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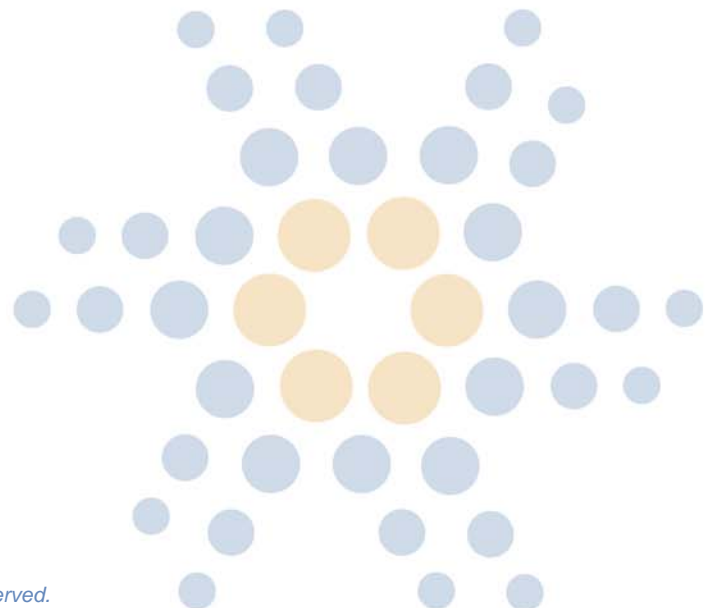
• • • *Dig deeper. Climb higher.*

WHITE PAPER



Advocate™

How to improve retention by transforming more customers into profitable brand promoters





Executive summary

This paper discusses how businesses can increase customer loyalty, improve performance and increase profitability by better understanding exactly what they can do to transform more customers into vocal brand advocates. Advocates are not only loyal, but they use a company's products and services more frequently and help strengthen and promote brands by spreading positive word-of-mouth and referring new customers to the brands with whom they feel an emotional affinity.

Advocate™ is a research product that delivers an evidence-based, executable plan to integrate operational planning, marketing and communications activities to strengthen brands and maximize profitable growth.

Every business understand the importance of loyalty, but few understand the importance of advocacy

Most companies and organizations use metrics to help manage their organizations. These range from sophisticated scorecards and dashboards to more basic metrics like profit and loss statements and cash in the bank. For many companies, one of the metrics that they try to measure and monitor is customer loyalty because they understand how critical it is to their success. When relationship tenure is longer—as it is among loyal customers—companies transact significantly higher lifetime value from each customer relationship.

Despite the prevalent use of commonly used consumer metrics, few organizations focus their attention on the ones that predict profitable growth. The argument outlined in this paper is analogous to Michael Lewis' bestseller, *Moneyball* (Lewis, 2003). In his book, Lewis shows how Bill James and Billy Beane transformed major league baseball by demonstrating how improving efficiency can leverage limited resources and create success. What James and Beane did was to redefine the metrics used to evaluate the value of each major league baseball player to a team. Instead of looking at traditional indicators like batting averages and earned run averages, Beane re-focused baseball on walks, on-base percentages and other metrics—because they are a better predictor of success (i.e., winning baseball games).

This paper outlines how Advocate™ helps businesses manage to the metrics of advocacy and dig deeper into them using advanced statistical modeling to understand exactly what they can do to transact more value from each customer relationship.



We know from years of research at the Harvard Business School what metrics organizations should pay attention to in order to increase customer loyalty and profitability. In today's increasingly competitive business environment, managers need to focus their attention on the metrics that matter—because they are better predictors of success (i.e., increased lifetime value from each customer relationship and increased profitability).

What leading managers need to know

In this paper we discuss how companies and organizations can become more successful and more profitable by focusing their attention on the right metrics of performance. We will also demonstrate how Advocate™ provides managers with a strategic business tool that shows them how to better measure, manage and improve the metrics that drive business success.

Businesses correctly understand that they need to pay attention to what customers think about their products and services. The disconnect that exists today is that most businesses manage to customer satisfaction, customer loyalty or other metrics that do not predict organizational success or profitability. This paper describes what an advocate is, and why businesses should manage to customer advocacy.

The academic origins of what most businesses focus on today

One of the widespread assumptions in marketing is that customer satisfaction is likely to result in repeat purchases, acceptance of other products within a brand portfolio and favorable word-of-mouth (Cardoza, 1965). Later attempts to understand consumers' post-purchase evaluations borrowed heavily from cognitive dissonance theory (Festinger, 1957). Anderson used assimilation theory to further our understanding of consumer satisfaction, positing that consumers adjust their perceptions about a given product to bring it more into line with expectations (Anderson, 1973).

“Focusing attention on the metrics that matter gives managers the specific insight they need to compete more successfully.”

Richard Oliver's academic work on customer satisfaction added to the work conducted by Cardoza and Anderson by formally introducing a methodology to demonstrate how satisfaction is the product of an expectation-disconfirmation framework (Oliver, 1980). Consumer expectations about a product or service are established prior to a purchase, and perceptions of quality are determined through the act of consumption. From Oliver's perspective, the important



piece of information to understand is consumers' post-consumption evaluations of quality. High quality post-consumption evaluations provide confirmation for higher consumer satisfaction, and, alternatively, low quality post-consumption evaluations provide disconfirmation (i.e., lower consumer satisfaction).

The need to move beyond customer satisfaction and quality

The early academic work of Cardoza, Anderson, Oliver and others has led to a dramatic proliferation of research and emphasis on measuring and managing to customer satisfaction and quality. Ironically, what we have learned over the past several years is that while we have developed a rich theoretical understanding of what generates customer satisfaction, we have discovered that it is not the most useful metric of performance. We have also learned that managing to quality also requires a subtle shift in emphasis.

The limits of customer satisfaction

It is widely believed that customer satisfaction is synonymous with loyalty and that companies and organizations should measure and track customer satisfaction in order to understand loyalty, and how and why it varies. This makes sense if satisfaction and loyalty are synonymous. However, the academic research indicates that they are not (Jones and Sasser, 1995). Based on customer satisfaction data from over 30 national companies representing 5 major industries, the research conducted by Jones and Sasser found that the predicted linear relationship between attitudinal satisfaction and behavioral loyalty held up in only 1 out of 5 cases. In response, some businesses have chosen to focus on customers who report that they are "completely" or "totally" satisfied, dismissing "weak" satisfaction. The problem with this approach is twofold.

First, it continues to focus managers' attention on an imperfect metric of behavioral loyalty. And second, customer satisfaction is the wrong metric because it does not predict profitability. Based on a review of many national companies representing multiple industries, recent scholarship reveals that customer satisfaction does not translate into profitability (Reichheld, 2003). Based on what we know from the Harvard Business School, customer satisfaction is not the most useful metric because: 1) it does not predict loyalty; and 2) it does not predict profitability. It is not that businesses should want their customers to be dissatisfied. They should not. It is simply the case that managing to customer satisfaction will not necessarily lead to profitable growth because satisfied customers defect (Jones and Sasser, 1995).



“Despite our thorough understanding of customer satisfaction, it turns out that it doesn’t drive profitable growth.”

The limits of quality

Quality initiatives are also frequently touted as ways to improve customer satisfaction, organizational performance and profitability. In response to Japan’s rising competitiveness in the 1980s, the U.S. Congress created the Malcolm Baldrige National Quality Award modeled after Japan’s Deming Award. This was followed by the Total Quality Management (TQM) movement and again by the Six Sigma™ movement. However, we know that managing to quality does not always lead to improved performance or profitability. For example, The Wallace Company went out of business just two years after winning the Baldrige Award in 1990, and Florida Power and Light nearly suffered the same fate after winning the inaugural award.

It is not the case that quality does not matter. But quality alone does not necessarily lead to profitability, which is ultimately where most managers are driven to perform. Still, there is an ancillary principle of quality that is important for managers to focus on. Specifically, reducing problem incidence and customer defections is extraordinarily important. Recent research indicates that reducing defections by 5 percent can increase profits by 25-85 percent (Reichheld, 1990). Understanding quality is not necessarily an important metric in and of itself. However, an emphasis on reducing problem incidence and defections is critical to increased profitability. The key metric to manage to is the behavioral loyalty that occurs when customers do not experience problems. Through this approach, managing to operational excellence actually becomes strategic marketing.

“Quality is important because problem incidence is related to defections, which hurt profitability.”

What are the metrics that matter?

Understanding the metrics that are useful to managers requires careful consideration of organization goals, which vary by business and mission. But if the goals are growth and increased profitability, a growing body of academic literature from the Harvard Business School from the past two decades provides definitive insight regarding the metrics that managers should focus on. The following is a partial list of these metrics and the reason why each one matters.



1. A customer would use a business' products or services again in the future.

Understanding consumers' intentions to use a product or service again in the future is critical to retention, and retention is critical to profitability. According to research conducted by Reichheld and Sasser, improving retention by 5 percent can increase profitability by 85 percent (Reichheld and Sasser, 1990). Here, the goal is to retain all current market share at no incremental marketing expense.

2. A customer would use other products and services from a business in the future.

Most businesses would prefer to maintain an exclusive relationship with their customers rather than share that relationship with their competitors. Academic research confirms what most businesses already know: it is easier to sell products and services to existing customers than new customers, and it is more profitable (Grant and Schlesinger, 1995). Here, the goal is to use cross-sell and up-sell strategies to grow market share (among current customers) at no incremental marketing expense.

3. A customer would feel a sense of loyalty to a business' products or services.

Customers who feel a sense of emotional connection with a business' products or services are more loyal, and that emotion is derived through experience (Pine and Gilmore, 1998). More powerful emotional experiences are more memorable—and therefore more cognitively accessible—to consumers when making purchasing decisions. We also know that emotional loyalty reduces the risk of defection and predicts positive word-of-mouth (Reinartz and V. Kumar, 2002).

4. A customer would be likely to recommend a business' products or services to people they know.

The number one predictor of profitable growth is whether a business' customers are likely to recommend them to their friends and family (Reichheld, 2003). Here, the goal is to acquire new customers through strategic referrals, growing market share (adding new customers) at no incremental marketing expense.

5. A customer would say many positive things about a business' products or services to people they know and would NOT say negative things.

In addition to consumers' likelihood to recommend a business, it is essential for businesses to understand what drives the conversations people have (both positive and negative) about a business' products or services. Research consistently demonstrates the link between positive word-of-mouth and profitability (Schneider and Bowen, 1995). We also know that



companies can engage with consumers in new ways to generate more positive word-of-mouth (Pine, 2007).

“The academic research from the Harvard Business School provides a definitive understanding of what managers need to focus on. If companies want profitable growth, they need to measure, track and learn how to affect the metrics that matter.”

6. A customer has not experienced a problem with a business' products or services.

Reducing problem incidence and delivering high quality experiences are critical to maintaining loyal customers and enhancing profitability. The academic literature consistently demonstrates that reducing defections based on service quality generates profitable growth (Heskett, 1997). We also know that customer experiences are a form of marketing (McKenna, 1991) and that consumers willingly pay a premium for better service experiences (Pine and Gilmore, 1998).

What is an advocate?

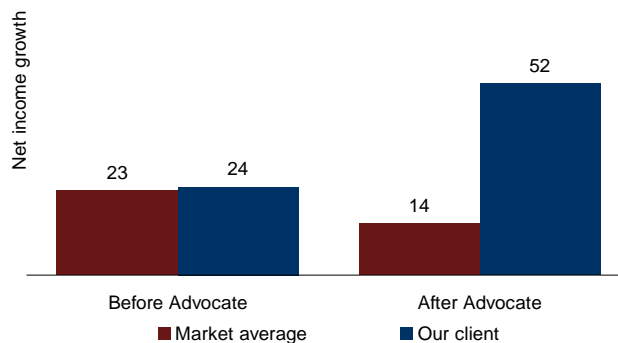
The simplest way to conceptualize an advocate is to imagine the behavioral characteristics of an “ideal customer” as indicated by the metrics that matter. An advocate is a customer who: 1) would use a product or service again in the future; 2) would use other products and services within a brand portfolio in the future; 3) would feel a sense of emotional connection to a business' products or services; 4) would be likely to recommend a business' products or services to people they know; 5) would make many positive statements about a business' products or services; and 6) would not make any negative statements about a business. At the opposite end of the spectrum is a detractor who: 1) would NOT use a product or service again in the future; 2) would NOT use other products and services within a brand portfolio in the future; 3) would NOT feel a sense of emotional connection to a business' products or services; 4) would NOT be likely to recommend a business' products or services to people they know; 5) would NOT make many positive statements about a business' products or services; and 6) WOULD make many negative statements about a business' products or services. For any given business, their current pool of customers is differentially distributed across this range of advocacy and detraction. Again, as businesses start to think in terms of transforming customers into advocates, operational strategy becomes marketing and brand strategy.



What generates an advocate?

Advocate™ not only focuses managers' attention on the metrics that matter. It also shows them exactly what they need to do in order to improve their business performance (i.e., grow market share and become more profitable).

Advocacy is a latent concept that is indicated by the metrics that matter. Consumer advocacy is driven by a combination of individual impressions, which, in turn, inform summary judgments of perceived value. Consumers either perceive value or do not perceive value in a business' products or services based on impressions that come from a variety of sources, including: 1) direct sources (i.e., what a consumer experiences directly when they see, use or consume a product or service); 2) indirect sources (i.e., what a consumer experiences indirectly through word-of-mouth); and 3) mediated sources (i.e., what a consumer experiences when they read, see or hear something about a business' products or services in news articles and through advertising). Each of these sources of impressions can be measured and statistically linked in a causally specified direction on advocacy. The model also carefully separates the cognitively derived value and the emotionally derived value that consumers realize through their purchase or selection decision. At the end of the day, Advocate™ delivers to managers a precise management tool to understand which impressions (and impression sources) create the most advocates. With Advocate™, managers can make fully-informed decisions about every business function within their organization knowing precisely where improvements will have the maximum impact on profitability.





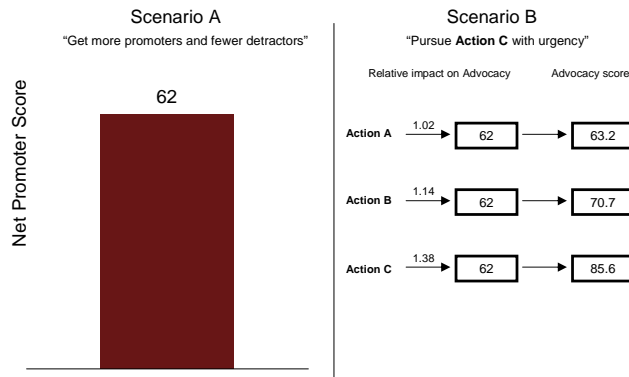
How do I “move the needle”?

Reichheld’s insight into the importance of word-of-mouth is extremely valuable and useful. However, we take exception to the following conclusion that a single “net promoter score” is all that managers need to know:

“By asking this one question, you collect simple and timely data that correlate with growth. You also get responses you can easily interpret and communicate. Your message to employees—‘Get more promoters and fewer detractors’—becomes clear-cut, actionable and motivating, especially when tied to incentives” (Reichheld, 2003).

We believe that managers need more than a single net promoter score in order to set a clear action plan for maximum impact. To illustrate this point, take the following example.

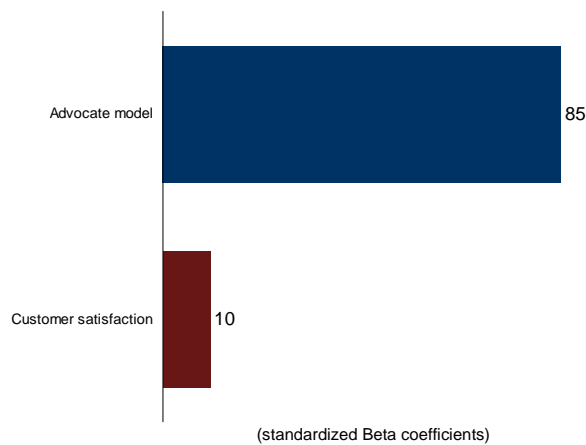
Under Reichheld’s original scenario, a manager is given a net promoter score of 62 and told by her CEO to “get more promoters and fewer detractors.” Under our scenario, a manager is given a net promoter score of 62 and provided with precise information regarding the relative impact of different courses of action. She would know, for example, to pursue Action C with a sense of urgency because it would have the greatest impact on the company’s net promoter score. She would also know that Action A should be considered a much lower priority. Armed with this insight, our manager has an action plan for setting clear priorities in order to achieve maximum success. This approach is consistent with a recent article in the Harvard Business Review. According to Christopher Meyer and Andre Schwager, “to understand how to achieve customer satisfaction, a company must deconstruct it into its component experiences” (Meyer, 2007). We believe strongly that this approach is correct. However, we take exception that the ultimate variable of interest should be Advocacy, not Customer Satisfaction or a single Net Promoter Score.



This is an overly simplified example which is merely meant to illustrate the importance of delivering specific information regarding the relative importance—or impact—of different courses of action on the metrics that matter. Without it, managers have no direction to guide planning. With it, they know exactly how to prioritize business functions and allocate resources accordingly.

The power of Advocate™

The power of Advocate™ is extraordinary. The following is an example taken from a case study using actual client data. Our goal was to explain variation in our dependent variable of advocacy behaviors. Using traditional measures of customer satisfaction, the model would predict about 10% of the variation in loyalty. Using data from our Advocate™ model, we are able to predict 85% of the variation in loyalty.





How we do it

The Advocate™ methodology uses a proprietary theoretical model and the most advanced statistical analytics to show how impressions from direct, indirect and mediated sources contribute independently to advocacy. It delivers an interactive statistical simulator that managers can use to predict how changes in specific impressions and experiences will create advocates and reduce detractors. Based on survey data using the most advanced measurement techniques, the model shows the relative importance of selected impressions and experiences on advocacy. While the statistical modeling seems complex, the results are delivered in a format that is simple to understand and easy to apply.

Why you need it

Advocate™ gives managers a tool that outlines a clear action plan for maximum impact. It provides managers with precise information to set clear priorities and see improvements in performance in the least amount of time. The model also gives managers a tool to control strategic referrals and positive word-of-mouth so that they can influence what their customers say about their business to people they know. Most importantly, it delivers insight to craft an evidence-based plan that seamlessly integrates operational, marketing and communications strategy to maximize loyalty, profitability and the lifetime value of every customer relationship.



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