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The effect of customer service on retailers' shareholder wealth: The role of availability and reputation cues

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Abstract

Retailer customer service has been shown to lead to increases in consumer attraction and retention, but what is less apparent is whether shareholders are fully rewarded for retailers' customer service efforts. Results from an event study on 48 retailer announcements of customer service strategies indicate that customer service increases retailer market values by 1.09 percent on average. The magnitude of this abnormal return suggests that customer service is one of the more effective ways for firms to create shareholder wealth. Further, analysis of the abnormal returns suggests that the shareholder value created by the retailer's customer service is affected by the heuristics and cues used to judge the likelihood of service delivery. Consistent with the availability heuristic, we find that services that are difficult to bring to mind and non-vivid services create significantly less shareholder value. Results further show that the retailer's reputation can also significantly inhibit the customer service's shareholder wealth creation.

Keywords: Retailer; Consumer; Customer service; Event study; Abnormal returns; Availability heuristic; Firm reputation

Considerable scholarly attention has been directed at understanding the financial rewards that result from retailers' competitive strategies. Research has examined the benefits due to retailers' merchandising (e.g., Chen et al. 1999), category management (e.g., Basuroy et al. 2001), and promotional strategies (e.g., Walters 1988). Another rewarding strategy for retailers is to compete through service (e.g., Berry 1986).

Prior research has shown that retailer customer service enhances customer satisfaction, increasing purchase intentions, word-of-mouth recommendations, and share-of-wallet (e.g., Reynolds and Beatty 1999; Sirdeshmukh et al. 2002). And retailer customer service has also been found to have a positive effect on store traffic and revenues (e.g., Gomez et al. 2004). These findings suggest that customer service leads to increases in retailers' cash flows, but evidence for this association remains elusive (Homburg et al. 2002; Judd and Vaught 1988).

Our first objective therefore is to examine the extent to which retailer customer service is associated with increases in retailer cash flows and shareholder value. Results from an event study are expected to document positive movements in retailers' stock prices in response to retailers' customer service strategies, indicating that investors associate retailer customer service with the creation of retailer shareholder wealth.

Investors are often assumed to be rational decision makers with high computational abilities who appropriately evaluate all relevant information (Colisk 1996). In reality, however, due to cognitive constraints and deliberation costs, investors often evaluate information using cues and heuristics (Stracca 2004) and the use of heuristics can lead to biases in investor decision-making (e.g., De Bondt and Thaler 1985; Tversky and Kahneman 1973). Thus, there may be anomalies in how investors evaluate retailers' service, and some retailers may not be fully rewarded for their customer service efforts.

How heuristics might affect service evaluation, however, has received scant attention in the prior literature. This omission is surprising because service delivery is uncertain (Parasuraman et al. 1985) and substantial psychological evidence indicates that individuals use heuristics to judge the likelihood of uncertain future events (e.g., Hoch 1984; Kahneman and Tversky 1982). Our second objective there-

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fore is to examine how heuristics moderate the effect of customer service on retailers' shareholder wealth.

The paper is organized as follows. We briefly review the literature on retail customer service and its consequences, using the service–profit chain to explicate the relationship between customer service and shareholder value. Applying extant psychological research on the availability heuristic (Tversky and Kahneman 1973) and research on firm reputation and its impact on information processing (Purohit and Srivastava 2001) to investors' perceptions regarding the likelihood of service delivery, we predict that investors' reaction to a retailer's customer service will be affected by (1) the service's availability and (2) the retailer's reputation. We validate these predictions through an event study and cross-sectional analysis of the abnormal returns. We conclude the paper with a discussion of the limitations of this research and the managerial and scholarly implications of our findings.

Literature review

The service–profit chain

Customer service is thought to lead to increases in firm profitability and market value through the service–profit chain (Heskett et al. 1994). This model proposes that customer service creates positive consumer cognitions and behaviors (e.g., satisfaction and loyalty) that create financial benefits for the firm (Fig. 1). The Return on Quality (ROQ) and the Return on Marketing (ROM) models advance this framework by recognizing the possibility of diminishing returns due to the costs of providing service (Rust et al. 1995, 2004), but the basic logic underlying all of the models is the same.

Service, by providing additional value for customers, leads to increased customer satisfaction, though the relationship between service and satisfaction can be non-linear (Anderson and Mittal 2000). Satisfaction, in turn, leads to increased retention (Bolton 1998; Zeithaml 2000) and to increased acquisition through word-of-mouth recommendations (e.g., Cronin and Taylor 1992). Satisfaction can also generate positive, though often non-linear, gains in share-of-wallet (e.g., Keiningham et al. 2003). For these reasons, customer satisfaction has consistently been shown to positively affect firm revenue, cash flow, and profitability (Gruca and Rego 2005; Kamakura et al. 2002; Morgan and Rego 2006).

Retailers have been found to gain similar benefits from their customer service efforts. Retailer customer service has been found to increase customer satisfaction, leading to increased repurchase intentions, willingness to recommend, and share-of-wallet (e.g., Beatty et al. 1996; Dabholkar et al. 1996; Reynolds and Beatty 1999; Sirdeshmukh et al. 2002). And while substantial research has shown that retailer customer service is associated with increases in store traffic and revenue (e.g., Babakus et al. 2004; Gomez et al. 2004; Sirohi et al. 1998), the extent to which retailer customer service increases cash flows is less clear.

Further, it is not apparent whether investors fully appreciate the retailer's customer service efforts. The behavioral finance literature has repeatedly shown that investors often use heuristics in their decision making, which can lead to biases in how investors react to firm information (De Bondt and Thaler 1985; Goldstein and Gigerenzer 2002; Stracca 2004). Because service is intangible, uncertain, and difficult to evaluate (Lovelock 1983; Zeithaml and Bitner 1996), it is likely that investors use heuristics to evaluate firms' service. But how heuristics influence investors' (and consumers') reaction to firms' service is currently not known.

To illuminate these issues, we used an event study to assess how investors respond to retailer customer service. This approach allows us to determine the shareholder wealth uniquely due to the retailer's service, and analysis of the abnormal returns allows us to test for any biases in investors' reaction. We now present our conceptual framework and then turn to the empirical tests of our hypotheses.

Conceptual model

The service–firm market value relationship

Extending the service–profit chain, we suggest that customer service leads to an increase in the retailer's cash flows, enhancing the retailer's market value. Recall that ample evidence links retailer customer service with increases in store traffic and revenue (e.g., Sirohi et al. 1998). However, only if the increase in business covers the cost of the providing the service, will retailer customer service generate higher

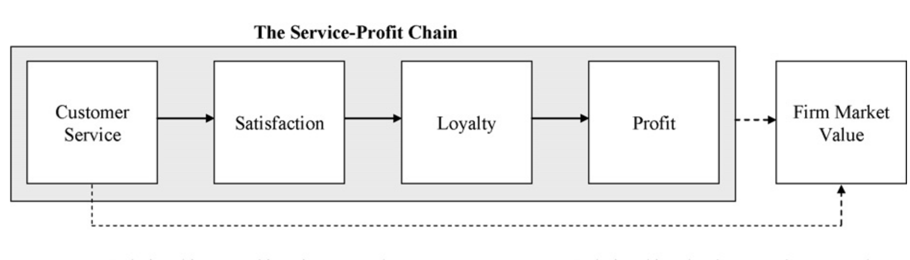

Fig. 1. A model of the relationships between service, profit, and firm market value.