Relationship marketing

Does customer-centric realignment pay off?

It's widely held that customer-centric firms outperform their peers because they nurture closer relationships, enhance customer value, and improve customer satisfaction. In reality, however, the results for companies have been mixed. Some companies like IBM and Fidelity Investments have enjoyed the fruits of customer-centric restructuring while others such as Cisco and Xerox have seen poor results.

"The problem," notes Robert Palmatier of the University of Washington, "is that the limited empirical research on the topic fails to support the widespread managerial belief that restructuring into customer groups improves firm outcomes."

With this in mind, Palmatier, Ju-Yeon Lee and Conor Henderson, all of University of Washington, and Shrihari Sridhar of Pennsylvania State University designed and conducted a study of the performance impact of such restructurings. Their findings appear in "Effect of Customer-Centric Structure on Firm Performance." These results partially confirm the views of managers and academics on the benefits of customer-centric restructuring, but they also bring to light ameliorating factors that might not have been considered previously.

"Our study differs from most past research in three ways," Lee comments. "First, it specifically models the effect of a customer-centric structure on performance, and second, it takes into account the 'mediating mechanisms' that might explain how a customer-centric structure impacts performance. Third, the study identifies when restructuring pays off through enhanced performance." "Our overall goal," adds Sridhar, "was to provide theoretical and empirical insights to clarify the confused picture that has emerged from the varying experience of firms like IBM and Cisco."

Customer satisfaction and costs

The authors analyzed 13 years of data linking the customer-centric structural alignment of 174 Fortune 500 firms to aa statistical measure of their overall financial performance. They categorized the alignment of these companies according to their organizational emphasis. Firms that focused on functions, for example, were the least customer-centric while firms that focused on customers were, naturally, the most customer-centric. The authors then looked at how the firms' alignment affected customer satisfaction (as assessed on the American Customer Satisfaction Index) and costs, in particular the added "expense" of more employees, greater communications challenges, resource competition, and more complex decision-making processes that attend customer-centric organizations.

"To the best of our knowledge, this study is the first attempt to look at the positive and negative mediating mechanisms at work during a customer-centric organizational realignment," Lee points out. The important general caution for managers from the analysis is that while greater customer alignment improves performance by increasing customer satisfaction, it also degrades performance by adding to costs. "This means that managers need to weigh external benefits against internal costs to determine the overall 'mediated' effect of restructuring on firm performance," Sridhar says.

The authors also looked at other structural factors that may have inherent customer alignment benefits. In particular, their model incorporated the effects of organizational granularity—the extent to which a firm divides itself into small units (Pfizer's organizational focus on patient and disease types, for instance)—and the effects of business focus—the extent to which a firm competes within a limited set of product markets (as with Intel's concentration on microprocessors).

For firms with a broad set of end customers, the benefits of customer alignment can outweigh the costs.

"Organic" customer alignment

The study results showed that the performance effect of customer-centric realignment varies depending on the presence or absence of these other two "organic" sources of customer-centric alignment. Specifically, the data shows that firms with low organizational granularity (bottom 25% of sample) who are highest in structural alignment (top 25%) perform

23% higher than firms who are lowest in structural alignment (bottom 25%). Structuring around customer groups pays off for Fortune 500 firms that do not achieve customer alignment through organizational granularity. Similarly, firms serving broad end markets (lowest 25% of business focus) and structured around customers perform 58% higher than firms not structured around customers. Thus, structuring around customers pays off very well for Fortune 500 firms that serve a broad set of end customers but has little effect on performance for highly focused firms.

Managers may have misguided expectations about the net performance effects of customer-centric reorganization.

"In other words, for firms already organically aligned, the costs of customer-centric organizational structures can outweigh the small incremental benefits, resulting in poorer performance," says Henderson. For example, firms with small business units that naturally work with less diverse markets (such as Xerox, Pfizer, and Microsoft), or firms that compete in just a few narrow end markets (TRW, Honeywell, and Intel, for instance), gain little incremental benefit from increasing structural alignment while incurring higher infrastructure costs and communication complexity. "To put it succinctly," Sridhar explains, "the benefits of different structural sources of customer alignment are redundant but the costs are additive." (In a particularly telling example, the authors note a study that describes how Cisco retreated from its customer-centric structure because "ten people would be doing the same thing across the company ten times over at ten times the cost.")

The primary lesson for managers from this is not to jump into costly restructuring efforts solely on the reported success of a few well-publicized cases. The authors note that 22% of Fortune 500 firms shifted toward a more customer-centric alignment in the past decade assuming, rather than relying on empirical evidence, that such structures outperform their competitors. Many of these firms failed to achieve the expected improvement and reverted to less customer-centric structures.

"As our study shows," Lee concludes, "neglecting the negative trade-offs involved in restructuring toward customer groups can create misguided expectations about the net performance effect of such changes. We hope our findings provide managers with some useful caveats to consider before altering their structural alignment."

BY KIM PEDERSON

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