Research Report

Recommendation Intention and Customer Value in Banking

IN THE PAST YEARS THE CUSTOMER FEEDBACK METRIC RECOMMENDATION INTENTION HAS GAINED IMPORTANCE, ESPECIALLY DUE TO THE WIDESPREAD CONCEPT NET PROMOTER SCORE (NPS). THE NPS CONCEPT IMPLIES A POSITIVE, NON-LINEAR RELATIONSHIP BETWEEN RECOMMENDATION INTENTION AND CUSTOMER VALUE. THIS ARTICLE INVESTIGATES THE RELATIONSHIP BETWEEN RECOMMENDATION INTENTION OF INDIVIDUAL CUSTOMERS AND THEIR VALUE FOR THE FIRM. THE RESULTS SHOW THAT RECOMMENDATION INTENTION SIGNIFICANTLY INCREASES CONTRIBUTION MARGIN BUT NEITHER RETENTION NOR CUSTOMER VALUE. THE METRIC SATISFACTION HAS A SIGNIFICANT, POSITIVE IMPACT ON CUSTOMER VALUE AND CAN THUS BE USED AS A LEADING INDICATOR. THEREFORE, THE RESULTS DO NOT CONFIRM THE SUPERIORITY OF THE NPS CONCEPT FOR CUSTOMER MANAGEMENT.

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Introduction

Both practitioners and academics agree that customers are the most important asset for most firms. Hence, the development of the value of this asset should be considered for strategic planning. Doing so, one major aspect is undoubtedly the selection of meaningful metrics for assessing the value of a customer. While there is wide agreement that customer metrics are important, there is no consensus on which metrics are the most appropriate ones.

One customer feedback metric has particularly gained attention in the past few years:

recommendation intention, which is the basis of the Net Promoter Score (NPS). Since loyalty consultant Fred Reichheld introduced it in a 2003 Harvard Business Review article, the NPS concept has been implemented by dozens of companies around the world, among them industry leaders such as GE, American Express and Allianz. The claim of the NPS concept is that recommendation intention is the most important customer feedback metric.

A recent research study conducted at Goethe University and the E-Finance Lab is the first to investigate this claim empirically. The results show that recommendation intention signifi-

cantly increases contribution margin but neither retention nor customer value. Another widely used customer feedback metric, satisfaction, has a significant, positive impact on customer value. Hence, the superiority of recommendation intention as customer feedback metric cannot be confirmed. This article summarizes the aforementioned research study by outlining the concept of the Net Promoter Score, reporting the empirical impact of recommendation intention on customer value and discussing recommendations for practice concerning the usage of customer feedback metrics.

The Net Promoter Score (NPS)

At the core of the NPS is a question about recommendation intention on a scale from 0-10 ("How likely is it that you would recommend [company X] to a friend or colleague?"). The customers are then clustered into Promoters (those answering 10 or 9), Passives (8 or 7) and Detractors (6 or lower). The NPS is the difference between Promoters and Detractors in %-points (see Figure 1).

The clustering into the three groups Promoters, Passives and Detractors implies a non-linear effect of recommendation intention. Reichheld (2003) states that only the most enthusiastic customers are the attractive ones. Hence, a firm should not try to marginally improve the recommendation intention of its customers (i.e. bring a customer with a recommendation intention of 3 to 4) but strive to lift its customers over the threshold of being a Promoter.

Reichheld (2003) claims that NPS should be used for two reasons: first, recommendation intention is supposed to be the most important customer feedback metric, since it shows the highest correlation with repeat purchases und referrals. Hence, promoters should differ from Detractors in retention, margins, money spent with the company, costs-to-serve, word-of-mouth and ultimately customer value. Second, NPS is supposed to be the most reliable indicator for the growth potential of the firm. Therefore, recommendation intention, as the basis of NPS, could be used as a (i) pivotal

How likely is it that you would recommend [company x] to a friend or colleague?

Figure 1: Calculation of the Net Promoter Score

tool for customer management and (ii) leading indicator for changes in firm value.

While practitioners appreciate the simplicity and intuitive comprehensibility of NPS, academic research has cast serious doubt over its superiority at the firm level (Keiningham et al. 2007). It has remained unclear whether this is due to methodological limitations of aggregate data or the fact that NPS is not an outstanding indicator of future revenue growth. To shed light on this important question, customer-level research about the basis of the NPS – recommendation intention – is needed and the potential impact of recommendation intention on customer value has to be addressed.

Empirical Impact of Recommendation Intention on Customer Value

Using data from private customers of a leading German bank we investigated the impact of recommendation intention on customer value and compared it with the impact of another widely used customer feedback metric, satisfaction. The two major drivers of customer value are the individual contribution margin and retention rate. In order to obtain a more thorough understanding of the impact of customer feedback metrics (i.e., recommendation intention and satisfaction), we also focused on each driver separately. The results show that:

- Recommendation intention does not have a significant impact on customer value.
- Recommendation intention has a significant, positive and sizeable impact on contribution margin.
- Recommendation intention does not have a significant impact on retention.
- Satisfaction has a significant, positive and sizeable impact on customer value.
- The impact of recommendation intention (and satisfaction) on customer value and contribution margin seems linear (see Figure 2).

Recommendations for Practice Concerning the Usage of Customer Feedback Metrics

Based on the empirical results we offer the following three recommendations to practice:

1. Measure satisfaction: Results showed a significant impact of satisfaction on customer value, while no such effect was found for recommendation intention. Hence, satisfaction seems more appropriate as a leading indicator for future customer value and should be used by forward-looking firms. Measuring recommendation intention might still make sense, but only as a complement to satisfaction not a substitute.

2. Improve customer feedback – small steps pay off, too: Results showed that customer feedback metrics have a linear impact on customer value and no threshold from which improvements count, as postulated by Reichheld (2003), was found. Hence, every improvement of customer feedback pays off as long as the costs for the improvement are not higher than the increase in value.

3. Connect feedback metrics with business metrics: To understand the drivers of customer value and other business metrics (e.g., contribution margin), feedback metrics (e.g., satisfaction, recommendation intention) and business metrics need to be connected on the individual level. Such a connection allows for better understanding the long-term influence of (soft) customer feedback on (hard) business success.

References

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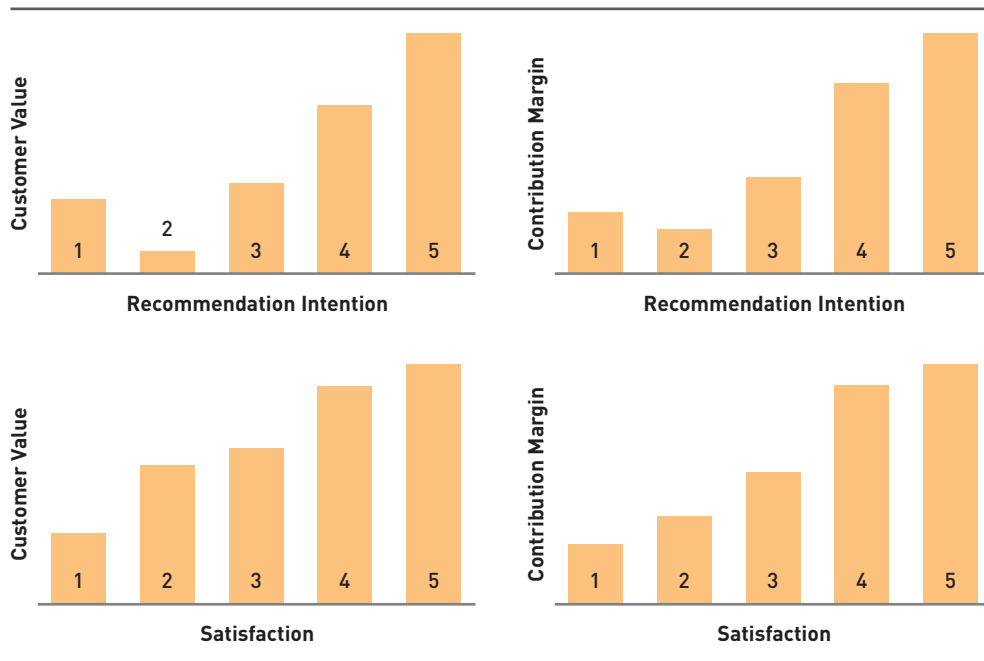
Figure 2: Relationship of Recommendation Intention (Satisfaction) and Customer Value / Contribution Margin*

*Numerical Values of Customer Value and Contribution Marging are not shown due to confidentiality. Recommendation Intention and Satisfaction are measured on a 1–5 scale. Concerning category 1 and 2 the low number of respondents (10 for recommendation intention and 13 for satisfaction) has to be taken into account.