Global Journal of Finance and Management.
ISSN 0975-6477 Volume 6, Number 5 (2014), pp. 403-412

http://www.ripublication.com

Linking of Customer Satisfaction with Shareholders' value: A Review

Pankaj Kumar Singh[1], J.K.Pattanayak[2]

[1] *Department of Management Studies, Indian school of Mines, Dhanbad- 826004, Jharkhand, India*
[2] *Department of Management Studies, Indian School of Mines, Dhanbad- 826004, Jharkhand, India*

Abstract

Firms that do better than their competitors in terms of satisfying customers, generate superior return at lower risk. Satisfied customers are more loyal, less sensitive to price movements. The aim of this study is to examine the impact of customer satisfaction on shareholders' value creation. Customer satisfaction involves behavior of customers that typically relate to purchase or consumption of product or services. Theoretically, managers wish for a balanced performance on both the dimensions viz. marketing and finance as both the dimensions are reciprocal in nature. Customer satisfaction increases future cash flows and reduces their variability and thereby the shareholders' wealth gets maximized in the long run. With this backdrop, the present study identifies the linkage existing between customer satisfactions with shareholders' value maximization by taking into consideration the available literature in this regard.

Keywords: Customer Satisfaction, Shareholders' Value.

Introduction

Over the last two decades, the shareholders' value has become a widely used indicator for the success of a firm. Commonly, the shareholder value orientation is increasingly changing the methods of corporate decision making. As a result, marketing strategies along with any other management decisions are evaluated by their ability to enhance shareholders' value and no longer by traditional yardsticks such as market share, sales growth or return on investment [1]. On the other hand, customer satisfaction is a central idea in theory and practice. It is widely accepted that delivering products and services of high quality leads to customer satisfaction and in turn to higher profits. In order to improve the competitive position, most of the companies use some form of customer satisfaction programme in monitoring, developing and evaluating their products and services, formulate strategies to enhance satisfaction [2,3,4]. Srivastava et al., [1] identified that satisfied customers can be viewed as economic assets that yield future cash flow. It is a measure of the degree to which a product or service meets the customer's expectations. The objective of this paper is to provide the first extensive theoretical association between customer satisfaction and shareholders' value. However, prior to the identification of the theoretical association, it is highly imperative to analyze the basic concept underlying 'customer satisfaction' and 'shareholders' value creation'.

Customer Satisfaction

Customer satisfaction can help a business not only in keeping its customers, but also providing valuable insights into how to attract new customers. Customer satisfaction is one of the strongest indicators of customer loyalty and is important because:

- This drives repeat business even if there is a lower price on offer from competitors.
- Loyal customers come back more often to take up cross sell opportunity, and are more likely to try new products from the preferred supplier.
- Loyal customers are more likely to recommend a business's services.
- Customer profit tends to increase over the life of the retained customer.
- So customer satisfaction leads to the following activities:
- Repurchasing
- Cross selling
- Reducing price-sensitivity
- Generate positive word of mouth

Shareholders Value

A firm's market-based assets can enhance shareholder value by improving market performance through helping a product or service penetrate markets faster, getting price premiums, making brand extensions easier, lowering costs for sales and service, and/or obtaining higher customer satisfaction and retention [1]. Shareholder value is composed of the present value of cash flows during the value growth period and the long-term, residual value of the product/business at the end of the value growth period [5,6]. Better market performance based on superior market-based assets can accelerate and enhance cash flows, reduce volatility and vulnerability of cash flows, and increase the residual value of cash flows that, in turn, generate higher value for shareholders' [7]. Therefore, benefits generated by market-based assets are unique and essential to enhancing shareholders' value. The goal of the shareholder wealth maximization is a long term goal. Shareholders' wealth is a function of all the future returns to the shareholders. So in order to maximize the shareholders' wealth, managers need to link non- financial measures with the financial outcomes through the generation of sales revenues which maximize shareholders' wealth. Koller et al., [8] argue that companies create value by investing capital at rates of return that exceeds their cost of capital. The more capital they can invest, the more value they will create and as long as returns on capital exceed the cost of capital and faster growth will create more value. The concept of opportunity cost by highlighting that shareholder value is not created simply through positive stock returns or increased market capitalization; rather, it occur if a company's stock returns are higher than any returns the company's shareholder might receive from alternative investments of similar risk. Various researchers identified different methods for measuring shareholders value, which are enumerated below:

1. According to Fama [9], shareholders' value can be measured by measuring total shareholder return (TSR), which is computed as follows:

$TSR= (Price_{end\,-}\,Price_{begin\,+}\,Dividends) / Price_{begin}$

$Price_{end=}$ Share Price at the end

$Price_{begin\,=}$ Share price at the begning

2. The shareholder value analysis determine that whether the value of their holdings in a company are increasing, decreasing or have remained unchanged, i.e. total shareholder return, earning per share and market-to-book ratio. Earning per share (EPS) is a popular indicator of shareholders' return and can be defined as the net profit after tax divided by total number of shares in issue.

EPS = Net profit after tax/ shares in price

3. A firm can create wealth for their shareholders' by ensuring that the market value of the equity capital invested in a firm by shareholder exceeds the book value of equity. A firm may create value when market-to-book ratio is greater than 1.0 i.e. (M/B > 1), destroy value when market-to-book ratio is less than 1.0 i.e. (M/B < 1), and sustain value when the market-to book ration is 1.

4. Economic Value Added: The central idea in most organization is to tie managerial compensation to measure of financial performance that is linked closely to change in shareholders' wealth. In theory this should motivate managers to maximize shareholders' value , thus effective measures of value creation should be linked with definition of value creation and in that connection, a measure that has already created a niche in the corporate world is the concept of 'Economic Value Added' or EVA [10]. EVA is a highly sophisticated tool of financial management covering all functions of financial management; starting from capital budgeting, acquisition pricing to strategic planning and shareholders' communication, apart from identifying shareholders' value addition by the enterprise during a specific period [10].

The basic computation of EVA is based on the basis rationale of subtracting cost of capital from earnings:
EVA = Economic Earning – (Economic capital employed x required rate of return on capital employed)

Literature Review

According to some available studies, research justifies the connection between customer satisfaction and shareholders' value creation. It has been observed that satisfies customers are more loyal, less sensitive to price movements, and more likely to engage themselves in positive word of mouth behaviors [11,12,13]. Thus, the firm experiences less volatility and risk associated with present and anticipated cash flows [14,15,16]. Lower volatility facilitates investment decisions that maximize a firm's value. Further, loyal and satisfied customers increase the firm's bargaining power with other stakeholders, such as suppliers, and enable the firm to demand specific investments that generates lower costs and risk, faster market penetration, and improve financial results [11]. However, beyond certain levels, customer satisfaction may exert a negative impact on shareholders' value. Firms whose managers focus mainly on satisfying customers may lose their competitive advantage because they neglect the interests of other stakeholders, to the determinant of their financial results [17]. Morgan et al., [18] influenced that customers may make managers particularly aware of their interests, in which the manager may gain a reinforced position with regard to shareholders. A growing body of empirical work supports the fundamental logic that customer satisfaction should positively influence customer retention [14,19]. It is argued that by increasing retention, customer satisfaction secures future revenue and reduces the cost of future customer transactions, such as ones associated with communications, sales and services [20,21]. It is reasonable to assume that companies with well established and profitable long term relationships generate higher future cash flows than companies with weaker, short-term customer relationships. As a consequence net cash flows should be higher, resulting the reduction of the variability of cash flows over time, which may reduce the firm's cost of capital and creates shareholders' value. Additional satisfaction-driven customer behaviors that are likely to influence shareholder value include buying more of a particular product or services from a given supplier, buying additional products and/or services, making recommendations to others, and increasing price tolerance. Customer satisfaction has been shown as positively impacting operating margins [22,23] accounting returns [24] returns on investment [25] and cash flow and shareholders' value [11,16]. It can be seen as an essential measure used to oversee business outcomes, decide on limited resource allocation, and provide rewards to management [25]. For the majority of firms, the pursuit of customer satisfaction is illustrated in their communications, including advertisements, public relations releases, and mission statements [26]. Considering the importance, a variety of marketing academics and practitioners have studied customer satisfaction for the past forty years and have defined and measured customer satisfaction in many different ways. Prominent among them i.e Oliver [27], who has identified customer satisfaction as pleasurable fulfillment; such as, the consumer views consumption as satisfying some needs, desire, goal, etc in which its fulfillment is pleasurable.

Relationship between and Customer satisfaction and shareholder value

At present, research studies have been undertaken by different researchers worldwide in identifying how deliver of high quality goods and services influences profitability through customer satisfaction [9,25]. A growing body of theoretical work supports the fundamental logic that customer satisfaction should positively influence the customer retention [14,19]. It is argued that by increasing retention, customer satisfaction increases and thereby reduces the cost of future customer retention [20,21]. Greater customer satisfaction indicates a more stable customer base that provides a predictable source of future revenue. Thus customer satisfaction should positively affect shareholders' value by reducing the volatility and risk associated with anticipated future cash flows. Satisfied customer always purchases more and thus reduces the transaction cost and increases revenue.

Recommendation and positive word of mouth from satisfied customers are also expected to enhance the shareholders' value. In principle positive word of mouth should lead to lower acquisition cost and thus may lead to increase net cash flow [10,20]. Additional satisfactions driven customer behaviors that are likely to influence shareholders' value include buying more of a particular product or service from a given supplier. Customer satisfaction should lead customers to purchase more requirements from the supplying firm [22]. A loyal and satisfied customer base provides a ready market for new add-on services or product line extensions. Srivastava et al., [7] suggest that market based assets such as customer relationship creates value for customers and thus result in improved market place performance and increased shareholders' value.

Numerous studies could find a positive relationship between customer satisfaction and profitability. With the help of drivers of shareholder value, one can establish the relationship between satisfaction and shareholders value. The drivers of shareholders value are

1) An acceleration of cash flow;
2) An increase in the level of cash flow;
3) Reduction in risks associated with cash flows;
4) Higher residual value;

Repurchase and Shareholders' Value

Customer satisfaction leads to repurchases [14,20,29]. The continuous repurchase of company's product by the customer gives a stable relationship between customers and firms. Through customer experience the company is significantly lowering down the relationship costs. Furthermore, cost for acquiring new customers decrease and as a result shareholders' value increases. In addition, the stable customer base can enhance the firm's shareholder value in a multiple ways [1]. The faster acceptance of new products by loyal customers accelerates market penetration and cash flows. A large stable customer base reduces the volatility of cash flows. The lower volatility of the cash flows also leads to a lower cost of capital and thereby to an enhancement of cash flows. Finally, customers' loyalty enhances the residual value of the firm through size and quality of the customer base.

Cross-selling and shareholders' value

Customer satisfaction leads to cross-selling [30,31]. The enhanced cross-selling has two effects. First the total sale of the company grows and markets can be penetrated faster because customers who have become loyal are responding better to a firm's marketing efforts [1]. The extra sales increase cash flows and reduce their volatility. A faster market penetration accelerates cash flows and therefore also enhances shareholders' value.

Lower price sensitivity and shareholders' value

Satisfied customers are less price sensitive [9,32]. The lower price sensitivity increases the willingness of the customers to pay for the benefits they receive. Furthermore, satisfied customers are more tolerant to price increases. Finally, they are less susceptible to price reductions of competitors. Customer satisfaction – through lower price sensitivity – therefore increases cash flow and boosts shareholder value.

Word of mouth and shareholders' value

Finally, customer satisfaction also leads to positive word of mouth [33,34]. Positive word of mouth can significantly enhance the effectiveness of marketing communication and therefore lower acquisitions costs for new customers, which increases a firm's cash flow. The enhanced effectiveness of market communication also enables a firm to penetrate markets faster, which accelerates cash flows. Word of mouth can also contribute to improve a company's reputation, which leads to an augmentation of its residual value [35]. In literature, numerous empirical studies that investigate the relationship between customer satisfaction and profitability can be found.

Conceptual Framework

With the help of above discussion we develop a conceptual model between customer satisfaction and shareholders' value.

Fig. 1. Relationship between customer satisfaction and shareholder value

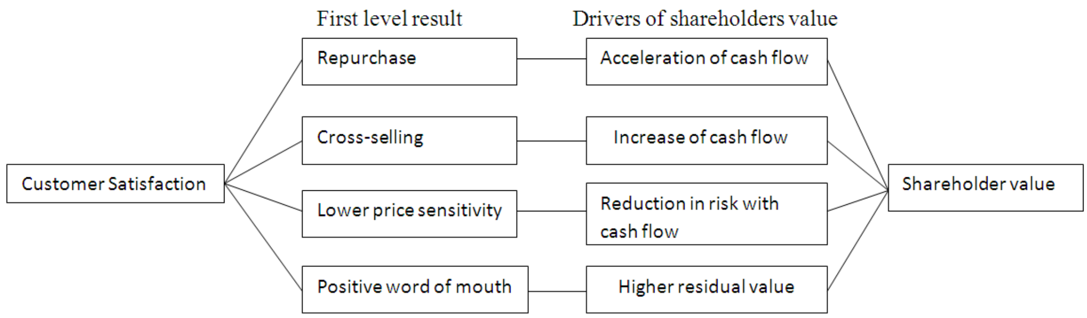

Fig. 1 A conceptual model of the relationship between customer satisfaction and shareholder value (Adopted from Matzler Stahl, 2000)

Figure 1. Illustrates the relationship between the variables. On the left hand side, the consequences of customer satisfaction are shown (First level) which are related to outcome that are directly influence the drivers of shareholders value. The outcomes of satisfaction make a link to the drivers of shareholders value. The repurchase behaviour of customer accelerates the cash flow of the business and thereafter enhances the shareholder value. Cross-selling behaviour of customer increase the base of cash flows that also increases the value of the shareholder. Lower price sensitivity is one of the good characteristic of satisfied customer. As a result, companies reduce the risk with cash flows. The reduction in risk with cash flows increases the value of the shareholders. Positive word of mouth plays an important role when the matter comes regarding shareholder value enhancement [36]. Positive word of mouth gives higher residual value and thereafter enhances the shareholder value.

Conclusion

We believe that the above paper makes an important contribution in the area of customer satisfaction and shareholder value creation. From a theoretical perspective, we try to find out the outcomes of satisfaction and link that satisfaction with the drivers of shareholder value. We developed a link between the four outcomes namely repurchase, cross-selling, lower price sensitivity and positive word of mouth with the drivers of shareholders value. It is important for the academics and managers to recognize not only that firm's tactics and strategies affect customer judgment of such satisfaction, but also the heterogeneity in the market assets.

Managerial Implications and Future Research

From managerial point of view it is vital to know how many resources should be devoted to customer satisfaction programmes. It is reasonable to assume that customer satisfaction above a certain level does not yield additional returns. If companies exaggerate in satisfying customers, value is destroyed. Our framework raises a number of research issues. We need to empirically test the notion that, in those organization in which marketing has reformulated its strategies in terms of the contribution they make to shareholders' value, marketing has now greater voice. The question here is, even if marketing incorporates a shareholder value approach, will this be enough to increase marketing's influence? Finally, once marketing adopts a shareholder value approach, it shifts from being a specialist activity to an integral part of the general management process. To do this, marketers need to extend their skill base to add expertise in modern financial planning technique.

References

[1] Srivastava Rajendra K, Shervani T, Fahey L. *Market-based assets and shareholder value: a framework for analysis.* The Journal of Marketing 1998; 62(1):2-18.
[2] Matzler K, Bailom F, Hinterhuber H, Renzl B, Pichler J. *The asymmetric relationship between attribute-level performance and overall customer satisfaction: a reconsideration of the importance–performance analysis.* Industrial Marketing Management 2004; 33(4):271-277.
[3] Matzler K, Pechlaner H. *Guest satisfaction barometer and benchmarking: Experiences from Austria.* Journal of Quality Assurance in Hospitality and Tourism 2001; 2(3-4):25-47.
[4] Fornell C. (2002). CFI Group. Marketing News 2002; 41.
[5] Day, George, Fahey L. Value Market Strategies. Journal of Marketing 1988; 52(July):45-57.
[6] Rappaport A. *Creating Shareholder Value.* New York: The Free Press 1986.
[7] Srivastava Rajendra K, Tasadduq A. Shervani T, Fahey L. *Marketing, Business Processes, and Shareholder Value: An Organizationally Embedded View of Marketing Activities and the Discipline of Marketing.* Journal of Marketing 1999; 63(Special Issue):168-79.
[8] Koller, Goedhart, Wessels. Valuation, 4th edition, John Wiley & Sons 2005; INC.Part One, Chapters 1-3.
[9] Fama E, Malkiel B. *Efficient Capital Markets. A Review of Theory and Empirical Work.* Journal of Finance 1970; 25(2):383-417.
[10] Pattanayak Kant J. *An integration of Economic value added and Balance scorecard concepts for effective Strategic management.* Das and Parmanik (ed), Economic Value Added, Deep and Deep Publication 2009; 29-50.
[11] Anderson Eugene W, Claes F, Sanal Mazvancheryl K. *Customer Satisfaction and Shareholder Value.* Journal of Marketing 2004; 68(4):172-185.

[12] Brady MK, Robertson CJ. *Searching for a consensus on the antecedent role of service quality and satisfaction: an exploratory cross-national study*. Journal of Business Research 2001; 51(1):53-60.
[13] Matzler K, Hans H, Christian D, Maximilian H. *The Relationship between Customer Satisfaction and Shareholder Value.* Total Quality Management 2005; 16(5):671-680.
[14] Anderson Eugene W, Sullivan M. *The antecedences and consequences of customer satisfaction for firms.* Marketing Science 1993; 12(2):125-143.
[15] Berger PD, Eechambadi N, George M, Lehmann DR, Rizley R, Venkatesan R. *From Customer Lifetime Value to Shareholder Value Theory, Empirical Evidence, and Issues for Future Research.* Journal of Service Research 2006; 9(2):156-67.
[16] Gruca, Thomas S, Rego L. *Customer Satisfaction, Cash Flow, and Shareholder Value*. Journal of Marketing 2005; 69(3):115-130.
[17] Luk C, Yau OHM, Chaw RPM, Tse ACB, Sin LYM. *Stakeholder orientation and business performance: the case of service companies in China.* Journal of International Marketing 2005; 13(1):89-110.
[18] Morgan N, Anderson Eugene W, Mittal V. *Understanding firms' customer satisfaction information usage.* Journal of Marketing 2005 (July); 69:131-51.
[19] Bearden, William O, Jesse Teel E. *Selected determinants of consumer satisfaction and complaint reports.* Journal of Marketing Research 1993; 20(1):21-28.
[20] Fornell C. *A national customer satisfaction barometer: The Swedish experience.* The Journal of Marketing 1992; 56(1)6-21.
[21] Rust Ronald T, Zahorik A, Timothy L. *Return on quality (ROQ): Making service quality financially accountable.* The Journal of Marketing 1995; 59(2):58-70.
[22] Bolton, Ruth N. *A Dynamic Model of the Duration of the Customer's Relationship with a Continuous Service Provider: The Role of Satisfaction.* Marketing Science 1998; 17(1):45-65.
[23] Rust Roland T, Zahorik A, Timothy L. *Service Marketing.* Addison-Wesley Pub Company 1996.
[24] Ittner, Christopher D, David F, Larcker. *Are Non-financial Measures Leading Indicators of Financial Performance? An Analysis of Customer Satisfaction.* Journal of Accounting Research 1998; 36(1):1-35.
[25] Anderson Eugene W, Fornell C, Lehmann Donald R. *Customer satisfaction, market share, and profitability: findings from Sweden.* The Journal of Marketing 1994; 58(3):53-66.
[26] Peterson Robert A, Wilson W. *Measuring Customer Satisfaction: Fact and Artifact.* Journal of the Academy of Marketing Science 1992; 20(1):61-71.
[27] Oliver Richard L. *Satisfaction – A Behavioral Perspective on the Consumer.* New York: McGraw-Hill 1997.
[28] Reichheld Frederick F, Sasser W. *Zero defections: quality comes to services.* Harvard Business Review 1990; 68(5):105-111.

[29] Anderson Eugene W. *Customer Satisfaction and Word of Mouth.* Journal of Service Research 1998; 1(1):1-14.

[30] Bolton, Ruth N, Prasanna K, Matthew D, Bramlett. *Implications of loyalty program membership and service experiences for customer retention and value*. Journal of Academy of Marketing Science 2000; 28(1):95-108.

[31] Rust Ronald T, Zahorik A, Timothy L. *Return on Quality (ROQ): Making service quality financially accountable.* The Journal of Marketing 1995; 59(2):58-70.

[32] Hallowell, Roger. *The relationships of customer satisfaction, customer loyalty, and profitability: an empirical study*. International Journal of Service Industry Management 1996; 7(4);27-42.

[33] Homburg C, Schafer H. *Cross-selling and their impact in satisfaction: A financial approach towards FMCG product*. Marketing ZFP 2002; 24(1):7-26.

[34] Krishnamurthi, Lakshman, Sethuraman P. *An empirical analysis of the relationship between brand loyalty and consumer price elasticity*. Marketing Science 1991; 10(2):172-183.

[35] Zeithaml Valarie A, Berry Leonard L, Parasuraman A. *The behavioral consequences of service quality*. The Journal of Marketing 1996; 60(2):31-46.

[36] Buzzell, Robert D, Bradley T, Gale. *The PIMS Principles*. New York: The Free Press 1987.