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Loyalty Linkage

Marketers are overlooking an essential measure in their ROMI arsenal.

by Lawrence A. Crosby and Brian S. Lunde

For the past few years, customer loyalty and retention have been on the list of the top-10 issues CEOs say are "of greatest concern" to them and their companies. At the same time, every marketer knows that marketing metrics and return on marketing investment (ROMI) are hot issues among corporate marketing leaders (and their chief financial officers).

It's interesting to note, therefore, that in all the words being written and spoken about marketing metrics it's quite rare to see the issue linked, even indirectly, to one of the CEO's greatest strategic concerns. Savvy marketers should want to close this gap.

In general, the evolving marketing metrics practices of large organizations still concentrate on measures that relate to near-term sales. One source of data to support this assertion comes from the *Association of National Advertisers 2006 Marketing Accountability Study* (now in its third year).

The study classifies marketers into three segments according to their degree of sophistication in addressing marketing accountability: "capable and confident," "progressives," and "other." Among the "capable and confident" marketers, the following metrics comprise the top five most-used predictive measures of marketing performance:

1. Predictive models for direct response
2. Recency, frequency, and monetary value (RFM) models
3. Media mix models
4. Marketing mix models
5. Models identifying likely prospects

All of these measures typically focus on short-term (i.e., current fiscal year) sales optimization.

Indeed, looking at the entire list of 11 reported predictive measures in the study, customer lifetime value models—which at least have the potential to incorporate the effects of customer loyalty—are the least-used among the "capable and confident." They are used by these accountability leaders no more often than they are used by the marketers who fall into the bottom "others" category.

These results are not surprising. It will always be the case that predicting results over relatively short time horizons is easier and more accurate than doing so over longer periods. The other major factor driving this condition is the emphasis virtually all publicly traded companies put on hitting quarterly earnings targets. Marketers are forced to respond with metrics and measures that help them justify marketing spend by showing results on the near side of the planning (and budget) horizon.

At the same time, a constantly growing body of evidence proves what we should already know intuitively: ***Loyal customers are good for business, and the financial benefits they bring transcend annual budget cycles.***

For example, the Jan. 15, 2006, edition of *Marketing News* reported on a January 2006 *Journal of Marketing* article (Customer Satisfaction and Stock Prices: High Returns, Low Risk"), which demonstrated a positive relationship between customer satisfaction (as measured by the American Customer Satisfaction Index, or ACSI) and the market value of firms. As the *Marketing News* article points out, these results are "consistent with previous studies in marketing in that a firm's satisfied customers are likely to improve both the level and stability of net cash flows."

In case you're suspicious of measurement sleight of hand here—advocating a loyalty metric but using a satisfaction measure

as supporting evidence—it's an easy step from one to the other. Although it's true that not all satisfied customers are loyal, it is also true that all loyal customers (defined both attitudinally and behaviorally) will report being satisfied (on average).

One can actually forecast the change in a business results measure based on investment in improving performance in an underlying factor (like brand image) that drives loyalty.

Therefore, firms with higher levels of customer satisfaction will, all else being equal, have a larger number of loyal customers. By definition, it is customers' loyalty behaviors, not their feelings of satisfaction per se, that directly influence business performance. (Note that in the complete ACSI methodology, satisfaction is "below" loyalty in terms of its position in affecting market results.)

Since CEOs recognize the strategic importance of customer loyalty, and loyalty can be linked to business performance, ***marketers have a clear opportunity to align themselves to the CEO agenda through efforts to build marketing metrics systems.***

Build a Predictive Measure

The first and most important step toward aligning with the CEO agenda is to build a solid foundation with a good predictive measure of customer loyalty. As mentioned earlier, satisfaction is not an ideal candidate as the sole measure because it is too unreliable as a predictor.

Another candidate measure that has gained a lot of media attention of late is the Net Promoter Score (NPS). The NPS is calculated from a single survey question about a customer's willingness to recommend. Should NPS be a key marketing metric? Caution is in order, as the method is being more vigorously tested through independent studies. In a Dec. 4, 2006, article ("One Question, Plenty of Debate"), the *Wall Street Journal* reported: "In the most stinging critique, three academic researchers and an executive of another market-research firm say they tried—and failed—to replicate [the] finding that net-promoter scores are better indicators of revenue growth than other customer-satisfaction measures."

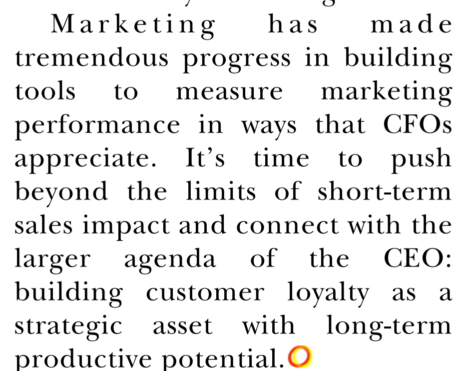
As previously argued in this column, any measure based on a single item is likely to be less predictive than multidimensional measures. Therefore, the optimal solution is a measure that takes into consideration the multiple facets of loyalty behavior, such as retention, expansion, compliance, and advocacy. These survey-based measures can easily be combined to form a simple, intuitive "loyalty index" that reliably represents how well the organization is doing in building strong customer relationships.

An additional measurement layer should be established below the loyalty metric. These measures incorporate the range of factors that drive loyalty (e.g., customer experience, brand, rational and emotional motivations). This layer is essential in making the loyalty metric actionable, which is fundamental to its value. Through analysis of this more detailed layer of variables, an organization can pinpoint precisely where to invest resources to increase the frequency of the loyalty behaviors captured by the overall metric.

With the key measurement foundation laid, the next step is to build a linkage model that shows quantitatively how the loyalty index relates to one or more measures of business performance (revenues, market share, customer profitability, and market capitalization). There are degrees of sophistication in this work; the best approach is the one that has enough rigor to be accepted by senior management as credible.

This linkage analysis gives marketing an important tool in establishing ROMI: One can actually forecast the change in a business results measure based on investment in improving performance in an underlying factor (like brand image) that drives loyalty.

With a loyalty metric in place, and credible linkage established between this measure and one or more key business outcomes, the final step is to embed the metric in the organization's key performance measurement systems such as a balanced scorecard. Short of that, it should be routinely reported in the context of key marketing metrics.



Marketing has made tremendous progress in building tools to measure marketing performance in ways that CFOs appreciate. It's time to push beyond the limits of short-term sales impact and connect with the larger agenda of the CEO: building customer loyalty as a strategic asset with long-term productive potential.

About the Authors

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