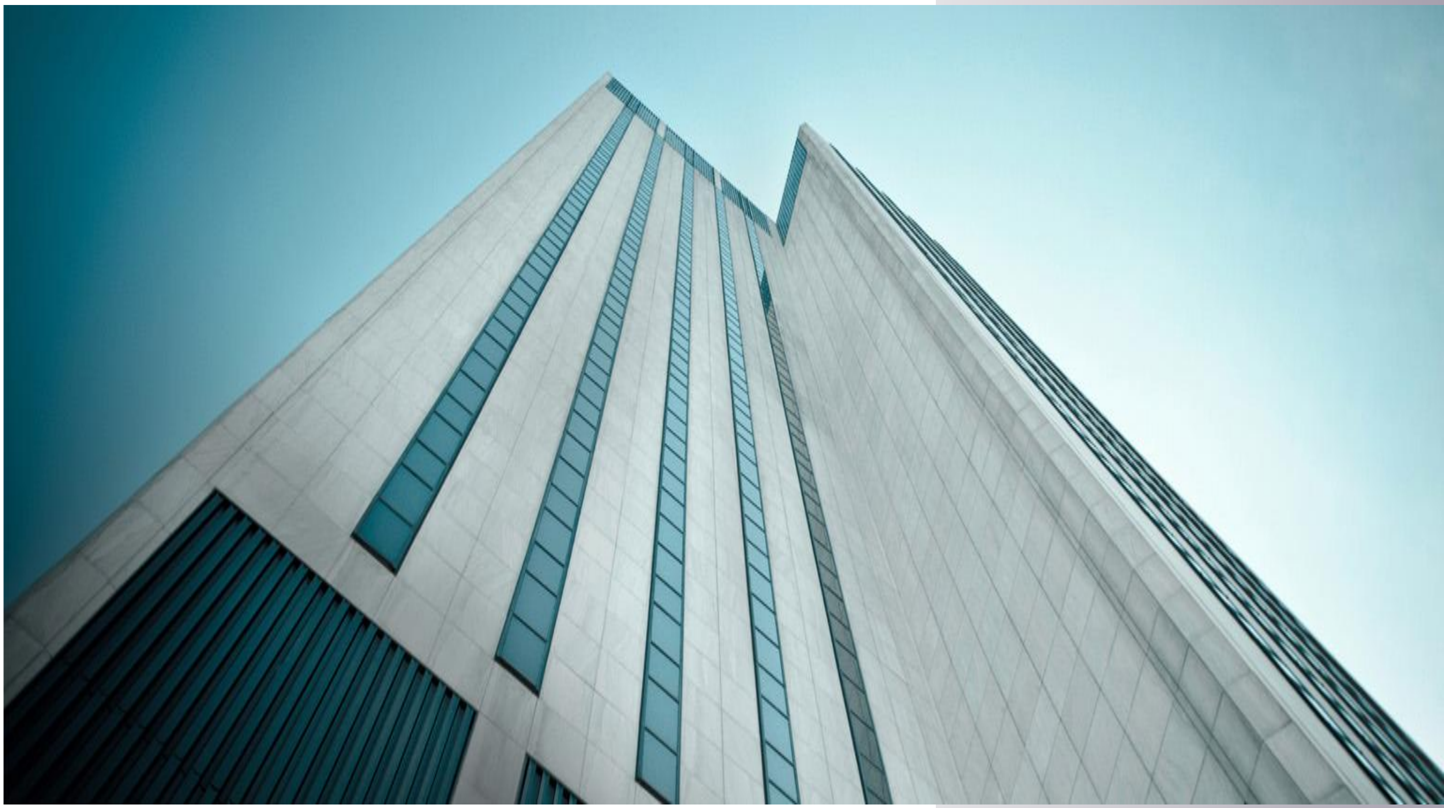
COLLABORATIVE FOR
CUBES™
Customer-Based Execution & Strategy



EXPANDING MARGINS

LINKING CUSTOMER VALUE AND MARGINS

Increasing margins can be difficult for business-to-business (B2B) companies. Why?

Many B2B clients are larger in size than their suppliers and purchasing departments can exert substantial pressure when negotiating contracts. The ability of B2B clients to lock prices can also limit a company's opportunities to expand margins. Inflationary pressures can compound this effect.

Some B2B CEOs double down on innovation, hoping to provide incremental product improvements or add more and new features. These are typically perceived as marginally better than competitors, rather than meaningfully differentiating the offering.

As the cost of providing marginal improvements increases, they are unable to get commensurate price increases from clients. Unable to increase prices, their margins erode.

They are stuck in a "value trap."

CEOs can expand margins by focusing on client value and excelling at its most important drivers. High customer value reduces price sensitivity[i], increasing pricing power, and expanding margins. Ultimately, client value is a proven driver of margins.

Customer Value

A company creates customer value when it satisfies the most important needs of a large majority of its customers.

Creating customer value is different than responding to the momentary desires, impulsive demands, wishes, yearnings, and proclivities that a small selection of customers may express in unstructured conversations. Simply pleasing customers does not create customer value for the long term or at scale.

Measuring customer value

Customer value measures the extent to which a company satisfies the most important needs of its customers. Customers perceive a high level of value when the company excels on the strategic areas that are most important to them.

Customer value can be measured as a Customer Value Index (CVI) score. CVI© is a valid and reliable measure of customer value created by C-CUBES™. A company's CVI can range from 0-100 and gauges a company's customer value for its existing customer base.

CVI is reliable because of the systematic, structured, and validated measurement approach.[ii] CVI is comparable across industries, companies, geographic areas, and business units, and over time.

Why use customer value (CVI) for strategy?

Successful growth strategies must be driven by customer value (CVI) as customers are the largest source of a company's cash flow.[iii] The benefits of using CVI for strategy planning include:

- CVI provides a predictive model for strategy planning, so executives do not have to use untested assumptions and unreliable scenarios.
- CVI gets rid of actions based on gut feel, intuition, and unstructured conversations.
- Though some companies use NPS (net promoter score), NPS is a poor measure of customer value, unable to predict financial outcomes, and incapable of diagnosing value drivers.[iv] *Wall Street Journal* labels NPS a "management fad."[v]

Customer Value (CVI) & Margins

A focus on customer value enables a B2B company to increase margins without having to load products and services with costly new features. Customers of a company with higher CVI are:

- Less likely to shop for competitive offers.
- Less price sensitive.
- More likely to continue using existing products/services.
- More likely to recommend products/services to others.
- Less likely to file complaints or request customer service.

All these outcomes reduce a business' operating costs, lower the pressure to compete on price, and expand a company's base of high-quality customers. As a result, a B2B firm with a higher customer value is likely to experience higher margins.

Since 2016, a national panel of more than 13,000 B2B clients of more than 840 companies have participated in the CUBES® assessment. The researchers measured a company's CVI score, ranging from 0-100.

Margins are calculated as a firm's sales and its costs of goods sold. This is an objective metric of margins from company financials.

The statistical modeling linking CVI to margins minimizes the confounding effect of non-focal factors related to a firm (e.g., size, liquidity, leverage), industry (e.g., industry concentration), and time (e.g., recessions or booms).[vi]

This process provides the unvarnished and unconfounded relationship of CVI and margins.

Customer Value Index (CVI) and Margins

The average CVI in the marketplace is 81.5. Figure 1 shows a clear linkage between increasing CVI and margin growth.

But, there is a nuance.

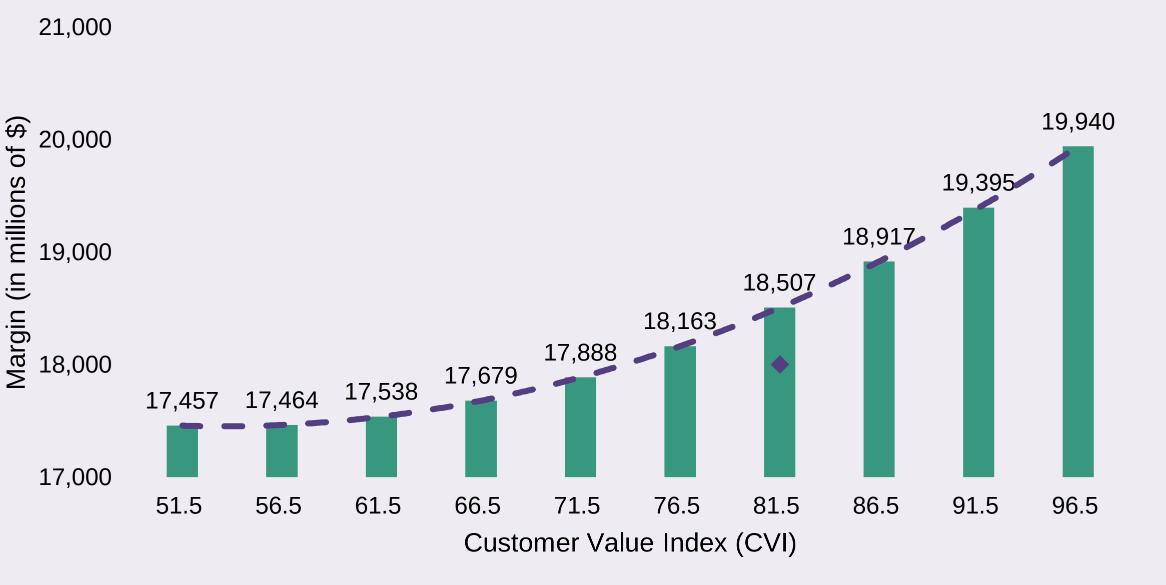
For companies with a CVI lower than 71.5 margins are low and relatively flat.

After a CVI of 71.5 the lift in margins increases.

Among companies with a CVI higher than 81.5, there is a relatively sharp—almost exponential—increase in margins.

On average, margins jump from $18.5 billion to $19.9 billion when CVI increases from 81.5 to 96.5.

Figure 1. C-CUBES™ CVI and Margins



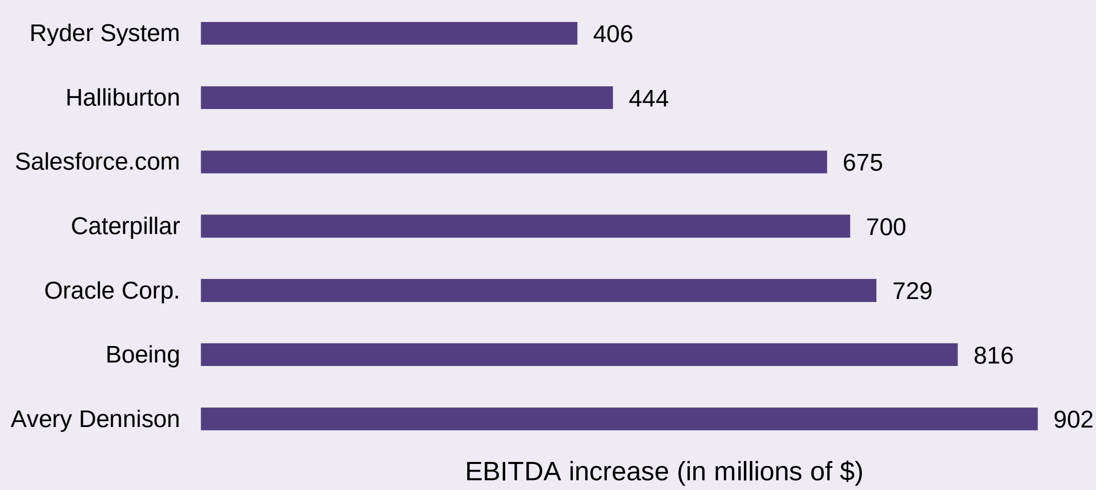
CVI and Strategy Planning

C-CUBES™ provides a concreate way to link margins to customer value, which can help CEOs focus their efforts. Instead of relying on multiple initiatives, CEOs can use customer value to decide the most promising initiatives.

A robust strategic plan should be based on CVI because it predicts margins.

What is the increase in margins for several prominent B2B companies when the CVI increases by 10 points? For Avery Dennison, the increase in margins amounts to $902 million. Ryder System would increase margins by $406 million.

Figure 2. Increase in Margins for a 10-point CVI Increase



What's Next?

A customer focused strategy plan can demonstrably increase sales and margins. CEOs need to know the precise margin lift they would get from customer value increase.

By relying on predictive models that link CVI and margins, CEO can develop a robust strategy that does not have to rely on gut feel, hunches, or emotions.

Citation

Kyuhong Han, Vikas Mittal, Shrihari Sridhar (2021) "Expanding Margins," *STRATONOMICS© Insight Series,* November 10, 1-6.

Available at: https://ccubes.us/briefs/

---

i Shaik, Muzeeb, Narendra Bosukonda, Vikas Mittal, and Shrihari Sridhar (2022), "Price Sensitivity and Customer Perceived Switching Costs in Business-to-Business Markets: Joint Effect on Customer Repurchase Intentions," *Journal of Service Management Research*, forthcoming.

ii Mittal, Vikas, Kyuhong Han, Ju-Yeon Lee, and Shrihari Sridhar (2021), "Improving Business-to-Business Customer Satisfaction Programs: Assessment of Asymmetry, Heterogeneity, and Financial Impact," *Journal of Marketing Research,* 58(4), 615-643. https://doi.org/10.1177/00222437211013781

iii Mittal, Vikas, and Shrihari Sridhar (2020), "Customer based execution and strategy: Enhancing the relevance & utilization of B2B scholarship in the C-suite," *Industrial Marketing Management*, 88 (July): 396-409. https://doi.org/10.1016/j.indmarman.2020.05.036

iv For further details see: Best, Roger J., Vikas Mittal, and Shrihari Sridhar (2022), *Market-Based Management,* Chapter 1, 7th edition.

v *Wall Street Journal (2019)* "The dubious management fad sweeping corporate America," May 15, 2019. By Khadeeja Safdar and Inti Pacheco.

vi Mittal, Vikas, Kyuhong Han, Ju-Yeon Lee, and Shrihari Sridhar (2021), "Improving Business-to-Business Customer Satisfaction Programs: Assessment of Asymmetry, Heterogeneity, and Financial Impact," *Journal of Marketing Research,* 58(4), 615-643. https://doi.org/10.1177/00222437211013781