Customer Satisfaction Underappreciation

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Abstract

Customer satisfaction contributes to firm financial performance, but does it contribute to top executives' pay? Our empirical evidence shows that it may not be the case. Customer-satisfying executives tend to have lower pay than their productive peers, even if both satisfaction and productivity strategies contribute to firm financial performance. Thus, customer satisfaction is underappreciated, which may result in both less societal welfare and also worse company performance. We propose a board myopia mechanism to account for this phenomenon. In facing short-term financial performance pressure from investors and the asymmetric information availability between accounting-based and market-based assets for compensation decisions, the board of directors may be myopic, underappreciating executives who invest in market-based assets such as customer satisfaction that drive long-term returns. We examine this satisfaction underappreciation phenomenon empirically using 23 years of panel data that detail firm productivity, customer satisfaction, firm financial performance, and executive compensation. The longitudinal data are analyzed using fixed-effect panel models and a simultaneous system of dynamic panel vector autoregression equations augmented with interactions to assess the direct effect of firm financial performance and its carryover effect to executive compensation across executives who are productive, customer-satisfying, or both. The results confirm that customer-satisfying executives are underappreciated: being productive is financially rewarding for both firms and executives, while being customer-satisfying is financially rewarding for firms but not as much for executives. We further demonstrate that using total shareholder returns to benchmark firm financial performance and reward executives with a higher proportion of stock compensation can encourage a long-term focus that alleviates this customer underappreciation.

Keywords. Customer satisfaction underappreciation; board myopia, productivity; firm financial performance; executive compensation; interacted dynamic panel VAR model

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