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To Cut Costs, Know Your Customer

Cost-trimming initiatives at B2B companies should be guided by an understanding of what customers truly value.

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The economic disruptions caused by the ongoing pandemic are forcing myriad decisions on CEOs of B2B companies. Often, the most pressing decisions are whether and how to cut costs.

As in business downturns past, some CEOs are implementing across-the-board salary cuts and widespread furloughs, while others are taking a more piecemeal approach — renegotiating vendor contracts; trimming underperforming products, regions, and divisions; and shifting to lower-cost sales channels. Our research shows that both of these approaches can be misguided.

A more effective cost-cutting strategy should begin — and end — with customer focus.

Customer focus tends to be overlooked during cost cutting because it is usually seen as a revenue enhancement strategy. This is a mistake: B2B companies that ignore what customers value when they are cutting costs leave a lot of money on the table.

In our benchmark assessment of 626 publicly traded B2B companies and 4,105 of their customers, we found that companies with high levels of cost cutting and low levels of customer value — as measured by customer satisfaction — had the worst gross margins, while companies with high levels of both cost cutting and customer value had the highest margins. [1] In other words, cost cutting that is devoid of customer value sank margins.

B2B companies can pursue cost reduction with a customer focus in three ways: by reducing value-added waste to deliver more compelling customer value, by improving the effectiveness of customer acquisition and retention, and by narrowing focus to those strategic initiatives best aligned with customer value.

Reduce Value-Added Waste

Value-added waste is produced when companies pursue value drivers that do not align with customer priorities. Innovation races that add increasingly sophisticated features (and costs) to offerings but outstrip customer needs and desires are a primary driver of value-added waste. Investments like these eat up resources but do not increase pricing power; hence, they reduce margins.

Value-added waste is rooted out by identifying and more intentionally pursuing the small set of drivers that are most instrumental in increasing overall customer value and eliminating features that are not aligned with those drivers. When we studied five B2B companies (a manufacturing equipment distributor; a modular office leasing company; an engineering, procurement, and construction company; an aviation equipment manufacturer; and a hospitality service provider), we found that two or three drivers generated at least 80% of the customer value in each company. This is a consistent pattern that we have verified across hundreds of B2B companies. [2]

By focusing on product and service features that best satisfy these select drivers of customer value and eliminating those that do not, companies can reduce fixed and variable costs without lowering sales. When the hospitality service provider we studied mapped its customer value drivers against its own offering priorities, it discovered that employee efforts were focused on sales and bidding, communication, and sustainability, while its customers were more interested in high-quality products, better ongoing service and support, and safety. Realizing this, the company reallocated resources to the drivers of customer value, improving the company's overall customer value index as well as its revenues and margins.

The lesson for customer-focused cost cutting: Within any product or service offering, focus expenditures only on the top drivers of overall customer value and cut the rest.

Manage Customers More Effectively

Focusing on the most important drivers of customer value will reinforce the perception among your current customers that you understand their needs, which will earn their loyalty and help your company win the right new customers at lower cost. This can be a significant source of cost savings: Recent research conducted with a sample of 128 large publicly traded companies concluded that a 1% increase in customer satisfaction lowers the future cost of sales by 0.53%, or roughly $130 million for the average company in the study. [3] These savings come from reductions in commissions, marketing and advertising expenses, freight-out costs, and bad debt.

Customer loyalty and word-of-mouth recommendations are particularly valuable in B2B. Indeed, our benchmark assessment found that over 82% of customers do business with a company due to prior experience or word of mouth. Satisfied customers will be loyal, lowering the cost of sales. Moreover, they will send like-minded prospects to your door — a low-cost source of new business.

Again, companies can leverage a focus on the top drivers of customer value to maximize these effects. After the modular office leasing company we studied focused its attention on product and service quality, communication, and ongoing service and support (its three drivers of customer value), its repeat business with existing clients improved dramatically. The company also highlighted its focus on those drivers in its marketing and sales efforts. For example, it collected customer anecdotes regarding the drivers and featured them on its website, and it invested in an online customer portal easily accessible by mobile devices. Over time, this focus helped the company build market share among customers who valued those drivers, and its cost of customer acquisition fell. Equally important, its market share among price-sensitive customers dropped — another sign that the company was attracting the right customers for the value it promised.

The engineering, procurement, and construction company we studied used a newfound focus on two drivers that represented 60% of its customer value — project management, and ongoing service and support — to increase its win rate on existing client bids by more than 42%. It also boosted a 46% win rate on new client bids to over 65%. The results: The company has met its revenue targets every quarter since 2018, using 30% fewer sales and business development personnel and submitting 18% fewer bids year on year.

Prioritize and Eliminate Strategic Initiatives

At any given time, B2B companies are undertaking a large number of strategic initiatives, such as installing customer relationship management software, investing in R&D for new products, and developing digital channels, each ostensibly designed to drive customer value and grow sales. Too frequently, however, these initiatives have not been linked to verified customer value.

When the manufacturing equipment distributor we studied ranked its 65 companywide initiatives by their potential lift in customer value, it found that 10 initiatives provided 71% of the lift — and of those, five initiatives provided 61% of the lift. As a result, the executive team decided to focus funding, attention, and effort on those five initiatives, putting 14 initiatives on hold and dropping 46 initiatives completely. Not only did this drive down costs and wasteful spending, but the focus on value drivers also improved sales. Killing the nonessential initiatives saved the company more than $15 million in costs and provided employees with greater strategic clarity and focus while expanding margin and increasing customer value.

In this unprecedented business climate, many CEOs are pursuing cost-cutting initiatives. But as they do, they should consider that cost cutting, like growth strategies, must be driven by customer value. Judicious cost reduction with a strong focus on the drivers of customer value will not only get companies through the current period of tempered demand but also serve as the basis for a long-term, customer-centered strategy that allows everyone — from the C-suite to the front lines — to stay laser focused on achieving more by spending less.

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