**THE INTERACTION OF OWNERSHIP STRUCTURE AND CUSTOMER
SATISFACTION AS DETERMINANTS OF BRAND EQUITY[†]**

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ABSTRACT

In this paper we study the interaction between ownership structure and customer satisfaction, and their impact on a firm's brand equity. We find that customer satisfaction has a positive direct effect on brand equity but an indirect negative one, through reductions in ownership concentration. This latter effect emerges when managers are focused mainly on satisfying customers. It gives out a warning signal that highlights the perverse effect of implementing policies focused excessively on satisfying customers at the expense of shareholders, on a firm's brand equity. We demonstrate our theoretical contention, empirically, making use of an incomplete panel data comprising 69 firms from 11 different nations for the period 2002-2005.

Keywords: Corporate social responsibility, Brand equity, Ownership structure and Customer satisfaction.

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1. INTRODUCTION

Mühlbacher *et al* (2006) define brands as complex social phenomena where different stakeholders have a role on creating brand value. This point of view departs from the traditional perspective that relies on a market orientation and considers managers as individuals, who are focused mainly on customers and being competent, in order to define value-maximizing firm's strategies. Recently, some authors have begun to recognize such limitations and have proposed a wider perspective that integrates different stakeholders (Greenley *et al.*, 2005). Stakeholders provide different types of resources to a firm thereby enhancing its value. Remarkably, customers and shareholders are the only stakeholders that provide financial capital to the firm hence we may expect that they are relevant in enhancing a firm's value. For customers, this is confirmed by Anderson *et al.* (2004) relying on the reduction of risk future cash flows volatility in the case of customer loyalty. Also, Mittal *et al.* (2005) connect customer satisfaction (CS) and long-term financial performance. For shareholders, there is a wide amount of literature based on the seminal paper of Jensen and Meckling (1976) that shows the connection between shareholders' commitment and firm's value. In this paper, we put together customer satisfaction and shareholder satisfaction, proxied by ownership concentration (OC), and we study this relationship, as well as their impact on brand equity as a performance measure (Keller, 1993).

Our principal finding is that both dimensions are very closely connected. Therefore, a manager aiming to improve a firm's brand equity cannot implement marketing tools that affect one stakeholder without considering the effect on the other. More specifically, costly customer-targeted marketing policies may lead to satisfied customers consolidating their linkages with the firm. However, shareholders may consider a strategy focused mainly on satisfying customers as managerial entrenchment (Cespa and Cestone, 2004). Entrenched managers may satisfy customers' interests in

order to protect themselves from the disciplining pressure of shareholders. In such a situation, existing shareholders may be less interested in the firm and will reduce their stake. This reduction in the ownership concentration may also be interpreted negatively by eventual new investors who prefer firms with visible shareholders (blockholders). Hence a firm's brand equity is affected negatively. We have found that this negative effect appears for large values of CS and may far outweigh the positive direct effect of CS on brand equity. Hence, a manager should contemplate customers as well as investors in order to maximize a firm's brand equity.

Using our results, we can also question several methods of improving customers' loyalty by bundling a firm's products and shares. Also, we can put several workers' compensation packages under the spotlight; these combine discounted prices on products with option-like schemes that transfer shares. Although capable of turning workers into satisfied customers, these packages may have a negative impact on brand equity value through reductions in the OC.

2/ THEORETICAL FRAMEWORK.

We set out the following model:

[Insert Figure 1 about here]

2.1 The interaction between customer satisfaction and ownership concentration

2.1.1. From shareholders to customers .

The presence of blockholders in concentrated ownership structures generates trust in customers based on their credibility and/or easy recognition (Power and Whelan, 2006). Identifying with the organization may also enhance the support and commitment from other stakeholders (Chernatony and Harris, 2000) and along with it CS. We find the same type of connection from OC to CS in papers that study the linkage between ownership structure and corporate social performance (CSP), of which CS is a relevant component. Neubaum and Zahra (2006) find that long-term institutional owners, who are generally controlling blockholders, affect a firm's CSP positively. Barnea and Rubin (2005) argue that large blockholders may fully benefit from being associated with

large CSP. This will stimulate the implementation of socially responsible actions that will lead to CS.

Hypothesis 1: There is a positive impact of OC on CS.

2.1.2. From customers to shareholders .

We can provide different arguments justifying such a connection. First, firms whose managers follow a market-oriented perspective, focusing mainly on satisfying customers, may lose their competitive advantage by neglecting the interests of other stakeholders which, in turn, will affect financial results detrimentally. However, this kind of strategy may be in the interests of a manager who pursues private benefits extraction that erodes profits, because he can canvass support from customers, as an entrenchment strategy to shield him from the disciplining pressure of shareholders.¹ Moreover, the manager can even disguise the decrease in profits linked to private benefits extraction as the consequence of implementing a policy aimed at customer satisfaction. In such a situation, blockholders will be less interested in the firms in which they have a shareholding, and will reduce their stake which, in turn, leads to a reduction in the ownership concentration. An example may be enlightening: when Coca Cola tried to change the flavor of Coke in 1985, some customers organized in pressure groups to agitate against such a change. The mass media also leaned in favor of customers given that Coke was considered an icon of the American way of life. Finally, the CEO of Coca Cola (Roberto Goizueta) decided to maintain both the classic coke as well as the new one; the latter was withdrawn from the market couple of years later. This was a very costly decision for Coca Cola and a major marketing flop that should have cost Goizueta his post as CEO. However, he avoided being fired by justifying such a move based on to customer satisfaction. Not surprisingly, investors were not satisfied with such an outcome and penalized Coca Cola shares and some institutional investors decided to reduce their stakes in the company, thus, diminishing the OC. In this example Goizueta

¹ Pagano and Volpin, 2005 use the same argument for workers' satisfaction as an entrenchment mechanism.

used CS as an entrenchment mechanism to avoiding being fired and the final outcome was a reduction in ownership concentration.²

A second channel through which customers and investors are connected emerges when those customers who are particularly satisfied with a firm's products may be inclined to go a step further and become shareholders of that firm. We argue that the decision to become a shareholder can be considered a latter stage of an *internalization* process (Festinger, 1953), when customers are increasingly identified with corporate image and in the extreme they want to be owners of that image.

On other occasions, the linkage from CS to OC is stimulated by the firm itself by bundling products with shares. This may happen when loyal customers receive shares directly from the firm (e.g. Puleva, a Spanish food company); and when workers get shares as part of their compensation package in addition to discounted prices for a firm's products. The outcome of this process where customers become shareholders –by their own volition or by bundling- should lead to a reduction in the ownership concentration as customers are generally small investors.

Hypothesis 2: There is a negative impact of CS on OC.

2.2. Financing Channel: Connecting ownership structure to brand equity

The presence of blockholders has different effects on a firm's value. One effect is connected directly to investors' decisions on financial markets. The other effect is indirect, through the aforementioned impact on CS which, in turn, also affects a firm's value.

With regard to the direct financing channel, the presence of blockholders has an ambiguity effect on a firm's value. On the one hand, large blockholders may expropriate minority shareholders and destroy value (Shleifer and Vishny, 1986; Thomsen and Pedersen, 2000), whereas on the other, the presence of large blockholders hinders the value-reducing agency problems linked to managerial

² See http://en.wikipedia.org/wiki/New_Coke.

opportunistic behavior (Shleifer and Vishny, 1989). The results from both effects are not clear. However, we expect that for listed firms –all those in our sample are listed firms–, when blockholders increase their stake, they will have a greater inclination to expropriate, because they generate private benefits, rather than implementing costly monitoring tasks to control managers. Moreover, listed firms may delegate the monitoring tasks to the financial markets (cross-monitoring hypothesis, Booth, 1992). Hence, we hypothesize a neutral or a negative direct impact from OC to brand equity

Once we focus on the indirect channel, we expect a positive impact, through CS, on a firm's brand equity. On the one hand, in Hypothesis 1, we present different arguments suggesting a strong positive connection from OC to CS; on the other hand, CS has an overall positive impact on a firm's brand equity resulting from the loyalty of satisfied customers, as discussed below.

From this discussion, we expect that the indirect positive effect connecting OC to brand equity outweighs the direct negative –or neutral– one. This defines our third hypothesis (see Figure 2):

Hypothesis 3: There is a positive indirect effect from OC to brand equity through CS because OC affects CS positively and the latter has an overall positive effect on brand equity. Also, OC has a neutral or a negative effect on brand equity, giving rise to a positive overall effect.

[Insert Figure 2 about here]

2.3 Customer channel: Connecting customer satisfaction to brand equity

Companies consider CS as the main strategy to gain loyalty and then customer retention. The more loyal the firm's customers, the less vulnerable it is from its competitors; this in turn, allows it to implement successful strategies to generate value (Anderson and Sullivan, 1993). CS is a major component of the broader concept of a firm's CSP. This is relevant because, according to the instrumental stakeholder theory (Jones, 1995; Donaldson and Preston, 1995), CSP is a mechanism for generating value. By behaving in a responsible way, firms obtain continued support from those stakeholders that are necessary to ensure access to valuable resources. This will improve their brand-equity value. Hence, we expect a direct positive connection from CS to a firm's brand-equity value.

However, as we state in Hypothesis 2, CS has a negative impact on OC and the latter, according to Hypothesis 3, has an overall positive impact on brand equity. This suggests the existence of an indirect negative channel connecting CS to brand equity through reduction in a firm's OC.

Finally, after we compare the arguments supporting positive direct effect with the negative indirect one, we expect that the direct effect will be more relevant for normal values of CS, while the indirect effect will appear mainly in more extreme values. Note that only when customers are very satisfied can the manager feel confident of being able to face the pressure from shareholders when the former extract private benefits that damage financial results. In such a situation the blockholders will reduce their stake. In the same vein, only those costumers that are particularly satisfied will become shareholders, thus reducing ownership concentration. Hence, we expect the direct effect to be superior to the indirect one under normal circumstances but this may not be the case for extreme values of CS. (see Figure 3).

Hypothesis 4: There is a strong direct effect from CS to brand equity as well as a negative indirect one resulting from reductions in OC that will appear mainly for large values of CS. Moreover, the overall effect is positive under normal conditions.

[Insert Figure 3 about here]

3. EMPIRICAL ANALYSIS

3.1. Sample and Data

Our sample is the result of crossing three databases. The first database, OSIRIS contains information on balance sheets that have been standardized to accommodate the wide variety of financial accounting practices across countries and industries. The second database, SiRi, is compiled by the Sustainable Investment Research International Company – the world's largest company specialized in socially responsible investment. Finally, we have used an additional database that gives information on brand equity. This is extracted from the list published yearly by Interbrand. The final sample is a panel data of 69 companies from 11 different countries for the period 2002-2005

3.2. Analysis

We have two types of hypotheses. First, Hypotheses 1 and 2 connecting both stakeholders -shareholders and customers- are tested through the following specification:

$$\begin{aligned} \begin{Bmatrix} Ownership_Concen \\ Customer_Satisf \end{Bmatrix}_{it+1} &= \mathbf{a}_1 + \mathbf{a}_2 \begin{Bmatrix} Customer_Satisf \\ Ownership_Concen \end{Bmatrix}_{it} + \mathbf{a}_3 Size_{it} + \\ &+ \mathbf{a}_4 (Leverage)_{it} + \mathbf{a}_5 (R \& D)_{it} + \mathbf{h}_i + \mathbf{e}_{it} \end{aligned} \quad (1)$$

We estimate in differences for preventing unobservable heterogeneity $\mathbf{h}_i$ from being correlated with the independent variables. Also, we have led the dependent variable by one period in order to prevent endogeneity problems.

We rely on the following specification to estimate the connections between CS and OC on a firm's brand equity (Hypotheses 3 and 4):

$$\begin{aligned} Brand_Equity_{it+1} &= \mathbf{b}_1 + \mathbf{b}_2 (Ownership_Concentration)_{it} + \mathbf{b}_3 (Customer_Satisfaction)_{it} + \\ &+ \mathbf{b}_4 (Size)_{it} + \mathbf{b}_5 (Leverage)_{it} + \mathbf{b}_6 (R \& D)_{it} + \mathbf{h}'_i + \mathbf{e}'_{it} \end{aligned} \quad (2)$$

As mentioned earlier, we also estimate in differences in order to prevent $\mathbf{h}'_i$ from being correlated with the independent variables. Further, we have led the dependent variable by one period so as to avoid endogeneity problems. Departing from specification (2), when we use one of the variables, OC or CS, but not both, we study the overall effect of each variable on brand equity. However, when we put both variables together, as shown in specification (2), we study the direct effect of each variable on brand equity. That is, we are detracting from each independent variable, the indirect effect due to the other independent variable. Finally, we include in the specifications a variable of size (the number of employees on a log scale) because it affects a firm's performance and visibility (Ullman, 1985). Also we control by financial structure, -leverage, defined as debt-to-equity ratio- as the literature (Roberts, 1992; Waddock and Graves, 1997) shows that it is a classical determinant of performance. Additionally, we include a variable that captures the existence of intangible resources (the R&D expenditures per worker) which is a clear determinant of a firm's

comparative advantage (Russo and Fouts, 1997). Lastly, in the specifications we include temporal, sectoral and country dummies.

4. RESULTS.

An analysis of the results of the interaction between both channels (OC and CS) shows that OC has a positive impact on CS in the next period (coefficient 0.637, 1% significant) supporting Hypothesis 1; conversely, there is a negative impact of CS on the OC in the next period (coefficient – 0.101, 10% significant) thus supporting Hypothesis 2. These relationships will help to determine the kind of indirect connection between these two variables and brand equity.

The test of the connection between CS, OC and brand equity shows that OC has an overall positive impact on brand equity (coefficient 0.948, significant at 1% level). This is also true for CS (coefficient 0.120, significant at 5% level). Both results support Hypotheses 3 and 4 partially. In order to separate the direct effect from the indirect ones, as aforementioned, we include both variables OC and CS in the specification explaining brand equity -specification (2). The results show that OC has a direct negative effect on brand equity (coefficient -0.082, 10% significant), while CS has a direct effect (coefficient 0.046, 1% significant). Moreover, given the previous results connecting OC and CS (hypotheses 1 and 2), we can ensure: first, that OC has a positive impact on CS and the latter also has an overall positive impact on brand equity. This generates a positive indirect effect of OC on brand equity through CS that outweighs the direct negative one (coefficient -0.082, 10% significant) because the overall effect is positive (coefficient 0.948, 1% significant). This supports Hypothesis 3. Second, CS has an indirect negative effect on brand equity as it affects OC negatively and the latter has an overall positive effect on brand equity. Moreover, this negative indirect effect is lower than the positive direct one (coefficient 0.046, 1% significant) given that the overall effect is positive (the aforementioned coefficient 0.120, significant at 5% level), which conforms to Hypothesis 4.

Finally, it is worth emphasizing that the strong overall positive effect of OC on brand equity, (the aforementioned coefficient 0.948, significant at 1% level) is more significant than the one describing the impact of CS on brand equity (0.120, significant at 5% level). This means that even a small (negative) impact of CS on OC, may well have important effects on brand equity. This will be particularly evident when CS increases substantially as the result of a customer-focused strategy. In order, to explore this issue, we conduct an estimation of brand equity in terms of CS as well as its quadratic term, in order to inspect whether there are some non-linearities. We find that there is a concave relationship. More specifically, when CS has a value larger than the mean of the sector, then, the overall effect of CS on brand equity is negative. This suggests that the described negative indirect effect between CS and brand equity through OC is relevant for large values of CS and outweighs the positive direct one.

5. DISCUSSION AND CONCLUSION

In this paper we study the relationship between the two dimensions underlying brand equity. On the one hand, the value of a brand depends on the degree of customer s' satisfaction; whereas, on the other, it depends on shareholders' satisfaction. This latter is captured by a firm's ownership structure. We argue that both dimensions are interrelated and that a manager who wants to improve a firm's brand equity should take both of these into consideration and not only focus on customer-targeted marketing policies. This is important; although customer satisfaction has a direct positive effect on a firm's brand equity, there is also an indirect negative effect through reductions in ownership concentration. This happens when blockholders infer that a policy aimed at increasing customers satisfaction substantially is a managerial entrenchment strategy. Moreover, this latter indirect effect is relevant for large values of CS and may even outweigh the positive one

From our results we can provide some recommendations concerning a particular strategy of achieving customer loyalty by giving them shares - bundling-. Also we call into question workers' payment schemes that rely on transferring shares, together with offering discounted prices for a firm's

products, in order to stimulate workers into becoming satisfied customers. These may have affect brand equity detrimentally, due to the negative impact from reductions in ownership concentration.

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FIGURES

Figure 1

Figure 2

Figure 3