Increased Customer Satisfaction Increases Stock Prices

Research by
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Most business managers understand intuitively that satisfied customers are the key to a business’ long term success. Changes in a company’s customer satisfaction should be a leading indicator of changes in their expected earnings, which are then reflected in stock prices. So if the stock market was efficient, news about an improvement in a company’s customer satisfaction scores should increase the company’s stock price.

That is not the case, according to recent findings by a team of researchers led by Claes Fornell, Donald C. Cook Professor of Business Administration at the University of Michigan, that included Sunil Mithas, assistant professor of decision and information technologies at the Smith School. In their paper, “Customer Satisfaction and Stock Prices: High Returns, Low Risk,” the authors show that markets do not react to news related to customer satisfaction, making it is possible for investors to generate high returns with low risk by incorporating customer satisfaction scores in their stock trading strategy.

The paper describes a hypothetical paper portfolio and an actual stock portfolio. The trading strategy employed to manage these portfolios was based on customer satisfaction of companies as measured by the American Customer Satisfaction Index (ACSI). Trading decisions such as long and short positions were made based on ACSI levels and changes. Long positions were taken in companies with high and increasing ACSI scores. Short positions were taken in companies with low and deteriorating ACSI score. No other type of data or additional information was considered in developing these trading strategies.

Both the paper portfolio and actual stock portfolio outperformed the Dow Jones Industrial Average and the S&P 500 over a period of 4 to 6 years. Customer satisfaction pays off in up-markets and down-markets. When the stock market grew, the stock prices of many firms with very satisfied customers grew even more; when the market dropped, customer satisfaction seemed to provide a certain amount of insulation.

If there is such a strong correlation between customer satisfaction and market equity, and if people intuitively believe this to be so, why don’t more investors make investment choices based on customer satisfaction information? It is possible that investors believe an improvement in customer satisfaction scores may actually be detrimental to their interests, as a company could be giving away too much for the price it is charging its customers.

Equity analysts, then, should look at customer satisfaction scores while conducting their research and ask marketing-related questions during investor meetings and conferences. They should also closely study customer satisfaction trends for a company and incorporate that information into their research and recommendation-making process.

Apart from the obvious implications for portfolio managers, these findings have significant implications for marketing managers and information officers. In a previously published paper Mithas and his co-authors showed that customer relationship management (CRM) applications increase a company’s knowledge about its customers, and that increased knowledge allows the company to provide better services. This in turn improves customer satisfaction. The current paper has shown that increased customer satisfaction is a leading indicator of higher stock prices.

“These findings are valuable because they demonstrate that intangible capital such as customer satisfaction matters because it impacts stocks prices.”

KUDOS

Edwin A. Locke, professor emeritus of management and organization, has won the James McKeen Cattell Fellow Award from the American Psychological Society. He received the award at APS 18th Annual Convention, May 25-28, 2006. Locke is the most published organizational psychologist in the history of the field. His pioneering research focused on work motivation and job satisfaction, and he is best-known for his publications on goal-setting theory. His 1976 chapter on job satisfaction continues to be one of the most highly-cited pieces of work in the field.

Violina Rindova, associate professor of management and organization, and J. Robert Baum, associate professor of management and organization, have been selected as Ongman Center Research Fellows in Entrepreneurship for the 2006-2007 Academic year. This research fellowship is meant to encourage and recognize research in entrepreneurship. Rindova will be a guest editor of a special research forum for the Academy of Management Review titled “Dreaming, Discovering and Creating: The Visions and Costs of Entrepreneurship.”

Ritu Agarwal, Dean’s Chair of Information Systems, Anil Gupta, , Ralph J. Tyser Professor of Strategy and Organization, and Robert Kraut of Carnegie Mellon will be guest editing a special issue of Information Systems Research on the “Interplay between Digital and Social Networks.”

Gupta and Ken Smith, professor of management and organization, are serving as guest editors for a special issue of Academy of Management Journal focusing on the topic of “Managing Exploration and Exploitation” with Chris Shalley of Georgia Tech, Susan Taylor, professor of management and organization, and Paul Tesluk, associate professor of management and organization, are serving as guest editors for a special issue of Organization Science focusing on the topic of “Innovation at and across Multiple Levels of Analysis.”

Soeren Hvidtjaer, assistant professor of finance, will be a distinguished speaker at the European Financial Management Association, Milan, Italy.

Wolfgang Jank, assistant professor of management science and statistics, and Galit Shmueli, assistant professor of management science and statistics, have been named guest editors for a special issue of the journal Statistical Science on “Statistical Challenges and Opportunities in Electronic Commerce Research.”

Janet Wagner, associate professor of marketing, delivered a seminar on service marketing to the CIT, Cornell’s Information Technology Service.