Chapter 4

THE CUSTOMER AND MARKET AUDIT PART 2: UNDERSTANDING CUSTOMER NEEDS AND DEVELOPING VALUE PROPOSITIONS

SUMMARY

- Customers never have been and never will be rational
- How to understand customers' needs and wants
- How to harness all this knowledge to make a better offer to customers
- What a value proposition is
- How to quantify value propositions
- Exercises to turn the theory into practice

INTRODUCTION

This chapter continues to spell out the essential components of a customer and market audit.

> Customers have never known what they want, so don't ask them!

Nonetheless, as the purpose of the audit is to provide all the data and intelligence necessary for the strategic marketing

The contents of a strategic marketing plan (T+3)
(less than 20 pages)

- The purpose statement
- Financial summary
- Market overview
  - how the market works
  - key segments and their needs
- SWOT analyses
- Portfolio summary
  - of SWOTs
- Assumptions
- Objectives and strategies
- Budget for three years

Figure 4.1: Hierarchy of planning.

plan itself, once again we repeat in Figure 4.1 the contents of the plan. This chapter will enable you to complete the section headed 'SWOT analyses' (of segments).

The first point we want to make is that people are not rational in their behaviour, no matter what the economists might say.

Most business people will have read about the Coca-Cola/Pepsi taste tests, which have been repeated many times over the past 40 years, always with the same results. In 'blind' tasting, a substantial majority prefer Pepsi. The same people, however, when tasting from bottles with the labels on, prefer Coca-Cola by a significant majority.

Even neurologists agree that people are not rational when choosing between products, as can be seen from the reference shown below.

NEUROLOGY AND BRAND PREFERENCE

'Ventromedial prefrontal cortex' (VMPC) is a critical neural substrate for the effect of commercial brand information on human decision making and brand preferences.

The key finding of this study is direct evidence that brand preference is the product of factors unrelated to the product taste. This effect is not present with patients with VMPC damage and defects in emotional processing.[1]

Neurologists repeated the Coke/Pepsi challenge a number of times always with the same result, except that people with a damaged brain section that affects the emotional part of decision making consistently preferred Pepsi Cola even when shown the brand names. Those respondents with normal ventromedial prefrontal cortex neural substrate consistently preferred Coke on being shown the labels.

Two further examples should convince you:

1. One of the big carmakers organized a competitor comparison day, buying one example of every rival model in a particular category and lining them up in a row. Each car was silver and the badges had been removed. Not only could the assembled experts not tell them apart, they couldn't even pick out their own car!

2. An extreme case has to be that particularly irritating class of drivel known as 'skincare' ads. Who on earth would believe the incredulous, ludicrously pseudo-scientific, indigestible goulash of molecules and meaningless polysyllables?

But a majority of people do!

Hence the crucial importance of the previous chapter, for a failure to understand market segmentation, irrespective of whether you are a business-to-business firm or a business-to-consumer firm, will prevent you from making offers that really meet not only their needs, but also their wants.

DON'T WASTE MONEY ON POOR MARKET RESEARCH

This heading may seem a little strange coming from two professors of marketing. The reality, however, is that most market research about customers and consumers is wasted, largely because respondents are asked inane questions about what they want, to which they invariably give rational answers.

To illustrate this point, let us give you an example.

A friend of ours, who prided himself on his rational behaviour, decided to apply a rational process to his new car purchase. He collected the brochures for 20 cars and analysed them on a spreadsheet according to factors such as speed, price, depreciation, and so on. Not only did he have a three-tier scoring system, but he also had a weighting system, because he reckoned he was less interested in price than speed, and so on. He scored all 20 models, multiplied the score by the weight and ended up with a rank order of cars of 1–20.

> Every market in the world is segmented. All we have to do is find out what these segments are and what they *need.*

He subsequently asked our advice, as he was clearly unhappy with the results of his own analysis. We asked him why he didn't want the number one ranked car. His response? 'It's a salesman's car'. His reason for being unhappy with the number two ranked car was 'It's an old man's car'. His reason for being unhappy with the third ranked car was 'It's a boy-racer car'. We eventually asked him which car he really wanted, to which he replied 'It's really difficult, because I quite fancy a BMW'. 'But,' we said, 'you can't have a BMW because it's number 19 on your list', to which he replied: 'Yes, it's really difficult, isn't it?'

Of course he eventually bought a BMW, but if someone had asked him stupid questions about why he bought a BMW, the truth about the emotional and social reasons for his purchase would not have been revealed. (Of course, a well-designed research study starting with an in-depth, genuinely open-minded qualitative stage is a different matter; we have plenty of good examples in this book, such as the tyre company at the start of Chapter 7.)

> Please don't ask customers what they want.

Please try to remember the segmentation examples given in the previous chapter. Here is one representing buyers of IT, shown here as Figure 4.2. Before the company in question understood this, their brochure contained references to wonderful technological features such as 'fast pad family, multi-media frads, pix firewall, LAN support, gigabit Ethernet' and the like.

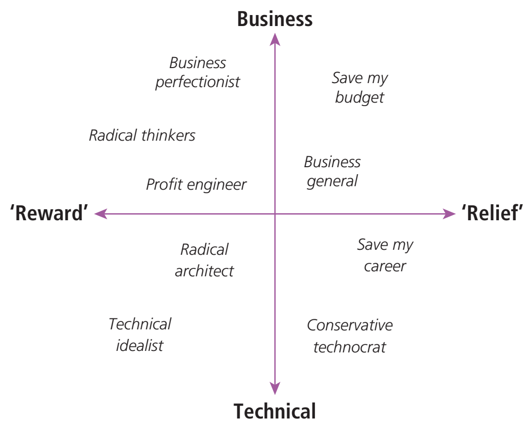

Figure 4.2: Understand the different category buyers.

Each of the nine segments shown is different from the others and it is quite easy to imagine how each segment would respond to approaches from suppliers of IT equipment. Let's not forget that it isn't companies that buy things, it is *people* in companies, and people don't stop being people just because they are performing a role in a company.

Most companies, however, 'marmalade' their average message across some mythical, average buyer of IT. The result? Because they don't understand the buyer's real motivations, they inevitably end up having to do a deal on price.

> The best way to understand customer needs is to observe them in their everyday environment.

Excellent market research organizations, of course, will not waste your money asking silly questions and there are a number of techniques to elicit the truth about customer motivations that do not involve asking questions.

There is absolutely no reason, however, why all organizations can't emulate the excellence of the 3Ms, GEs and P&Gs of the world when it comes to understanding real customer needs. P&G, for example, before launching products in, say, China, spend time living with families to observe actual behaviours so that when they do launch, they always hit the bulls-eye.

Let's take as a hypothetical example a company whose customers include factory managers. By observing their environment, the noise, the irritations, the blockages, the interruptions, and so on, it is then possible to go back to the 'laboratory' and invent something that helps to reduce all these problems.

Let's take one more hypothetical example. Imagine a 19th-century horse and carriage with four passengers. At a stop, one of our early market researchers approaches them and asks them what they want.

The first passenger says: 'Could you please go away and invent the internal combustion engine?' 'What's that?' says the researcher. 'It's the associated corpuscular emissions per zero point zero gram of air, producing ions carrying one electrostatic quantity of electricity of either sign…'

The next passenger says: 'This horse stinks – could you go away and invent air conditioning please?'

The next passenger says: 'Could you please go away and invent ABS brakes?'

The fourth passenger says: 'Could you please go away and invent windscreen wipers?'

And so on, after ridiculous so on. As Henry Ford said: 'If I had asked customers what they want, they would have said "A faster horse!"'.

Have we made our point by now? Your job is to understand the environment in which your customers work and to come up with solutions (offers) that make their lives easier, more profitable, and so on. Later in this chapter we deal with value propositions.

A PROCESS FOR UNDERSTANDING WHAT CUSTOMERS WANT

Please don't think we are about to suggest that you should all become sophisticated market researchers. You don't even need to worry if you can't afford expensive research firms, as we are about to show you how you can proceed to do a much better job of understanding your customers' real needs. After all – and this has always been our experience of most organizations – you already have a wealth of data, information, knowledge and wisdom about your markets and your customers, otherwise you wouldn't have got as far as you have. All you need is a process for harnessing all your wisdom and this is what follows. Once you've followed this process, by all means refine your key actionable conclusions with some fresh in-depth research if time and budgets allow; at least you will then know exactly what you are looking for.

You cannot, however, implement this part of the process if you have not bothered to complete the market segmentation part in the previous chapter, otherwise you will be adding yet more nonsense to your marketing audit and planning process.

> You need a process for harnessing all the knowledge and wisdom you already possess.

SWOT ANALYSES

Everybody on Planet Earth knows what a SWOT is – it is an analysis of strengths, weaknesses, opportunities and threats. Our experience, however, of SWOTs is that they are so badly completed as to be almost useless.

> Most SWOT analyses are as useless as an ashtray on a motorbike.

Why is this? Figure 4.3 below shows what SWOTs normally look like and you will observe that we have scrawled across the cross the word 'WRONG'.

As experienced presenters at in-company workshops and conferences, we travel all over the world and often visit the business part of the hotel in which we are staying. In every syndicate room, in every hotel in the world, there is a flip chart with a SWOT on it and they ALL say more or less the same things!

Under 'Threats', they all list: 'the weather; competitors; government legislation; the Koreans'… and so on, and so on. On the 'Opportunities' side, they all list: 'the weather; competitors; government legislation'… but note – 'the Koreans' never make it to the Opportunities side of this totally ridiculous method!

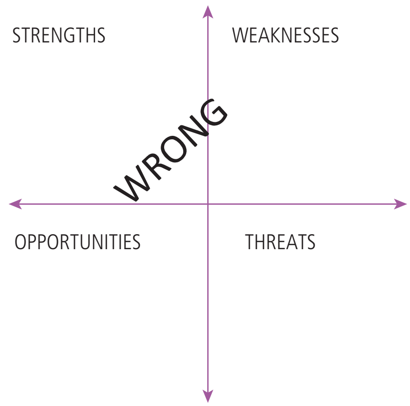

Figure 4.3: An incorrect SWOT format.

Strengths	Please tick appropriate boxes	Hidden meanings
High quality		We can't think of any real reason why we do business in this market . . .
Low price		That must explain it . . .
Personal service		We still can't . . .
High value to customers		Our products are a bit expensive, but we still sell some
Old-established firm		We must be OK, we've survived so far
Technologically sophisticated		We know more than the customer
Product strengths		Look at the product, never mind the customer
The 'natural' supplier to this market		We don't know who our competitors are
We are the industry standard		We don't think we have any competition

Figure 4.4: 'Motherhood' strengths statements.

Let us give you some more fatuous examples, where words are written down without any thought given to their real meaning. These are given in Figure 4.4.

From our sceptical interpretation of these strengths and weaknesses (with thanks to Professor Nigel Piercy from Swansea University Business School for his original thinking about this topic), you will see that they mug words and that they come out in a meaningless cacophony.

Don't use meaningless words in SWOT analyses.

Even worse, this vapid stream of words reaches a sort of 'my head is in the oven, my feet are in the fridge, so on average I am quite comfortable' conclusion, especially when the technique is applied to any commercial group other than a real segment.

Guidelines for a Better Approach

Before setting out a more robust way of carrying out a SWOT analysis, let us set out some guidelines to ensure a more meaningful output. These are shown below in Figure 4.5.

Set aside time for conducting proper SWOT analyses on segments.

Conducting a meaningful SWOT, however, is still quite a difficult task that will, alas, consume some of your valuable time. The results, however, will more than compensate for taking your attention away from the pressing day-to-day problems that confront you. Our advice is to set aside a morning or afternoon to meet with a small team of colleagues to complete SWOT analyses on at least five or six segments. Include in your team at least one person who is closely involved with customers, either in a sales or customer service capacity, one person who understands the product/service well and one person who understands your database well. If you have a marketing executive, they should obviously be included.

This small team of four or five people should find an environment in which they will not be interrupted and should be prepared to be totally open-minded about the task to be undertaken. Figure 4.6 describes the process the team should go through, and Figure 4.8 is the template to be completed. It can be seen from column 1 that the exercise should be completed on a *segment*; hence, if you have discovered six or seven segments from your work resulting from Chapter 3, you will need to do six or seven SWOT analyses.

Strengths
- It can create value for the organization and customers
- It is unique
- It is inimitable
- It is lasting

Opportunities
- It is large
- It is accessible
- It is lasting

Weaknesses
- It is meaningful to the customer
- It is unique
- It is difficult to fix

Threats
- It is significant
- It is lasting

Figure 4.5: Guidelines for doing a proper SWOT.

1. Identify the Critical Success Factors (CSFs) that influence the customer's decision. There are usually not more than six really important factors.
2. Assign an importance weighting to each CSF so that the weightings for each segment totals 100%.
3. Identify the key competitors for each segment and score performance of your company and each key competitor on a scale of 1 to 10, where 1 = very poor and 10 = excellent. Limit to a few competitors (between one and three).
4. Multiply the weights by the scores and add up the weighted score for each competitor.
5. Assess your relative strength by dividing your score by the best competitor's score.
6. Identify the key issues from the analysis.
7. Note you can change your relative business strength by focusing on improving your strength on the criteria that matter most to customers.

Figure 4.6: A process for completing a SWOT.

The following two figures explain the process. Figure 4.7 is a completed example. Figure 4.8 is the template to complete for each segment. From column 2 (critical success factors – CSFs) it can be seen that there are only five spaces. The problem here, however, is that there is a tendency to write down words such as 'Product Performance', 'Price', 'Service', and so on, all of

CSFs	Weights	Score/weight Score out of 10–multiplying these by the weight			
		You	Compet. A	Compet B	Compet C
1. Thought leadership	50	6 / 3.0	8 / 4.0		
2. Impact on practice throughput	25	8 / 2.0	7 / 1.8		
3. Patient satisfaction	15	7 / 1.1	10 / 1.5		
4. Impact on practice budget	10	6 / 0.6	5 / 0.5		
5.					
6.					
Totals	**100**	**6.7**	**7.8**		

Relative Business Strength: -1.1

Figure 4.7: Critical success factors: example.

1. SEGMENT DESCRIPTION
It should be a *specific* part of the business and should *be very important* to the organization

2. CRITICAL SUCCESS FACTORS
In other words, how do customers choose?

1	
2	
3	
4	
5	

3. WEIGHTING
(How important is each of these CSFs? Score out of 100)

Total 100

4. STRENGTHS / WEAKNESSES ANALYSIS
How would your customers score you and each of your main competitors out of 10 on each of the CSFs?
Multiply the score by the weight

	You	Comp A	Comp B	Comp C	Comp D
1					
2					
3					
4					
5					
°					

5. OPPORTUNITIES / THREATS
What are the few things outside your direct control that have had, and will have, an impact on this part of your business?

OPPORTUNITIES

1	
2	
3	
4	
5	

THREATS

6. KEY ISSUES THAT NEED TO BE ADDRESSED
What are the really key issues from the SWOT that need to be addressed?

Figure 4.8: Strategic marketing planning exercise – SWOT analysis.

which are meaningless unless accompanied by a more detailed explanation.

Ensure that 'critical success factor' analysis is properly understood.

The following simple case will explain a methodology for making the summary of CSFs more meaningful.

Involve a multi-disciplinary team in completing SWOT analyses.

In 2008, the recession led to a decline in the number of parents sending their children to independent/private schools. In other words, sales declined for most independent schools. The knee-jerk reaction of independent schools was to drop the price, with the inevitable result that the whole sector became unprofitable.

Faced with this dilemma, the authors were asked to help. Figure 4.9 below shows the five key buying factors that parents took account of when considering which school to send their child to. It is important to stress that uncovering these key buying factors did *not* require research, as the schools already knew them – it was just that until then no one had asked them to rationalize what they already knew!

It was a simple task after that to explore in more detail what each heading really meant and some of the details for just one of these headings are shown in Figure 4.10. The same level of detail was generated for each of the four other factors. Just understand how easy it was to generate these details from the heads of these very experienced people.

Executives in the independent school sector already knew the factors for success. All that was required was a process to elicit this knowledge from them.

The next step was obviously to generate a number of segments of parents, for clearly not all parents have the same needs or considerations in choosing an independent school for their child.

5 CSFs
academic
school/family relationships
convenience
costs
enhancement

Figure 4.9: Independent schools.

- Personality and vision of Head
- Exam results
- Class size
- League table position (compared to regional competitors)
- Student academic successes (Oxbridge, major universities, competitions)
- Academic planning: A level, IB, pre-U; IGCSE? New subjects?
- Flexibility of subject choice
- Academic history (results over a number of years)
- Quality/knowledge/experience of staff
- Facilities for teaching and learning
- Learning opportunities outside mainstream subjects (could be vocational skills)
- Reporting procedures
- Innovations in teaching and learning

Figure 4.10: Academic factors.

The main point, however, is that it is OK to write in column 2, for example, 'Academic factors', because behind this there will be a deep understanding of what this really means in the case of a particular segment.

Independent schools are, of course, small organizations in the main, so this case illustrates that this process is not just for large companies.

More importantly, however, is the fact that, having done this SWOT analysis on each segment, each independent school can now look at its asset base and appeal, via communications, to those segments to which it is most likely to appeal.

The main points to take from this little case example are:

- Irrespective of the 2008 recession, these schools had absolutely no reason to reduce their prices. All they needed to do was to harness the knowledge and wisdom they already possessed, using the processes outlined in Chapter 3 and in this chapter.
- Zero market research was involved, as the independent schools already knew this stuff.
- They could now carry out focused, meaningful SWOTs on each segment.

Having completed a SWOT on each segment, it is now possible to select those that most closely match our asset base.

Let's now move to column 3 in Figure 4.8. This requires each CSF to be weighted according to its relevance/importance to each segment. Usually, once the hard work has been done on column 2, this isn't too difficult to fathom, but if it is important and if you have real doubts, go and talk to some customers. In some cases, it might even be necessary to do some market research, but this will only be necessary if the team does not possess deep knowledge of the customers' world already … and that should be a key criterion when recruiting staff, so often the requisite insight is resting in the heads of your colleagues.

This process will clearly establish what you need to improve to succeed in each segment.

In the above case of independent schools, one segment might rank academic achievement very highly, with price being of lesser importance.

Once this step has been completed, it is possible to move to the fourth column in Figure 4.8. Make a note your own organization's score out of 10 for each CSF as well as the score for at least one major competitor. A simple process then follows of multiplying the scores by the weights to arrive at a weighted score out of 1,000 for you and at least one major competitor. (Or divide by 100 to get a score between 1 and 10.)

These weighted scores will indicate why you are the best competitor in this segment or, if not, where your weaknesses lie compared with your competitors.

This step is crucial in developing a winning strategy to grow sales and profits, because these weighted scores will later become the driver of your strategies to achieve your objectives. This will form the basis of Chapter 6.

The results from your SWOT analyses will also form the basis of your value propositions, which are discussed later in this chapter.

Boxes 5 and 6 in Figure 4.8 are the opportunities and threats from outside the company as they relate to each segment. They are *not* internal and at this stage are *not* things you will do. The

- CSFs provide a customer-focused way of assessing the strengths and weaknesses of our offering
- Obtain a customer view where possible – otherwise use a team of those who are close to the customer
- Validate the results against current financials
- Our weighted average score, compared with the best competitor score, is plotted on the horizontal axis of the Directional Policy Matrix

Figure 4.11: Summary.

final step in completing a SWOT analysis for each segment is to summarize all the key issues arising from your analysis.

The lessons to be learned from the independent schools case are crucial to conducting truly powerful SWOT analyses on each important product/market segment.

We must stress here once again that a SWOT should be conducted on ALL segments, of which there are likely to be at least seven or eight. So it can be seen that this is the most time-consuming and most difficult of all the strategy-formulation steps. Done correctly and diligently, the setting of objectives and strategies becomes a lot easier and more productive.

It is also useful to remember that each SWOT will be much more useful and relevant as a result of the marketing audit process. This audit will inevitably produce significant amounts of data. A SWOT is a very useful way of converting all this data into intelligence as part of the strategy development process.

Figure 4.11 summarizes the process described above.

Remember:

- Focus on real segments, not on the whole market.
- Shared vision – it works best if done in a small, experienced group.
- Ideally, write the customer's *goal* as a CSF, rather than what we sell; for example, 'Save my budgets' or 'Enable my radical business model' in the case of the IT company from the previous chapter, rather than 'Price' or 'Service'. For more on this, see the section 'Gaining competitive advantage through value-in-use' in Chapter 11 on Pricing.
- Expressions like 'customer orientation' are meaningless. It is only meaningful if explained properly and if customers really value it.
- Opportunities and threats exist outside the organization – they are not things we plan to do.

We are now ready to proceed to the next step – developing value propositions for each important segment.

Opportunities and threats are outside your control.

UNDERSTANDING THE REAL MEANING OF CUSTOMER VALUE

Understanding more about value propositions will help make the resulting plans much more powerful.

What is Value?

The very word 'value' is highly contentious, because it totally depends on whose point of view is being taken and the context in which the word is used.

Before we give you our own interpretation of the term (which will be used through the remainder of this book), let us share with you some common definitions of the term. We will do this as briefly as possible and only in the interest of not wishing to be labelled as biased marketers.

It is important to understand the meaning of 'value'.

Value chain analysis

Firstly, there is Michael Porter's well-known concept of value-chain analysis.[2] Porter's concept of value added is an incremental one; he focuses on how successive activities change the value of goods and services as they pass through various stages of a value chain. 'The analysis disaggregates a firm into its major activities in order to understand the behaviour of costs and the existing and potential sources of differentiation. It determines how the firm's own value chain interacts with the value chains of suppliers, customers and competitors. Companies gain competitive advantage by performing some or all of these activities at lower cost or with greater differentiation than competitors.'

Shareholder value analysis (SVA)

Secondly there is Alfred Rappaport's equally well-known research on shareholder value analysis (Rappaport 1986).[3] Rappaport's concept of value added focuses less on processes than Porter, and acts more as a final gateway in decision making, although it can be used at multiple levels within a firm. He describes the process of analysing how decisions affect the net present value of cash to shareholders. The analysis measures a company's ability to earn more than its total cost of capital. Within business units, SVA measures the value the unit has created by analysing cash flows over time. At the corporate level, SVA provides a framework for evaluating options for improving shareholder value by determining the trade-offs between reinvesting in existing businesses, investing in new businesses and returning cash to stockholders.

Customer perceived value

A third way of looking at value added is the customer's perception of value. Unfortunately, despite exhaustive research by academics and practitioners around the world, this elusive concept has proved almost impossible to pin down: what constitutes [customer perceived] value – even in a single product category – appears to be highly personal and idiosyncratic. Nevertheless, the individual customer's perception of the extra value represented by different products and services cannot be easily dismissed: in the guise of measures such as customer satisfaction and customer loyalty it is known to be the essence of brand success, and the whole basis of the new science of relationship marketing.

Accounting value

Finally, there is the accountant's definition of value added: 'value added = sales revenue – purchases and services'. Effectively, this is a snapshot picture from the annual accounts of how the revenue from a sales period has been distributed, and how much is left over for reinvestment after meeting all costs, including shareholder dividends. Although this figure will say something about the past viability of a business, in itself it does not provide a guide to future prospects.

One reason that the term 'value added' has come to be used rather carelessly is that all these concepts of value, although different, are not mutually exclusive. Porter's value chain analysis is one of several extremely useful techniques for identifying potential new competitive market strategies. Rappaport's SVA approach can be seen as a powerful tool, which enables managers to cost out the long-term financial implications of pursuing one or other of the competitive strategies that have been identified. Customer perceptions are clearly a major driver (or destroyer) of annual audited accounting value in all companies, whatever strategy is pursued.

However, most companies today accept that value added, as defined by their annual accounts, is really only a record of what they achieved in the past, and that financial targets in themselves are insufficient as business objectives. Many companies are now convinced that focusing on more intangible measures of value added such as brand equity, customer loyalty or customer satisfaction are the new route to achieving financial results.

Common sense (and with apologies for this quasi-academic discussion) might argue that developing strong product or service offerings, and building up a loyal, satisfied customer base will usually require a series of one- to two-year investment plans in any business. Also, such is the universal distrust of marketing strategies and forecasts, it is common practice in most companies to write off marketing as a cost within each year's budget. It is rare for such expenditure to be treated as an investment that will deliver results over a number of years, but research shows that companies who are able to do this create a lasting competitive edge.

> Accounting value only represents what has been achieved in the past.

So we will quantify what a value proposition is from the customer's perspectives.

Differentiation

For any organization today, differentiation that is wanted by the customer is more challenging than at any time in history, but it remains at the heart of successful marketing. More importantly, it remains the key to a company's survival.

The truth is that if you are in an overcrowded market where you don't stand out, all lowering prices will achieve is to erode your margins and unless your business costs are lower than anyone else's, discounting is a losing game.

The alternative, of course, is successful differentiation. If you can't come up with something genuinely different and better, there isn't much future for your company.

> Differentiation that is wanted by customers is the key to commercial success.

However, before we explain how to go about this, we want to point out that because of technological advances, product differentiation is unlikely to win in the long run, because this is comparatively easy to emulate today.

Much more likely, differentiation will result from the way you relate to your customers.

Excellence is not enough – differentiation is essential

For now, let's call this 'customer service' and we will explain later in the book the myriad of forms that customer service can take (see particularly Chapter 9). One such form is the result of market segmentation and we devoted a whole chapter to this fundamental form of differentiation and competitive advantage (Chapter 3).

For now, however, all we want you to understand is that differentiation is the key to commercial success and must be encapsulated somehow in a value proposition.

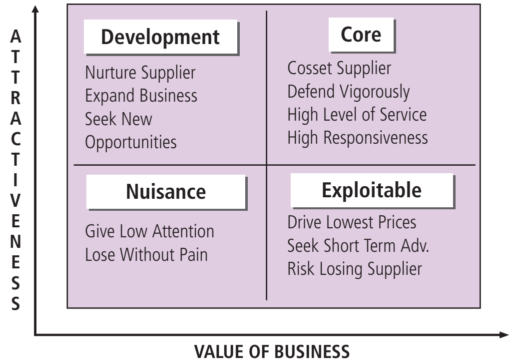

Figure 4.12: Strategic purchasing.
Source: Based on: Kraljic, P. *HBR* 1 September 1983.[4]

Let's start by looking at Figure 4.12 above.

It is used by most buyers in most markets, the only difference being that the vertical axis is sometimes labelled 'differentiation' (high or low). The most important box to look at is the bottom right box. Here, the buyer orders a lot and they can get it from virtually any supplier, so not surprisingly, they buy on price.

The bottom left box (low differentiation and the buyer does not purchase a lot), represents a great opportunity for firms to take responsibility from the customer by means of outsourcing.

> Buyers will pay a premium price (and buy a lot) for something which is different and which will help them.

The top left box, providing a firm offers something different that the customer really values, is an even better opportunity, because even though they don't buy much, price is rarely important.

By far the best box to occupy is the top right one. Buyers order a lot and they really value the differentiation offered. Here, it is not unusual for them to pay up to 20 per cent premium to deal with such suppliers.

The bad news, however, is that the low differentiation axis nearly always leads to very low prices and margins for suppliers. This is OK, however, providing at least some of the main products or services you supply are differentiated and it is to this that we now turn our attention in the context of value propositions. Have a look at Figure 4.13.

Then have a look at your own website. Typically they say things like:

- We are innovative.
- We have better quality.
- We have a great reputation.
- You can trust us.
- We are the leading provider of ….
- We get good results for our customers.
- We are very responsive.
- Blah, Blah, Blah ……….

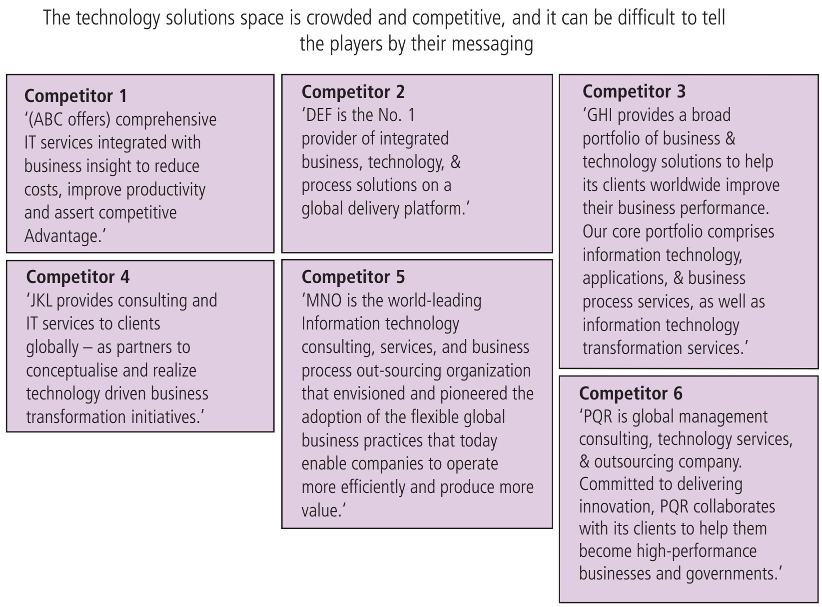

Figure 4.13: The lack of differentiation in competitors' messaging.
Source: Malcolm Frank, Senior Vice President, Strategy & Marketing, Cognizant, as presented at ITSMA's Marketing Leadership Forum, April 2006.

Everybody sounds the same and in the main, customers just don't care. We defy you to see any difference in what these suppliers claim to be offering.

> Our definition of a value proposition is 'A promise of our offer's relative value, which equals perceived benefits minus sacrifices such as cost and time. This equation must be positive'.

The Investopedia definition of a value proposition is: 'A business or marketing statement that summarizes why a consumer should buy a product or use a service. This statement should convince a potential consumer that one product or service will add more value or better solve a problem than other similar offerings.' McKinsey's definition is: 'A clear, simple statement of benefits – both tangible and intangible – in the company will provide along with the price which a customer in that segment will pay for those benefits.' Our own definition is: *A promise of our offer's relative value. Relative value = perceived benefits minus sacrifices such as cost and time. This equation must be positive.*

A value proposition should also be:

- Distinctive — It must be superior to competitors.
- Measurable — All value propositions should be based on tangible points of difference that can be evidenced and, where possible, quantified. In business markets, this quantification should be in monetary terms.
- Sustainable — It must have a significant life.

	STRATEGIC	HIGH POTENTIAL
CREATING ADVANTAGE		
AVOIDING DISADVANTAGE		
	KEY OPERATIONAL	SUPPORT

Key: **Strategic** = Issues that will ensure the customer's long term success.
High Potential = Issues that, whilst not crucial currently, could potentially lead to differential advantage for the customer.
Key operational = Issues that, unless solved reasonably quickly, could lead to disadvantage for the customer.
Support = Issues that, whilst of a non-urgent nature such as information availability, nonetheless need to be solved to avoid disadvantage for the customer.

Figure 4.14: Identifying sources of differentiation.

Business customers expect their business to be better off as a result of dealing with you and you must be able to prove that dealing with you will create advantage for the customer, not merely help them to avoid disadvantage. This is summarized in Figure 4.14 and please note the key words: creating advantage, not just avoiding disadvantage.

A value proposition has five potential parts, as follows:

- Added value (e.g. revenue gains, improved productivity, service enhancement, speed, etc.).
- Cost reduction.
- Cost avoidance.
- Reduction of other sacrifices. Notable are time (being easy to deal with) and risk (how likely are things to go wrong? If they do, who pays, and who takes the blame?).
- Emotional contribution (e.g. trust, 'feel-good factor', confidence, self-esteem, etc.).

In business-to-business markets it is essential to spend time understanding the intricacies of the customer's processes in order to find ways of adding value. Just the same applies with a family's processes: how can a bank help them manage their money better, for example?

The first three are comparatively easy to quantify, the last one less so, although particularly with well-known brands such as SKF, IBM, GE, 3M and the like, they are often high on the business agenda.

An excellent example of this is SKF, the Swedish bearing company. They have a global President of Value Propositions. They tailor them to each customer, but Figure 4.15 shows a generic value.

From this it can be seen that over the life of the bearings, the significant premium over the bearings of competitors saves the customer $30.25, representing the quantified added value.

This, of course, is a simple example and value propositions can be more complex. Look, for example, at Michael Porter's well-known value chain, shown in Figure 4.16.

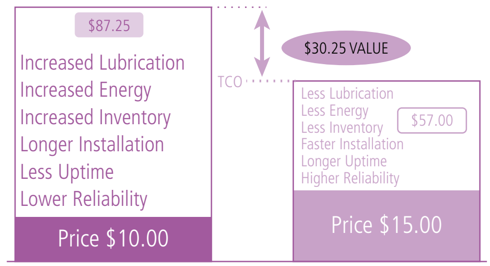

Figure 4.15: SKF quantified value proposition.
Source: Reproduced by kind permission of SKF.

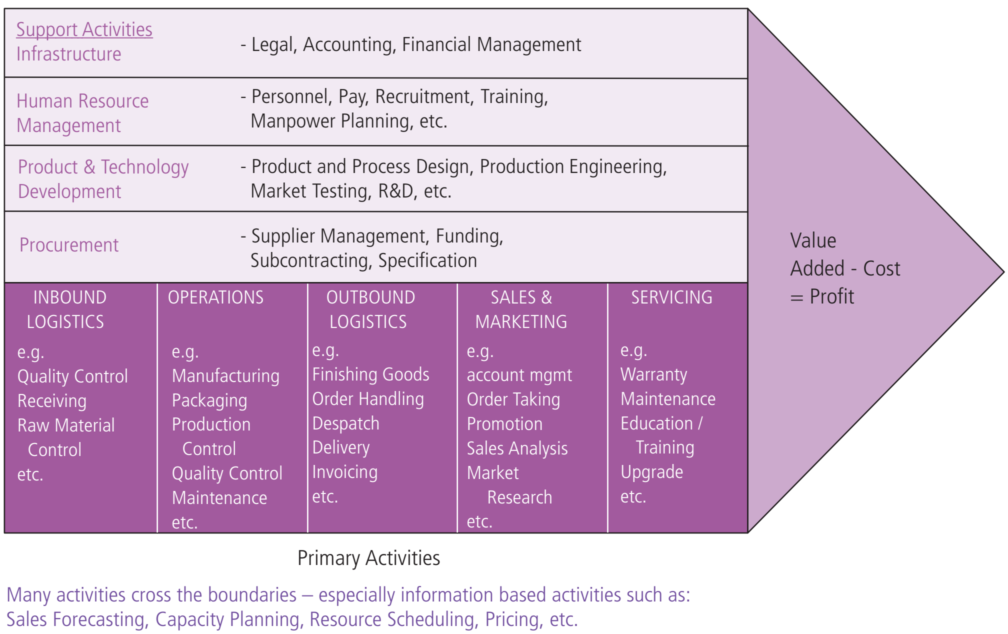

Figure 4.16: The value chain.

It will be seen that, particularly for a large, complex customer, the opportunities to add value, reduce or avoid costs, are substantial. But this will require the supplier to spend time understanding the intricacies of how the customer's business works from end to end.

Figures 4.17 and 4.18 give some examples of how this is possible, whilst Figure 4.19 gives a real example from Tetrapak (reproduced with their kind permission).

Although Tetrapak is a large organization, it nonetheless is involved with a technology that hundreds of competitors also understand. The difference is that customers value Tetrapak more highly because of their attention to detail throughout the value chain.

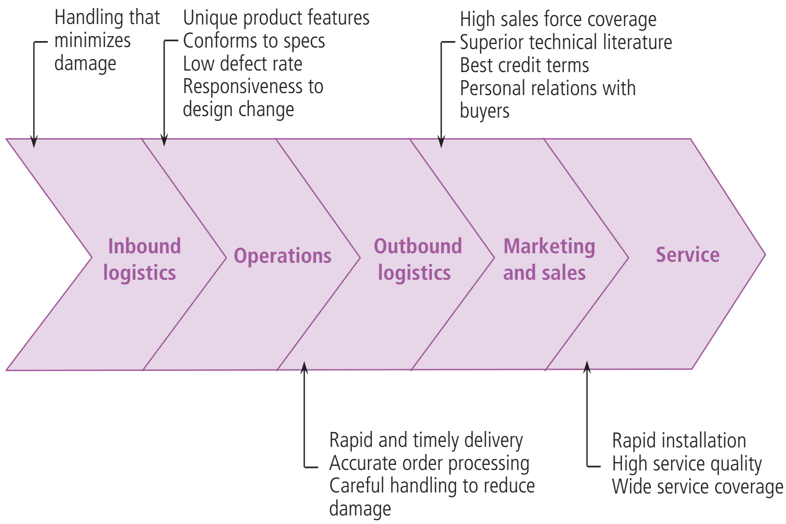

Figure 4.17: Sources of differentiation in the value chain.

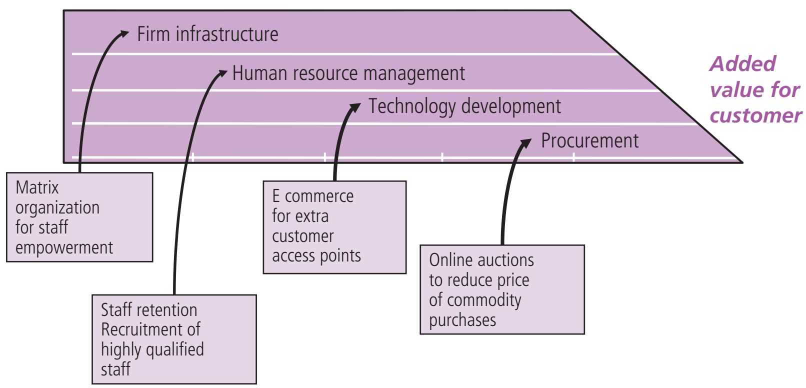

Figure 4.18: How do you add value through key support activities?

An example of a small label company is shown in Figure 4.20 and the benefits are shown in Figure 4.21.

The benefits of financially quantified value propositions

Figure 4.22 shows the benefits of financially quantified value propositions.

The process for quantifying value propositions

The process for quantifying value propositions is shown in Figure 4.23 and Figure 4.24 shows where this fits in the marketing planning process.

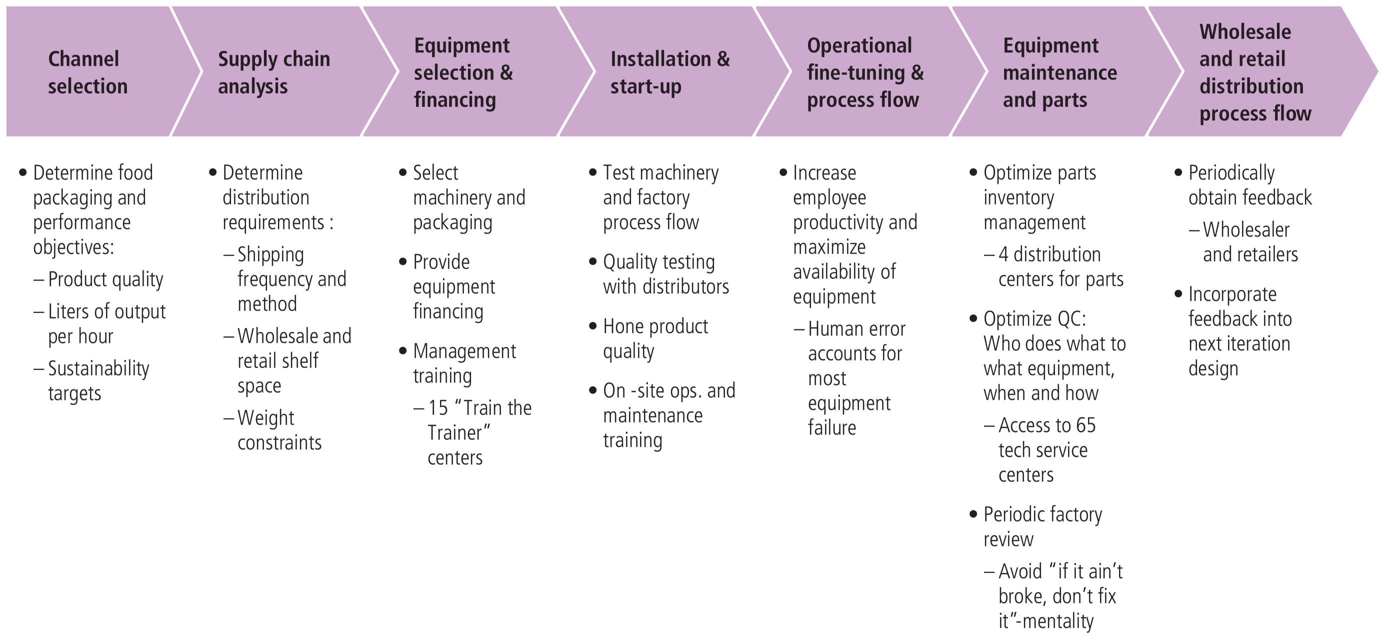

Figure 4.19: Tetra Pak is a multi-stage, multi-level partner.
Source: Reproduced by kind permission of Tetrapak.

They quantified all of the following:

- It reduces your inventory from six to two weeks
- It reduces the cash tied up in inventory
- It reduces the problems when you have a stock-out
- It reduces stock-put costs (downtime, expedited shipping, overtime)
- It reduces inventory-carrying costs
- It reduces inventory obsolescence
- It increases sales when you can make quick changes
- It eliminates the need to place orders
- And all at the same price

Figure 4.20: Example of a label company to food manufacturers taking over responsibility for almost eliminating their stock-holding.

- They answer the question: 'Why should I buy from you'
- They are different from their competitors
- They reduce the risk of losing a customer to a competitor offering a price reduction
- They make it more difficult for a customer to leave
- They become better at the production and distribution processes
- They can then gain new customers
- Their sales and profits increase

Figure 4.21: Advantage to the label company.

Will help you increase profitable sales for a number of reasons:

- Only 5 per cent of companies have financially quantified value propositions (McKinsey) and developing them will differentiate your company
- Even if you DON'T have any differentiation, the very act of financially quantifying the benefits, even if they are standard benefits, will give you an advantage over your competitors
- You will close more deals (typically an additional 2–10 per cent)
- The sales cycle will be reduced by 10–25 per cent
- It will help reduce discounting by 20–30 per cent
- It will help make marketing campaigns more productive

Additional benefits (harder to quantify) are:

- Avoidance of no/delayed decisions to buy
- Improved customer relationships
- Referrals from satisfied customers
- Sustained relationships

Figure 4.22: Financially quantified value propositions.

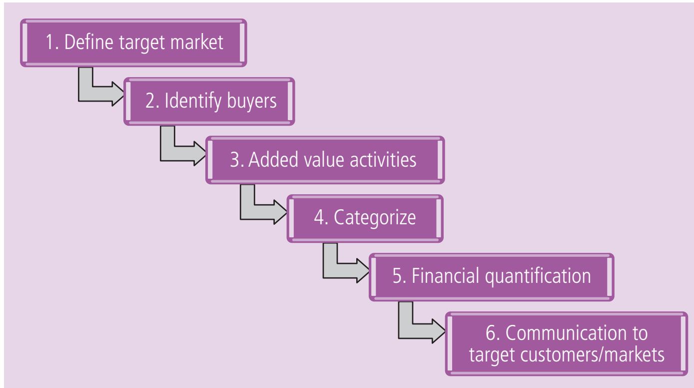

Figure 4.23: Value proposition process.

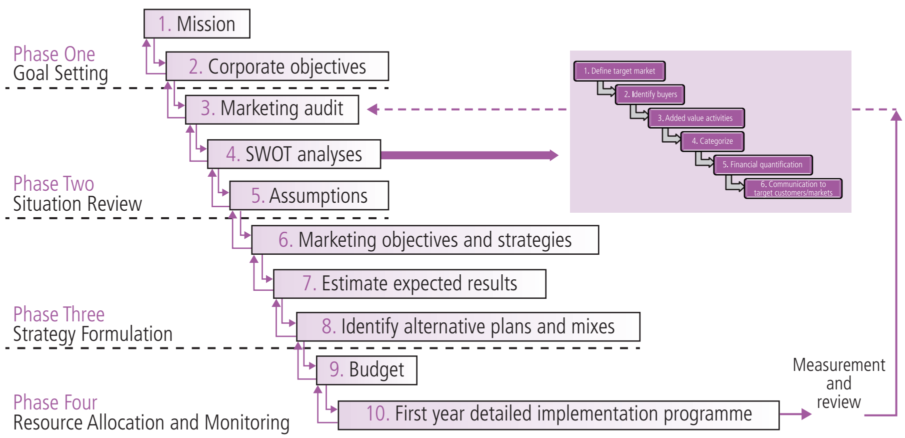

Figure 4.24: The ten steps of the strategic marketing planning process.

Figure 4.25 shows how the analysis done on the customer's value chain as described above can be summarized in financial terms.

In conclusion, we hope we have convinced you that differentiation and quantifiable value propositions are crucial to profitable growth. There is one final point, however. Everything an organization does, from R&D through to after-sales service, manifests itself in the value proposition offered to the customer and, of course, this value proposition has a name on it – either a brand name or the name of the supplying company. This important topic is covered in some detail in the next chapter.

Everything an organization does is represented by the offer, which has a name attached to it, that is, a brand.

Customer's value chain weaknesses and opportunities for the supplier to add value		Customer weaknesses	Describe in words the opportunity for us (the supplier)	Importance to the customer or impact (high/med/low)	Added value + ($ € £)	Cost reduction – ($ € £)	Cost avoidance + ($ € £)	Intangible benefits – ($ € £)
VALUE CHAIN	Inbound							
	Operative							
	Outbound							
	Marketing and sales							
	Customer service							
VALUE CHAIN FIRM INFRASTRUCTURE	Finance							
	Procurement							
	Technology development							
	HR management							
	Other (e.g. CSR)							
				Subtotal:				

TOTAL: $ € £

Figure 4.25: Worksheet.

APPLICATION QUESTIONS

1. Try to establish whether you have any evidence that your customers do not behave rationally. Explain why this should be so.
2. Have a look at some of your SWOT analyses that you and your colleagues have completed in the recent past. Critically analyse them in the light of what we have explained in this chapter.
3. Does your organization have financially quantified value propositions for customers? If not, why not?
4. Are your products/services significantly different from those of your competitors?

CHAPTER 4 REVIEW

Customer behaviour

Customers do not behave rationally, no matter what economists might say.

SWOT analyses

Understanding needs and wants by segment is a crucial step in the marketing planning process.

Be certain not to enter meaningless SWOT analyses headings, such as 'customer service' as this could mean anything from answering the phone within five seconds to on-time-in-full delivery.

Customer value

The word 'value' has many meanings, but customer value relates to what customers think is important to them.

Try Exercise 4.1

Differentiation

Differentiation will mainly be achieved through needs-based segmentation rather than through products/services.

EXERCISES

Exercise 4.1 Process (Steps 1–11)

Step 1 – Why Do Customers Buy?

– Why do customers buy a product or service like yours?

Step 2 – Business Problem

– **Because** we are ________________ (what is the unit of measure)

Step 3 – Outcome

– **Therefore**, we want to reduce ________________

Step 4 – Importance

– Score 1–3

Step 5 – Key stakeholders

– CEO, Sales Director, purchasing

Step 6 – Our offer

– List your offers

Step 7 – Comparison to competitor

– Score 1–3

Step 8 – ROI category

– Reduce a cost, avoid a cost or increase revenue

Step 9 – Value Metric

– Staff costs, maintenance costs, downtime

Step 10 – Gather data

– Build savings and/or sales increase profile

Step 11 – Build financial model and dashboard

– Develop model break even, ROI, cost of doing nothing

(*Continued*)

Exercise 4.1 Process (Steps 1–9) Example

	Step 1	Step 2	Step 3	Step 4	Step 5	Step 6	Step 7	Step 8	Step 9
	Why Do Customers Buy?	**Business Problem**	**Outcome**	**Importance**	**Key Stakeholders**	**Our Offer**	**Comparison to Competitor**	**ROI Category - Reduce, Avoid, Increase**	**Value Metric**
1	**I** need to be able to predict revenue	**because** if we don't (and miss) our shareholder value drops	**therefore,** I want to maintain or increase my shareholder stock price (mitigate the risk of missing from lack of information)	2	Sales Director	Demand management	3	Increase revenue	Shareholder value, earnings, profit, EBITDA
2	**I** need to understand my true margins	**because** it affects our profitability	**therefore,** I want access to better (more, accurate, etc.) information on costs and revenues	2	VP Finance, CFO,	Financial	1	Increase revenue / Reduce cost	Added new revenue, reduction in labour costs, earnings, operating cost, profit, sales/emp, payroll as % of sales, EBITDA
3	**We** need to increase our billable utilization	**because** we need to offset costs for our revenue generation workforce	**therefore,** I want to increase revenue per employee	2	Services Delivery Director	Resource	2	Increase revenue	Revenue per employee, profit, operating cost
4	**We** need to understand our sales opportunities in the pipeline	**because** if we don't, we end up spending too much on outsourcing	**therefore,** I want to reduce my outsourcing costs	2	VP Sales	Demand management	1	Reduce cost	Outsourcing costs, **profit, operating costs**
5	**We** need to better understand our staffing of the projects and how to more effectively align resources	**because** we want to drive down the resource cost for every project	**therefore,** improving my margin on each resource assignment on a project	1	VP Services, CFO	Project management	1	Reduce cost	Internal resource / labour cost, earnings, operating costs, profit, sales per employee

Exercise 4.2 Simulation practice

Complete a SWOT in your game:

a) Go to the SWOT page in the Marketing Plan.
b) Choose a key segment for your company. This should be one that is key to your future success. It could be one that you are thinking about investing in or one that you are considering divesting from to release more funds.
c) Complete the SWOT for this key segment (make sure you discuss it within your team).
d) Copy the SWOT above to a new sheet [Excel tip: move your cursor to the tab at the bottom, right-click on your mouse, choose 'Move or Copy' and check the 'Create a copy' box].
e) Repeat for the other key segments.

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