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Customer-Centric Org Charts Aren't Right for Every Company

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The new conventional wisdom on corporate structure is that companies can do better by organizing themselves around customer groups. The logic sounds compelling: A *customer-centric structure*, as the approach is known, can help a company understand its customers better, develop deeper relationships with them,

and improve customer satisfaction. Some 30% of *Fortune* 500 firms, including Intel, Dell, IBM, and American Express, are already on board, and the numbers are growing all the time.

But customer alignment doesn’t work for everyone. Cisco and Xerox, for example, have seen poor results. And even when it does work, a company can go through years of poor performance before the benefits kick in. Is there a flaw in the logic?

Our analysis of *Fortune* 500 firms shows that the strengths of the strategy are real: Customer-centricity does allow divisions to focus on specific customer segments, and this narrower focus increases their knowledge of those groups. But it introduces greater complexity into communication and decision making and leads to duplication of certain functions across divisions. Details of the competition and of customer segments determine whether the positives outweigh the negatives, and years can pass before customer-centricity bears fruit.

We’ll show how companies can use our findings to estimate whether—and when—a customer-centric structure is likely to work. But first a little background.

The idea that companies should adopt customer-centric structures has been around in both academia and practice for a while, but it was George S. Day of Wharton who reignited interest in the concept. In his 2006 survey of U.S. managers, he said the proportion of U.S. firms with structures organized around customers would grow from 32% to 52% as firms raced to build customer-centric organizations, and he interviewed companies including IBM and Systems Group that had announced customer-centric restructurings. He also emphasized in a 1999 book that “the wrong structure can doom all other market-driven initiatives in the organization to failure.”

A good example of customer-centricity is Tumi, the innovative U.S.-based maker of suitcases, which has been customer-centric since its founding in 1975. Each division focuses on one customer group—premium customers or young adults, for example—and, through research, designs products for that segment. Surveys commissioned by the company show that it does a good job of satisfying customers by matching their needs.

Intel, whose top-level divisions had been organized around product groups or functional areas, adopted customer-centricity in 2005, and its improved knowledge of and commitment to customers has resulted in greater customer satisfaction. Dell, which adopted customer-centricity in 2009, has seen positive results too: After aligning its corporate business units around customer groups, such as large enterprises and consumers, the company learned to operate seamlessly in the new structure and improved its financial performance.

Examples like these, as well as the seemingly bulletproof logic of making customers' needs central, have helped sell customer-centricity to many corporate leaders. And there's no doubt that a customer-centric structure helps organizations amass rich depositories of customer knowledge and expertise and thereby uncover unmet needs.

But our research, conducted with Conor M. Henderson of the University of Oregon and Irina V. Kozlenkova of Michigan State University, tells us that there are situations in which discovering and acting on unmet customer needs either amounts to mere table stakes or contributes little to profitability:

- **Prevalence of customer-centricity and high competitive intensity**. When competitors already have customer-centric structures or otherwise do a very good job of meeting customer needs, any one company's customer-centric structure is less valuable. Customer-centric firms with many customer-centric competitors exhibited 11% lower performance than peer firms with product-centric structures.

Moreover, customer-centric firms that operated in highly competitive markets had 69% lower performance, compared with product-centric peers.

- **Low industry profitability**. When few customers value greater customization or responsiveness, the headaches of restructuring around customer segments aren't worth the trouble. Customer-centric firms in less-profitable industries performed 20% lower than firms whose structures were not aligned with customers.

Take, for example, two exponents of the customer-alignment philosophy: the for-profit health-care company Anthem and software and services firm SunGard. Anthem implemented a customer-centric structure in 2008 when it was known as WellPoint and when few of its competitors had adopted the approach. It was able to use its new organizational structure to discover and meet new customer needs such as better quality of care, enhanced transparency, and lower health-care costs. Its adoption of customer-centricity yielded a 36% increase in return on assets over the four-year period after the restructuring. The company has maintained and still benefits from its structure, even though some of its competitors have adopted customer-centricity.

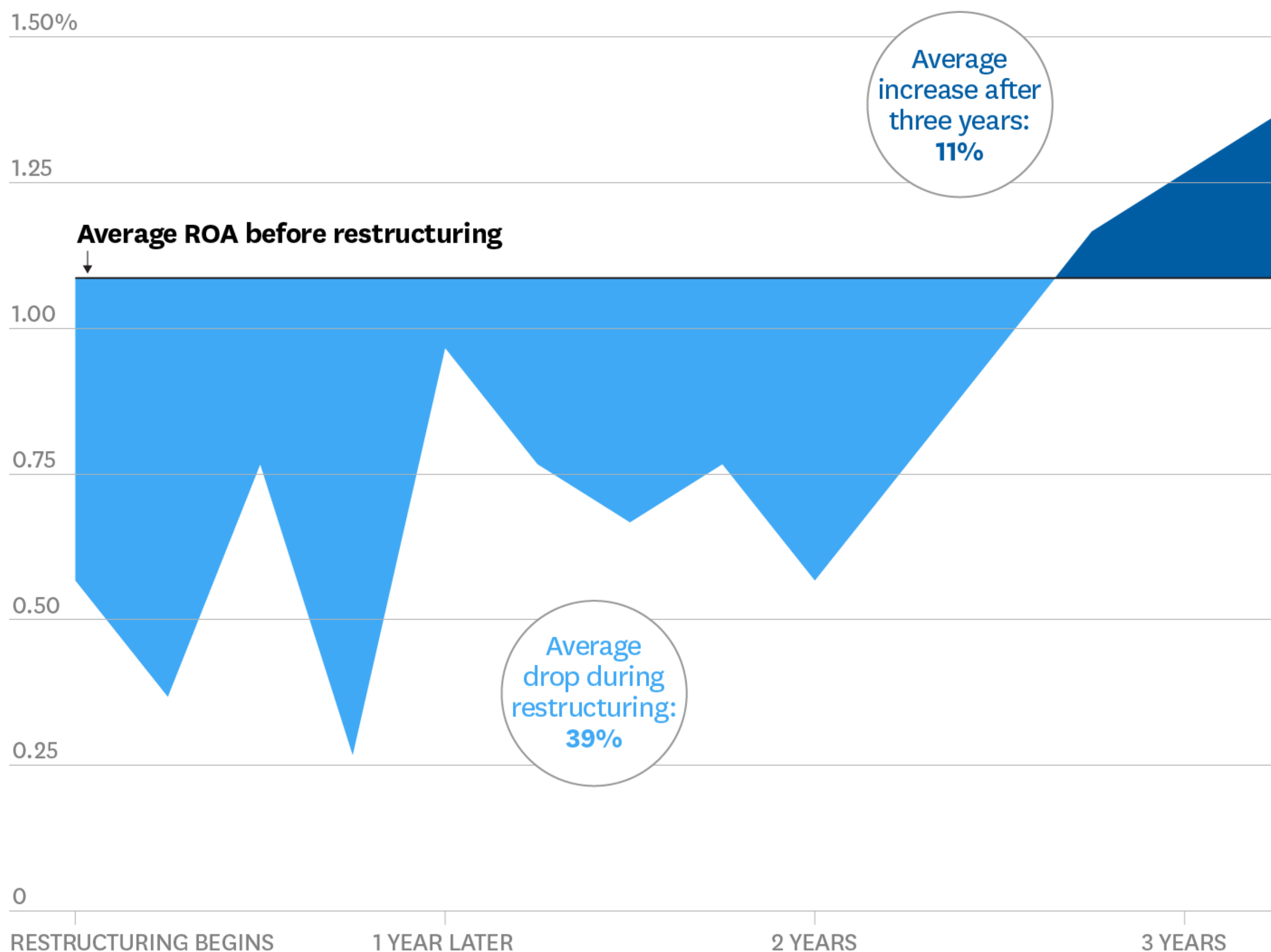
SunGard's competitive environment was different. Its competitors, such as Affiliated Computer Services and Leidos Holdings, were already doing a good job of discovering and addressing unmet customer needs. Its 2002 restructuring offered little incremental benefit while adding cost and complexity. Its ROA dropped 81% over the four years after the restructuring.

There's also a gray area in which customer-centricity provides significant advantages while simultaneously dragging down results. Tumi, for example, has recently struggled with the drawbacks of customer-centricity. With each division focusing on only its own customer segment, the structure appears to be poorly suited for generating widespread corporate brand awareness. Customer-centricity appears to be a reason for the company's high marketing and coordinating costs: Its customer-focused structure has entailed a division of resources, capabilities, and people; raised

organizational barriers to sharing and communicating; and led to greater complexity-related costs and losses of economies of scale. These high marketing and coordinating costs may be the cause of its problems today.

In cases where customer-centricity is an appropriate structure, we found that it takes more than two years after a restructuring, on average, for companies' performance to exceed prior levels. During that period, performance typically deteriorates significantly as the firm incurs coordinating costs due to internal conflicts and confusions.

Among 37 *Fortune* 500 firms that went through customer-centric restructurings, the performance drop averaged 39% from companies' pre-restructuring levels; it was only after 10 quarters that performance exceeded those levels — at which point it exceeded them by 11%, on average.



Before initiating adoption of a customer-centric structure, companies should look carefully at the extent to which this approach has permeated the competition. Firms should also gauge the industry's competitive intensity and take a close look at their industries' profitability. There are no simple rules of thumb for these assessments – every industry is different – but a predominance of customer-centricity, high competitive intensity, and high commoditization and a prevalence of low margins all suggest that restructuring around customer segments may not pay off.

And if executives determine that a customer-oriented restructuring is a good gamble, they should enter into the process with eyes wide open, establishing clear expectations that performance will sag before it rises.

In addition, CEOs and functional heads need to talk to each other about proposed changes in organizational structure. Top executives should get guidance from marketing, sales, and R&D before making structural-design decisions, and managers from those functions should weigh in on the harm that could be done by the greater complexity and duplication that are so often a consequence of customer-centricity.

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