The COMPETITIVE ADVANTAGE of CUSTOMER CENTRICITY

USING CUSTOMER CENTRICITY TO DELIVER SUSTAINABLE SUCCESS

The COMPETITIVE ADVANTAGE *of* CUSTOMER CENTRICITY

USING CUSTOMER CENTRICITY TO
DELIVER SUSTAINABLE SUCCESS

by

Sathit Parniangtong

Printed and distributed by The Post Publishing Public Co., Ltd.
Bangkok Post Building, 136 Na Ranong Road, Klong Toey, Bangkok 10110, Thailand

National Library of Thailand Cataloging in Publication Data
Sathit Parniangtong

The Competitive Advantage of Customer Centricity—Bangkok :
Sasin Graduate Institute of Business Administration of Chulalongkorn University, 2553.
000 p.

1. Stratigic Planning 2. Competitive Strategy 3. Customer Servicing Strategy
1. Title
000.0

ISBN: 000-000-0000-00-0
750 Baht

Publisher:
Sasin Graduate Institute of Business Administration of Chulalongkorn University
Sasa Patasala Building, Soi Chula 12, Phayathai Road, Pathumwan,
Bangkok 10330, Thailand
Tel. +66 2218 4001-9
Fax. +66 2218 4036

Contents

Preface

How businesses generate profit has been an interest of mine for as long as I can remember. But what is more fascinating is the diversity of mechanisms that businesses in different competitive environments around the world use to compete. This probably explains why I so enjoyed more than a decade of working as a business strategy consultant in the US. The experience I gleaned from working with a wide range of firms operating across several regions gave me more perspectives on business operations than I would have previously dared to imagine. All of these companies confronted unique challenges but they shared a common journey in how to take their business forwards, be they the world's former largest automaker in Detroit, a telecom company in London, state-owned enterprises in Moscow and Beijing, transportation-related operators in New Zealand and South America, or any number of companies in my motherland, Thailand. Any market leader has to deploy strategies to maintain its dominant position. If a company is a follower, its management is preoccupied with developing breakthroughs to leapfrog the market leader. And a company is struggling to stay alive, the management dreams of generating positive cash flow and becoming self-sufficient. The means for achieving these various objectives is what strategy is all about.

Creating a roadmap for these companies requires analyses to gain insight into their unique strategic needs. In any case, many firms are in a rush to implement developments adopted by leading companies in the US. But this raising concerns over the portability of strategy, after all, a strategy that brings success to one company is not guaranteed to work for another, in extreme cases it could even result in disaster.

Becoming a professor at a business school, for me, was akin to being a child in a candy store. I found myriad fascinating disciplines and theories to explore in order to feed my intellectual curiosity. Not to mention the absolute freedom to delve deep into any specific fields of interest that took my fancy. There seems to be no end to how far I can go. But as I tried to comprehend certain academic articles I came to realize that many authors had abstracted themselves much further from reality than I believed was necessary. Determining how "far" is "too far", however, is better left to the judgment of individual academics.

It was when I was working with the world-renowned strategy guru, Michael E. Porter, on Thailand's National Competitive Advantage I saw how each new academic development in the field of business thinking required real world examples to substantiate it. The more examples you can cite, the more legitimate the theory seems. It is no wonder then, how over the years we have witnessed a raft of academics flood the field with retrospective theories on how certain companies have become successful (e.g., Southwest Airline, Wal-Mart, Microsoft). But very few dare to take their new theory and show how it can be practically applied to turn around sub-par companies. In the meantime, when business leaders confront critical operational issues they hire strategy consultants to deploy the latest discoveries with proven track records (e.g., best practices) to address the situation in hand. Yet, the two worlds do not always reinforce one another. For me, a sizable gap remains between the worlds of business and academia. If anything, the book attempts to bring these two worlds a little closer together.

This book offers some of the latest thinking on business strategy and shows how to put this thinking to work under in a number of different real world circumstances.

- It presents an overview on the evolution of theories and concepts of strategy. This overview is relevant to practitioners and it offers discussions on the limitations and applicability of these theories in the business world.
- This book lays down the latest strategic developments in customer centricity. It not only provides different perspectives on customer centricity but also outlines how to formulate strategy around customers.
- It details step-by-step approaches for formulating strategy, as practiced by leading consulting firms. While new strategy must be deployed when a firm experiences deteriorating performance, determining how to begin the process of developing a more effective way to compete too often remains elusive. Clarifying practical measures for doing so is what this book is all about.

- Strategy tools such as industry trend analysis, competitor analysis, five forces, value net framework, and SWOT analysis are analytical methods. The insight they provide does not automatically result in developing a more effective competitive strategy. In addition, strategy models such as Porter's generic model, experience curves, and the Growth-Share matrix, have all proven to be short lived as they are too generic for unique business situations. This book demonstrates ways to leverage analytical results and transform them into meaningful strategic outputs.
- Several examples and case studies garnered from the author's consultancy work are presented. Each chapter contains examples to illustrate the complexity executives are confronted by when having to address strategic issues. A process for deploying relevant analyses beyond the strategy tools mentioned is outlined to provide a new strategic direction.

Customer centricity is another highlight of this book. Many firms still have misconceptions over the concept despite it being more than half a century old. Too often customer centricity is seen as mere corporate gloss, with senior management remaining unconvinced of its elusive goal of enhancing the lifetime value of customers, and with most attempts to operationalize the concept kept within the narrow context of marketing. Customer centricity advocates valuing customers as a firm's most important assets, ones which need to be acquired, developed and cultivated to generate profit over the lifetime of their relationship with the company. By recognizing that not all satisfied customers will automatically become loyal customers, and that loyal customers are not always the most profitable, this book provides a comprehensive panoramic view of various customer management programs for enhancing customer profitability and equity as a new source of competitive advantage.

Three distinct views of customer centricity are presented. The classical approach to formulating customer-driven strategy; customer centricity viewed as a change journey that the entire company needs to take in order to realize more value from customer relationships; and a collaborative approach which engages all supply chain constituents to deliver more value to end-customers.

Who should read this book? This book is aimed at MBA students and business executives who are interested in putting new strategy concepts to work. Those who already have a handle on competitive strategy may be familiar with the content of the first two chapters. If you are a practitioner interested in formulating a customer-driven strategy, you should concentrate on chapters 3 and 4. Those who are looking to deploy the latest thinking on customer centricity and turn a product-centric company into a more customer-centric organization, then chapters 5, 6 and 7 should be your focus. Chapters 8 and 9 provide several ways for manufacturers to compete more effectively by creating more value for their customers.

Acknowledgment

My first debt of gratitude must go to all business leaders and executives who allowed me to participate in addressing the crucial issues confronting their organizations. It seems that the stakes are high and their jobs instead of getting easier, are, on the contrary, becoming increasingly more complex, more dynamic, and much larger in scope. Of course, addressing these issues head-on requires more than courage—it demands a drive and desire to achieve a new level of excellence, something to inspire these individuals to endure the intense mental and physical challenges that must be overcome. I hold a deep respect for all of these people who continue to make our life and this world a much better place to live in.

I would also like to thank Sasin Graduate Institute of Business at Chulalongkorn University for its support in giving me a work environment that is so conducive to writing this book. Having an opportunity to write this book is a dream come true for me. I have contemplated writing since I became a professor after years of working as a management consultant. The opportunity to work at Sasin made completing this book an easier task.

The book's origins are in consulting project reports, course packages, teaching notes and classroom materials I prepared for an advanced strategy course for second-year MBA students at Sasin Graduate Institute of Business Administration. This content has been updated to make it applicable for executive training as well. As such, I would like to acknowledge all of those who have contributed to discussions that have shaped this book.

This book is more than just new concepts and theories I have been recently exposed to as a faculty member. My past experience shaped my current thinking. I am extremely grateful to all those who have contacted with me during my time at Booz, Allen & Hamilton and AT Kearney, as well as the numerous business leaders

I have worked with throughout my consulting career. There were, at times, difficult and challenging moments, but I have learned a great deal through coming into contact with these visionary individuals. All of them have taken my abilities to a new plateau, one that I can never before have imagined. It is difficult to acknowledge all by name. But I am extremely grateful to everyone who has helped my professional growth.

With respect to the development of this book, I am particularly grateful to Professor Teomsakdi Krishnamara, Sasin Director, Khun Kittirat Na-Ranong, Deputy Director for Academic Affairs, for paving the way for the project; his direct guidance and continued support throughout the project are highly indebted. I would like to express my appreciation to my editors, Dan Ten Kate, Greg Lowe, and Rochell Powtong who were a tremendous help in making these ideas more easy for others to understand; Khun Wiboon Jaruwongwanich, our executive editor, who took time to read and comment on the manuscript; and Khun Thanaporn Julsukot, my assistant, without whom I would not have managed to get this done.

Finally, there is my family, particularly my wife, Botan, her support and positive energy were unstoppable; my two daughters, Beam and Beth, provided such tremendous inspiration to writing this book and kept me in touch with reality when I took things too seriously.

Chapter 1

Gaining sustainable competitive advantage

At the forefront of every CEO's mind is the question: "How do I make my company achieve a superior financial performance?" Superiority, whether measured in terms of profits, earnings and sales growth, returns on capital, investment or assets, is a relative concept. In this context, it means doing better than the previous quarter, the industry average, or rivals. Of course, it is every CEO's dream to build a track record of consistently achieving a superior financial performance. To do so, a company must produce products and services that uniquely benefit customers in the most cost-effective manner. Amid intense competition, companies that possess a sustained competitive edge generate superior financial performances.

A sustained superior financial performance is measured by year-in-and-year-out robust growth over previous periods—not a constant measurement. A commonly used measurement of this is the Compound Annual Growth Rate (CAGR). For example, a company with a CAGR of 12% in return on assets over say a 10-year period saw growth over the previous year throughout the decade. Each year, the growth rate may be more or less than 12%, but the average over ten years is 12%.

Is the concept of sustained superiority just a dream? According to Charles Darwin's survival of the fittest theory, "*In the struggle for survival, the fittest win out at the expense of their rivals because they succeed in adapting themselves best to their environment.*" If he is right, a company must learn to adapt to environmental changes and reconfigure its business model to sustain superiority. No company with a constant or rigid business model can achieve sustained superiority forever; the concept of "built-to-last" or "eternity" is simply unrealistic. Given this, is the loose interpretation of sustained competitive edge explained earlier realistic? If so, one must demonstrate that it is achievable.

Now let's consider some firms that have achieved a consistent superior financial performance. Microsoft[1] is often the most-cited example. Since it was created, the company has seen sales growth of 32%, operating profit growth of 36%, and net income growth of 35% in CAGR. Wal-Mart has sustained a return on equity of over 20% for more than 30 years while growing revenue a thousand-fold during the same period. Southwest Airlines is another. It has made a profit every quarter for 30 years, while other much larger airlines have all struggled to turn a profit at all.

A sustained superior financial performance can be measured two ways: the rate of growth on financial results, and the sustainability of growth (robust growth for at least 10 years or more). For most CEOs, keeping a close watch on quarterly financial reports is routine. But over time it is mind-boggling, since it is always "too little and too late" to fix a disappointing result. To substantially improve a company's finances, the CEO and his management team must come up with fresh ideas for earning new revenue streams from existing and new customers. For example, a mid-sized domestic bank will take at least six months to derive a new revenue stream from modifying existing products. Launching a new add-on product, such as a new lending scheme targeting college students, will take at least one year. Adding a new family of products into a new business domain requires a new growth platform that can take several years to develop and implement. Expanding geographically can take just as much time, if not more, depending on the scale of expansion. For these reasons, a CEO must have a dynamic game plan to formulate a winning value proposition, which is a product or service that customers want more than what's currently on the market. Let's call this the "game plan strategy."

Over the past few decades, academics, professional consultants, and business executives have been forging efforts to understand a fundamental business management question: "Why are some companies able to constantly generate superior profits than others?" The answer seems to lie in a company's "ability to better compete," which many people refer to as its "business strategy." Let's examine how the companies cited earlier compete. Wal-Mart[2], the world's largest private employer with 1.4 million employees, is known for deploying different store formats, including discount stores, super centers, neighborhood markets, and member clubs. At the same time, it relentlessly squeezes costs out of its supply chain by dealing directly with manufacturers, improving warehousing operation

[1] David B. Yoffie, Dharmesh M. Mehta & Rudina Seseri, Microsoft in 2005, HBR Case, January 9, 2006.
[2] Pankaj Ghemawat, Stephen Brady, and Ken Mark, Wal-Mart stores in 2003, HBS case, January 30, 2004

with "cross-docking,[3]" and investing in new technology such as Electronic Data Interchange (EDI) and Radio Frequency Identification (RFID) tags. Microsoft's strategy centers around dominating the market with a huge market share. It now holds a 90% share in Desktop Operating Systems and Office Suite Applications, and an 80% share in Internet browsers. Microsoft uses this market power to set standards by constantly upgrading its products and bundling them together so they are easier to use. Southwest[4] positions itself to attract cost-conscious customers. It established a unique culture that emphasizes an employee focus and operational discipline, which prompts employees to pitch in on tasks outside their job descriptions. More importantly, it democratizes air travel by finding a way to offer it cheaply to the masses. The secret was using one type of jets (Boeing 737), offering no meals for first-class passengers, and instilling customer friendliness, team work, and down-to-earth services—all while leveraging this unique culture to achieve rock-bottom operating costs.

Obviously one would like to believe that the continuing success of Southwest, Wal-Mart or Microsoft is by no means accidental. There must be a logical explanation for why these companies have become so successful. Academics and management consultants are constantly striving to find ways to explain the continuing success of these companies, formulate a theory around the findings, and apply it to other companies to become just as successful, if not more. This doesn't necessarily mean they will be able to explain all aspects of business success and rule out any cases related to pure luck or the entrepreneurial insight of great business tycoons. Surely many of these success stories are due to "dumb luck." But while luck helps, in my view "smart luck will always beat dumb luck." And understanding how firms succeed may lead to smart luck.

A firm is said to have gained a sustained competitive advantage when it is able to constantly generate a superior performance compared to its peers amid competition. This superiority is a result of its ability to create and capture value, and then sustain the superior value-creation process. A superior value creation happens at a specific point in time, while a sustained value creation is seen over a long period of time. In order for us to find out how firms continuously achieve a superior performance in a sustainable manner, we must first develop a common understanding of these two concepts.

[3] A practice where shipments on an in-bound truck can be directly transferred to an out-bound truck without having to store and retrieve goods.
[4] James L. Hasket, Southwest Airlines 2002: An Industry Under Siege, HBR Case, March 11, 2003

Economic value creation

When discussing business strategy, the term value comes up as often as the term strategy. In defining value, we must first understand that there are two different types of value—value to customers and value to shareholders. While in the field of marketing we often focus on creating more value to customers, strategists are more interested in creating value to shareholders. Customer value[5] defined as ratio of benefits of a product or service (adjusted for any associated risks) to price (including any cost to customers associated with obtaining the product or service, for example, cost associated with searching for the product). Therefore, a company may seek to increase customer value by increasing benefits to customers (or make customers perceive that the product or service has a higher value) and/or reduce price. Prevalent accounting adjustments to reported profitability can obscure true economic performance and lead to bad competitive choices. For example, changes in accounting procedure (e.g., accounted for certain expenses over several years instead of one-time expense report) can increase accounting profit without adding any value to customers—the company gain more profit without efficiently make the better use of its resource to create more value to customers. To avoid this, shareholder value is measured in terms of Return on Invested Capital[6] (ROIC). ROIC calculated as EBIT (Earnings Before Interest and Taxes) divided by Average Invested Capital (Total Assets less Excess Cash less Current Operating Liabilities). A company may seek to increase ROIC by increasing earnings and/or reducing costs of capital. The field of business strategy focuses on the former rather than the latter.

Increasing customer value may or may not automatically lead to more value to shareholders. Any attempt to increase the benefit of a product or service will increase cost and subsequently reduce profit. So, shareholder value[7] will increase as a result of a higher customer value only when the "increased benefits customers perceived" leads to a higher customer willingness to pay without a commensurate increase in cost-the company can maintain the same profit level without having to increase price. By the same token, when a company seeks to reduce price, if the demand is elastic, revenue should increase as a consequence. And if revenue increases more than offset the price reduction, profit should also increase. Consequently, EBIT and shareholder value should increase. From a business

[5] Customer value = Benefits realized from consuming company's offering/Price
[6] ROIC = EBIT (earning before interest and tax)/Average invested capital (total asset—excess cash—current operating liabilities)
[7] Value a firm delivers to its shareholders in terms of dividends and capital gains.

strategy perspective, we are interested in finding ways to increase shareholder value as a result of a higher customer value creation (see more of this discussion in a later chapter).

We must understand a company's value creation process[8] in order to formulate a new way for the company to compete. Regardless of what industry a company operates in, it will attempt to make money by acquiring something from suppliers, adding value to the materials, and then selling the modified product to buyers. The value created is said to equal the difference between the buyer "willingness to pay" and the supplier "opportunity cost." The buyer willingness to pay is dictated by the product's potential benefits. With perfect information, no buyer will pay more than what he will get in return from using the product. If anything, a smart buyer will try to pay as little as possible and avoid paying more than the product's perceived value. At the same time, no seller will sell the product for more than what it costs the buyer to produce. On the other hand, the seller will try as hard as possible to sell the product to the buyer at a price close to what the buyer perceives as its value.

In determining the buyer willingness to pay, let's say a buyer is interested in acquiring a certain quantity of product from a firm. The firm begins by giving away the product to the buyer free of charge. It will then take only a small amount of money away from the buyer. If only a little money is taken away, the buyer will see the situation as better than the status quo. In other words, the buyer can make more money on the product than the cost of raw materials. As the supplier charges the buyer more money to the point where the buyer realizes that the costs no longer justify the product's benefit, it will terminate the transaction. At this point, the amount of money that the buyer refuses to pay is its maximum willingness to pay.

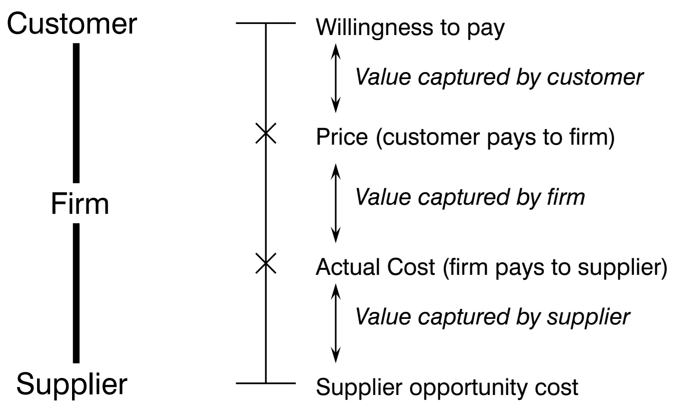
The other factor in the value-added[9] equation is the supplier's opportunity costs. Say a firm is interested in acquiring a certain resource from a supplier. The firm begins to take the supplier's resource and give money in return. The firm then slowly reduces the money it gives to the supplier. The amount of money that leads the supplier to realize it is no longer gaining a benefit from supplying the resource and terminates the supply contract is defined as the supplier's opportunity cost.

[8] Adam M. Brandenbuger and Harborne W. Stuart, Jr., "Value-Based Business Strategy," Journal of Economics & Management Strategy, Volume 5, Number 1, Spring 1996.

[9] Refers to additional value a firm adds to its customers and shareholders compared to competing firms.

The above examples make no mention of price, as the actual price is settled between the firm, the buyer and the supplier. In the real business world, the settled price reflects the outcome of the bargaining between all parties. Often the buyer will try to secure the lowest possible price it can get. Of course, the prices of competitors, substitution, and imitation can all affect a firm's ability to bargain. The difference between the settled price and the product's benefit is the value captured by the buyer. At the same time, the difference between the settled price for acquiring resources and the supplier's opportunity cost is the value captured by the supplier. The remaining value is captured by the firm, as is illustrated in Figure 1.1. A more detailed look at how a firm's procurement strategy can affect its ability to bargain is presented in a later chapter.

Figure 1.1 Economic Value Division



No firm can create economic value[10] in isolation. The firm can only create economic value when it completes a transaction with the buyer, and settles a transaction with the supplier. The other point worth noting is that even though all parties (the firm, buyer, and supplier) are involved in the economic value creation process, the created value may not be divided equally. How the created value is split up depends on the settled price reached through the bargaining power of the negotiating parties. In an ideal world of superior value creation, if a firm that possesses a unique value creation were to disappear, it would be difficult to find another identical firm to perfectly replace it (Figure 1.1). However, if the firm can be easily substituted, and no one misses it, then the company has little or no

[10] Refers to value a firm created to its customers and shareholders by means of economic value not of changing accounting procedures