Regaining customer relevance: the outside-in turnaround

George Day and Christine Moorman

Why did the value proposition offered by once successful companies like McDonald’s, Starbucks, IBM and Charles Schwab lose its luster, and how did they recover? Their declines began when their offering stopped being the first choice of their best customers. The products and services of these companies went from being at the top of their customers’ consideration set to just another adequate option. As their value proposition lost relevance, profits and stock prices plummeted.

Fortunately, the fall from grace is not inevitably irreversible. In-depth investigations of six successful turnarounds indicate they regained the loyalty of their customers by pursuing a similar approach – one that is applicable to a variety of businesses. In each of the six cases, the outside-in turnaround began with a new management team that stepped outside the boundaries and constraints of the company and looked at its market through the eyes of customers and competitors. Managers sought straight answers to tough questions such as:

- How and why are customers changing?
- What new needs do they have?
- Why is our value proposition less relevant?
- What are competitors doing and how can we get ahead of them?

Once they had the answers to these questions the companies were able to stop doing what got them into trouble, energize employees and sharply change course. Because their firms were in such dire straits, leaders had a mandate to adopt the perspective of the customer to examine every aspect of the buying and using experience and the operations that delivered it – a step we view as central to the success of a turnaround.

McDonald’s, for example, faced near-calamitous experiences a decade ago by failing to keep customer value their highest priority[1]. By 2000, McDonald’s had become a fast food “fuel depot” beset with serious problems including a decline in food quality, shoddy service, a hazy brand promise and its first-ever quarterly loss. McDonald’s leaders erroneously assumed that becoming bigger by adding new stores was a more expeditious growth strategy than becoming bigger by being a better choice for customers. The company was resuscitated by a new management team lead by Jim Cantaloupo, who favored a strategy that sharply scaled back growth plans and focused everyone on the core customer’s desire for an effortless service experience, with a promise of “simple, easy enjoyment”[2].

As another example, in 1993, IBM was about to break itself into independent product and service companies in the face of a shocking billion dollar loss. Its turnaround began with Lou Gerstner’s clear realization that IBM had everything needed to solve its customers’ information technology problems[3]. What it lacked was a customer-driven focus. Its new outside-in strategy married technology breadth with powerful customer solutions that were in sync with emerging networks and Internet trends. Rather than an inside-out view of solutions as bundles of products and services. IBM adopted an outside-in view that the purpose of a
solution was to help their customers succeed, a mutually beneficial approach. That “customer first” mindset became the principal that guided IBM’s strategy successfully through the great recession and into the present.

In March 2011, Starbucks CEO Howard Schultz was asked how Starbucks was able to regain its footing after sales weakened in the recession[4]. His answer captures the essence of a turnaround from the outside in: “... putting our feet in the shoes of our customers, understanding what they were dealing with and the anxiety of the [financial] crisis. In addition to that, getting our own people to understand what was at stake and specifically asking them to be more accountable. We were growing the company with such speed and aggression that we lost sight of the customer experience.” We heard variants of this refrain in each of the successful turnarounds we studied.

**Leading turnaround: outside-in not inside-out**

Traditional inside-out turnaround processes take various approaches[5]. Some adopt an urgent fire-fighting approach as befits a crisis, demanding increased effort from operations. Some emphasize mobilizing the organization to stabilize the situation and then address root causes, perhaps developing new capabilities. Others concentrate on pulling financial levers by disposing of assets, cutting costs and improving employee productivity. Each is a reasonable and necessary feature of any disciplined inside-out turnaround processes. However, when the root cause is loss of customer relevance, these important financial and operational steps are not enough. What is needed, in our view, is to refocus the company on the needs and expectations of who pays the bills – the customer. This customer focus energizes and focuses the entire organization toward a shared sense of purpose.

Well-designed outside-in turnarounds start by mastering three distinctive steps:

- They have a grasp of the centripetal forces that caused the firm to become self-absorbed and turn inward.
- They face reality and instill a sense of urgency based on a shared immersion in market realities.
- They rally the entire organization around an outside-in vision by reconnecting strategy with customers.

Once these steps have been accomplished, the situation is on the way to being stabilized. But hard decisions still remain: Which nonessential activities can be eliminated? Which expenses can be cut without jeopardizing the recovery? And what talent and resources need to be protected?

All these elements were evident in the turnaround of Liz Claiborne[6], the storied fashion brand for career women who didn’t have time to shop. By 1994 the company was in serious straits, having been slow to see the trend toward more casual work attire. Liz Claiborne’s management seemed to believe it was invulnerable to market changes. The cost of this hubris was high; the market cap in 1994 was 70 percent below the 1991 peak.

A turnaround was instituted by a new CEO brought in from outside the company who immediately set about to revitalize and modernize the company’s marketing and fashion designs (Exhibit 1). The brand was revitalized with a campaign to reestablish its relevance in
the eyes of a new generation of professional women. The return to relevance paid off. By 1997, sales set a new high mark.

Confronting market reality

In each of the turnarounds we studied, the companies got into trouble by becoming self-absorbed and succumbing to inside-out thinking[7]. The priority became defending their position, improving productivity, or chasing scale gains to maximize short-run earnings. These are worthy pursuits, but when they dominate the strategy dialogue, they slowly and subtly disconnect the firm from the market and deaden its sensitivity to changing customer needs.

Successful turnarounds start with a deep and shared understanding of how the offering may be failing to satisfy current customers and why the firm took an inward turn that disconnected the strategy from a focus on customer value. We found four reasons:

1. **The myopia of complacency.** Successful companies can lead themselves astray by believing they have found the recipe for success and then resisting evidence to the contrary. These companies become locked into a set of strategic choices and beliefs and see no need to challenge what they are doing even as the market is transformed. The combination of complacency and obsolete mental models dulls the response to contrary signals. This was at the heart of Liz Claiborne’s tardy response to changes in women’s fashion needs[8].

   Worse still is when complacency gives way to arrogance. This was the trap Bausch & Lomb management fell into when they came to believe the company’s strong optical brand gave them permission to sell “anything above the neck.” Lacking solid evidence to support this belief, nevertheless, Bausch & Lomb entered diverse markets such as dental implants, skin care and mouthwash! Each failed in its own way, but together these detours extracted a high cost by diluting the strategy and diverting R&D funds and talent from the core eye-care business[9].

2. **Unsustainable performance pressures.** For decades Toyota set the standard for automotive quality and reliability. With close attention to detail and an unrelenting expectation of continuous improvement, the company could credibly promise a car that

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**Exhibit 1 Outside-in turnarounds**

<table>
<thead>
<tr>
<th>Trigger</th>
<th>Diagnose reasons for loss of customer relevance</th>
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<tbody>
<tr>
<td></td>
<td>Replace management team</td>
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<tr>
<td>Craft a distinctive value proposition</td>
<td></td>
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<tr>
<td>Rally the organization around outside-In vision</td>
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<td>Sustain turnaround</td>
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<tr>
<td>Regain relevance</td>
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- Restructure
- Repair finances
- Build coalition of supporters
- Align incentives

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was close to trouble-free. This image was badly tarnished in 2010 by a storm of quality complaints and a dozen recalls[10]. As Chairman Aiko Toyoda confessed before a Congressional hearing, the pursuit of growth meant the firm lost sight of the priority of putting customer satisfaction above all else. The origin of Toyota’s problems has been traced to a decision in 2002 to overtake GM as the world’s largest car maker. This objective altered priorities and performance metrics. For example, to meet the accelerated growth target Toyota chose to work with a large number of new component suppliers that didn’t have a deep understanding of the Toyota culture, quality standards or just-in-time manufacturing system. Toyota completely missed how these choices would affect its value proposition.

3. Protecting valuable assets takes priority. A capabilities or resource-based view of the firm is an idea that can inadvertently tilt the dialogue toward an inside-out view[11]. Supporters argue that the source of a firm’s defensible competitive position lies in its distinctive, hard-to-duplicate resources and capabilities. Excellent service operations, strong supply chains and superior human resource practices are advantages that are cultivated slowly over time and are hard for competitors to copy. In this theory of competitive advantage, the task of management is to improve and fully exploit these resources. This is certainly a worthwhile goal. However, if these capabilities are no longer serving customer needs, this view of the firm can distort how it directs its resources.

4. Internal concerns take precedence. At one of his first meetings with IBM staff, Lou Gerstner began by telling the audience that the customer was now running IBM. During the same meeting he spelled out his expectations that all the company priorities would be redefined by listening to their customers and delivering performance they expected[12]. This was revolutionary leadership because up until then “customer service” meant servicing IBM machines on the customer’s premises instead of helping them solve their problems and there was no accountability for customers’ welfare within the organization.

Instilling urgency through market immersion

The challenge of beginning a successful outside-in turnaround is to find the right balance between realism and optimism. This means confronting complacency and flawed assumptions by making everyone aware of the dire consequences of inaction. But drawing a picture that is so bleak that the best people leave is counterproductive.

At the beginning of the IBM turnaround, Gerstner took a critical step that is the signature of many successful outside-in turnarounds – he forced his managers into the market to see first-hand what was going on with customers. IBM’s Operation Bear Hug required the top fifty officers to visit a minimum of five of the firm’s biggest customers within three months. The officers were to listen, show the customers they cared about their concerns and take immediate action as needed. This process also made it clear that IBM should not be dismembered into separate companies. Instead, IBM was seen as uniquely equipped to provide solutions that integrated technology into the processes of their major customers.

Such an immersion program is a necessary step in the turnaround because it shakes any residual complacency about market realities. Other methods for capturing full attention include scenario exercises that develop alternative plausible futures (such as when the firm is a loser) or a Red Team exercise in which teams role play an attacker to expose points of vulnerability.

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Reconnecting with customers

In 1992 the British retailer Tesco was in a state of crisis[13]. As an undifferentiated also-ran, the chain was steadily losing share. However, between 1995 and 2010, Tesco's UK market share doubled despite intense competition and now clearly dominates their home market. How did Tesco move from an also-ran to titan? Tesco began its journey in 1995 when it adopted this core purpose: "To create value for customers to earn their lifetime loyalty." All questions about operations, human resources, finance and retailing were addressed by assessing whether the firm's target customers would see value in the answers. This customer-centric lens, known as the "Tesco Way," means that employees obsess over delivering value to customers – whether in the form of a clean restroom, short checkout lines or lower prices on staple goods – and ignore ideas that don’t do so.

This foundation for success was laid in 1995 by Terry Leahy, the CMO at the time, who later became the CEO. He began the turnaround by asking, "Why exactly are the customers leaving?" Over many months, Leahy and his team dug deeply for the answers by engaging directly with customers. From these insights, he crafted a proposal to the board of directors with three messages for reconnecting the company to its customers. First, if Tesco was to win, it had to first stop copying competitors – especially Sainsburys. With a focus on "ordinary" customers that wanted value, Tesco has been able to craft a distinct value proposition that is differs from the rock-bottom prices of deep-discounters such as Asda and higher-quality retailers such as Sainsbury and Marks & Spencer. Second, listening to customers had to happen continuously, at every level and across the entire firm. Programs such as "Tesco Week in Store Together" required managers to run the cash registers and stock shelves. What they encounter mirrors what customers experience in Tesco stores. Third, the retail strategy and merchandising offers would be based on what Tesco's customers valued – not on what the company could do.

Sustaining the turnaround

A turnaround is an exacting test of leadership. Almost always it will be undertaken by a new management team that must ensure strong, visible and sustained board support. Before accepting the position top management should reach an agreement on the measures of success and the resources they will need, for this is when they have the greatest bargaining leverage. But top management needs to keep ‘managing up’ while ‘managing down.’ Constant communication in both directions is needed to sustain support on the journey to regaining customer relevance. Silence by the board should not be confused with assent, nor should lack of complaint from customers be taken for enduring approval[14]. Leading and sustaining an outside-in turnaround means giving the organization a clear sense of purpose around the unifying theme of delivering superior customer value. This takes time, and usually it is necessary to buy time by taking urgent actions to cut operating costs and staunch a cash hemorrhage. Non-core activities may be stopped or outsourced to further conserve cash. But even during the process of conserving scarce resources, there has to be an implementation plan that builds a coalition of supporters and ensures incentives are aligned with outward facing metrics. By celebrating early wins management can signal both the board and the rest of the organization that the firm is on the right path.

The importance of the right organizational moves can be seen in the case of Charles Schwab[15]. By 2000 the company had lost its way as a low-cost, no-frills brokerage firm. Account fees had risen and client services had declined. Customers felt abandoned. New
leaders re-focused the whole firm on customer loyalty. In the campaign “Through Clients’ Eyes,” Schwab took several steps to regain customer trust. It reallocated resources so that 84 percent of the retail staff was client-serving. This resulted in an 80 percent reduction in wait times for callers. The company began measuring client satisfaction, and clients with low satisfaction scores received a personal call from a manager. It also made pricing for CDs, money market funds, margins and home loans transparent to customers. Finally, the company changed its internal reward system to focus on client satisfaction, not on whether the client bought products with certain types of fees.

The change in customers’ ratings of Schwab was dramatic, and the company ended 2007 with a market cap of $25 billion, up from $8 billion in 2004. By 2011, Schwab ranked highest in customer satisfaction among all US online brokerage firms.

Avoiding irrelevance

The forces moving a company to an inside view are persistent and powerful. They must be countered with a tough resolve to ensure a company meets its customers’ test for relevance. As an example, CEO Howard Shultz took an extraordinary action after he had diagnosed Starbucks’s problems – he shut all stores at 7,100 US locations for three hours on February 26, 2008[16]. This unprecedented step was taken to re-educate Starbucks’s baristas in how to deliver to customers the “art of espresso” – the central element in the unique mix of service, ambience and great coffee the company refers to as “Starbucks Experience.” Knowing what action to take is a matter of listening, learning and acting on market signals. Leaders stuck in corner offices or on conference calls with analysts are likely to miss these opportunities to reconnect with customers. In contrast, best practice involves experiencing customer needs as they evolve, being aware of impending market shifts, keeping an open mind for learning and developing a set of strategy choices that evolve from the outside in.

Three principles for getting value from customer contact

Meetings with key customers who are willing to voice their frustrations are a valuable wake-up call. However, market immersion only works when three key principles are followed. First, all the key parties in the turnaround must participate. If only top managers or those in boundary-spanning roles are involved, what is learned is not likely to permeate the rank and file of the company. Second, participants must have face-to-face contact with customers where products and services are used. If not, the full reality of customers’ experiences will be lost or diluted. Visiting customers in this way also helps managers see things more effectively and empathically from the customer’s point of view. Managers should also spend time with employees on the periphery of the organization who first saw the problems emerging. These could be partners, sales people or R&D personnel with an understanding of emerging technologies. What did they see? What went wrong? Where do we need to improve? Third, market immersion must be approached with an open mind – to hear what the customer is really saying and to learn about what is happening. “Yes, but […]” must be replaced with “I see” and “I understand.”
Notes

8. Siggelkow op. cit.

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