Mark L. Frigo, Editor

Blowing the Whistle on Bad Profits

BY FRED REICHHELD & ROB MARKEY

Too many companies can't tell the difference between good profits and bad. The consequences are disastrous. Bad profits choke off a company's best opportunities for true, lasting growth. They blacken its reputation and make it vulnerable to competitors.

By "bad profits" we mean profits earned at the expense of customer relationships. Whenever a customer feels mistreated, those profits are bad. Bad profits come from unfair or misleading pricing, saving money by delivering a poor customer experience, or extracting value from customers rather than creating value. At many firms, more than 30% of customers fall under the category of bad profits.

Good profits are dramatically different. A company earns good profits when it so delights its customers that they not only willingly come back for more, but they also tell others to do business with the company. Satisfied customers become, in effect, part of the company's marketing department. They become promoters.

A simple technique can help you distinguish good profits from bad. Ask your customers to answer what we call "the ultimate question": On a scale from zero to 10, how likely is it that you would recommend this company to a friend or a colleague? The responses will help you tally a metric known as Net Promoter® Score (NPS℠). NPS has been shown to correlate well not only with customer referrals and repurchases, but also with companies' growth rates.

Customer responses cluster into three groups. The first group—customers who give the company a nine or 10—we call promoters. Customers in the second group, which rates the company at seven or eight, are "passively satisfied." Detractors, with ratings from zero to six, make up the third group. A company's NPS is simply the percentage of promoters minus the percentage of detractors.

Bain has found that companies with the leading NPS in an industry usually enjoy superior growth—typically, more than 2.5 times the average growth rate of the competition.

How can a company raise its NPS? First, by designing the right propositions for the right customers. A vital step toward clarifying your priorities is to quantify the average lifetime value of your company's promoters and detractors, factoring in margins, annual spend, cost efficiency, and referrals. Another step that will help is to map your customers onto the grid illustrated in Figure 1.

High-profit promoters, in the upper right, love doing business with you. These customers should be your top long-term priority for strategic investment and innovation. Your entire organization should focus on delivering flawlessly to them. Too often, however, customers in this sector are taken for granted (no squeaky wheels here). Inadvertently, companies may be milking profitable promoters to fund solutions for less-profitable customers.

In the 1980s, American Express took the healthy profits from its core travel-card business and financed an expansion into financial services. Within the card division, margins from high-volume customers subsidized the acquisition of new customers outside the core business.

Predictably, American Express's growth and profits tailed off…until it revitalized compelling propositions for core customers. For example, the company transformed its Membership Miles program into Membership Rewards, one of the industry's most generous rewards programs, and created the Rewards Plus Gold card, now one of its most popular products.

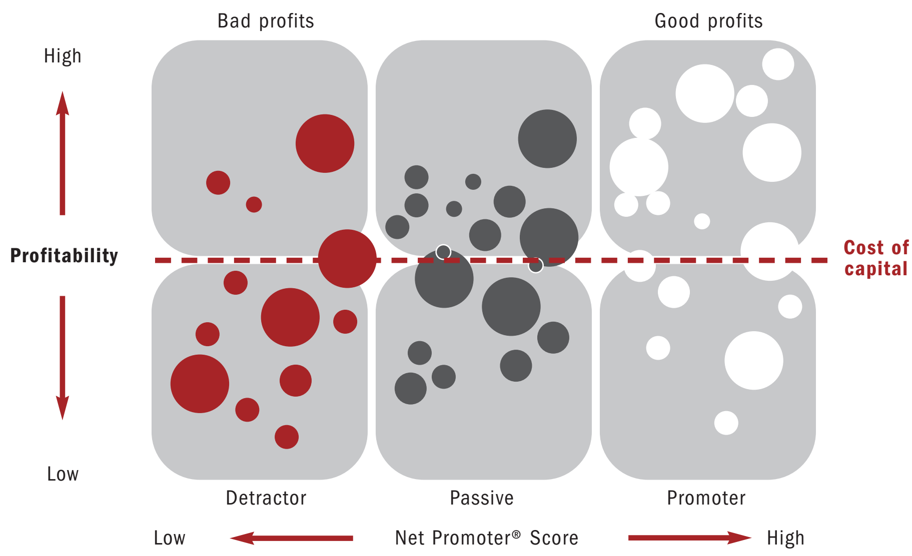
High-profit detractors, in the upper left corner, should be the second priority. They don't like doing business with you and are telling others. They will likely defect at the first opportunity.

A mobile-phone provider found that many accounts in this sector were locked into long-term contracts at fixed prices. When these prices became uncompetitive, the customers were furious. The fix was easy: Offer more favorable terms in advance of renewal. That cost money, but holding angry customers hostage would've cost even more.

Moving more customers into the upper right sector should be your third priority. Begin by looking for ways to encourage low-profit promoters to do more business with you. Amazon.com, for example, began to use personal recommendations and incentives such as premium shipping to do this. You'll also have to figure out what would win over the passives, and then calculate whether such investments make sense or would merely "steal" resources away from your core.

Leading companies like GE, Intuit, and American Express are now deploying NPS and discovering how versatile it is. Like any good metric, NPS allows experimentation and accelerates learning. It helps you understand your core customers and design propositions that captivate them—and discover opportunities to deliver a great customer experience at every touchpoint. By producing NPS data regularly, you'll institutionalize a cultural shift, making customer metrics every bit as auditable and practical as financial metrics such as profit and return on equity. You'll develop your capability to keep turning customers into advocates that lead your company to lasting growth. And it all starts by asking just one question. ■

Figure 1: Customer NPS—Profitability Grid



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EDITOR'S NOTE

The Net Promoter Score approach presented here provides a very useful way for aligning strategic activities and investments of a company toward the right customer groups. Previously in this column, we have noted that companies such as Harley-Davidson, Costco, and Dell, in the Return Driven Strategy Initiative, have demonstrated superior cash flow return on investment, growth, and total shareholder returns. Interestingly, these same companies also show high Net Promoter Scores. The innovative offerings of these companies focused on fulfilling otherwise unmet needs for the right customer groups combined with the competencies to deliver the offerings logically drive high Net Promoter Scores. On the performance measurement front, the Net Promoter Score would be a valuable addition to most balanced scorecards, which would align the strategic themes with the right customer groups to drive profitable growth.—Mark L. Frigo, Ph.D., CMA, The Center for Strategy, Execution, and Valuation, Kellstadt Graduate School of Business, DePaul University.