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RESEARCH BRIEFS

MOTIVATING CEOs TO FOCUS ON CUSTOMER SATISFACTION: IS LONG-TERM COMPENSATION THE ANSWER?

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RESEARCH QUESTIONS

In recent years, the financial value of customer relationships has received more attention from senior executives, who increasingly tend to see customer satisfaction as a valuable corporate intangible asset. Finding ways to encourage senior executives to build customer–firm relations and improve customer satisfaction, however, has been challenging. What incentives should firms employ to motivate CEOs to enhance customer satisfaction and thereby improve firm value? And what are the related mechanisms for doing so?

A recent study by Xueming Luo (University of Texas at Arlington), Jan Wieseke (Ruhr-University Bochum), and Christian Homburg (University of Mannheim), helps answer those questions. Their study examines two routes of influence that firms can use when designing appropriate executive compensation structures aimed at raising firms' customer satisfaction and market value.

The first route calls on *external marketing* to implement actions that build customer–firm relations. Luo and his colleagues conjecture that increasing the proportion of CEO long-term equity-based compensation will positively influence corporate engagement in long-term customer relationship management. Actions that build customer–firm relations should, in turn, improve customer satisfaction and ultimately raise firm value. Indeed, the "tone at the top"—often used to describe CEOs' focus on financial matters, such as quality financial reporting and effective control systems—also applies to marketing efforts aimed at "knowing the customer," including efforts to establish effective customer service departments that respond quickly to customer complaints.

The second route of influence involves *internal marketing,* expecting that long-term equity-based CEO compensation will encourage actions to build employee–firm relations that positively affect customer satisfaction and firm value over time. Here the state of employee morale, internal communications (followed by actions that "walk the talk"), and performance-based salaries all contribute to employee attitudes toward the business and its customers.

Both of these "marketing routes" use organizational actions to positively influence customer satisfaction—a key leverage point for raising sales, profits, and firm value. The external route specifies direct firm efforts to improve customer satisfaction, while the internal route focuses on building those employee behaviors and attitudes that facilitate improved customer satisfaction. Furthermore, Luo and his colleagues proposed that the strength of the effects of CEO compensation structure on corporate actions to build customer and employee relations depends on market instability. Unstable markets often feature rapidly changing customer demands, short product cycles, and fierce market competition (Dobni & Luffman, 2003). So in unstable markets, firms may have a greater need to motivate CEOs with compensation structures that build effective long-term customer–firm relationships as competition for customers becomes more intense and customers tend to be less bound to suppliers. Finally, Luo and his colleagues proposed that changes in corporate actions to build customer– and employee–firm relations positively influence changes in firm-specific customer satisfaction measures. Those changes in customer satisfaction partially explain the associations between changes in corporate actions to build customer—and employee—firm relations and changes in firm market value, making customer satisfaction a channel whereby CEO long-term equity compensation can affect firm market value.

STUDY DESIGN AND METHOD

Luo and his colleagues compiled a unique dataset from several archival sources to study their research questions. For CEO compensation data, the authors drew from Standard & Poor's Execu-Comp dataset, pulling comprehensive compensation information on more than 1,500 publicly traded firms. To assess the strength of corporate actions to build long-term customer–firm relations and long-term relations with internal employees, the authors turned to the Kinder, Lydenberg, Domini & Co. (KLD) multisource dataset. And finally, for customer satisfaction data, the authors used the ACSI database, a national barometer of customer satisfaction (Fornell et al. 1996) developed by the National Quality Research (NQR) Center at the University of Michigan.

To mine the data, Luo and his colleagues developed a system of equations to simultaneously test the associations between long-term equity-based CEO compensation, actions to build customer and employee relations, customer satisfaction, and firm value.

KEY FINDINGS

This study developed and documented a framework predicting that (1) increases in the proportion of CEOs' equity-based compensation positively influence customer and employee relations; (2) such influences should be stronger in unstable markets; and (3) actions that build customer and employee relations affect firm value both directly and indirectly via customer satisfaction. The most important conclusion is that if firms can properly design top executive packages to focus on long-term organizational goals and rally the entire organization to assure product quality and safety, create consumer welfare, and deliver customer value, then they can achieve higher shareholder value.

CONCLUSION AND IMPLICATIONS

This study makes several meaningful contributions to the overall long-term versus short-term quandary often confronted by management. First, it conceptualizes and tests the vital role of CEO compensation structure as a key corporate governance policy fostering customer satisfaction. This approach advances the customer satisfaction literature by examining the reasons behind customer satisfaction. Specifically, Luo and colleagues found that when coping with low customer satisfaction, owners and shareholders should examine the elements of the CEO's compensation structure that might be part of the problem.

Second, this investigation aids in understanding the distinct paths of influence, based on internal and external relationship building. It finds that corporate actions fostering customer– and employee–firm relations are key intermediate processes in the quest to boost overall customer satisfaction. It also extends the relationship marketing and market orientation literature by finding that firms can, through appropriate incentives, motivate CEOs to stimulate organization-wide actions that cement the healthier relationships with customers and employees that can achieve higher firm value. Echoing the notion that "top management factors, a communication–action gap, and employee *esprit de corps* affect customer responses and business performance," Luo and his colleagues argue that firms should use long-term incentive instruments to motivate their CEOs. After all, CEOs set the tone for the entire enterprise—they play a key role in stimulating organizational actions that lead to superior firm value by assuring product quality and safety, creating consumer value, and taking better care of employees.

Third, the study offers a theoretical framework that examines how practices of customer relationship management (CRM) and top management compensation affect firm performance. Extending prior research on the direct link from CEO or CRM variables to firm performance, Luo and his colleagues' sequential framework suggests that a long-term equity-based pay structure at the top affects organizational conduct and, through resulting actions, has a far-reaching impact on customer satisfaction and market performance outcomes.

To the extent that a long-term equity-based compensation structure for the CEO influences customer relationship development and firm value, this study helps practitioners gain a broader understanding of the role of proper incentives for top management. Shifting to more long-term equity-based compensation (vs. short-term fixed pay and bonuses) should help firms motivate CEOs to promote the development of customer and employee relationship management systems that will improve firms' customer satisfaction and financial value. These kinds of management systems are particularly important in unstable markets, where steering a course through "challenging waters" requires an increased focus on customer and employee relations.

Managers are undoubtedly concerned with how the "return" on customer satisfaction relates to the financial impact of investing in customer relationships. Although satisfying employees and customers is costly, industry practices provide ample evidence of the need to satisfy more profitable customers and—like Sprint, Verizon, Comcast, and AT&T—move money-losing customers to other suppliers. Many firms, such as Cisco, tie employee compensation to customer satisfaction so that workers are rewarded for excellence in internal marketing performance. Overall, the results of this study point to customer satisfaction as an important metric for tracking the financial payoffs to building employee–firm relationships and the fruits of crafting sound equity-based executive incentive packages.

SOURCE

Luo, X., Wieseke, J., & Homburg, C. (2012). Incentivizing CEOs to build customer– and employee–firm relations for higher customer satisfaction and firm value. *Journal of the Academy of Marketing Science, 40,* 745–758.

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