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Customer Equity Sustainability Ratio: A New Metric for Assessing a Firm's Future Orientation

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EXECUTIVE SUMMARY

Securitization is best-known in banking, but its use had been growing increasingly popular in diverse industries such as utilities, soccer clubs, non-profit organizations and even states. While previous research intensively deals with the unknown risks of securitizations, this research addresses another remarkable aspect of securitizations. They enable sellers to increase their short-term profits at the expense of the long-term value of their customer base. This ability might be tempting for firms, especially because this shift does not have to be made transparent to stakeholders and increases in short-term profits might be linked to higher variable compensations and higher dividends.

The authors show how their newly developed Customer Equity Sustainability Ratio (CESR) complements Customer Equity Reporting (CER) and creates more transparency about the consequences of securitization for future earnings and the riskiness of the underlying business model. CESR compares the future value of an existing customer base with current earnings. The authors illustrate that out of their sample of 38 banks from 10 different countries very few banks provide enough information in their financial statements to further determine the impact of securitizations on long-term value creation. They present in an empirical study of the former market leader in mortgage lending and origination in the United States, Countrywide Financial Corporation, that securitizations allowed this bank to realize 79.0% instead of just 32.7% of the profit of its contracted business in the same period.

They also show that CER and CESR easily detect this short-term profit realization over long-term value creation. Additionally, the authors outline the difficulties that other well-established performance ratios such as ROE, return on risk-adjusted capital (RORAC), and the securitization ratio provide. They also confirm the adequacy of CESR of creating more transparency for nine firms from non-banking industries.

In summary, the authors outline that the lack of transparency in current financial reporting about the long-term effects of securitization is unacceptable. CER and the CESR provide more transparency to stakeholders and demonstrate the financial stability of banks and firms. The authors recommend that marketing should not leave the field to finance and accounting; instead, it should emphatically assert its claim and provide stakeholders with substantial information about the long-term value of the customer base.

BIOGRAPHIES

Bernd Skiera is a Chaired Professor of Electronic Commerce at the department of marketing at the Faculty of Business and Economics at Goethe University Frankfurt, Germany, and a member of the board of the E-Finance Lab and the Retail Banking Competence Center at the House of Finance at University of Frankfurt. His research areas are customer management, pricing, online marketing (in particular search engine marketing) and prediction markets, with a particular focus on the financial service industry. He was a finalist for the Journal of Marketing’s 2008 MSI/H. Paul Root Award with the paper "Customer Equity – An Integral Part of Financial Reporting". His work has been published in, among others, Journal of Marketing, Journal of Marketing Research, Management Science, Marketing Science, Journal of Management Information Systems, Journal of Product Innovation Management, Journal of Service Research, and European Journal of Operational Research.

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