in finding the right approach for your specific business. Follow these steps to improve your odds of success:

1. **Remember that any loyalty metric doesn't cause growth; it's just an indicator.** A speedometer doesn't make your car go; it just tells you how fast the car is going. Make sure your loyalty metric is one of the key “dials” on your business management dashboard, in balance with other key business measurements such as revenue growth, profitability and shareholder value.
2. **Keep surveys as short as possible but not too short.** Depending on the situation, long surveys can work quite well. But keep transactional surveys limited to just a few questions (five to 10). Make sure they include the right questions—those that link to improved business performance and provide adequate diagnostic capability on underlying loyalty drivers.
3. **If you decide to rely solely on NPS, validate it with common sense and some history.** Not so sure? Then hedge your bets by also asking questions about overall satisfaction and likelihood to repurchase. These three questions are enough to keep your surveys short, while increasing your odds that one of the three, or a combination, is the right metric.
4. **Brand your metric and make it your own.** Develop an internal marketing campaign to explain what the metric means (no statistical arguments, please) and how it helps the organization succeed. The lesson to be learned from NPS' popularity is that it's important to clearly communicate your metric in language that business managers understand.
5. **Reward managers and employees for improving customer loyalty, but don't overdo it.** Management judgment has not gone out of style. If you make the rewards or penalties too strong, you'll stimulate unwanted “gaming” behavior. Keep tangible rewards to less than 20 percent of variable compensation. No limits on pats on the back.
6. **Plan to evolve and refine your measurements and rewards.** You'll need to make adjustments over several years to keep it working just right. We live in a complex global economy. Your loyalty program must adapt and change along with your industry and customers.

For success with customer loyalty management, there are no shortcuts. You must figure out the right metrics for your business, create a systematic process to manage customer feedback and reward the organization.

If that sounds like a lot of work, it is. But it's worth it because what's at stake is nothing less than your customers' loyalty—and your future success. Good luck!

About the Author and Sponsor

About the Author

Bob Thompson is CEO of CustomerThink Corp., an independent customer management research and publishing firm. He is also founder of CustomerThink.com, the world's largest online community dedicated to helping business leaders improve customer-centric business strategies.

Since 1998, Thompson has researched the leading industry trends, including partner relationship management, customer value networks and customer experience management. In January 2000, he launched CRMGuru.com, renamed CustomerThink.com in 2007 and serving 300,000 business leaders monthly through its web site and email newsletters.

Thompson is a popular keynote speaker at conferences worldwide and has written numerous articles and papers, including his most recent report, *Customer Experience Management: A Winning Business Strategy for a Flat World*. Before starting CustomerThink, he had 15 years of experience in the IT industry, including positions as business unit executive and IT strategy consultant at IBM.

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