NPS – The One Measure You Really Need to Grow?

The Net Promoter Score (NPS) has often replaced customer satisfaction indices or customer loyalty metrics as a customer feedback measure. But does it keep its promise to predict future performance better than alternative measures? A closer look at academic studies gives some guidelines on how to apply NPS as a useful instrument for management control.

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It was just a simple question that management consultant Fred Reichheld introduced in a Harvard Business Review article in December 2003 (cf. Reichheld 2003): "How likely is it that you would recommend [company name] to a friend or colleague?" Responses to this question were to be transferred into a new metric which was claimed to better predict "future growth" than previously used measures of customer satisfaction or customer loyalty. Since then, this metric, the so-called Net Promoter Score (NPS®), has become an impressive success story in business practice. Not only has it been adopted by some of the world's most prestigious firms but remarkably across a wide range of industries and business models (cf. Keiningham et al. 2007). The following illustrative comments from company executives and opinion leaders reflect these trends:

> "We will focus our organization on what we call Net Promoter Score, which goes much beyond the pure customer satisfaction index."
> (René Obermann, 2005, CEO of T-Mobile International AG)

> "Net promoter score (NPS) is the most famous and probably the most important performance measure for marketing management control. This is due to two reasons. First, it has been proven that it drives corporate success. Companies that increase NPS increase their revenues. And second, it is easy to measure and to calculate."
> (Hauner 2014 on Sputnika, a German marketing blog)

There are many companies where in the meantime NPS has partly replaced or at least supplemented traditional measures of customer satisfaction or customer loyalty. NPS gets high top-management attention and is frequently used in a variety of management fields such as forecasting and resource allocation (e.g., at Allianz Swiss as in Helten/Hoffjan 2016), to incentivize employees (e.g., as in Adidas 2015, p. 12), or for the purpose of communicating with external stakeholders such as investors (e.g., as in Zalando SE 2016, p 4). In short, for many firms it has become a dominant, if not the dominant non-financial performance measure to evaluate relationships to customers and to manage business.

"The attractiveness of NPS stems from its simplicity which comes at a cost."

Therefore, it seems justified to have a critical look at this performance measure. First, I will describe how NPS is formed in its original concept and what makes it so attractive for firms and managers. Then, I will evaluate whether the measure actually keeps its promise. Several academic studies use data from companies across a wide range of industries and apply rigorous statistical analyses to challenge whether NPS is indeed superior to other measures, especially to a customer satisfaction index. The major point of investigation is whether NPS predicts future firm performance, such as company growth, well and even better than alternatives. Finally, I will present some major take-aways for management practice of how to use and how not to use NPS.

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A simple concept and its attractiveness

The key idea behind the NPS is not new and has been discussed by "word of mouth" for quite some time. It is based on the simple assumption that the most loyal and valuable customers of a firm intend to promote a company's products and services actively to others. Following that logic, the concept is based on the perspective that every company's customers can be divided into three segments: "promoters", "passives", and "detractors". By asking this single question "How likely is it that you would recommend [company name] to a friend or colleague?", the company can track customer response on a 0-to-10 points rating scale and categorize customers as follows:

- The share of customers with scores of 9-10, called "promoters"
- The share of customers with scores of 7-8, called "passives"
- The share of customers with scores of 0-6, called "detractors"

Promoters are therefore customers who actively intend to recommend a product, passives are customers who still intend to recommend a product but show a lower likelihood to do so, and detractors are those customers showing the lowest likelihood and probably no significant motivation to promote. The final NPS measure is the share of promoters subtracted by the share of detractors. Thus, the NPS metric spans from -100 percent (zero percent promoters, 100 percent detractors) to 100 percent (100 percent promoters, zero percent detractors) with typical bandwidths of 25 percent to 75 percent in practice. Notably, this classification is based on three major assumptions:

Companies have implemented the NPS concept due to its easy application and presumed relevance for future performance.

- First, it does not matter whether customers do indeed recommend the company to others – all that is captured by the measure is whether these customers estimate themselves to have a (high) likelihood of doing so. Whether these intentions really translate into behavior is of no importance for the concept. Furthermore, the concept is assumed to be applicable for any kind of company. However, it is likely that for some (mostly utilitarian) brands or products, customers simply do not intend to talk about to others – no matter whether they are satisfied or not.
- Second, low or lower scores for likelihood of recommendation are either interpreted as passive customer behavior (scores 7-8) or even as if customers had expressed negative word of mouth and critique to others (scores 0-6). Both assumptions are strong and can be very misleading. Why should a customer with a comparably low score of 0-6 necessarily engage in active and negative critique?
- Third, it is assumed that data aggregation does not bias the results. A simple example shows that this assumption might be misleading. Imagine Company A showing five percent promoters, 90 percent passively satisfied, and five percent detractors, resulting in a NPS of zero (five percent minus five percent). Company B shows 50 percent promoters, 0 percent passively satisfied, and 50 percent detractors, leading again to a NPS of zero. Very likely, the same final NPS value measures two completely different phenomena that are very likely to require different managerial actions.

So what makes NPS so attractive? As indicated in the introductory quote, it is its simplicity. Customers are far more willing to respond to a single question instead of answering a long battery of detailed customer satisfaction questions. Especially e-commerce business models can easily integrate the single question into the customer's online shopping process. Response rates are high(er) and in many cases no incentives for participation in a survey are required. The cost of field market research is substantially reduced and a single measure, such as NPS, is easier to use and communicate both inside the company and to external stakeholders than a wide range of different and probably more complex customer satisfaction measures.

Does NPS keep its promise?

Academics and practitioners have developed different quality criteria for performance measures such as controllability and understandability of metrics for managers (cf. Merchant 2012) or whether performance measures are SMART, i.e., specific or time-bound (cf. Doran 1981). However, the most important criterion for any performance measure is predictive validity, sometimes also described as congruity or goal consistency. It means that the measure goes "hand in hand" with a company's future performance which could be measured as long-run growth in revenues, profits, cash flows, or stock market valuation measures. Any measure that allows managers to predict future success to some extent is highly welcome as it allows management to take timely actions today with strong implications for future business tomorrow. Then, the measure is congruent and becomes managerially relevant.

> *"NPS does not provide significant additional value to any other alternative customer feedback metric."*

There is broad evidence in the academic and practitioner literature that responses from customers can serve as such a measure. Customer attitudes and behavior in terms of satisfaction, referrals, or word of mouth can translate into future behavior, making their feedback about these attitudes and behavior a potentially useful non-financial performance measure for management control (cf. Gupta/Zeithaml 2006). If NPS is to keep its promise of being the superior measure of customer attitudes and behavioral intentions, it has to fulfill three different conditions that build on one another:

1. NPS should be strongly correlated with future company performance measures. When introducing the concept of NPS, Fred Reichheld presented positive correlations between NPS and revenue growth for selected industries and claimed that traditional customer satisfaction measures do not show these positive correlations (cf. Reichheld 2003).
2. NPS should be more strongly correlated with future company performance measures than alternative customer feedback measures. Companies can choose between different customer feedback metrics. Relying on NPS is only useful if it proves to be the superior metric for predicting future

> The NPS concept makes strong and implicit assumptions for customer behavior.

Summary

- The Net Promoter Score (NPS) measures customer feedback by using a single question. It has been widely used as an indicator for future performance.
- Whether NPS is predictive of future performance has been rigorously tested by some academic studies, comparing it with several other customer feedback metrics.
- This article gives indications as to how companies could use NPS to their benefit.

performance. Otherwise, companies should use alternative and more predictive measures.

3. NPS should be more strongly correlated with future company performance measures than alternative customer feedback measures beyond information the company already has (e.g., current customer profitability, relationship length with the customer, customer's industry affiliation, customer's country). Only if NPS provides information about the future incremental to existing information, then it clearly outperforms alternative measures. If there is no such "on-top" effect, then companies could also rely on alternative information being available at the time such as current customer profitability or current relationship length with a customer.

These three conditions have been subject to academic interest and **Table 1** illustrates the core findings of the most insightful studies in this area. It shows that NPS does not perform well on all the three dimensions summarized above. Although different studies reach slightly different results (due to differences in data sources, methods, and type of analyses), some overall conclusions can be made.

Academic studies show that NPS is not superior to alternative customer feedback metrics.

Tab. 1 NPS and Future Performance – Overview of Study Results

Authors (Year):	Morgan and Rego (2006)	Keiningham et al. (2007)	Van Doorn/Leeflang/Tijs (2013)	De Haan/Verhoef/Wiesel (2015)
Country:	US	Norway	Netherlands	Netherlands
Sample (# firms):	569	21	46	93
Level of analysis:	Company	Company	Company	Company & Customer
Method:	Regression analysis	Partial correlations	Regression analysis	Regression analysis
NPS metric:	Slightly different to the method in Reichheld (2003)	Slightly different to the method in Reichheld (2003)	Same as in Reichheld (2003)	Same as in Reichheld (2003)
Future performance metric:	Tobin's Q, cashflow, shareholder return, revenue growth, gross margin, market share	Revenue growth	Revenue growth, gross margin, cash-flow	Customer retention
Condition (1): Correlation between NPS and future performance metrics?	Partly, for Tobin's Q, cash flow, and market share; even negative (!) for revenue growth, gross margin, and shareholder return	No	Yes, between NPS and revenue growth / gross margin	Yes
Condition (2): Correlation higher than for alternative customer feedback metrics?	No	No	No	No
Condition (3): Correlation higher than for alternative customer feedback metrics, beyond other influences?	No	Not tested	No	Partly, for identification of the most risky customers

Source: Table developed by author

Regarding the first condition, results are already mixed. Two recent studies applying the NPS concept as suggested by Reichheld (2003) show a positive and statistically significant correlation to future performance metrics. However, NPS does not outperform alternative measures here (condition 2) and this observation holds if the predictive power of alternative information is considered (condition 3). NPS does not provide significant additional value to any other alternative customer feedback metric and shows even smaller correlations in most studies than, for instance, customer satisfaction measures. Thus, increases in NPS neither necessarily lead to increases in future performance, nor is NPS a superior measure compared to alternatives.

Should companies increase their NPS?

Research shows that the managerial relevance of NPS is given, but it is limited and not superior to alternative customer feedback metrics. Its attractiveness therefore stems from its simplicity which comes at a cost. As with any global single question, NPS does not give any deeper insights into the reasons why customers respond the way they do. However, without knowing why customers are not willing to recommend, there are few management actions that companies can take to improve the situation.

"Increasing NPS values can get very difficult and unprofitable if companies already have high market shares."

Even if customer motives were well understood, one has to be very careful about simply maximizing NPS values. It is easy to imagine a scenario where customers are quickly pleased and become promoters as a result of low product prices, notable loyalty bonuses, additional services, or valuable quality promises. Although these "underpriced and over-served" customers are likely to be loyal over time, they will not necessarily contribute to future performance measures such as sales growth or profits. Increasing NPS values can also get very difficult and unprofitable if companies already have high market shares, and convincing additional customers to respond positively to a company's efforts is very costly (cf. Keiningham et al. 2014).

NPS gives no clear indications about manageable areas for improvement of customer relationships.

Should companies refrain from using the NPS concept now? I suggest a more nuanced view. Results from academic studies give us evidence for the "average firm" in the respective sample. Thus, I strongly encourage companies to test the usefulness of NPS in their particular firm using their own historical data. If it appears to be a useful measure, I recommend asking customers, in addition to the NPS question, for reasons of potential (dis)satisfaction and (il)loyalty. Finally, I suggest managing NPS closely together with customer profitability. Then, and only then, is NPS a potentially useful performance measure for managing customer relationships, future growth, and profitability.

Recommendations for Action

- Run statistical analyses (e.g., panel regressions) to test whether and which customer feedback metrics have predictive power to find the most suitable one for your own company's business model.
- Research shows that differences in NPS and other customer feedback metrics can be substantial between customer's country or customer's industry. Consider these influences when analyzing historical data.
- If NPS turns out to be managerially relevant, make use of both the raw data and the final aggregated NPS. Using the latter can be useful for reasons of simplicity. However, beyond simplicity there is little benefit in losing data by aggregation as suggested in the original concept.
- Ask your customers to respond to more than just the NPS question. Gain an understanding about the drivers of poor satisfaction or low recommendation intention in order to manage them appropriately.
- Manage NPS in line with customer profitability and customer lifetime value (CLV) metrics. In some cases, an increase in NPS requires substantial price discounts, additional services, or preferential customer treatment. This can be prohibitively costly and simply increasing NPS can never be an ultimate goal.

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