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Certified value sellers

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Certified

value sellers

Some companies think that offering deep discounts to buyers is the only way to sell their products in business markets. James Anderson, Nirmalya Kumar and James Narus propose a better way.

Companies that sell products and services to other businesses (B2B) operate in an extremely competitive environment. Purchasing managers are increasingly held accountable for reducing costs, so they don't have the luxury of simply believing suppliers' claims of cost savings. A relatively easy and quick way for these managers to obtain savings is to focus on price and obtain price concessions from suppliers. Consequently, to enhance negotiating power, purchasing managers attempt to convince suppliers that their offerings are the same as their competitors' – that they could be easily replaced.

Given this atmosphere, many business marketers believe they can sell their products only by deeply discounting them; however, this is not true. Suppliers can use three approaches to sell their products and services in the business marketplace.

- *The first approach is to sell on the basis of price.* The only way to sustain this strategy is to slash costs to the bone and to try to trade higher volume (if attainable) for lower margins. This often becomes a dangerous balancing act that most firms cannot sustain.
- *The second approach is to claim exceptional value to realize higher prices.* Unfortunately, salespeople often cannot substantiate these claims in any meaningful way. Therefore, this approach seldom works. Purchasing managers are too sophisticated to fall for a "trust us, we have additional value" appeal.
- *The third option is a customer value management approach.* We think this is the best approach. It calls for using verifiable data to demonstrate and document the firm's product or service value in monetary terms.

For a moment, put yourself in the role of a commercial grower. Two suppliers are offering you mulch film, a thin plastic sheet placed on the ground to hold in moisture, prevent weed growth and allow vegetables to be planted closer together. Supplier A comes to you with this proposition: "Trust us. Our mulch film will lower your costs." →

→ Supplier B comes to you with this proposition: "We just lowered the cost of your mulch film by $16.83 per acre." Supplier B also offers to show you exactly how it determined that figure. Which supplier's value proposition is more persuasive?

Demonstrate and document value

Unfortunately, most companies can't sell using a customer value management approach because they have made no effort to understand the value they provide their customers in financial terms. Companies should show prospective customers what cost savings or added value they can expect from using the supplier's offering relative to the next-best alternative. The best way to demonstrate this value to prospective customers is through customer value assessment tools, which we term value calculators.

These tools are spreadsheet software applications that salespeople or value specialists conduct on laptops as part of a consultative selling approach to demonstrate the value that customers likely would receive from their offerings.

Demonstrating superior value is necessary, but it is no longer enough to become a best-practice company in today's business markets. Suppliers also must document the cost savings and incremental profits their offerings have delivered to customers. Thus, suppliers must work with their customers to define the measures by which they will track the cost savings or incremental profit produced and then, after a suitable period of time, work with customer managers to substantiate the results. Value case histories are one tool that best-practice suppliers, such as Nijdra Groep in the Netherlands and Rockwell Automation, use to accomplish this. Value case histories are written accounts that document the cost savings or added value that customers have received from using a supplier's market offering.

Documenting the superior value delivered to customers provides four powerful benefits to suppliers. First, it enhances the credibility of the value demonstrations for their offerings, because customer managers know that the supplier is willing to return later to document the value received. Second, documenting enables customer managers to get credit for the cost savings and incremental profit produced. Third, documenting enables suppliers to create value case histories and other marketing communications materials to persuade prospective customers of the value they, too, might obtain from the supplier's offering. Finally, by comparing the value actually delivered with the value claimed in the demonstration and regressing these differences on customer descriptors, documenting enables suppliers to further refine their understanding of how their offerings deliver the greatest value. This sharpens subsequent efforts to target customers.

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Conceptualizing customer value

With its emphasis on assessing customer value in practice, customer value management requires a conceptualization of value that is well reasoned, comprehensive and easily grasped. We start by defining customer value: "Value in business markets is the worth in monetary terms of the technical, economic, service, and social benefits a customer firm receives in exchange for the price it pays for a market offering." Initially, we express value in monetary terms, such as dollars per unit, euros per liter, or renminbi per hour. Economists may be interested in "utils", but we have never met a manager who was! After doing this, we can conceptually represent any market offering as a set of technical, economic, service, and social benefits that a customer firm receives. By "benefits", we mean net benefits, which include any costs a customer incurs in obtaining the desired benefits except for purchase price.

Then we focus on value; this is what a customer firm receives in exchange for the price it pays. Raising or lowering the price does not change the set of benefits that an offering delivers to customers, only the willingness of those customers to purchase the offering. Thus, we conceptually view a market offering as having two elemental characteristics: its value and its price. Finally, we contend that customer value in business markets is a comparative concept in which customers assess the value of a given market offering relative to what they regard as the next-best alternative to it.

This is no small point. There always is an alternative. It might be:

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- A market offering from a competitor using comparable, or alternative, technology to fulfil the customer's requirements and preferences: this is the most frequently encountered situation in business markets.
- The customer's decision to source an item from an outside supplier or to make the item itself: an example is a company that decides to outsource a part of its IT operations to an Indian supplier.
- The status quo (not doing anything): companies deciding whether to expand their facilities or to purchase management consulting services are examples.
- The most recent offering from the same supplier: a challenge that Microsoft faced, for example, was persuading its customers to upgrade from its Windows NT/2000 Server to its Windows Server 2003 when many of them were still satisfied with the performance of the NT/2000 server

Points of difference, parity and contention

The essence of our conceptualization of value can be shown in the following equation:

$$(\text{Value}_f - \text{Value}_a) > (\text{Price}_f - \text{Price}_a)$$

where:

Value_f = Value of the focal firm's market offering

Price_f = Price of the focal firm's market offering

Value_a = Value of the next best alternative's market offering

Price_a = Price of the next best alternative's market offering

What really matters is not the value of each offering but the difference in value between the two offerings relative to the difference in their prices. While the market offering of a supplier may deliver cost savings or incremental revenue and profit to customers in a number of ways, so, too, may the next-best alternative. Thus, although offerings in business markets may have many technical, economic, service, or social benefits that deliver value to customers, the paramount, overriding distinction to understand is this: how do these value elements compare to those of the next-best alternative? There are three possibilities:

Points of parity – those value elements whose performance or functionality is essentially the same as the counterpart elements of the next-best alternative

Points of difference – those value elements on which either the supplier's market offering is superior to those of the next-best alternative or the next-best alternative's market offering is superior to the supplier's

Points of contention – those value elements on which the supplier and its customers disagree about performance or functionality relative to the counterpart elements of the next-best alternative.

Points of contention arise in two ways: the supplier regards a value element as a point of difference in its favour while the customer regards that element as a point of parity relative to the next-best alternative; or, the supplier regards a value element as a point of parity while the customer regards it as a point of difference in favour of the next-best alternative. Points of contention are not problems; they can provide motivation for the supplier and its customers to work together to gather data to resolve the differences in perception.

Value word equations

Central to customer value management is the expression in monetary terms of the worth of the benefits that a customer firm receives from a supplier's offering. Doing this in practice is not easy and takes time, money, persistence and some creativity. Yet businesses must tackle this challenging task if they wish to become value merchants. As examples, consider the following:

- An economic benefit, such as providing consolidated monthly invoices instead of invoicing the customer after each purchase, must be translated into processing cost savings over the year for the customer.

Central to customer value management is the expression in monetary terms of the worth of the benefits that a customer firm receives from a supplier's offering.

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- A technical advantage, such as greater gloss from a diamond-like coating applied to plastic injection moulds that results in fewer machine jams and faster operations, must be translated into additional revenue and profit that the customer would generate from greater uptime and faster cycle time.
- A unique service, such as a chemical supplier's collection of used drums from the customer's site, must be translated into the customer's cost savings from not having to dispose of used containers in an environmentally safe way.
- A social benefit, such as Caterpillar's strong brand name, must be translated into the higher resale or trade-in prices that Caterpillar equipment receives versus Komatsu, reducing its life-cycle cost to customers.

Value word equations are a tool that enables a supplier to demonstrate and document points of difference and points of contention for its offering relative to the next-best alternative so that customer managers can easily grasp them, understand precisely how the supplier is assessing them, and be persuaded by the results. Value word equations provide a methodical way of convincingly demonstrating and documenting superior value in monetary terms.

A value word equation expresses precisely in words and simple mathematical operators (e.g., +, ÷) how to assess the differences in functionality or performance between a supplier's offering and the next-best alternative on a value element and how to convert those differences into monetary terms. An equation is constructed for each point of difference (and point of contention). The value element, expressed as either cost savings or incremental profit, is on the left side of the equal sign, and the components defining the differences in functionality or performance and what they are worth are on the right side. Accompanying each word equation are the assumptions that the supplier is making about the value element and how its monetary value is assessed.

Value word equations counter the rampant problem of unfounded value claims, when suppliers argue that their offerings deliver cost savings or added value relative to the next-best alternative but can provide little or no specifics of exactly why that's the case. With each retelling, the value claims from these unverifiable stories tend to grow larger and larger, taking on the character of fishing stories.

Customer managers in a series of business roundtable discussions we conducted in Europe and the United States related to us that prospective suppliers increasingly deliver to them what has become almost a generic value proposition: "We can save you money!" But, as one participant in Rotterdam wryly observed, with all the claims about how much money suppliers were saving him, it was a wonder that his firm had any costs left at all! To assess the validity of these claims, though, he said that he would follow up a prospective supplier's statement with a series of questions to probe whether the supplier had the people, process, tools and experience to substantiate its claims. He said that, based on their answers, most of the suppliers were telling fairy tales.

In contrast to this, firms such as Intergraph and Rockwell Automation use value word equations to make clear and easily understandable to customers how their offerings will lower costs or add value relative to the next-best alternative, what data needs to be gathered and how this data will be combined to provide value estimates.

Value word equations are a tool that enables a supplier to demonstrate and document points of difference and points of contention for its offering relative to the next-best alternative.

Value word equations at Rockwell Automation

Consider a value word equation that Rockwell Automation used to calculate the cost savings from reduced power usage that a customer would gain by using a Rockwell pump solution instead of a competitor's comparable offering:

Cost savings =

[kW spent * number of operating hours per year * $ per kW hour * number of years system solution in operation]
Competitor solution

– [kW spent * number of operating hours per year * $ per kW hour * number of years system solution in operation]
Rockwell Solution

The term "kW spent" represents the amount of electrical power consumed in terms of unit horsepower and unit efficiency. Unit horsepower

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and unit efficiency are industry-standard product specifications that the manufacturer prominently displays on the side of the motor solution.

Although the meaning of this value word equation may seem obscure, it reflects the heavy usage of industry-specific jargon that suppliers and customers in business markets rely on to communicate precisely and efficiently about functionality and performance.

The data for value word equations are most often collected from the customer's business operations by supplier and customer managers working together; but, at times, data may come from outside sources, such as industry association studies. In presentations of the results, each word equation is presented first. Then the data is substituted in each equation to calculate the estimate. These results are then collected in a value summary, which we refer to as the customer value model.

Best-practice companies in business markets that have adopted customer value management work with customers to develop the parameters of the research, as well as the particulars. Customer value research involves three phases: securing customer support, collecting data (not relying on customer attitudes or perceptions) and analyzing the data and creating a customer value model.

Becoming a value merchant

A value merchant recognizes the supplier's own costs and the market offering's value to the customer and works to obtain a fair return for both the supplier firm and the customer firm. The value merchant stands in stark contrast to the all-too-common value spendthrift who squanders the superior value of the supplier's market offerings, getting little in return.

In managing their sales force, firms too often make the mistake of rewarding revenue or volume while hoping for profitability. In fact, many companies emphasize volume over revenue, regardless of how they calculate their salespersons' pay cheques. Salespeople understand this and work accordingly. Indeed, this is a primary reason why so much price discounting takes place in the B2B marketplace.

To transform the sales force into value merchants, suppliers must have compensation plans that seamlessly reward value-selling behaviours and profitable outcomes. The company's emphasis in compensation plans must change from volume to total gross margin. However, transforming salespeople from value spendthrifts into value merchants involves more than just compensating them on the basis of profitability.

Firms must focus on value-selling skills in sales training and role playing, use sales councils and similar internal groups to promote value selling and develop a company culture that recognizes and honours value merchants. Along this line, some companies now rate specially trained salespeople as "certified value sellers" and compensate them accordingly. Companies should ensure that salespeople use value case histories in the field and that they keep these histories up-to-date. Finally, marketing materials should tout value selling at every opportunity.

Selling provable value makes profits. If a firm is delivering superior value that can be demonstrated and documented, it will be rewarded by its customers. So, get out of the commodity business. Be a value merchant instead – selling on the basis of proven superior value. ■

Resources

James C. Anderson, Nirmalya Kumar and James A. Narus, *Value Merchants: Demonstrating and Documenting Superior Value in Business Markets*, Harvard Business School Press, 2007.

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