Corporate Governance and Customer Satisfaction

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Abstract

Customer satisfaction is one of the most important aspects of firm performance. Although extant research has explored various antecedents to customer satisfaction, no research has investigated whether corporate governance affects customer satisfaction. This paper is the first empirical study that explores the relationships between board composition and customer satisfaction. Using secondary data of 163 public firms, we find that CEO duality is associated with low customer satisfaction. However, we do not find a significant association of the percentage of outside directors to customer satisfaction.

Key words: Corporate governance, board, customer satisfaction

Introduction

Due to the separation of principal and agent, the primary function of a board is to ensure the decisions and behaviors of top executives serve the best interests of shareholders (Finkelstein &D'Aveni, 1994). Over the past two decades, corporate governance research has steadily become one of the mainstream research themes in strategic management. Extant research has examined a variety of associations of corporate governance practices to financial performance (Peng, 2004; Rechner& Dalton, 1991), R&D investments (Baysinger, Kosnik, & Turk, 1991), corporate fraud (Dunn, 2004), and corporate entrepreneurship (Zahra, 1996; Zahra, Neubaum, &Huse, 2000). Customer satisfaction is an important organizational outcome.

The success of a business depends on whether it creates a satisfied customer (Drucker, 1974). A great deal of marketing research has found positive effects of customer satisfaction. Satisfied customers tend to repurchase more (Brady & Cronin 2001), spread positive words about the focal firm(Swanson, 2003) and financial performance (Fornell, Mithas, Morgeson, & Krishnan, 2006; Luo, 2007). For example, Luo and Homburg (2007) suggest that due to the increasing availability of customer service information, not only customers but also job seekers are able to learn more about a firm's customer service, from which they make inferences about the firm's management and corporate cultures. Based on such inferences, job candidates make their employment decisions. They also find that a high level of customer satisfaction helps save investments in adverting and promotion. Relatedly, empirical evidence suggests that customer dissatisfaction hurts firm performance.

Luo (2007) finds that in the U.S. airline industry, when dissatisfied customers complain to Department of Transportation against an airline, the stock price of that airline declines dramatically. He finds Southwest Airlines would suffer a loss of $262 million from stock market if it experiences a 1% increase in DOT complaints. Despite the importance of customer satisfaction, no corporate governance research has investigated its association with board composition. The purpose of this paper is to fill this knowledge void by examining the effects of outside directors and CEO duality on customer satisfaction.

Hypothesis

Outside Director

Outside directors refer to the board members that are not employed by the firm. Agency theory suggests that a board's effectiveness in monitoring managers is influenced by a board's independence (Dalton, Hitt, Certo, & Dalton, 2007). Boards dominated by outside directors are believed to be more independent than boardsdominated by inside directors, thus more effective.

A stream of empirical research has investigated the effects of outside directors. Yet, the findings are mixed and inconsistent. Chen, Firth, Gao, and Rui (2006) finds that in China, outside directors are more effective in preventing corporate frauds than inside directors. But, in a recent meta-analysis, Deutsch (2005) finds that the outsider director ratio is positively related to debt intensity, takeover defenses and CEO turnover, but negatively related to R&D expenditure. Such mixed findings suggest previous studies need to examine the intermediate links between outside directors the effects of outside directors on firm performance. In the context of this study, we explore the relationships between outside directors and customer satisfaction.

Provision of quality service to create and retain satisfied customer involves substantial organizational commitments that are associated with strategic controls from the board instead of short term financial controls. Baysinger et al. (1991) and Zahra (1996) find that outside directors have a negative impact on R&D investments and corporate entrepreneurship, because outside directors tend to focus less on strategic measures of firm performance than inside directors. Thus, we propose

Hypothesis 1: The percentage of outside directors is negatively related to customer satisfaction.

CEO Duality

CEO duality occurs when a CEO is also the chairperson of the board. Since one of a board's primary functions is to monitor the top executives, CEO duality may lessen its monitoring effectiveness.

Scholars have investigated the effects of CEO duality on different aspects of organizational performance. Despite the impressive amount of research on CEO duality, the majority of research does not report systematic and consistent findings. For example, Dalton, Daily, Ellstrand, and Johnson(1998) do not find significant effects of CEO duality on financial performance. Uzun, Szewczyk, andVarma, (2004), Beasley (1996), and Chen et al., (2006) do not report findings that suggest a separate leadership structure is effective in preventing corporate frauds.Dalton et al., (2007:15) note "agency perspectives related to separating the CEO from the board chairperson remain decidedly unsettled". In line with previous research, we propose

Hypothesis 2: CEO duality is not significantly related to customer satisfaction.

Methods

Data Collection and Measures

The data of customer satisfaction were collected from the American Customer Satisfaction Index (ACSI), which is widely used in customer satisfaction research (Fornell, Johnson, Anderson, Cha, & Bryant, 1996; Fornell, Mithas, Morgeson& Krishnan, 2006; Fornell, Rust, &Dekimpe, ; Luo& Bhattacharya, 2006; Luo& Homburg, 2007). The ACSI surveys customers of more than 200 companies in 44 industries.

We collected data pertaining to board composition from Hoovers.com, where board information was compiled from SEC filings for 2009. We applied two criteria in sample selection. First, if a diversified company appeared in more than one ACSI industries, then that company was removed from the sample. Second, private companies were removed from the sample, because their board information is not publically available. This procedure resulted in a sample of 163 companies included in our analyses.

Measures

Customer satisfaction: We used ACSI scores on a 0-100 scale.

Outside directors: This variable was operationalized as the percentage of outside directors on a board. An outside director was identified when a director was not currently employed by the focal company.

CEO duality: A firm with CEO duality was coded “1”. Otherwise, it was coded “0”.

Control variables: We used firm size and board size to control for firm and board effects. As for firm size, we used natural logarithm transformation of sales revenues of the focal firms in 2009. Board size was operationalized as the number count of board members. Both control variables were collected from Hoovers.com.

Analysis and Results

Table 1 provides a summary statistics of and correlations between the key variables in this paper.

Table1. Descriptive Statistics and Correlations

	Mean	SD	1	2	3	4
1,Customer Satisfaction	76.22	6.92				
2, Firm size (log)	9.64	1.28	0.37			
3, Board size	11.60	3.01	0.01	0.48***		
4, Outside director (%)	0.83	0.14	-0.03	-0.05	0.12	
5, CEO duality	0.56	0.50	-.017**	0.22	0.02	0.21***

No. of observations=163; *** $p < 0.01$, ** $p<0.05$, * $p < 0.1$

We used hierarchical regressions to test our hypotheses with Stata 11. Table 2 presents the regression results. Model 1 is the base model that includes the two control variables—firm size and board size. To test hypothesis 1 that predicts a negative relationship between outside directors and customer satisfaction, we added outside directors in Model 2. As shown in Model 2, hypothesis 1 was not supported because the percentage of outside director was not significantly related to customer satisfaction. To test hypothesis 3 that predicts nonsignficant effects of CEO duality on customer satisfaction, we included CEO duality in Model 3. Interestingly, the results show that CEO duality has a significant negative relationship with customer satisfaction. We used ‘test’ procedure in Stata and found the change in R^2 was significant. We also used ‘VIF’ function in Stata to test multicollinearity and found the VIF score was below 10. Thus, multicollinearity did not become an issue for our analyses.

Table 2: Hierarchical Regression Analysis Results

	Model 1	Model 2	Model 3
Firm size (log)	0.24	0.44	0.53
Board size	-.04	-0.10	-0.15
Outside director (%)		-1.51	0.05
CEO duality			-2.08**
Constant	74.31***	75.65***	75.23***
R^2	0.00	0.00	0.03

No. of observations=163; *** $p < 0.01$, ** $p<0.05$, * $p < 0.1$

Conclusion

This exploratory study investigates the relationships between board composition and customer satisfaction. We relied on secondary data of 163 to test our hypotheses. We do not find outside directors have a significant impact on customer satisfaction. Yet, we find CEO duality is negatively related to customer satisfaction such that a separate leadership structure increases customer satisfaction.

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