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Customer satisfaction and brand equity

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ABSTRACT

The study here examines the interaction between shareholder value and customer satisfaction, as well as the impact on a firm's brand equity. Customer satisfaction may have a positive effect on brand equity, except when managers show excessive customer orientation, in which case the effect is negative because of reductions in shareholder value. The empirical analysis uses incomplete panel data pertaining to 69 firms from 11 nations during the period 2002–2005 and supports the theoretical contentions. This result warns of the perverse effect on brand equity of implementing policies focused exclusively on satisfying customers at the expense of shareholders' interests.

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1. Introduction

Drawing on Mintzberg's (1983) work, different theorists stress that managers should adopt a broad perspective that integrates not only customers but also other stakeholders' interests and values to define a successful firm strategy (Greenley et al., 2005; Miller and Lewis, 1991). According to this stakeholder view, a firm should adopt different positions depending on the importance assigned to the interests of different stakeholders.

Mintzberg (1983) also suggests that stakeholders with more power should receive greater "care". This vision then prompts the descriptive approach associated with stakeholder theory (Jawahar and McLaughlin, 2001; Mitchell et al., 1997), which indicates that the degree to which managers prioritize competing stakeholders' claims (i.e., salience) relates positively to the stakeholder attributes of power, legitimacy, and urgency. An extreme case of this line of research states that customers should receive all power, so managers should focus on satisfying the needs of these stakeholders (Anderson, 1982). Greenlay and Foxall (1998) similarly establish customer orientation as the basis of any policy addressed to employees or stakeholder-like competitors.

In contrast, Miller and Lewis (1991) defend a balance between the values and needs of different stakeholders, without prioritizing any of them. Luk et al. (2005) reveal that the combined effects of different stakeholder orientations constitute the essence of a firm's competitive advantage. In particular, these authors show that the interaction among customer orientation, competition orientation, and employee orientation explains the success of service firms in China. Aupperle (1984) further links social practices involving all stakeholders to positive financial performance. Satisfied stakeholders provide different types of intangible resources to a firm, which enhances its value (Blumenthal and Bergstrom, 2003) and therefore its brand equity (Keller, 1993). This view provides the basis for instrumental theory (Donaldson and Preston, 1995; Jones, 1995), which argues that corporate responsibility performance positively influences financial performance and has a positive overall effect on a firm's brand equity value.

Recent attention also centers on the idea of connecting social and financial performance to brand equity (BE), defined as the marketing effects or outcomes that accrue to a product with its brand name compared with those that would accrue if the same product did not have that brand name (i.e., Ailawadi et al., 2003). On the social performance, for example, Mühlbacher et al. (2006) define brands as complex social phenomena in which different stakeholders play roles to create BE. On the financial performance, the slack resources hypothesis confirms the connection between financial results and a firm's BE (Waddock and Graves, 1997). Stronger financial performance leads to a surplus of resources that provide firms with the financial wherewithal to satisfy their stakeholders, which in turn improves the firm's BE (Kraft and Hage, 1990; McGuire et al., 1988; Preston et al., 1991).

The study in the present report adopts an integrative view and recognizes the relevance of shareholder value (SV), as well as corporate social performance (CSP) involving all stakeholders in general and customer satisfaction (CS) in particular for the creation of BE. Specifically, this article proposes two claims. First, SV partially mediates the connection from CS to the creation of BE. Second, through this mediation, an inverted U-shaped relationship exists

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between CS and BE. A manager who focuses on satisfying only the most salient stakeholders (i.e., customers) and neglects remaining stakeholders will cause the firm's SV to erode and with that its BE. This approach contrasts with the traditional literature that suggests an unambiguous positive effect of CS on value generation. Anderson et al. (2004) show that satisfied customers are more loyal, which decreases a firm's risk by reducing the volatility of demand. In less uncertain conditions, firms can better generate value, as captured by Tobin's q—the ratio of a firm's market value to the current replacement cost of its assets. Mittal et al. (2005) find a connection between CS and long-term financial performance. Similar results appear in customer equity literature (e.g., Hogan et al., 2002). However, Matzler et al. (2008) suggest that an optimal level of CS exists that generates value for shareholders, whereas beyond that level, the effect becomes negative.

This research extends the work by Matzler et al. (2008) by connecting CS and SV to explain a firm's BE and suggesting an inverted U-shaped relationship between CS and SV, which translates into an inverted U-shaped connection between CS and BE. Unlike the article by Matzler et al. (2008), this research provides theoretical arguments. That is, at high levels of CS, financial performance should suffer for two reasons. First, if a manager satisfies customers at the expense of the firm's non-customer stakeholders, the latter group will not provide valuable intangible resources, which may damage a firm's BE value. Second, if managers satisfy customers as well as non-customer stakeholders, the resulting policy may represent an entrenchment strategy that a manager implements when confronted with dissatisfied shareholders (Cespa and Cestone, 2007; Surroca and Tribó, 2008). This policy likely has negative effects on performance (Morck et al., 1988), which would then translate into a reduction in BE value.

An example serves as a good illustration. When Coca-Cola tried to change the flavor of its Coke brand in 1985, customers organized pressure groups to agitate against such a change. The mass media supported these protesting customers, noting that Coke represented an icon of the American way of life. Finally, the CEO of Coca-Cola, Roberto Goizueta, decided to maintain both Classic Coke and New Coke, which entailed a costly decision and led to a major marketing flop that should have cost Goizueta his post. However, he retained his position as CEO by justifying the move on the basis of an attempt to increase CS. In this example, Goizueta used CS as an entrenchment mechanism in response to dissatisfied shareholders, who suffered because of the expensive policy of doubling the number of Coca-Cola products despite their minimal differentiation (Friedman, 1992). In the long term, the Coca-Cola brand benefited from this policy, perhaps because significant CS (above the mean), though not too great (less than the last quartile of the distribution), has a negative effect on financial performance but an overall positive effect on BE. Section 4 provides details supporting this explanation.

To confirm the proposed theoretical contention, this study undertakes an empirical analysis of an international database composed of 69 firms from 11 nations during the period 2002–2005. The results indicate that CS has a positive effect on BE for small to medium values of the distribution, but for large values (i.e., last quartile of the distribution), the effect becomes negative. Hence, the findings offer a clear recommendation: A manager aiming to improve a firm's BE value cannot implement marketing tools focused solely on satisfying customers without considering the effects on shareholders and non-customer stakeholders.

The remainder of this article proceeds as follows: Section 2 summarizes the relevant literature related to the objectives of this work and develops the hypotheses. Section 3 presents the research method including a description of the sample, variables and empirical models. The empirical results appear in Section 4. Section 5 provides a simulation. The final section of this article covers the main conclusions of the research and discusses their importance.

2. Theoretical framework

The proposed model establishes a partial mediation by SV in the connection from CS to BE. This partial mediation indicates that CS directly affects BE but also indirectly affects BE through the influence on SV, as Fig. 1 shows.

2.1. Impact of customer satisfaction on shareholder value

Early research justifies the connection from CS to SV, according to several arguments. First, satisfied customers are more loyal, less sensitive to price movements, and more likely to engage in positive word-of mouth behaviors (Anderson et al., 2004; Brady and Robertson, 2001; Matzler et al., 2008). Thus, the firm experiences less volatility and risk associated with present and anticipated cash flows (Anderson and Sullivan, 1993; Berger et al., 2006; Gruca and Rego, 2005; Hogan et al., 2002; Luo and Bhattacharya, 2006; Mittal et al., 2005). Lower volatility facilitates investment decisions that maximize a firm's value. Second, loyal, satisfied customers increase the firm's bargaining power with other stakeholders, such as suppliers, and enable the firm to demand specific investments that generate lower costs and risk, faster market penetration, and improve financial results (Anderson et al., 2004).

However, beyond certain levels, CS may exert a negative impact on SV. Firms whose managers focus mainly on satisfying customers may lose their competitive advantage because they neglect the interests of other stakeholders, to the detriment of their financial results (Luk et al., 2005). Even if satisfaction ranks high among both customers and non-customer stakeholders, the strategy may appear to be an entrenchment policy that a manager adopts in order to protect his or her private benefits, which could erode profits. Such a strategy enables the manager to canvass support from customers as a shield against any disciplinary pressures from shareholders. Morgan et al. (2005) argue that powerful customers may make managers particularly aware of their interests, in which case the manager may gain a reinforced position with regard to shareholders. For example, NetworkCo, a data scanning company, established a separate unit and a formal system to track the CS of its 12 largest customers given that these customers accounted for the majority of the firm's revenue (Morgan et al., 2005). Hence, the satisfaction of these customers substantially reinforces the managerial position in the firm. Pagano and Volpin (2005) use a similar argument applied to employees and suggest that firms offer long-term labor contracts to improve employee satisfaction and thereby deter takeover threats. When they experience less pressure from financial markets, managers have fewer incentives to generate SV and more incentives to pursue their own private benefits. Moreover, managers can disguise a decrease in profits, which is actually due to private benefit extraction, as a consequence of implementing a policy aimed at satisfying customers.

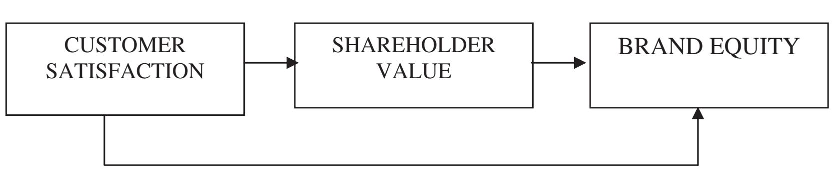

Fig. 1. Model.

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