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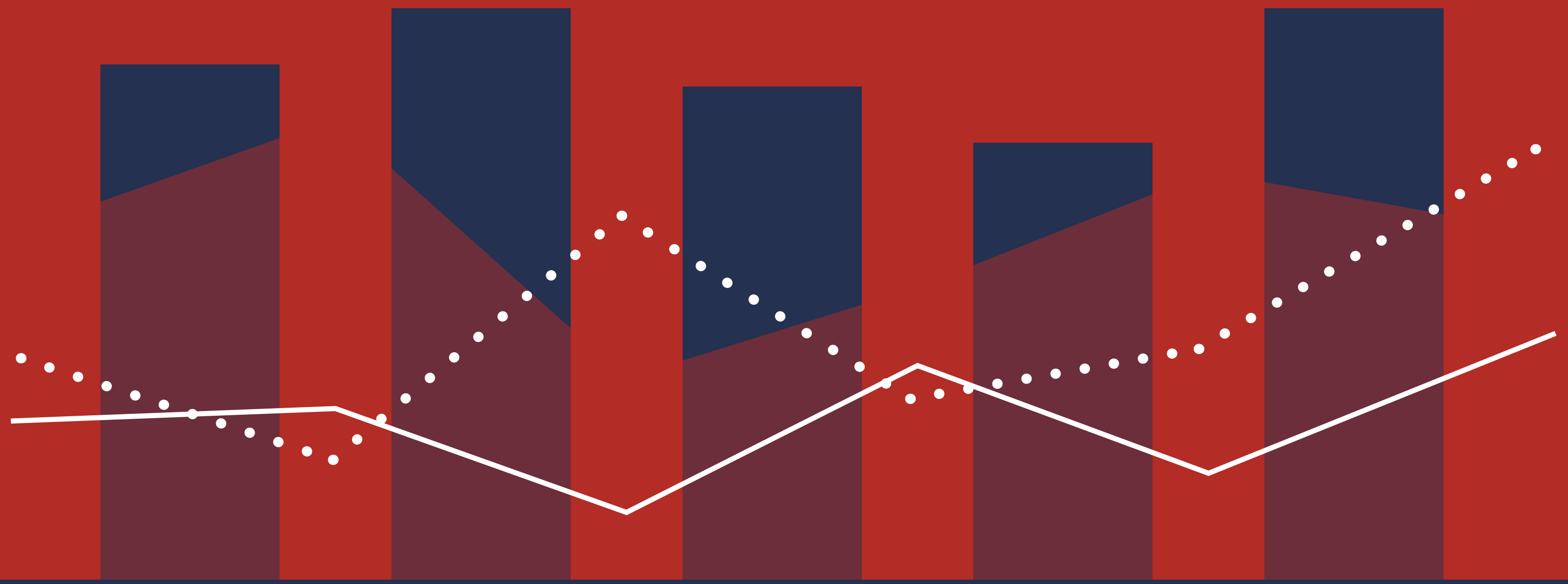

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Customer Satisfaction: An Organizing Framework for Strategy

By Shrihari Sridhar and Roger Best | 3.8.2021

Today's CEOs are under intense internal and competitive pressure to drive strategy in a way that grows sales, margins, and shareholder value. But frameworks like mission/vision/values statements, strength and weakness analyses, cataloging opportunities and threats, and budget-based approaches can lead executives to greenlight unrelated strategy initiatives that fail to improve their target metrics.

Customers are the most significant source of any company's cash flow, and customer satisfaction is the most reliable way for CEOs to increase sales and improve stock performance. Furthermore, executives can use customer satisfaction as an organizing framework for their overall strategy.

Customer Satisfaction and Value

Forty years ago, Richard Oliver showed customers were satisfied with a company's offerings when the firm met or exceeded the implied promise in its value proposition. Since Oliver's seminal 1980 paper in the Journal of Marketing Research, scores of studies, summarized in 2010 by Carly Frennea and Vikas Mittal, have shown satisfaction is the most reliable measure of customer value. Improving customer satisfaction increases customer repurchase, retention, and share of wallet. Satisfied customers offer favorable word of mouth and referrals, leading to increased customer acquisition—all of which grow company sales, margins, and EBITDA.

CEOs can use customer satisfaction as a fulcrum for their strategy framework. Douglas Bowman and Das Narayandas (2004) showed companies can build strategy by focusing on initiatives that truly satisfy customer needs. The researchers linked performance to various strategic areas, such as sales and bidding, product quality, product line breadth, and pricing, and showed companies must ensure their ongoing execution levers satisfy customer needs to enhance performance in each area. For example, sharing underlying pricing information satisfies the customer need for transparency.

The key to driving customer satisfaction and sales is understanding 80% of customer value accrues from just three to four strategic areas, as

Vikas Mittal and Shrihari Sridhar (2020) have shown.

Bowman and Narayandas implemented their approach for a major processed metals vendor. Linking satisfaction in each strategic area to overall customer satisfaction, the researchers found knowledgeable sales representatives and product line breadth were critical. The initiatives reliably increased overall customer satisfaction, as well as sales and margins, while initiatives like improving packaging did not.

Customer Satisfaction and Value-Based Market Segmentation

Almost every major company can organize its customer base into several distinct market segments, and CEOs can use satisfaction to target the right customers across segments.

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When CEOs try to grow their companies organically via product depth within an industry sector, they must remember customer satisfaction levels vary across offerings. Bart Lariviere and colleagues (2016) studied the link between customer satisfaction and shareholder value across 137 companies from 2000 to 2009. They found the link is especially low for companies selling durable products and services (e.g., shoe stores and cut-and-sew apparel manufacturers) because of the industries' short purchase horizons and extensive switching between preferred providers. Durable products CEOs should focus only on new areas where their firms can deliver the same customer value they offer in existing areas without incurring excessive additional costs.

Trying to add customers via new products, geographies, and industry sectors where a company's strategy framework cannot deliver superior value lowers the consistency of a firm's value proposition. Rajdeep Grewal, Murali Chandrashekaran, and Alka Citrin (2010) studied seven airlines from 1997 to 2005 and found increases in overall customer satisfaction improved financial performance. For example, Southwest Airlines enjoyed shareholder value growth by providing the highest customer satisfaction levels among the seven airlines in the late 1990s. The authors also found low customer satisfaction consistency (i.e., high customer satisfaction variance) hurt the airlines. As Southwest added more routes, larger planes, and performance-enhancing winglets in the early 2000s, the company ignored what customers wanted—punctuality and reliable onward transport. As a result, Southwest experienced a drop in shareholder value as its customer satisfaction consistency suffered.

Customer Satisfaction and Financial Market Response

CEOs can use customer satisfaction to communicate their companies' fundamentals to financial markets.

Increasing customer satisfaction enables CEOs to lower the cost of debt financing. With higher customer satisfaction, a company is more likely to retain customers and generate stable cash flow, signaling a lower default risk to debtors. In a study based on the American Customer Satisfaction Index, Eugene Anderson and Sattar Mansi (2009) examined 166 firms from 1994 to 2004 and found each customer satisfaction unit increase was associated with a 2% lower debt financing cost. In the first quarter of 2019, non-financial corporate businesses held $9 trillion of debt, with AT&T ($166 billion), Ford Motor Company ($100.7 billion), and General Electric ($95.2 billion) being some of the largest holders. For AT&T, reducing debt financing by 2% would have saved $99.6 million.

Brokerage firm analysts, investment bankers, and private researchers offer stock buy/hold/sell recommendations based on a firm's customer base quality, projected financial strength, and incremental product value. CEOs communicate their strategy through annual reports, earnings calls, and investor presentations in an attempt to garner favorable stock recommendations. A simpler way to show their companies' strength would be to improve customer satisfaction. Xueming Luo, Christian Homburg, and Jan Weiske (2010) tested the link between customer satisfaction and brokers' stock recommendations using companies from 24 industries from 1995 to 2006. They found improving customer satisfaction increased recommendations, reasoning satisfaction signaled robust future cash flows and profitability.

Summary

CEOs concern themselves with providing customers the best possible value, managing markets and segments to maximize profits, and improving stock market outcomes. And customer satisfaction provides executives a simple, practical framework to manage their goals.

Focusing on customer satisfaction enables CEOs to align their strategy and execution not only with the needs of their customers, but also with the expectations of their board and investors.

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