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Are promoters valuable customers? An application of the net promoter scale to predict future customer spend

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ABSTRACT

The Net Promoter Score (NPS) is widely used in industry to measure loyalty and predict revenue growth. The mechanisms underpinning this revenue growth are thought to be (i) positive recommendation from loyal customers to potential customers, and (ii) increased purchases from the existing base of loyal customers. These claims are controversial, with both the methodology and the performance of NPS being challenged by a number of researchers. The present study adds evidence to this debate through the analysis of a repeated cross-sectional data set ($n = 2785$) from a services company operating in a business to business context in the New Zealand primary sector. The data include recommendation scores matched to past, current and future revenue, at both the aggregate and individual level, over a five-year period. The analysis of this data provides directional support for the association between NPS and company revenue growth, and confirms that promoters do spend more in the current year. However, the analysis shows promoters to be a relatively minor and inconsistent source of same-customer revenue growth, with same-customer growth mostly arising from a general increase across the whole customer base.

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1. Introduction

Customer loyalty measures are frequently used in academic and commercial market research due to their perceived ability to predict future purchase behaviour. Globally, one of the most commonly adopted loyalty measures is the Net Promoter Score (NPS) – a metric derived from word of mouth likelihood scores by subtracting the proportion with low scores (0–6) from the proportion with high scores (9–10). Reichheld (2003) developed NPS in response to concerns that existing satisfaction and retention measures were poor predictors of company revenue growth. Reichheld claimed a key advantage of Net Promoter is that companies need only to ask their customers a single question to manage loyalty and predict growth; how likely they are to recommend the company to a friend or colleague.

Reichheld (2003, 2006) found a strong correlation between NPS and company growth rates in most industries he studied. However, other researchers have criticised Reichheld's claim that Net Promoter is the most accurate method to measure loyalty and predict company growth. Keiningham et al. (2007a) note that Reichheld actually correlated NPS with past growth rates, rather than current or future growth rates. Keiningham et al. (2007a) found that customer satisfaction was a better predictor than NPS for current growth

rates, while Morgan and Rego (2006) claimed that customer satisfaction was also a better predictor than NPS for future growth rates. However, Van Doorn et al. (2013) pointed out that Morgan and Rego's findings were not statistically significant, and when Van Doorn et al. compared NPS against other metrics on a range of outcome measures, they found all metrics performed equally well on predicting current outcomes, and equally poorly on predicting future outcomes.

As company growth is a result of aggregated customer behaviour, Leisen Pollack and Alexandrov (2013) argue that NPS must first have a positive impact on individual customers for revenue growth to occur. That is, for companies to grow revenue at the firm level, it is necessary to increase the amount spent by their existing customer base, attract new customers to purchase their goods and services, or achieve a combination of both outcomes. The relative importance of these components of individual behaviour is hardly studied, although there is evidence that growth relies more on acquisition than on retaining the existing customer base (Riebe et al., 2014).

The present research uses a unique dataset to add evidence to the NPS debate. Specifically, this research uses a 5-year longitudinal data set ($n = 2785$) that contains individual promoter index scores and customer spend data together with aggregate company revenue data. Analysing this dataset provides some fresh evidence on the relative performance of NPS as a lagged, current or leading indicator, and the performance of NPS in predicting revenue growth for the existing customer base. It also casts light on the extent to which growth in revenue from the existing customer

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base comes from individual promoters increasing their spend in the following year.

2. Net Promoter

Net Promoter is a word-of-mouth (WOM) metric, calculated by asking customers, "How likely is it that you would recommend [company X] to a friend or colleague?" Customers report their likelihood of recommendation on an 11-point scale ranging from 0 to 10. Scores of 10 indicate extremely likely to recommend, 0 indicates not at all likely, and 5 indicates neutral. The respondents who give an index score of 9–10 are classified as promoters, 7–8 are passively satisfied, and 0–6 are detractors. The NPS is calculated by subtracting the percentage of promoters by the percentage of detractors.

Reichheld (2003) claimed that a strong correlation between NPS and growth rates exists in most industries. Reichheld also claimed that a 12-point increase in NPS corresponds to a doubling of a company's growth rate (Reichheld, 2006). Other work has found that a 7-point increase in NPS produced a one percent increase in brand growth (Marsden et al., 2005).

NPS has been adopted by a large proportion of companies globally. It is even sometimes reported to investors and applied to determine pay for senior staff (Creamer, 2006). A key reason for the widespread commercial adoption is that the NPS calculation is very simple (Grisaffe, 2007; Keiningham et al., 2008), and this makes the NPS very easy for managers and shareholders to understand and interpret. With numerous companies using the Net Promoter metric, it has become a common tool for comparisons across organisations and industries.

Another advantage of NPS is the ability to reduce long and complex surveys to a single concise would-recommend question. This decreases both respondent fatigue and the resources spent on research (Keiningham et al., 2008).

However, questions remain about the accuracy of NPS in measuring loyalty and predicting company growth. As identified earlier, the first concern regarding NPS is the lack of research that supports the superiority of Net Promoter in predicting growth rates. Outside of studies by Reichheld, only Marsden et al. (2005) found strong support for a positive relationship between NPS and revenue growth. Further, these prior studies have been criticised as they correlated NPS with past growth rates rather than with future growth rates (Keiningham et al., 2007a; Sharp, 2008).

Other research fails to validate the superiority of the Net Promoter metric (Keiningham et al., 2007a; Morgan and Rego, 2006; Van Doorn et al., 2013). In particular, Keiningham et al. (2007a) examined the relationship between NPS and company growth rates in a cross-industry, longitudinal study. They replicated Reichheld's study, but instead of using past growth rates they correlated NPS with company growth rates from identical time periods. By comparing correlations of both NPS and American Customer Satisfaction Index (ACSI) scores with current company growth rates they determined that Net Promoter performance is not superior to the ACSI.

Additionally, Reichheld (2003) noted that Net Promoter was not applicable in a few of the industries he studied. With only a dozen or more industries tested, discovering that the NPS could not predict growth rates in some of these industries illustrates that a significant proportion of companies may be unable to use the metric. In particular, Net Promoter was shown to be ineffective in determining growth rates in monopolistic industry and for niche companies (Reichheld, 2003). These inconsistencies show that Reichheld's claim that NPS is the only number companies require to predict growth is not universally accepted (Grisaffe, 2007).

Further concerns with Reichheld's methodology are that the 11-point Net Promoter scale is broken into three categories and that the passively satisfied category is excluded from his calculations

(Grisaffe, 2007; Pingitore et al., 2007). While debate has continued over the optimal number of scale categories to use, researchers have found that validity and reliability worsens when the number of scale points is reduced, especially when using 4-point scales (Green and Rao, 1970; Lozano et al., 2008; Preston and Colman, 2000). Due to this, Grisaffe (2007) questions why only promoters and detractors are used to calculate the NPS when it is expected that more scale points would result in a more accurate prediction of growth.

Grisaffe (2007) also raised concern over including rating scores of six in the detractor category, as the Net Promoter scale considers a score of five as being neutral. By grouping the zero to six ratings together, consumers who rate their likelihood to recommend as neutral or slightly above are assumed to be detractors with the same chances of defecting as those that give a rating of zero. This criticism adds further weight to the case against the NPS calculation of promoters minus detractors, and indicates that other methods of analysing the "would recommend" question may need to be explored.

3. NPS and Word-of-mouth (WOM)

An important consideration with NPS is the effect of WOM, as this is a principal method of recruiting new customers. WOM is the informal communication between consumers about a product, service, organisation or brand (Anderson, 1998; East et al., 2008; Westbrook, 1987). Reichheld (2003) introduced NPS as a loyalty measure based on consumers' intentions to engage in positive WOM by recommending a company or brand to a friend or colleague. He proposed that intentions to recommend are one of the most prominent signs of customer loyalty and most accurate indicators of company growth, as consumers are putting their personal reputation on the line. However, for NPS metric to predict company growth accurately two assumptions must be met; that WOM impacts purchasing decisions and that intention to recommend correlates with actual behaviour. These assumptions are discussed below.

Research has indicated that WOM is an influential information channel when making a purchase decision. Early studies found effects from WOM on purchase probability for a new food product (Arndt, 1967) and a hypothetical personal computer (Charlett et al., 1995). Other research by Engel et al. (1969) found that WOM was the most influential type of information sought by consumers when conducting a search for information into a new automotive diagnostic centre. Work by Keaveney (1995) discovered that half the respondents chose a new service provider through WOM.

WOM about a product or brand can be either positive or negative (Charlett et al., 1995; East et al., 2008). Negative WOM is less common and has less impact on purchase intention than positive WOM (East et al., 2007, 2008, 2016). The goal for companies using NPS may be to both increase positive WOM and decrease negative WOM, consistent with the NPS calculation of promoters minus detractors. Prior research therefore suggests that while the focus of Net Promoter on WOM is justified, the emphasis should be more on positive WOM than negative WOM.

There is limited research that examines the relationship between intentions to recommend and actual recommendations (Keiningham et al., 2007b). As Net Promoter measures intentions to recommend, it is important that there is a strong link between intended behaviour and actual behaviour. If this relationship is weak then it is unlikely that NPS will accurately forecast whether a company will grow. A limited number of studies have explored the relationship amongst intention to recommend and actual recommendation. In a meta-analysis, Kraus (1995) found only moderate correlations between attitudes and behaviour. Kumar et al. (2007) found fewer than half the consumers who stated an intention to recommend actually recommended the company. Romaniuk et al. (2011)

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