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Customer satisfaction: Cost driver or value driver? Empirical evidence from the financial services industry

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ABSTRACT

We investigate the relation between customer satisfaction, customer servicing costs, and customer value in a financial services firm. We find that customer satisfaction is positively associated with future customer servicing costs, as well as with customer value. The relation between customer satisfaction and customer value appears non-linear; higher customer satisfaction appears to have a higher return for the most profitable customer segments. Our findings indicate that customer satisfaction is a value driver; however, customer satisfaction is not cost-free and managers have to consider the costs, as well as the benefits, of increasing customer satisfaction.

Introduction

Is customer satisfaction a cost driver or a value driver? A review of the literature reveals two conflicting viewpoints (see Anderson, Fornell, & Rust, 1997): one school of thought argues that increased customer satisfaction reduces costs, while the second argues that it requires additional costs. Therefore, prior literature is ambiguous regarding the question whether customer satisfaction is a cost driver or value driver. This issue is especially important in the (retail) banking industry, which is facing radically new challenges that may negatively affect the industry margins and profitability. Among the challenges faced are the advances in modern information and telecommunication technologies, which have resulted in changes in the cost transparency, service quality, customer retention rates, and in the commoditization of basic banking products.

In order to face these challenges, many banks focus on customer satisfaction as a key strategic value driver; we investigate whether this is a sensible decision at the individual customer level. The objective of this paper is to provide more detailed insight into the long-term relation between customer satisfaction, customer servicing costs, and customer value at the individual customer level in a financial services firm. Our study differs from previous studies by providing a more detailed analysis of specific cost and revenue components over a three-year and, thus, longer time period. After reviewing the literature and developing our hypotheses, we use a Dutch retail bank's unique dataset to empirically test our hypotheses.

Literature review

Customer satisfaction

Customer satisfaction may be regarded as a customer's response to consumption experiences (e.g. Oliver, 1997, p. 13). One of the pivotal definitional issues in the literature is whether satisfaction is best conceived as a transaction-based evaluation, or as an overall evaluation of a series of transactions. Traditionally, satisfaction has been viewed as transaction specific, an immediate post-purchase evaluative judgment, or as an affective reaction (Gupta & Zeithaml, 2006). In more recent studies of the relation between customer satisfaction and companies' performance, the focus of satisfaction is often (the long-lasting relation with) the company and not a single product from, or a single contact with, the company. For example, studies such as Anderson, Fornell, and Lehmann (1994, p. 54) consider satisfaction an 'overall evaluation based on the total purchase and consumption experience with a good or service over time'; that is, customer satisfaction is evoked by the customer's entire experience with the company. We therefore define customer satisfaction with a retail bank as a valenced state of mind, which the customer's experiences with the bank throughout time evoke.

Customer profitability and customer value

Customer profitability (CP) can be defined as the difference between individual customers' revenues and costs (Cooper & Kaplan, 1991). It measures customers' contribution to the firm profits. CP is of major importance for all commercial companies in the service industries, including the financial services industry. In the context of retail banking, customer revenues are, for example, provision

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revenues (associated with the purchase of financial products such as shares, bonds, or life insurance), annual service charges (such as the annual fees for checking and savings accounts), and interest revenues (the interest earned on savings accounts or mortgages). Customer servicing costs are, for example, transaction costs (the cost of providing the customer with the purchased product), contact costs (handling customer inquiries regarding financial products), and other overhead costs (including information technology costs, central service department costs, etc.). Finally, customer value (CV) refers to an individual customer's long-term profitability (Verhoef & Lemon, 2013; Chenhall & Langfield-Smith, 2007; Bayon, Gutsche, & Bauer, 2002; Gupta & Zeithaml, 2006).

Customer satisfaction and financial performance

There is considerable disagreement concerning the relation between customer satisfaction and financial performance (Anderson et al., 1997). Marketing literature generally suggests that a firm with high customer satisfaction should devote fewer resources to complaint management and field service recovery costs. In addition, satisfied customers tend to be loyal and willing to purchase more of the firm's services at higher prices. Finally, positive word of mouth from satisfied customers lowers the costs of attracting new customers; this benefit may manifest itself at the business unit or firm levels, but not at the individual level. However, the economics and operations management literature provides arguments to suggest that the pursuit of customer satisfaction increases servicing costs as it requires efforts to improve (perceived) service attributes, or the overall service delivery design.

Empirical studies in this area find mixed evidence of the relation between customer satisfaction and financial performance (for reviews see Blattberg, Malthouse, & Neslin, 2009; Kumar, Lemon, & Parasuraman, 2006; Luo & Homburg, 2007; Srinivasan & Hanssens, 2009; Gupta & Zeithaml, 2006). A first stream of studies investigates the relation between (changes in) customer satisfaction and (changes in) stock prices at the firm level. For example, Ittner, Larcker, and Taylor (2009) and Fornell, Mithas, Morgeson, and Krishnan (2006) find a positive association between customer satisfaction index scores and stock prices. However, Morgan and Rego (2006) find mixed results, depending on the customer satisfaction measure that is used. Jacobson and Mizik (2009), and Ittner and Larcker (1998) find evidence of customer satisfaction's value relevance in specific industries.

A number of other studies have investigated the relation between customer satisfaction and accounting performance in firms and/or business units (including sales growth, profitability and return on investment; see Luo & Homburg, 2007; Gupta & Zeithaml, 2006, p. 725 for a review). With regard to the financial services industry, Yeung and Ennew (2001) find a positive relation between customer satisfaction, contemporary sales, and operating profits. There is no positive relation with contemporary net profits. Similarly, Nagar and Rajan (2005) find that customer satisfaction has both positive and negative relations with accounting performance. Ittner and Larcker (1998) find that that there is an indirect increase in branch-level performance through growth in new customers. Increased profits from satisfied existing customers do not contribute directly to branch-level performance.

Few studies investigate the relation between customer satisfaction, customer servicing costs, and individual customer value. Helgesen (2006) investigates the relation between customer satisfaction and contemporaneous customer profitability in a sample of four Norwegian fishing companies. The results indicate that customer satisfaction is associated with customer profitability; however, the association is non-linear and certain thresholds have to be reached before an increase in customer satisfaction pays off. Niraj, Foster, Gupta, and Narasimhan (2008) find a positive and non-linear association between customer satisfaction and contemporaneous customer profitability in the US beverage industry. The results regarding the financial services industry are mixed: Lariviere (2008) finds a positive non-linear association between customer satisfaction and gross customer profitability in a Belgian financial services provider. On the other hand, Yu (2007) finds a positive association between several customer satisfaction measures, revenues, and costs in a Taiwanese retail bank, but no such an association with current and future (one and two years ahead) customer profitability.

Hypotheses

Customer satisfaction is not cost free (Anderson et al., 1997; Rust & Oliver, 2000). Prior literature (Lariviere, 2008; Niraj et al., 2008; Yu, 2007) suggests that higher customer satisfaction leads to higher customer demands. Financial services firms may face rising personnel costs in order to handle increased levels of customer information inquiries, customer contacts, and communication. Consequently, it is likely that associated contact costs and transaction costs will increase with higher levels of customer satisfaction. Product and facility-related overhead costs (IT-systems, internal auditing, product development costs, etc.) will remain relatively constant in the short run. In the long run, firms will have to keep investing in IT systems to remain competitive (Campbell & Frei, 2010); therefore, all customer servicing costs are likely to increase at the individual customer level in the long run. The line of reasoning results in the following hypotheses:

H1. In retail banking, customer satisfaction is positively associated with future customer servicing costs.

Some studies have found a positive association between customer satisfaction and profitability at the firm and business unit levels (for a review see Luo & Homburg, 2007; Gupta & Zeithaml, 2006, p. 725). It is unclear whether this relation also holds at the individual customer level in the financial services industry. One line of reasoning argues that higher customer satisfaction leads to higher customer demand, resulting in revenues that are higher than the associated customer servicing costs (Gupta & Zeithaml, 2006; Niraj et al., 2008). In addition, operations and production management literature suggests that highly satisfied customers generally have lower transaction costs (e.g. fewer returns and complaints, reduced maintenance costs, etc.; Niraj et al., 2008). However, it is unclear whether these advantages also manifest themselves in the financial services industry. Empirical evidence that Lariviere (2008) and Terpstra (2008) present suggests that customer satisfaction increases the gross profitability within a year; however, neither Lariviere (2008) nor Terpstra (2008) include the allocated overhead costs in their analysis. Ittner and Larcker (1998) suggest that, in the financial services industry, the advantages of higher customer satisfaction in one-quarter ahead's profitability is indirect through the growth in new customers and not directly through increased profits from existing customers. Similarly, Yu (2007) finds that increases in customer satisfaction do not increase customer profitability within a year. Based on this contradictory evidence, we posit our second hypothesis in the null form:

H2. In retail banking, customer satisfaction is not associated with future (i.e. one year ahead) customer profitability.