Interview

Customer first thinking.

A Question of Loyalty

An Interview with Fred Reichheld, Loyalty Guru and Creator of the Net Promoter System

Fred Reichheld:

Fred Reichheld is a Bain & Company Senior Advisor and the Creator of the Net Promoter System.

It’s been touted as the “one number a business needs to grow”. A number based on asking just one question: “*How likely are you to recommend us to a friend or colleague?*”.

Since it was first introduced in a 2003 Harvard Business Review article by Fred Reichheld, head of Bain & Company’s loyalty practice at the time, the Net Promoter Score has been widely adopted by organizations of all sizes and types to measure customer sentiment. The rationale behind it is simple: If customers feel strongly enough about a brand to recommend it, the positive word of mouth should spur revenue growth. And past studies by Bain have shown that it can be a great predictor of business performance.

The strength of NPS has always been its simplicity. The more net promoters you have, the more likely you are to have a strong base of loyalists whose value is likely to increase over time through increased spending and referrals. But what’s really helped make NPS a popular metric is that the formula is non-proprietary, free to anyone who wishes to use it. That’s enabled it to become a benchmark score in just about every industry where customer loyalty matters, allowing organizations to easily compare themselves to their competition.

Companies renowned for putting customers first, like Apple, Costco, USAA, Amazon, and Intuit regularly earn the top scores, while less admired companies like wireless service providers and insurers get negative scores. That fact alone suggests a strong correlation between a great customer experience and market success.

Or does it?

NPS has its own share of detractors. Critics quibble with the arbitrary nature of the scoring methodology – some say the results are “too noisy” - others raise the question of correlation versus causation. And the NPS system is prone to gamesmanship when it’s managed in-house and not by a neutral 3rd party.

Yet all of these critics are missing the point: the true value of NPS is that it has put the question of loyalty on the radar of many business leaders who might otherwise be obsessed with serving the short-term interests of investors. The real payoff of adopting NPS is not the score it generates – it’s the influence it has on the customer orientation of companies. Within the span of 20 years, NPS has achieved what customer satisfaction surveys could never do: make customer experience a strategic priority for executive management.

In his latest book “Winning on Purpose” Fred Reichheld distills his 44 years of experience as a loyalty guru into a manifesto and set of “Golden Rule” operating principles. The purpose of a business, he declares, is not to maximize profits – it’s to maximize the happiness of customers – to “enrich their lives”. This worldview is a natural progression from his 1996 landmark book, “The Loyalty Effect” which made the economic case for focusing on customers.

SS **Stephen Shaw (SS):** Your first book "The Loyalty Effect" remains highly relevant a quarter century later. Have we made much headway since then?

FR **Fred Reichheld (FR)**: I don't think the world has come very far in appreciating the importance of loyalty. We've made some important progress for sure. In my opinion the more you can invest in making someone else's life better, the better the world gets. But most people don't see business that way. All the control systems and measurement systems and governance and compensation are all based on accounting. The accountants' mindset dominates – namely, to maximize profits. But those companies who focus on enriching the lives of customers as their focal point have usually built great businesses.

SS In "The Loyalty Effect" you approached the subject of loyalty mainly from an economic standpoint. But in your new book, you make more of a plea for business leaders to take the moral high ground - to practice the "golden rule". Why the switch in emphasis?

FR Well, the reason I started with the economic argument is that until then no one had really demonstrated the value of increasing loyalty. And I understated the case because I skipped over the customer referral part which is actually the most important. Over the years, I became more cognizant of the challenge of winning people over to this new mindset. And it was more than a measurement framework, more than an economic argument. People just had a mindset that was wrong, a wrongheaded notion about what made for a great business, what leads to successful, profitable growth. And so I went back to "first principles" - the notion that you want to treat people the way you want to be treated. And I think that argument has more inspirational energy,

SS You're a big proponent of customer capitalism. Is that idea an extension of stakeholder capitalism, or something altogether different?

FR I think it's quite different. Maybe radically different. All stakeholders aren't equal – just one is primary, the customer. Putting customers first is the only solution I've seen that creates great businesses that are sustainable.

SS Because, without customers, you don't have a business.

FR Yeah. And it's more than an opinion. There's a fair amount of data and evidence in the book that the only companies delivering real value to investors are the ones where customers are feeling the love. I do lay out [Costco Founder] James Sinegal's philosophy about rank ordering the stakeholders: customers first, employees second, investors third - I'm sympathetic to that. I'm not 100% in agreement with it. Yes, I think every human being you touch deserves a golden rule of treatment. But the customer cash flow funds everything. The accountants really hide that fact. Accountants can't even tell you how many customers you have let alone how many are coming back, and certainly not how many are referring their friends.

SS The other thing they ignore is the importance of customer value creation.

FR Right. Accounting does not help you understand how much value you put in a customer's wallet. It only keeps track of how much you extract from a customer's wallet to your benefit. And that's a problem. You know, accounting is set up to protect the short-term interests of the company. The accountants don't care to consider if you're making the customer's life better.

SS It's really the short-term versus long-term investment question, isn't it?

FR That's the big question in almost everything - understanding the trade-offs. Having an investment time frame is vital and we do not have metrics that are …

SS Longitudinal.

FR Yeah, people ignore that, it's mind-boggling. The marketing guys work like crazy to bring in all these new customers and are so proud because their cost per new customer is real low, but then they never figure out what percentage of those new customers ever turned into loyal promoters who really have a positive net present value. In most cases, I find, new customers are destroying value because they don't stick around long enough to actually pay back the investment cost of acquiring them.

SS In your new book you talk about Bain almost going bankrupt early in your tenure and how a new leadership team led by Mitt Romney turned it around by putting customers first. It's quite a vivid example of what you're talking about.

FR Yeah. I am very pleased that my partners at Bain were willing to let me share the secret sauce and some of the internal practices we have because they're powerful. I would say the tools and the processes we built are the best I've seen in the world in how to treat employees, how to build teams, how to keep them inspired, and working constantly toward the best interest of customers.

SS Employee enthusiasm is critical, isn't it?

FR Yeah. How can you be happy as an employee if the people you're serving, your customers, aren't thrilled with what they're getting? Are you going to put in more ping pong tables and beer refrigerators to solve that problem? I don't think so.

SS An estimated two-thirds of the Fortune 1000 have adopted NPS but you say that many of those companies really haven't adopted the right mindset. How would you describe their mindset today versus what it needs to be?

FR I think only 10% of leaders today believe the customer comes first. So 90% of businesses have embraced a mission that is in my mind guaranteed to fail. You know, I wasn't wealthy - I am now. But I kept investing in companies that have the highest NPS in their industry. Because I thought, their customers are feeling the love and they've got this flywheel going that the accountants can't quite measure, it's invisible, but customers keep coming back for more and bringing their friends. I've more than tripled the stock market in my investments over the last decade. I'm not a fancy investor. I didn't look at one financial statistic of these companies I invested in. I just looked at their customer feedback and the guys at the top have crushed it.

SS How do CEOs in public companies reconcile the immense investor pressure to grow at all costs with the moral and social obligation to do what's right?

FR Well, they just have to look at the examples in my book of the companies that have taken the highest road and put customer interests first. Those are the guys that have delivered the best returns to shareholders. They have a duty to make sure the customers feel the love and they need metrics to track progress against that goal. Right now companies are flying blind because the board is just looking at financials. Financials don't tell you whether you're treating the customer right.

SS So is the problem at the board level?

FR It's one of the problems. I don't think it's the only one. I think it's a secondary problem. Although the governance structure in most public companies I see as deeply flawed. CEOs have enormous power. They pick the board, they recruit it. It's the CEO's private advisory group for most companies until they do a lousy job and outside activists come in. I think the biggest shift has got to be in the mindset of the leadership team and how they measure success, measure customer outcomes, and how they define success in customer terms, not just in selfish financial terms.

SS You've proven a correlation between NPS and revenue growth. But finance people think it's voodoo. Until they're won over, it's really hard to make the business case, isn't it?

FR Yeah. And you know, I'm sympathetic to the financial guys. I started out life as a financial guy - I really like the discipline of finance and accounting. One of the nice things about accounting is you can audit the books and make sure it's real because you go to jail if you cheat. We don't have that on the customer side yet. So we need a rigorous customer-related metric. That's why I've introduced the idea of "earned growth". How much of our business is coming from repeat and expanding customers and their referrals? And I believe the smart financial guys will get on board very quickly with that.

SS But how do you change accounting practices that have been in place for 100 years or so?

FR Well, one of my favorite tricks is just to say, let's look at all the new customers in the last quarter or the last year. Ask them what was the primary reason they joined the business. Split them into referrals versus promotions - look at the behaviour and get a net present value estimate of those two customer groups. CFOs get that very quickly. They say, my gosh, we have been wasting a ton of marketing dollars on negative net present value outcomes. And when people ask, "Where should I invest instead?" -well, it has to be in delighting your existing customers and creating more promoters or helping the customers who really love you to refer more people. Give them the digital tools - make them feel like insiders. I think that is where smart marketers should focus more of their energy.

SS The concept of customer equity has been around for a while, brand equity as well. And yet it's not reflected on the balance sheets, right? It's buried under this abstract term called goodwill.

Interview

FR Yeah. First of all, goodwill is a fuzzball concept in accounting. It makes the "book's foot", but it doesn't really do anything to help understand the underlying economics. That's why private equity firms who are pretty economically rational just wipe out all of this baloney accounting like depreciation and goodwill, and they just look at EBITDA. How to make customer equity or brand equity more credible? Let's keep it simple. Let's use metrics that you can audit. And that's what "earned growth" is. How much of your growth is coming from your existing book? That gives you a really good sense of what the future looks like for you.

SS Who owns the championing of the earned growth rate? Is that marketing? Because marketing is still dismissed as having little financial literacy. Who should take up that challenge?

FR I think the best marketing guys are going to convince the CFOs that they need to be measuring earned growth and then they're going to demonstrate that Net Promoter is a very useful tool for managing it.

SS You offer a lot of great examples in the book about best-practice companies, whether it's Discover or Enterprise or First Service, a Toronto company …

FR Go Canada! My Grandfather Reichheld was from Canada!

SS Have any of those companies achieved the progress they have based on your financial proof of "earned growth", or has it been driven more by leadership recognizing that it's the right thing to do?

FR I think those companies for the most part have morally certain leaders who have a strong, intuitive understanding of this. And that's why it is so hard to do. I hope the tools and the frameworks and the process I've laid out in "Winning on Purpose" help mere-mortal CEOs embrace it and make it real. But business is run by accounting numbers. And yet accounting numbers are orthogonal to this objective, maybe worse. And so it takes great leadership and a moral foundation that inspires teams to put customers first.

SS Classical direct marketers have always understood the basic math of customer retention and recurring revenue. The lifetime value methodology has been around a long time – yet it still isn't being applied today outside of a very small circle of pure-play DM companies, is it?

FR Yeah. At one point I thought this loyalty game was really a niche strategy. But as I got older I could see that it's the only strategy that works long-term. And it's not that you put customers ahead of investors - you put customers first because that's the only way to achieve outstanding results for investors. And so that's the subtle difference I have with Jim Sinegal at Costco, who's a brilliant businessman. I don't think you need to rank order the stakeholders. The primary purpose of a CEO should be to make customer lives better.

SS The Professor of Marketing Science Byron Sharp, always the contrarian, has been quoted as saying, "Loyalty isn't an important question. Certainly not for practical people, especially since all measures, attitudinal to behavioral are highly correlated." What do you make of his opinion?

FR A lot of people have a very superficial understanding of loyalty. Loyalty is an investment. And that's the magic of recommendation and referral. A CEO once said to me, "Fred, you don't recommend to a friend a business that abuses employees or harms the environment. A recommendation is a really high standard. You have to believe it's going to be in the best interest of a friend or family member to have the same experience as you.

SS Back to Byron Sharp. I think his main beef is that if you have a high-value customer, of course, they're loyal. He even disputes your famous statement that higher retention leads to higher profits.

FR I hope he reads the chapter on investment returns.

SS Can you explain how you actually landed on the fact that likelihood to recommend was in fact the best predictor of true loyalty?

FR I thought there were too many surveys in the world. I wondered if there was just one question we could ask that would actually get to the heart of true loyalty and I tested what Enterprise was using and a dozen other questions about satisfaction. We actually watched customers over the next year or two and compared that to the scores that they gave back when T was zero. And "likelihood to recommend was the best predictor. Now, not the best in every industry, but almost the best everywhere. Repeat purchase - that doesn't really get at loyalty. Referring to a friend - that is the highest standard and it's totally contemporaneous, it's timely.

SS What do you attribute the success of NPS to?

FR I've thought about that. Recommendation is an act of love. You want something good for your friend or family member. However, one of the problems with it is that people don't get the challenges of measuring it yourself. There all these biases - sampling bias, response bias - how you answer it. So getting apples-to-apples comparisons is hard. We built a new business at Bain called Net Promoter NPS Prism that finally gives you really reliable, rigorous data competitor by competitor, brand by brand, not just at the relationship level, but at each episode, each touchpoint. So it's killer. But until now, I've just seen people throwing crap at the wall and saying, that's my Net Promoter score.

SS I think one of the brilliant moves you made was making it open source so that everybody could adopt it. But that also made it susceptible to manipulation.

FR Both conscious and unconscious. It's just trickier than meets the eye. It sounds simple and it gets criticized for being overly simplistic when in fact getting this right - right timing, the right degree of anonymity, the closed-loop processes, it takes a lot of work.

SS One of the knocks on NPS for a long time was that it wasn't really a diagnostic tool per se.

FR Yeah, but that was one of the most unreasonable criticisms. From Day One Net Promoter was always 0 to 10: "How likely are you to recommend us to a friend?", followed by an open text question "What's the primary reason you feel this way?". Now, the research statisticians don't like it because they don't have lots of nice, structured data that they can use their cool statistical tools on. But if you read the customer comments and the reason for their rating, it's just gold for understanding what you need to get better at.

SS NPS has been, as you point out, unfairly criticized, and one of the really stinging rebukes came last year when Gartner predicted that more than 75% of organizations would abandon NPS as a measure of success for customer service.

FR I have never read a useful criticism of Net Promoter that didn't come from somebody who had an alternative metric they were trying to peddle – one that was way more complicated, and I fear that's true of the example you just cited. I think they just bought a company whose business was based on an alternative metric. You're supposed to learn from your critics? I haven't learned much from my critics. I've learned a lot from practitioners who have done smart things and not so smart things and what works. So I'm humble about how much I have to learn, but I think in general, the critics have been not up to the task, sadly.

SS One of the other things you hear sometimes is that it's too simplistic a measure.

FR The cool thing about likely to recommend, 0 through 10, is it catches the "wows". Now there's a bunch of other touchpoints where we may not be able to "wow" customers. So then other metrics like customer effort score, or customer satisfaction, or "rate your experience" work just fine. But those tend to be the less important transactions. And no one knows exactly how they link up to the customer's overall relationship. So I'm totally open to using the right metric and the right process for different parts of the experience.

SS Is there a requirement to look at loyalty from both a corporate brand perspective and a product brand perspective?

FR There's no simple answer. You know, Apple has different product lines - there's certainly an Apple relationship score and it's different for different products. It really depends on how you want to identify the relationship in the consumer's mind. And that becomes the most important element. But measure both and see which one is the most important.

SS Back to the question of who's holding the purse strings - today customer experience is still very much an operational expense, isn't it?

FR It is indeed. And I think that's one of the reasons to get the board of directors interested in this is because they should be demanding reliable information on customer results because they are so vital to the long-term interests of investors.

SS You mentioned earlier that just 10% of executives believe the purpose of their business is to enrich people's lives. What more is it going to take to get them over the hump? You've spent your entire career doing this - what more do you think needs to be done?

FR Measuring earned growth rates should be part of that and changing the investment strategy and changing the customer experience. The book ends with a manifesto and a really detailed list of best practices. So I like to think the book offers an answer. I think earned growth rate will be a centerpiece of the next 10 years. And just like Net Promoter was unheard of when I invented it 20 years ago, I'm hoping that earned growth rate becomes standard. No business would ever consider not having an audited earned growth rate that they understood internally and could report outside.

SS What's the next phase of business life look like for you personally?

FR I don't know the answer to that. I think you know, I'm getting old, so it's time to go out in the garden and start taking care of it. You know gardening's a pretty good metaphor for a lot of things in life.

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