A Customer-Focused Approach Can Curb Short-Termism

Companies like Amazon, Southwest Airlines and Costco define long-term business success and financial returns primarily based upon customer metrics. By Sheila Hooda

Amazon, the fifth most valuable firm in the world with a market cap of $400 billion, has a singular focus on the customer — with metrics like customer growth, loyalty and brand effectiveness being primary drivers of their definition of success.

This long-standing focus is a key reason the online-shopping giant isn't a short-termism casualty.

Short-termism — defined as an excessive focus on assessing company performance over short periods of a year and most often less than two years — has been widely criticized for the destruction of company value. Management and boards have been vilified for failing to invest in long-term growth projects or R&D and for managing quarterly results. At a macro level, this intense focus on the short-term has resulted in slower economic growth, reduced job creation, stagnating wages and a de-emphasis on much needed investment and innovation.

While most current business thinking on corporate value is focused on "maximizing the stock price for the shareholder," I suggest a refreshed focus to "maximize value for the customer."

At Amazon, the company culture and all long-term step up investments have been completely focused on building the customer experience through service, technology and convenience, enhancing selection and reducing pricing. The goal is to always deliver compelling customer value through a laser focused data-driven approach.

CEO Jeff Bezos has been quoted saying, "The most important single thing is to focus obsessively on the customer. Our goal is to be Earth's most customer-centric company." He believes, "In order for innovative ideas to bear fruit, companies need to be willing to wait for five to seven years, and most companies don't take that time horizon."

In line with this thinking, Bezos is also known to spend "less than six hours a year on analyst and quarterly calls," focusing instead on long-term investors who do not churn and who believe in his long-term customer-focused vision.

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Other companies frequently mentioned for this customer-driven strategy include Southwest Airlines and Costco — proving that industry sector is not a factor in driving the longer-term stock price or corporate value when a customer-focused strategy is followed. In effect, it further illustrates that the best way to maximize the stock price is to maximize value to customers.

In addition to being customer focused, there are three related considerations for management and boards.

- **Share buybacks and compensation**

The current focus on short-term stock prices is further reinforced by today's compensation practices. This is a huge double edged sword as both CEOs and investors get rewarded based on the stock price. With CEO tenure on the decline, the incentive to think long-term and invest accordingly does not make sense and is too risky. Further, asset managers are paid on assets they hold and with technology facilitating trading there is added incentive for rapid turnover instead of focusing on long-term fundamentals.

In this scenario, stock buybacks are an easy and perfectly legal alternative under Rule 10b-18. Research indicates that well over 50% of net income by S&P 500 companies was returned as stock buybacks over the last 10 years. While this is a high percentage, I also recognize here that corporations may not be able to find appropriate investments for these surplus funds to make an attractive return for their shareholders. Despite this, the very high percentage of buybacks reflects a general aversion on the part of management toward long-term investment or R&D.

Governance recommendations to overcome this issue have included changes in compensation design to lengthen the time frames for corporate management and risk-adjusted performance measures over a longer term for asset managers. Governance experts may want to also advocate the use of a metric which publicly tracks longer-term investments as a percentage of surplus funds.

• The shareholder base and engagement

At the same time, short-term investors, despite the publicity they receive through analyst's questions on quarterly calls or as "activist investors," still account for only around 25% of all shareholders. The balance 75% are truly long-term holders investing essentially for retirement. These are "patient" investors who understand the company's strategy and are willing to support management to take difficult long-term strategic investments. Examples include bio-tech and pharmaceutical companies that are highly valued even though their success in terms of drug development and patents is long-term. There are many examples of technology company shares with small but growing revenues and almost no profits that are also highly valued.

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To cultivate and best manage these long-term shareholders, recommendations from governance experts and leading consulting firms include the refocus of the quarterly analyst call to emphasize progress on and meeting of milestones toward the long-term strategy. Transparency with shareholders is important as is taking full accountability for speed bumps along the road. This information and progress toward the long-term strategic goal needs to be shared with investors to develop confidence and trust. In addition, the current focus on "meeting or missing the target number" and providing details for sell-side analyst models should not be encouraged.

• Employees, social and environment

Since the majority of investors are inherently long-term oriented, these investors are most likely to see the bigger picture. Broad but critical issues impacting the environment, society and governance including human rights, wage and employee relation practices of supply chains, climate change, and employee diversity will be factors they consider for management effectiveness and long-term profitability.

All of these factors need to be included as part of the dialogue and engagement with shareholders.

Implications and Questions for Boards

To overcome short-termism, questions for boards and management should include:

- Does the company have a long-term customer-focused strategy?
- Are the company's culture, organization, technology, processes and data analytics aligned with the customer?
- Does the company have a good understanding of their current and prospective customer base and their evolving needs? What needs are not being met and what needs can/should the company consider as growth opportunities?
- Are current and future investments, compensation design, risk and financial metrics geared towards best supporting the customer?
- Are the company's brand and sustainability policies compatible with the customer?

And always start and end with the customer.

The guru of modern management Peter Drucker eloquently voiced this more than 50 years ago, when he stated: "There is only one valid definition of business purpose: To Create a Customer." He added that corporations have to manage for results, do the right thing and make serving the customer the center of everything.

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With this customer focus being the primary goal, increasing profits and rising share price would follow. Share price appreciation would therefore be the result of a customer-focused strategy and decisions around the long-term or short-term would not prove as relevant, since the metrics for success would radically change.

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