Do Happy Customers Lead to Happy Shareholders?

By David Midgley , INSEAD Professor of Marketing

Customer satisfaction has an impact on firm value if, and only if, marketing managers make the right investments.

Study after study confirms that customer satisfaction and stock price generally tend to move in tandem. That shouldn't be surprising, as both are fairly reliable indicators of a firm's vitality. However, since many firms nowadays are hard-pressed to satisfy the escalating demands of both digitally-empowered consumers and activist shareholders, there are ever more variables feeding this relationship. CMOs, therefore, need to understand this issue at a deeper level, so they can isolate and control the levers by which customer sentiment comes to influence the market.

While recent academic literature has provided this depth to business practitioners (summarised in my comprehensive article "**Strategic Marketing for the C-Suite**"), it's somewhat ironic that out of all disciplines in business academia, marketing has perhaps received the most criticism of late for being **out of touch** with the needs of professionals in the field. The issue, I believe, is not that marketing research is behind, but that its findings aren't well communicated.

Quantifying the relationship

The first question marketing managers may want answered is whether academics have found convincing data-based evidence that customer satisfaction and stock price are linked. Assuming the answer is yes, their next question would likely be whether we can start to isolate the variables behind this relationship.

A **2006 *Journal of Marketing* paper** was one of the first major studies along these lines. The authors hypothesised that customer satisfaction constitutes "an identifiable, but intangible, asset on market capitalisation". Using a mathematical model accounting for book value of assets and liabilities over the period 1994-2002, they estimated that a one-percent increase in a firm's **American Customer Satisfaction Index** (ACSI) score is associated with an eventual 4.6 percent increase in market value.

Interestingly, they go on to conclude that because the market is insufficiently receptive to ACSI data as a leading indicator of financial performance, it's possible to beat the market by investing in firms that do well on the ASCI. As you might expect, these controversial findings were greeted with scepticism in some quarters — and other scholars have since taken an opposing view.

Managing satisfaction

Not all increases of customer satisfaction are equally valuable from a shareholder perspective, however. A 2010 study in ***Journal of Marketing Research*** focuses on the idea that rapid growth powered by customer satisfaction can present long-term challenges as new sets of customers join the fold, or firm systems come under pressure. Consequently, aggregate data showing a high level of customer satisfaction can deceive leaders into complacency, when they should be paying more attention to the variances in satisfaction levels among the customer base.

Based on data for seven U.S. domestic airlines over the period 1997-2005, the authors concluded that in situations where satisfaction ranges more widely, the impact of increased overall satisfaction upon shareholder value was blocked by as much as 70 percent. The authors find that companies' advertising investments within this industry led to generally higher, but less consistent, customer satisfaction, while service quality investments brought about a more uniform rise in satisfaction – an outcome likely to make shareholders happier in the long term.

The findings seem to bolster the case for customer service as a sustained investment priority rather than a mere tool for achieving scale. The authors find that when Southwest Airlines appeared to shift emphasis away from service and toward growth and cost reduction, customer satisfaction not only sank overall but also became the least consistent of all seven airlines included in the study.

Investing in customer service

Of course, every dollar spent improving customer service is a dollar denied to other organisational priorities, such as cost-cutting technologies. Managing tricky trade-offs between productivity, service quality, and profit is the subject of **a 2012 study from *Journal of Marketing***. The authors go so far as to posit a "new theory of service productivity", according to which any service provider should aim to achieve the most profitable level of productivity, as distinct from maximum productivity.

When factors such as higher margins or better prices motivate the provision of better service, the authors argue, company dollars are often better spent improving customer service, even when efficiency suffers as a result. In high-wage, low-margin, or low-competition environments, companies should feel freer to automate wherever the technology allows.

Analysing Compustat data for more than 700 firms during 2002 and 2007, the authors find that, relative to the optimal level of productivity, firms in 2002 may have been too concerned with reducing costs considering the strong economy, while in 2007 they may have cut less than was necessary to gird themselves for the coming recession. The authors also note that during both years, larger service firms appeared to overshoot the optimal productivity mark by about nine percent, implying that established firms may be overemphasising cost control and underinvesting in customer service quality.

Takeaways

Today's increasingly service-based economy requires leaders and shareholders alike to take a more contingent view of productivity than they have in the past. Short-termism can be especially damaging in this climate, given that the considerable market benefits of increased customer satisfaction are unlikely to manifest in time for the next quarterly report.

At the same time, adding more customer service capacity is not always the answer. Economics still matters, and it seems likely that at the margin many firms overinvest in customer satisfaction and would do well to consider the desired level of their service productivity more strategically.

David Midgley *is a Professor of Marketing at INSEAD*

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About the author(s)

David Midgley is an Emeritus Professor of Marketing at INSEAD.

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