

The Microeconomics of Customer Relationships

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The Microeconomics of Customer Relationships

Reichheld (2006) discusses the effectiveness of using the Net-Promoter Score, NPS, to predict an organization's growth rate. The idea behind this consumer-relationship metric is to ascertain the extent to which new and existing customers are willing to recommend a firm's products to their colleagues and hence boost its revenues realization and profitability capacities (Reichheld, 2006). General Electric Company has resolved to adopt this model, an aspect that will compel it to first ascertain the number of promoters, passives and detractors among its customer base. As per the metric, the corporations will then have to focus on turning its passives and defectors into promoters by addressing the issues which are inhibiting members of the two groups from exhibit a complete loyalty to the entity (Reichheld, 2006). This will eventually enhance the likelihood of the firm's growth rate improving significantly in the long run.

A Critique of the Article

I concur with the article's viewpoint that the knowledge of the extent to which customers are willing to recommend a firm to their friends and peers can be used in predicting its growth rate. This is largely due to the fact that from a marketing point of view, customers who manage to derive adequate satisfaction after consuming certain products are more likely to convince their peers to also try such commodities and get similar experiences as compared to those who end up being dissatisfied after using such goods. This implies that by acquiring information relating to how customers are likely to recommend a business or its products/services to potential consumers, companies can succeed in gaining an insight of how their revenues will grow in the future.

In addition to this, I agree with the author's assertion that retention rate, annual spend and margins are some of the major factors which can be used in correctly differentiating between promoters and the other two groups of customers, i.e. passives and defectors. A firm's retention rate is a direct representation of the level of loyalty that it enjoys from its customers. A company that manages to retain its customers for many years succeeds in creating strong relationships with them, an aspect that further implies that there are likely to impact positively on its marketing and advertising activities. Moreover, the high level of loyalty that such customers have for the business keeps on compelling them to purchase more products from it even at times when overall prices are on the increase.

On the contrary, it is quite hard for companies to retain passives and defectors for a long time since there is a high likelihood they may switch their loyalty to other companies as they continue searching for better satisfaction. It is also due to this attribute that the purchasing behaviors of members of these groups are strongly affected by the prevailing product/service prices. However, I disagree with the inclusion of the factor of word-of-mouth in this list bearing in mind the fact that the article has failed to provide a viable methodology of measuring the likelihood of customers sharing positive or negative comments about the products they have purchased and consumed with their friend. The formula proposed by the author relies heavily on the information realized from customer interviews, an exercise that is not only costly but is also prone to biasness and many errors.

I also find it quite inappropriate for the article to fail to recognize that the correlation between NPS and growth rates may be affected by various factors. For instance, a firm may predict that its revenues will grow by a unit of its sales simply because a customer has indicated that he will recommend a particular product to his friend. However, this may end up not being

the case if the income level of the person the product is being recommended to, cannot allow him/her to make the purchase. This implies in order to enhance the reliability and validity of the NPS metric, the companies using it should put into consideration factors that are likely to inhibit potential customers from purchasing the products or services which have been recommended to them, an aspect that the author of this articles fails to give much thought about.

Moreover, the author of the article isn't sincere to fail to recognize that the response customers provide in relation to the question of whether they are willing to recommend firms or products to their friends may be affected by different environmental factors such as the corporate image of these entities. The article commits this mistake when it strives to make it clear that all satisfied customers ought to be grouped as promoters. However, this might not be the case in every situation, a good example of this being that of a satisfied customer opting not to recommend an organization's product to his peers simply because the entity has not been performing well as far as the issue of exhibiting its corporate citizenship attributes are concerned. Therefore, before grouping customers as passives, defectors and promoters, firms ought to consider the external/outside factors which may have an impact on the responses they are likely to provide.

Reference

Reichheld, F. (2006). The Microeconomics of Customer Relationships. *MIT Sloan Management Review*, V. 47, No. 2, pp. 73-78.