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FORETHOUGHT CUSTOMER SERVICE

# Beating the Market with Customer Satisfaction

by Christopher W. Hart

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# Beating the Market with Customer Satisfaction

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If you're looking to boost customer satisfaction, one of the most promising places to start is customer service. Unfortunately, it's also a place where long-term goals tend to buckle under short-term financial pressures. Companies try to meet Wall Street's immediate demands by cutting costs through automation and outsourcing—despite a growing body of research conclusively showing that customers are fed up with lousy service and that increased satisfaction has a positive impact on consumer spending, cash flow, and business performance.

In a groundbreaking 2006 study, University of Michigan business professor Claes Fornell and colleagues showed the relationship between customer satisfaction and financial success by creating a hedge portfolio in which stocks are bought long and sold short in response to changes in the American Customer Satisfaction Index (ACSI). Developed by the University of Michigan's National Quality Research Center, the ACSI is an indicator of economic success that reflects levels of customer satisfaction with goods and services purchased from about 200 companies in more than 40 industries; it's based on interviews with more than 65,000 U.S. consumers each year.

Collectively, as the exhibit "Why Service Matters" demonstrates, the companies with high customer-satisfaction scores have blown the S&P 500 out of the water, especially over the last few years. Not only have they produced higher stock returns, but their stock values and cash flows have been less volatile.

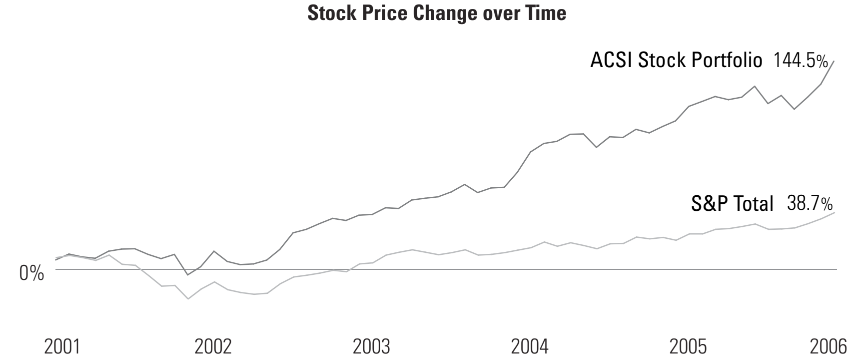
How are these results possible, given efficient-market theory, which says you can't consistently outperform the market? It's because today's stock valuation methods fail to incorporate the kind of information that forms the basis for making stock trades in the ACSI portfolio. If they did, the ACSI portfolio would closely track the S&P 500.

Customers' attitudes improve or deteriorate as people notice consistent quality differences. Changes in companies' customer satisfaction scores don't happen overnight; they have to work their way through complex value chains that ultimately affect quarterly profits and stock prices. (This accounts for the modest performance difference between the ACSI portfolio and the S&P 500 in the study's early years.) As the ACSI companies have attained higher levels of customer satisfaction and the laggards have been sold short, the fund's performance has significantly improved. A decrease in Home Depot's ACSI score, for instance, led the fund to sell the DIY retailer's stock short—and that was consistent with the company's poor financial performance and downgrades by stock analysts, even before the current housing downturn added to the company's woes.

The implications of the ACSI study will differ from one company or industry to another. In businesses with long purchasing cycles, like life insurance and durable goods, changes in customer satisfaction will take a while to make a difference in a company's sales, ability to increase prices, and so on. (After all, how often do you need to replace your dishwasher?) In many service-intensive industries, however, if a

**Why Service Matters**

A study of 200 companies shows a clear correlation between higher levels of customer satisfaction and higher stock prices.



company's customer satisfaction increases, customers will be quick to adjust their behavior and tell other people, whose own purchase behavior is also likely to change quickly.

What's more, in a recent study of the personal computer industry using data from PlanetFeedback.com, I found that problems with service had a much larger effect than problems with the products themselves on customers' likelihood to recommend a brand. Since service calls involve direct interaction between companies and their customers—and customers do the work of initiating contact, expressing a strong desire to solve their problems—such calls elicit more immediate and vocal reactions than do the product problems that stimulated them.

Now that this market inefficiency has been exposed, business leaders—especially CFOs—have a responsibility to seriously question decision-making criteria that result in stronger short-term earnings but could weaken customer attitudes and relationships. The stakes are high. Leaders who do not actively work to increase customer satisfaction will be responsible for damaging their companies' future earnings and shareholder value.

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