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Marketing: How does business debt affect firm value and consumer satisfaction?

September 23 2015

Feeling less satisfied with the businesses you patronize? It might be because those businesses are in a lot of debt. According to a new study in the *Journal of Marketing*, a company that has a lot of financial leverage—that is, a company that has a lot of debt in relation to its value—spends a lot less on advertising, which in turn decreases customer satisfaction.

"Surprisingly little research has been done on the effects of debt on marketing," write the authors of the study, Ashwin Malshe (ESSEC Business School) and Manoj K. Agarwal (SUNY-Binghamton). "That's surprising for a number of reasons, including the fact that companies with higher leverage tend to invest less in long-term, intangible assets—the very assets that have an impact on customer satisfaction."

To investigate the relationship between leverage and marketing and the effect of that relationship on customer satisfaction, the authors used a sample of 171 firms surveyed in the American Customer Satisfaction Index over seventeen years. They estimated a system of five equations and found that higher leverage leads to less advertising, which in turn results in lower customer satisfaction. The impact of leverage on satisfaction is economically significant. As the authors report, a one-standard-deviation increase in leverage from the average level results in a 0.47-point decrease in customer satisfaction, which is equivalent to an estimated loss of $26 million in net operating cash flows.

What's more, leverage negatively moderates the link between customer satisfaction and firm value. When firms are extremely highly leveraged, an increase in customer satisfaction can actually reduce the value of a firm. This happens because a high amount of leverage increases a high risk of bankruptcy, which can make it difficult for companies to realize the full value of a satisfied customer base in the future.

The study has several lessons for company managers. "Increased financial leverage can prevent marketers from realizing the full value of strategic opportunities embedded in customer satisfaction. Without that understanding, chief marketing officers are likely to overestimate the value implications of their marketing expenditures that help maintain and increase customer satisfaction," the study authors write.

More information: Ashwin Malshe and Manoj K. Agarwal. "From Finance to Marketing: The Impact of Financial Leverage onCustomer Satisfaction." Forthcoming in the *Journal of Marketing*. dx.doi.org/10.1509/jm.13.0312

Provided by American Marketing Association

Citation: Marketing: How does business debt affect firm value and consumer satisfaction? (2015, September 23) retrieved 25 April 2024 from https://phys.org/news/2015-09-business-debt-affect-firm-consumer.html

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