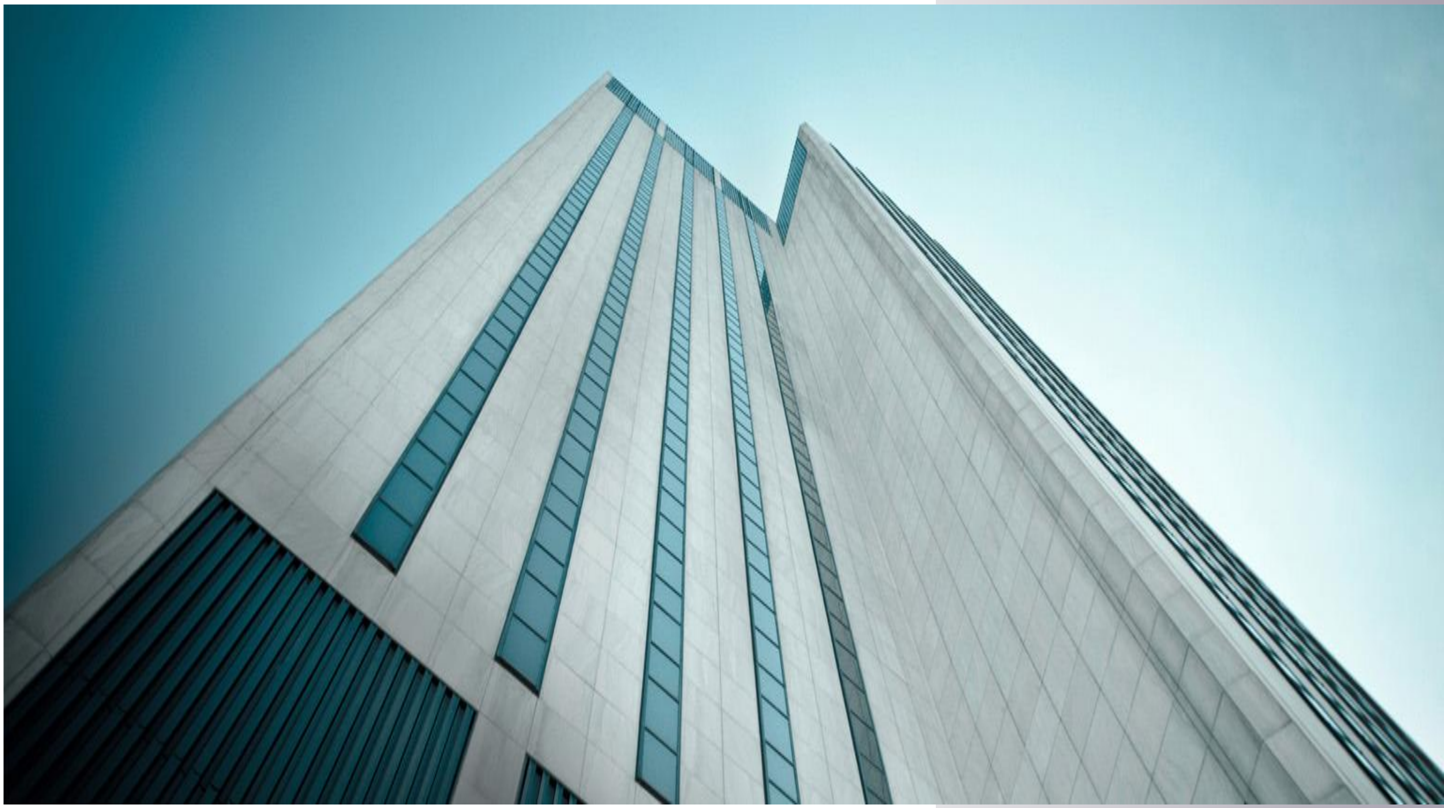
COLLABORATIVE FOR
CUBES™
Customer-Based Execution & Strategy



SOLVING THE EBITDA PUZZLE

CUSTOMER VALUE PREDICTS EBITDA

Board members and CEOs evaluate the financial health of their company using EBITDA, or earnings before interest, taxes, depreciation, and amortization.

Increasing EBITDA is the goal of many strategic plans. Senior executives manage EBITDA by pruning operational expenditures via cost cutting and efficiency-initiatives.

Although managing EBITDA via operating expenses can sometimes be effective, it can make executives inward-looking and detached from customers. In a bid to cut costs, many executives slash important initiatives that drive customer value, trimming muscle alongside fat.

There is no doubt that driving efficiency can create shareholder value. Yet, a 2005 study showed companies that supplement their drive for efficiency with a focus on delivering customer value create even more shareholder value—up to 1.5 times more[i].

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. Pleasing customers in this manner 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 is measured as a Customer Value Index (CVI) score, a valid and reliable metric 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.

Therefore, CEOs and senior executives use CVI as part of their strategy planning and execution process.

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.
- Some companies use NPS (net promoter score) to drive strategy. NPS is a poor measure of customer value, unable to predict financial outcomes, and incapable of diagnosing value drivers. *Wall Street Journal* labels NPS a "management fad."[iv]

Customer Value (CVI) & EBITDA

A focus on customer value drives EBITA in two ways.

- First, it enables a company to trim "value-added waste", or initiatives that add work and expenditure but do not add any customer value. Executives start initiatives with good intentions, but many initiatives do not drive customer value or cash flow. A customer-value focus can identify such wasteful initiatives for cost cutting and boosting EBITDA.[v]
- Second, CVI-scores enable executives to craft a customer-focused strategy. They can double down and more in invest in initiatives that increase their CVI scores, while pausing or deferring other initiatives.

Since 2016, a national panel of more than 13,000 B2B clients of more than 840 companies have participated in the C-CUBES™ assessment. For these companies, EBITDA is calculated using accepted accounting principles from objective company data.

The statistical modeling linking CVI to EBITDA 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 EBITDA.

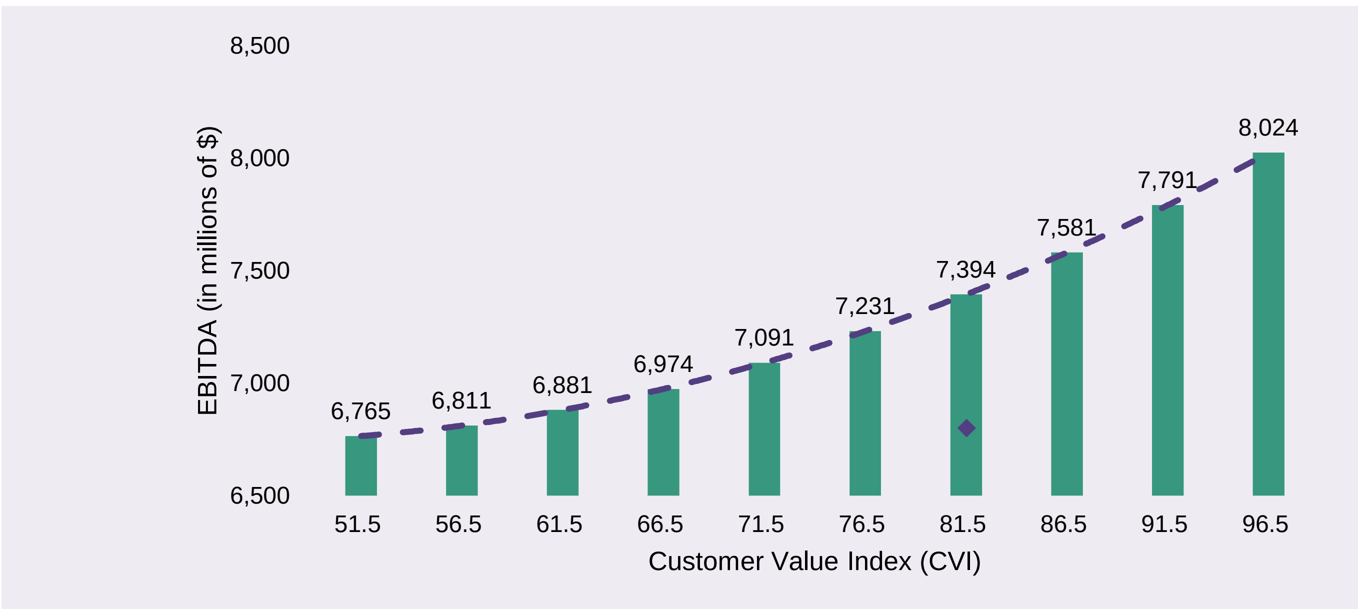
Customer Value Index (CVI) and EBITDA

Figure 1 shows a clear linkage between increasing CVI and EBITDA—there is a sustained increase in EBITDA as CVI increases.

The average CVI in the marketplace is 81.5. Reassuringly, CVI, or customer value is positively linked to EBITDA.

The rate of increase in EBITDA is higher among companies with a CVI higher than 81.5. EBITDA jump from $7.4 billion to $8.0 billion when CVI increases from 81.5 to 96.5.

Figure 1. C-CUBES™ CVI and EBITDA



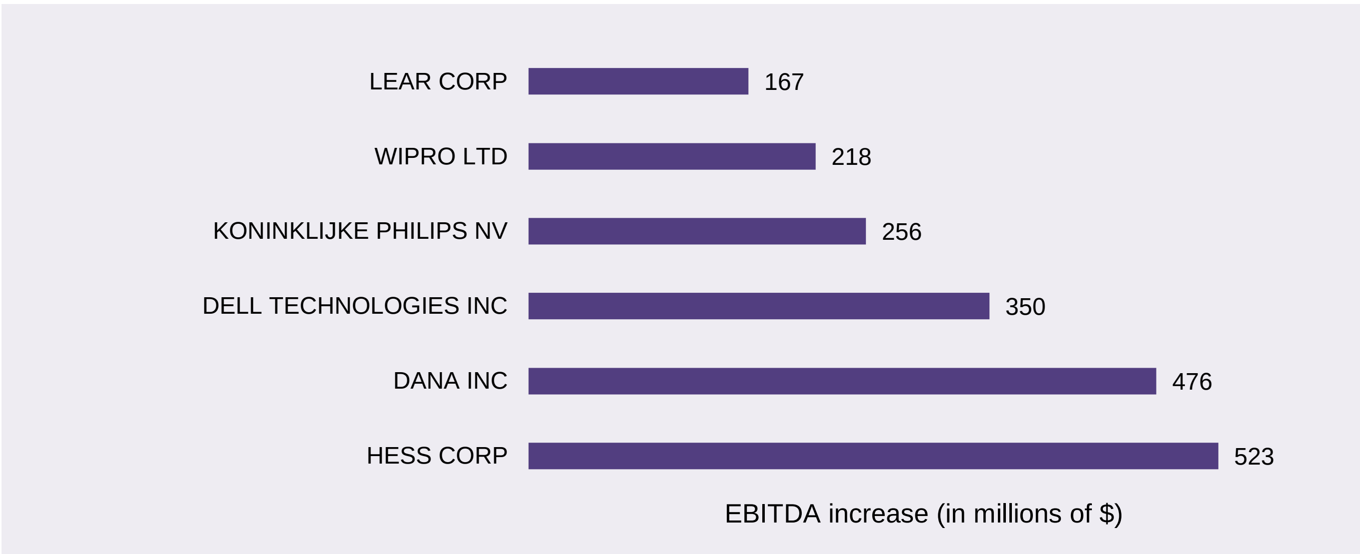
CVI and Strategy Planning

C-CUBES™ provides a concreate way for CEOs to incorporate customer value and EBITDA in their company's strategic plan.

Providing customer value and shareholder value are consistent goals.

Figure 2 shows the increase in EBITDA for several B2B companies when the CVI increases by 10 points. For Hess Corporation, the increase in EBITDA amounts to $523 million. Lear Corporation would increase EBITDA by $167 million.

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



What's Next?

At the 100,000-foot level, CEOs of B2B can increase EBITDA by improving customer value. By incorporating CVI in their strategy planning process CEOs are ensuring they deliver on both fronts—customer value and shareholder value.

Notably, customer value, as measured by CVI, also enhances sales and margins.[vii]

Citation

Kyuhong Han, Vikas Mittal, Shrihari Sridhar (2021) "Solving the EBITDA Puzzle," *STRATONOMICS© Insight Series,* December 10, 1-5. Available at: https://ccubes.us/briefs/

[i] Mittal, Vikas, Eugene W. Anderson, Akin Sayrak, and Pandu Tadikamalla (2005), "Dual emphasis and the long-term financial impact of customer satisfaction," *Marketing Science*, 24(4), 544-555.

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

[v] Mittal, Vikas, Shrihari Sridhar, and Roger Best (2021), "To Cut Costs, Know Your Customer," *MIT Sloan Management Review*, 62(2), 11-13.

[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

[vii] Kyuhong Han, Vikas Mittal, Shrihari Sridhar (2021) "Busting the sales trap in strategy planning," STRATONOMICS© Insight Series, November 10, 1-6, Available at: https://ccubes.us/briefs/

Kyuhong Han, Vikas Mittal, Shrihari Sridhar (2021) "Expanding margins," STRATONOMICS© Insight Series, November 10, 1-6, Available at: https://ccubes.us/briefs/