RE-INVENTING VALUE PROPOSITIONS

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ABSTRACT

While many managers face the challenge of lower profits in increasingly competitive and commoditized industries, a few firms break out as market value leaders generating superior growth and shareholder returns. How do these firms break out of the commoditization trap? In this paper we propose these firms invent unique value propositions and offer them in superior ways to their customers. Based on our study of a number of market leaders, we provide a framework for systematically understanding and re-inventing the firm's value propositions. We propose that clearly understanding and defining the dimensions of a firm's value proposition is a critical first step in building an effective strategy.

INTRODUCTION

In industry after industry, competitors converge ever more quickly to offer similar products and service features. The trend for competitive companies to imitate each other leads to the increased commoditization of these products and services. This results in shrinking profit margins that limit the growth of shareholder value.

Despite this trend, there is an emergence in the marketplace of value leaders who break away from the pack and consistently outperform their competitors in creating shareholder value. These companies enjoy increased profits and superior performance in their industries.

Many management consultants and authors have identified these superior performers. Their common wisdom holds that these superior performers understand and serve their customers' needs better than their competitors. Emerging research suggests these firms also organize to better fit new competitive environments. However, while case examples abound, this research does not identify *how* managers can improve their value propositions or organizations to better serve customers, and simultaneously take advantage of new growth opportunities to create superior shareholder value.

For example, why do Amazon, Contadina, Southwest Airlines, Progressive Insurance, MBNA, or Dell Computer consistently outperform their competitors (e.g. United Airlines, CNA, and Apple)? We have identified and analyzed a number of market value leaders and found that they consistently created new value propositions and architectures for delivering value to customers. Value propositions define how product & service features are assembled and offered to meet customer needs. Value architectures define the specialized organizational system designed to deliver customer value.

What emerged from our analysis was a framework that identifies the key dimensions of customer value and provides a systematic way to map and compare the value propositions in an industry. This framework will help managers to identify opportunities for transforming and re-inventing existing value propositions to achieve market leadership.

CHANGING VALUE PROPOSITIONS TO ESCAPE THE COMMODITIZATION TRAP

How do value leaders escape the commoditization trap? They escape by reinventing their value propositions. Value propositions define how items of value (product and service features as well as complementary services) are packaged and offered to fulfill customer needs. To understand how firms can change their value propositions, we first need to define the concept of a value map and value frontier. A *value map* defines the relative position of different companies in an industry along the cost-performance axis. The *value frontier* defines the maximum performance currently feasible for any given cost (to the customer), and represents the different segments offered to customers. Successful market leaders create *unique positions* on the value frontier. However, if all the competitors converge toward a similar point on this frontier, the industry faces commoditization and potentially reduced margins.

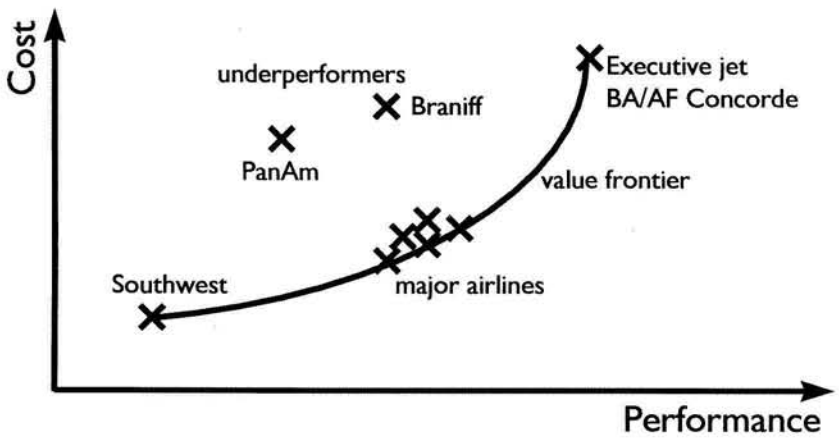

Figure 1: a value space map for the airline industry

Figure 1 illustrates a value map for the airline industry. It shows that most major airlines converge towards very similar value propositions, resulting in commoditization and lower profit margins. On the other hand, the extremes of the curve show companies which provide significantly different service. Southwest Airlines is the typical low-cost, low-frills supplier, yet still provides the basic performance attributes customers expect (frequent departure, on-time arrival, good customer service). Executive jets and the Concorde form the other end of the curve, providing extremely high-quality service (flexibility, comfort, privacy) at a corresponding price. Extending the frontier allows managers to radically reframe the value proposition.

We analyzed a number of value leaders, based on five-year market value growth. We found that market leaders escape the commoditization trap of their industry by either extending and reinventing the value frontier, or by radically shifting the frontier. In doing so, they create new markets and define new value propositions. Let us look at three strategies for changing value propositions with a value map, and some well-known companies in light of how their value propositions changed.

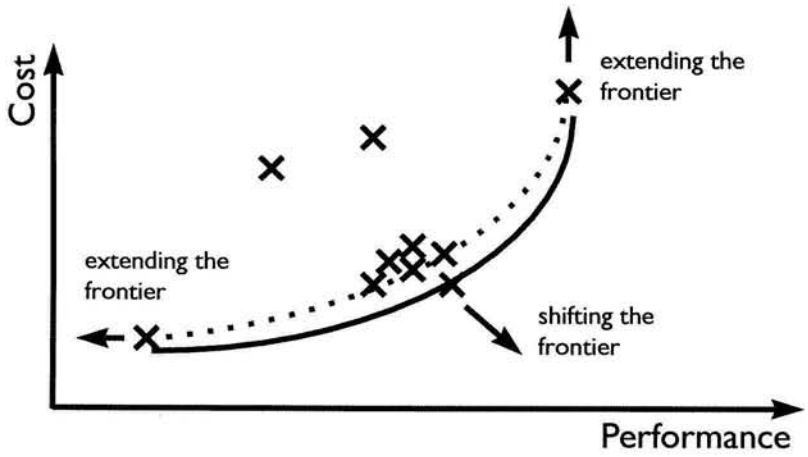

Figure 2: value space map transformations

Strategy One: Extend the value frontier toward the low-end

Southwest Airlines has been the fastest growing airline in recent years. In the last five years, their market value grew by an average of 19.6% per year. They also proved to be one of the most innovative airlines when they introduced low-cost, basic service. By combining frequent schedules and very low ticket prices, they were able to steal market share from the major airlines, but maybe more significantly, switch people from driving, or taking the bus. By offering affordable travel for everyone, they also increased the demand for air travel, as visiting friends and relatives became feasible on a much more frequent basis. They achieved such results by combining very efficient and lean operations, a multi-skilled staff, standardized operating procedures and aircraft, and a carefully controlled growth strategy.

It is easy to see how Southwest extended the value frontier toward the low end by examining the attributes of the industry value propositions. The airline understood very well that some customers would trade off a lower ticket price for some traditionally expected features, such as food service, interline baggage handling, or assigned seats. By providing the core needs of their customers, and focusing the entire organization to serve those needs efficiently, they were able to open a whole new

market segment, where they reign as kings. The key critical success factor is to find exactly which benefits/services customers are ready to trade off, and what compensation they need for it.

Extending the value frontier toward the low-end caters mainly to customers willing to trade performance for price.

Strategy Two: Extend the value frontier toward the high-end

In many industries, a certain number of customers are willing to spend a considerable amount of money to get a high level of service. The Concorde is one such example, with people spending thousands of dollars, in addition to the business-class airfare, just to gain a few hours crossing the Atlantic. Very often customers are ready to pay more to get higher service, but this higher service is simply not available. New technologies can provide the solution, as in the case of the Concorde.

Contadina, is another example of satisfying customers with a higher-level performance, at a comparably higher cost. This Nestle subsidiary has extended the pasta market, by offering customers fresh pasta that can be quickly boiled or micro-waved at home. It is five times more expensive than traditional dried pasta, but offers an unequaled level of quality and freshness. Similar to the Southwest example, which attracted people other than traditional airline travelers, the customers that switched to Contadina didn't come so much from the home pasta market, but from people who traditionally ate out in restaurants.

Other examples of companies extending their market toward the high-end include McKinsey, the consulting company, and BMW, the car manufacturer. McKinsey doesn't undertake small consulting projects, and doesn't work without the support and attention of the highest level of customer management. Typically, they interact with the CEO, and their smallest project would be to send a team of 5-7 consultants to work for two months. Selecting only the very best people to work as consultants,

combined with their total devotion to their jobs, and working only at the highest level of management at their customers, allows McKinsey to provide extremely high service. The cost of these services is generally not an issue, and the relations established between McKinsey's partners and their customers usually extend over long periods of time.

BMW also extended its market toward the high-end. When redesigning its 3-series car line, it created a special high-end version named the M3, which combined a family sedan-type car with the engine and car-handling dynamics most often found in a Porsche. By offering the M3, BMW created something that was not commonly available before: a car that was perfect for driving the whole family during the week-end, but one that also imparted a type of pleasure traditionally associated only with high-end sports cars.

Extending the value frontier toward the high-end caters mainly to customers willing to pay the price for extra performance.

Strategy three: Shift the value frontier

A third way to change the value frontier is to shift it within an industry, providing better performance, or lower cost than the rest of the industry, or both in the best cases. When one competitor is able to position itself lower or on the right side of the frontier on the value map, it forces the rest of the industry to catch up. Until it does, there is a temporary competitive advantage, proportional to the barriers preventing others to catch up. Dell Computer is a good example of a company which shifted the value frontier, and offered its customers better performance without a higher price.

Dell Computer manufactures and distributes personal computers worldwide. Its net sales grew from $890 million in 1991 to a whopping $5.3 billion in 1995, with a net income of $272 million. In the last

five years, its market value grew by an average of 62.4% per year. Dell sells 90% of its computers to corporate accounts.

Dell buys standardized computer components on the third-party market. It assembles them in its plants, sells computers directly to customers - mainly through phone-based channels - and delivers directly from its factory. It also offers phone-based support for hardware or software installation, which is deemed a major selling advantage.

Before Dell, the industry was dominated by two types of players: major manufacturers such as IBM or Compaq and little clones assembled in East Asia, both selling through networks of resellers. Prices were high in the first case, usually with good service, while the clone manufacturers had low prices, inconsistent quality, and virtually no service. No large corporate customer would dare buy from a smaller manufacturer or through mail-order. Dell understood, before anyone else, that computers were becoming commodities and that their wide diffusion, combined with increasingly more knowledgeable customers, required a different value proposition. Their focus on direct sales for people who knew how to buy, while delivering consistently high-quality products, insured their success.

Compared with traditional manufacturers, Dell offered products with similar performance for a much lower price, while it offered much more performance than clone manufacturers for a similar price. As such, Dell changed the value frontier in the PC industry considerably. Today, many manufactures have imitated its business model, from Gateway 2000 to Micron, but Dell retains a significant share of the mail-order PC market, and is now the second largest provider of PCs to large corporations.

Other examples of companies which have switched the value frontier include Virgin Atlantic, the airline which offered first class service at a business class fare (therefore increasing performance for a constant price) or Pepsi-Cola in the 1930s when it reduced the price of its sodas by half, while keeping quantity

and quality constant.

RE-INVENTING VALUE: THE CONCEPT OF VALUE EXPANDED

Extending or shifting the value frontier requires a deeper understanding of the dimensions of value, cost, and performance. Identifying these dimensions enables managers to better understand how customers select among competing companies.

A review of current literature on customer value and value propositions shows limited consensus on their exact definitions. Today, the common definition of value relies on the price/quality ratio of a product or the difference between perceived benefits (the extent to which a product or service fulfills or exceeds customers needs) and perceived costs (the full costs associated with the product or service) [1]. However, such a general definition is too broad for managers who are seeking new ways of providing service to customers. What is lacking is an actual specification of the attributes of the perceived value, both on the benefits and cost sides.

Similarly, and although widely used by business practitioners and academics alike, we did not find a commonly accepted definition of value propositions. This term seems to be understood by all without having ever been properly defined. We suggest that value propositions define the relationship between what a supplier offers and what a customer purchases, by identifying how the supplier fulfills the customer's needs across different customer roles. Specifically, it defines the relationship between the performance attributes of a product or service, the fulfillment of needs across multiple customer roles (e.g., acquiring, using, and disposing of products/services), and the total cost. In its simplest form, a value proposition defines the relationship between the attributes of a supplier's product and the specific needs of the customer.

In Figure 3, we build on these definitions and on prior research in marketing to illustrate the attributes of value (the ratio between performance and cost), and value propositions (value across the multiple roles customers play in relation to suppliers). This dimensions of value propositions developed below will provide managers with more systematic and precise tools to understand, evaluate, and compare the types of value embedded in different products and services.

Figure 3: the dimensions of a value proposition

PRODUCT PERFORMANCE

Now that we have discussed how companies reposition on the value frontier, we will examine the concept of value and value propositions in greater detail. The concept of value has two major attributes: Performance and Cost. Value is ultimately created only when a customer uses a product. To paraphrase a famous quote, *value is in the eye of the beholder.* Value is created when product attributes (e.g. features, design, service, support) match specific customer needs. The product performance refers to how many customer needs a product fulfills and how well it fulfills them. To explore this concept, it is important to map customer needs, and match them to product service attributes designed to fulfill those needs.

Albrecht[2] provides a useful classification to map customer needs. This classification includes the following four categories of needs, matched to product attributes. They are:

Attributes category	Description
Basic	mandatory attributes so that the product/service serves its purpose
Expected	those that the competition typically delivers
Desired	those the customer would want to have, but that no one delivers for the price the customer is willing to pay
Unanticipated	those the customer would value, but didn't think about asking

Here are some examples of these four categories.

Basic attributes fulfill the core functions of a product. They are the necessary elements in each product category required to serve the customer. For example, a refrigerator which does not cool food, a car engine which does not start, or a package transport company which loses packages are three examples of failures to deliver basic attributes.

Expected attributes are those that all players within a specific industry perceive they need to compete. In the computer industry today, 16 megabytes of memory is the minimum acceptable level of memory. In the overnight package delivery business, parcels are expected to be delivered the following morning. Anyone offering less displeases customers and incurs a competitive disadvantage.

Desired attributes are usually those that another segment of the industry offers, but that cannot be acquired at the price point of a specific customer. Some airlines have successfully introduced "first class

service at a business class fare" in order to better serve customers who were not ready to pay the premium to upgrade to first class, but still desired that service. Similarly, British Airways created a "super first class" by adding beds, a feature traditionally reserved for executive jets.

Unanticipated attributes are certainly the hardest to elicit. By definition, simply monitoring the competition or asking customers about their needs isn't enough. Nevertheless, for those who succeed in finding new market segments, the rewards can be huge. When Kodak introduced the disposable camera, understanding that customers were more interested in souvenirs than in cameras *per se,* they created a new industry overnight, and gained a significant competitive advantage for a number of years.

Developing unexpected product attributes that customers value is an excellent way to enhance a company's competitive position. In the credit card industry, for instance, MBNA became the second largest credit card issuer in the U.S. by pursuing a co-branding strategy. Customers were faced with a plethora of hard-to-differentiate cards (commoditization). MBNA decided to play the image factor by linking up with more than 3,900 companies, from professional (e.g., American Medical Association, American Bar Association) to sports associations (such as the National Football League), and printing custom-designed cards. In addition, the co-sponsors sometimes made special offers to their card holders.

These specially designed MBNA cards were an immediate success. For example, 40% of American physicians and 30% of U.S. lawyers carry them. The cards became a status symbol and improved the holders' image by affirming their identity and association with a specific organization. This was something one would not typically expect to find in a credit card.

New technologies often allow customers to satisfy unexpected needs [3]. When Sony invented the Walkman, 3M invented the Post-It, or Tim Berners-Lee created the World Wide Web, they offered

products to fulfill needs that customers could not previously expect to have filled. As these well-documented examples show, serendipity, visionary leadership, and technological innovation often combine to create new products which satisfy unanticipated needs and desires. Fashion and image projection are other sources of latent or unanticipated needs. Few people *need* five watches, but Swatch, the Swiss manufacturer, proved that many people *desired* them. In other words, the goal is to have customers desire what the company produces. Or put another way, the goal is to create a desire.

In summary, the fit between product attributes and specific customer needs determines product performance. Improving product performance in these four "needs" categories creates greater customer value.

PRODUCT COSTS

Customers understand that the sticker price does not necessarily reflect the true cost to them of merchandise or service. Today's savvy shopper considers more than just price when choosing among competitive offers. Murphy & Enis[4] identified risk and effort as two key categories in determining a product's cost. We have adapted and extended their definitions, and added new categories to identify the less visible attributes of product cost. We also categorize the cost of a product or service under three dimensions: price, risk, and effort. Let's describe these attributes in more detail (see Table 1):

Dimension	Attributes	Definition
Price	direct financial cost	the sticker price, is the most common attribute used to differentiate offers. In competitive markets for commodity products, this is often the key differentiator. Some retailers offer price guarantees to protect customers and assure them that they are paying the best available price. This cancels the advantage competitors might get from lower prices.
Risk	physical risk	the actual danger of using the product. In some markets, such as lawn mowers, this is a very important attribute. Recent progress in car manufacturing (airbags, lateral protection bars) has emphasized safety.
	financial risk	the fear that the value of a purchase will go down in the future, or that the price of goods purchased through a long-term contract will go up. Insurance contracts, buy-back guarantees, and financial options are ways to protect against a decrease in price, while long-term price guarantees are often found in contracts for commodities.
	selection risk	the probability of not finding the right product in the supplier's stock or not choosing the best product for the task at hand. Large department stores sometimes offer "personal shoppers," i.e., specially trained personnel who will accompany customers and assist them with all their shopping needs.
	delay risk	the risk that the product/service won't be delivered or perform in a timely manner, thereby creating opportunity costs.
	functional risk	the risk that a product that won't perform as predicted or expected, now or in the future (i.e. obsolescence). Product guarantees and "backward compatibility" are two ways of reducing functional risk. In the photographic industry for instance, Nikon has maintained compatibility between its camera bodies and lenses for over 35 years, unlike most of its competitors. This reduces risk for professional photographers as camera bodies change. In the computer industry, backward compatibility is often maintained. Some retailers offer upgrade guarantees to protect customers from obsolescence and insure that software can be reused on newer hardware.
	psychological risk	the risk that a poor product choice will embarrass its user in front of family, friends, or colleagues or harm a consumer's ego. Peer pressure is a very strong motivation in certain product categories, such as fashion or sports shoes for teenagers. Similarly, many people wouldn't want to be seen using an old Apple Newton, or at a party wearing the same cocktail dress as another guest, or leaving and driving an old clunky car.
Effort	acquisition effort	the time, energy, and cost needed to acquire a product (e.g. driving to a shop, waiting in line). For corporate acquisitions, this would be the time needed to search for, evaluate, and get the product.
	operations & maintenance effort	the maintenance and disposal cost, as well as the time it takes to learn how to use the product, wait for the product to perform, and monitor it.
	complementary effort	the time it takes and the cost to find and acquire complementary products, i.e. the additional products or services to really fulfill one's objectives. Such efforts include, buying the blades for a razor, the film for a camera, or renting a car, in addition to purchasing an airline ticket, in order to get to a meeting. One-stop shopping is a way of packaging the product and all its complementors under one roof to increase customer convenience.

Table 1: dimensions of the cost to acquire a product or service
[adapted and extended from Murphy & Enis, 1986]

Defining these attributes of product performance and cost allows us to move away from the simpler notion of price/quality and expand our understanding of the concept of value. Changing the configuration of price, risk, and effort dimensions in a product alters a customer's perception of value.

CUSTOMER ROLES

So far, our definition of value proposition has concentrated on the delivery of value to the customer. While performance and cost dimensions identify the content of value, a value proposition defines the relationship between the customer and various dimensions of product value. In a supplier-customer relationship, customers can play different roles, corresponding to the multiple processes they engage in with their suppliers and others who offer complementary services [5]. Although other analytical frameworks focus on the price/performance tradeoff, they ignore the relation between these tradeoffs and customer roles. Successful companies make trade-offs with an understanding of different customer roles, and link them to defining their product's attributes of value. We will identify four distinct roles customers play in their relations with their suppliers:

- the *buyer* role defines how a customer determines needs, assesses suppliers, orders, and pays for and takes delivery of a product or service
- the *user* role describes how the end user derives the expected performance from a product or service to satisfy a specific set of needs
- the *co-creator role* refers to how customers cooperate with their suppliers to produce the expected value, often passing it to another customer
- the *transferer role* defines how customers dispose of a product. For example, a physical product can be discarded, recycled, or resold, while information know-how can be stored, transferred to others, or resold.

These roles can be played by the same person or by different persons or organizations. Typically, a customer would buy a car, drive it, and then sell it. On the other hand, an organization buying complex products will have different departments dealing with suppliers, such as purchasing, maintenance, finance, the actual product users, etc.

Companies often tend to create value by focusing on satisfying the core needs of a customer as embodied in the "user" role. As competitors converge on similar product offers to satisfy core needs, it becomes important to consider how these offers create value in relation to the buyer, co-creator and transferer roles. Considering these roles simultaneously helps us understand customers better, and reconfigures product offers to reinvent value propositions for customers. For example:

Dell Computer understood before everyone else that computers were quickly becoming commodities and should therefore be treated as such. By focusing on streamlining the acquisition process for its customers through standardized components, direct sales, phone-based ordering and support, the company has redefined the standard within its industry. (Buyer role)

When *Airbus*, the European airspace consortium, launched the A320 family of aircraft, it created a family of airplanes (A319, A320 and A32I) sharing most characteristics, and differing only in size. By using the same inside equipment, pilot instruments, maintenance procedures, etc., Airbus makes it easier for companies to schedule the use of these airplanes. Substituting a larger airplane on a temporarily crowded route doesn't require a change in pilots, flight crew, food carts or any other equipment. Airbus customers can therefore generate much more value out of the use of their aircraft. (User role)

IKEA, the Swedish furniture giant, is well known for partnering with its customers to co-create value. if customers play the role IKEA assigns to them (drive out of town, shop alone, transport their furniture home and assemble it), then IKEA will provide them with one-stop shopping for quality furniture at excellent prices, while making their shopping experience fun and rewarding. Similarly, McDonald's has established a system where everyone buses their own tray before leaving. In the these cases, the supplier focuses on adding the maximum value in its core specialty and "outsources" the rest of the work to the customer or a complementor. (Co-creator role)

Leasing companies have understood that customers were sometimes not interested in dealing with their cars after a few years. Rather than having to bother with reselling them and buying a new one, it is easier to outsource these chores to a leasing company. The leasing company acquires the car, provides basic maintenance and simplifies its transfer (disposal) after its useful life. (Transferer role)

Focusing on and satisfying all the roles a consumer interacts with a supplier is the key to adding value at the periphery of the customer's core needs. For instance, in the case of a textbook, the customer (usually a university professor) will start by matching all textbooks on the market with the course syllabus (buyer role), and then ordering the books for the students. The professor will then co-create value by using the textbook in class to improve the students' education. Last, transferring value could be a specific service of the bookstore or publisher to buy back books at the end of the term, or could be the way the publisher gets feedback from professors to update the next edition of the book. Using such a broad view of customer interactions could entice a publisher to offer professors a free comparison between all the textbooks on the market and their syllabus, customized versions of their books, an online service updating chapters as they become obsolete, or a repository of material (slides, cases, tests, etc.) developed by faculty around the country.

VALUE MAPPING

To summarize, we define value propositions as the configuration of a company's offering in terms of its product or service attributes to deliver value across multiple customer roles. Reinventing a value proposition means altering and creating new tradeoffs among these attributes, in terms of performance and cost [6]. Let's use Progressive Insurance as an example showing a complete reinvention of the traditional insurer value proposition.

Progressive Insurance began business in 1937; its 60 operating subsidiaries provide personal automobile insurance and other specialty property-casualty insurance and related services sold primarily through independent agents in the United States and Canada. Its revenues for 1995 were US$ 3 billion. Progressive decided to redesign its value proposition by emphasizing a reduction of risk and effort for its customers when buying and using insurance policies.

Seeing its customers as buyers, Progressive is moving toward a collaborative model with customers. The company has taken what can be a formidable task - shopping for auto insurance - and made it easier. The company's toll-free, 24 hours a day, 7 days a week service gives callers customized rate comparisons of up to four leading auto insurers. Progressive also offers a similar service through its home page on the Internet.

The service reduces the financial risk and acquisition effort customers put in buying insurance and places Progressive in the spotlight as the premier shopping service for auto insurance. Progressive's policies are not always the lowest cost, but even in these cases the company generates goodwill (by giving consumers other companies' rates) and referrals. In the future, we could imagine that this broker role might become a business in itself, similar to computer reservation systems in the travel

industry.

Seeing its customers as users, Progressive redesigned its claims and policy service, setting up a 24 hour phone service to answer policyholder and independent agent questions and to handle claims. For instance, when a policyholder reports a claim, a claim representative can be dispatched immediately to begin the inspection and settlement process. The claim representative can answer questions (regarding, for instance, police reports and legal procedures) and can arrange for towing and a rental car. In some cases, the claim representative can even settle the claim at the scene of the accident, literally minutes after the crash happened.

Thanks to extensive employee training and advanced computer tools such as PACMan (Progressive automated claims management system), Progressive representatives have available the required information (copy of customers' insurance policies, information on car's market value, etc.) to help customers as quickly and painlessly as possible. The Immediate Response claims service® was introduced in 1990 and allows Progressive representatives to make contact with 80% of accident victims within nine hours of a crash, inspect 70% of damaged vehicles within one day and close most cases within a week. All of this definitely reduces the effort and risk involved in dealing with insurance claims and offers the customer what they need most at that time: peace of mind.

Looking at value co-creation potential, Progressive relies on a network of 30,000 insurance agents, in addition to direct marketing (24 hour phone service, Internet) to maximize customer exposure. This allows customers to easily find a way to get in touch with the company, thereby reducing the effort it takes to do business, while preserving their options to use a broker who might offer additional services. To differentiate itself, Progressive offers insurance agents a software package named ProRater $_{Plus}$® which automatically rates an insurance policy and uploads the customer application directly into Progressive computer system. This eliminates redundancies, makes more efficient use

of the agents' time and generally makes Progressive a company easy to do business with.

If the caller is satisfied with the Progressive rate, they are given choices in how to buy the policy - over the phone, through the mail or in person with one of the more than 30,000 independent agents representing Progressive throughout the US and in Canada.

Let's summarize the difference between Progressive and its industry, using a **value proposition framework**:

Buyer		**User**	
Performance	• Progressive provides complete & accurate information to speed up and simplify the shopping process	Performance	• Progressive offers a hassle-free settlement process and assists its customers through timely information provided by onsite representatives armed with modern technology systems
Cost	• Progressive reduces the risk of overpaying and reduces the search costs by limiting the time necessary to gather relevant information	Cost	• By communicating with the customer and assisting as quickly as possible , and empowering representatives to settle claims on-the-spot, Progressive minimizes the trauma associated with accidents
Performance	• By being available 24 hours a day on the phone and the Internet, as well as through 30,000 insurance brokers, Progressive is available where and when customers are ready to do business • ProRater $_{Plus}$ reduces effort to access policy ratings and customer forms	Performance	(In the future simplify customer reimbursement and transfer of policy to another company or agent, when the customer moves location or other circumstances change)
Cost		Cost	
Co-creator		**Transferrer**	

Table 2: Progressive's value proposition

Another example of value co-creation, is illustrated by a new fast growing company, Amazon Books (Amazon.com). This startup, created in 1994, sells books over the Internet and has gone out to transform the buying and value co-creation processes customers engage in when thinking about books.

It maintains a virtual catalog of 1.1 million books, and provides buyers with the ability to buy almost any book in print in English, any time, cheaply. Carrying five times as many books as the largest physical bookstore carries is only possible because the inventory is maintained at the publishers' warehouses and electronically integrated to appear as Amazon's own stock. Not having to own and operate physical bookstores, and running a lean operation allows Amazon to discount prices on the top selling 300,000 books distributed by wholesalers.

In terms of value co-creation, Amazon maintains discussion groups for book-lovers, and allows readers to enter their own book reviews for the benefit of others. These reviews get automatically included with the book description in the on-line catalog, therefore affecting the choice of future potential buyers. Amazon has also created automated agents that customers can program to be informed by electronic mail of new book arrivals, either by their favorite authors, or on a specific theme.

Amazon also offers an exciting possibility for Internet users: the Associates program. World-Wide-Web site maintainers are able to create mini bookstores on their own sites, using Amazon as a back-end processing engine. For instance, an Internet user maintaining a site offering ethnic dish recipes could add a list of books relevant to the subject, write her own reviews, and offer her site's visitor the ability to buy books directly from her site. All the back-office work (filling orders, processing payments, customer service) is handled by Amazon, and she gets a commission on every sale. This innovative form of partnership driven by new technologies is a way of co-creating value between Amazon and Web site maintainers.

Amazon does not release any detailed financial information but is growing very rapidly - about 35% a month (that's around 3,500% a year) - and has maintained that pace over the course of the last year. Experts estimate its online sales at over $15 million a year.

This is Amazon.com's **value proposition framework**:

Buyer		**User**	
Performance	• Amazon offers seamless, hassle-free, anytime, anywhere ordering through the use of modern technology and an organization entirely focused on book ordering	Performance	• By offering multiple product suggestions (book of the day, editor's choices), user-programmed agents, as well as discussion forums, Amazon offers frequent readers a constant streams of suggestions matching their tastes
Cost	• Amazon virtually guarantees that an existing book can be delivered, cheaply and reliably through a simple order process accessible from customers' home or offices. It reduces risk by allowing potential buyers to check synopsis and reviews of books, while its matching agents insure relevant books are brought to the customer's attention	Cost	not applicable here
Performance	• By allowing its readers to input book reviews in its catalog, build their own customized book catalogs, and handle the back-office work for them, Amazon creates a valuable network of partners to maximize joint revenue and satisfaction	Performance	• not applicable as of yet, but Amazon could easily extend its model to buying back books and selling used-books on the Internet; this would leverage the current infrastructure and would be a natural product line extension
Cost	not applicable here	Cost	• By guaranteeing that books bought at Amazon could be resold at a given price, Amazon would enter the book-leasing business, potentially very lucrative
Co-creator		**Transferrer**	

Table 3: Amazon's value proposition

As illustrated, value maps allow managers to specify the company's value proposition in terms that are easily propagated to customers and internal staff. These are certainly more meaningful than mission statements, as they clearly communicate the key elements of value that are important to a firm's customers. Managers and employees should focus on delivering all dimensions of a value proposition efficiently and effectively to customers.

To summarize, we propose a three-step program to help managers reinvent value propositions. First, managers must identify the industry value frontier and define the key value propositions. Second, they must select and define new, more attractive, value propositions for customers. And third, they must organize and innovate to deliver their propositions to customers. Now we will examine different ways managers can diagnose, identify, and reposition their company in the marketplace.

Defining the Key Value Propositions and Value Frontier

The first step in the process is to define the value frontier. This is fairly easy to do. Managers must first identify what their competitors offer in terms of performance and cost. A value frontier extends from low-cost substitutes to fulfill a specific need (automobile or railway vs. aircraft) to high-end embellishments that are currently offered at high prices and define superior performance. Thus, we ask managers to consider ways of fulfilling core needs beyond the ways currently offered in their industry segment. This is a critical first step in identifying new strategies.

Once the value frontier is defined, what are the value propositions of the companies along the frontier? What are the performance, price, risk and effort attributes across customer roles that define the companies on the frontier? Defining the value proposition of different locations on the frontier allows managers to elicit key attributes for differentiation. It also forms the basis for comparing the companies value propositions vis-à-vis competitors.

Creating New Value Propositions and Changing the Frontier

In order for a company to move to an unique position on the value frontier, it must change its strategies. Value propositions can be changed along three dimensions (cost, performance, and customer roles) to achieve one of the three strategies which alter positions on or of the value frontier (extending toward the low-end, toward the high-end, and shifting the frontier).

First, a company must identify which of the three strategies is appropriate. Extending the frontier toward the low-end is worthwhile if the low-end frontier point in a specific industry can compete with the high-end point in another industry (e.g., low-cost air travel competing with buses) or if customers would be interested in a product/service of lower performance at a lower price. Extending the frontier toward the high-end can be considered when the high-end in a specific industry can compete with the low-end point in another industry (e.g., high-quality prepared pasta competing with restaurants) or when there are customers willing to pay for more performance than what is currently available. If neither option makes sense, then shifting the frontier is the only alternative. This has traditionally been the basis of market competition.

Changing value propositions to achieve such frontier changes rely on changing one or more of the three dimensions. Managers need to think of innovating ways to reduce price, risk, and effort, as well as to address the multiple roles customer play, such as having customers co-create some of the work. We have given numerous examples of these, so now we will focus on transforming product performance by suggesting generic ways of changing product/service attributes.

Value can be enhanced by adding or removing three of the four attributes. The first level (basic attributes) usually can not be modified, as it represents the attributes without which the product or service doesn't make sense. We can therefore identify three ways of altering attributes: reduce expected attributes, add attributes to fulfill desired needs, and elicit and deliver attributes to serve unanticipated

needs.

Expected attributes represent the common wisdom within an industry, the rules of the game. They usually frame the thinking of managers looking for ways to distinguish their product/service. Some innovators have been successful at delivering only part of these attributes, the ones valued most by their customers. They focused on their core strengths and outsourced the rest to other suppliers, or directly to the customer. For example, in the airline industry, Southwest Airlines realized that its customers basic needs did not include perks such as food, assigned seating, or interline baggage handling. By reducing the level of service, and designing a business model that efficiently and successfully delivered the basic attributes that mattered to customers (cheap air travel, frequent departures, on-time arrivals), Southwest is the most successful airline in recent years.

Food service is an example of an attribute that is well addressed by the various food vendors operating in airports. The added service of delivering food in airplanes was not valued by Southwest customers, and therefore successfully dropped. Food is therefore an attribute that can be substituted (i.e., other vendors can provide it as well). A basic attribute, by definition, is not. The availability of good complementors enables a firm to reduce expected attributes, while greater variety and choice may be delivered to customers. By having McDonald's establish outlets near Southwest gates, Southwest wins by having happy (non-hungry) customers on its planes and McDonald's wins because of the customer traffic generated.

Our earlier example of computer memory showed that customers would not be satisfied if computers were delivered without a specific amount of memory. The substitute of memory is time, which is a very valuable attribute for computer users. One way to elicit the attributes customers are ready to relinquish for a cost decrease is to look for the core service an organization would still need to deliver if customers were only ready to pay half of the current prices (e.g., IKEA which focuses on designing furniture kits).

Desired attributes are those most often already delivered in another customer segment, but unreachable at the price point of customers who also desire them. Technological innovation is the most common lever for bringing down the price points to deliver such attributes to a new market segment. For instance, Virgin Atlantic started providing individual color screens to every economy class passenger when matrix display technology got advanced enough to lower the costs sufficiently. One way to elicit these attributes is to find out what performance level customers would ask for if they had unlimited resources. What service could be delivered to them? And are there any ways to provide some of these services at a more reasonable price (e.g. British Airways adding beds to airplanes)?

Most executives assume that they know implicitly what customers want or need. Nevertheless, changes in demographics, customer tastes and competitive offers affect customers' expectations. Therefore, the only way to follow these changes is to keep studying and monitoring customers' behavior. This can be done through different methods. Basic and expected attributes are the easiest to understand, and can usually be derived from what the industry is currently offering. Desired attributes are, by definition, expressed but not satisfied, and can be derived by market research, including focus groups, questionnaires, or surveys.

Understanding unanticipated customer needs can't be done by talking to customers directly, but by observing how they behave with products and services. In one famous example, PepsiCo sent market researchers to live with families in order to better observe their shopping and consumption practices. Conventional wisdom was that customers would buy only enough Pepsi to fulfill the family's drinking needs. When shopping with customers, market researchers quickly observed that the actual behavior was different. Customers were actually buying as much as they could carry, knowing that no matter how much they bought, everything would be consumed anyway. Thanks to that insight, Pepsi increased the size of the bottles and redesigned them for maximum ease in handling.

Observing customers in their environment is one path to innovative value propositions. Visionaries (such as Charles Schwab, Jim Clark or Steve Jobs) have also regularly proved that they were able to find solutions to the needs they *felt* customers had. Industry analysts attribute Charles Schwab's tremendous success in the discount brokerage industry to the visionary capabilities of its leader, who sensed before everyone else that customers were ready for an innovative value proposition, where their broker would provide them with information and trading capabilities, and they would do the analysis work traditionally performed by full-service investment banks.

In summary, managers have many different dimensions to consider in order to discover and define new value propositions. However, to successfully compete with a new value proposition, they also need to redesign the system delivering value to customers.

From Value Propositions to Value Architectures

Selecting a new value proposition does not guarantee success. Managers need to re-architect the organizational system in ways that allow them to effectively deliver the value proposition, and create a unique defensible position. Value propositions may be copied, but well-designed value architectures are much more difficult to replicate.

A value architecture defines the organizational system that delivers value to the customer. Firms that succeed create architectures that combine three core components: organizational structure and processes, technology, and organizational leadership and culture to fit their value propositions in a superior fashion. Organizational structure and processes combine distinct internal and external roles through business processes to create value. Technology provides the supporting infrastructure to coordinate and enable the activities creating and delivering value. Organizational culture and leadership

provide the vision, focus and norms that serve to motivate organizational members and align the goals of the organization to effectively link technology, structure and processes [7]. To illustrate this, let's consider some examples.

Amazon's value proposition is based on low cost prices for a high selection of books ordered through an anytime, anywhere extremely convenient mechanism. To achieve this, they designed a unique organizational system relying on an entirely automated order management system, tightly linked to their suppliers and payment networks, allowing them to minimize human intervention, therefore reducing costs. Special deals with their partners (suppliers) allow them to maintain very little physical inventory. Technology is used both in the back-office as well as in the interaction with the customer (World-Wide-Web for product information and ordering, electronic mail for customer service). They also use unique roles to create a sense of community among book readers, who collaborate to serve as reviewers or salespersons (through the Associates program). The value architecture that Amazon created is unique, hard to replicate for competitors and can be used a basis for future competitive advantage. For instance, supporting discussion forums or allowing readers to listen to authors discussing their works, Amazon could in the future enhance its position as the main digital-age bookstore.

IKEA's value proposition emphasizes high-quality furniture at rock-bottom prices. In order to achieve that feat, the company has created a process to look for very low-cost suppliers in remote areas of the world (usually developing countries). IKEA then sends in training and quality-control teams to insure that the quality of the production will satisfy its standards. The production of its different suppliers is then coordinated through a global logistics system and a network of warehouses, which insures that the different components of a piece of furniture reach the warehouse in time for assembly and the shops in time to restock shelves. This process is specifically tuned to the value proposition IKEA delivers, and leverages a combination of internal processes, suppliers and technology to create a world-class

operation.

Dell's value proposition relies on state-of-the art technology, delivered at low price through a convenient ordering process, and offering top-notch remote support. In order to deliver such a value proposition with profit, Dell designed a unique value architecture based on direct marketing, extensive use of call centers and magazine advertising. In the early 1990s, Dell ventured outside its core niche and started to sell through conventional retail channels. This quickly turned out to be a mistake: with the rapid pace of change in the computer industry, the new models sold direct would compete with older models still on the retailer's shelves, and force Dell to compensate these retailers. After a few years, Dell got out of the retail market and has been rewarded with record profits ever since. This shows that a value architecture needs to be specifically tuned to deliver one value proposition, and that trying to address multiple value propositions with a single architecture only leads to lower profitability.

Changes in technology (specifically information technology) and the recognition of potential partners and complementors provide firms with new options for redesigning their architectures. Amazon has designed an architecture that leverages suppliers (publishers), complementors (e.g. Web site maintainers) and the Internet technology to create a new way of shopping for books. In addition to effectively leveraging new technologies, the culture and the leadership of the firm provide a means of aligning the various components of the firm into an integrated unit. It is the difficulty of effectively combining these components that create entry barriers and makes it difficult for competitors to provide similar value propositions efficiently.

CONCLUSION

We believe all strategy should focus on creating and delivering unique value propositions to customers and on extracting and transferring value to shareholders. Value frontier analysis and our framework for value mapping provide managers with new tools to analyze dimensions of value and re-invent value propositions offered to customers. Successful firms in highly competitive or commoditized industries change their strategy in ways that create unique positions on the value frontier, or shift the frontier to to provide higher levels of performance. These companies simultaneously specialized their organization and leveraged technology, new partnership opportunities and organizational culture and leadership in order to architect new systems for delivering customer value. Often these new organizational designs are simultaneously efficient, innovative, close to customers and difficult to replicate for traditional competitors creating new sources of competitive advantage. Our forthcoming work examines the use of information technology and the design of value architectures by superior market performers.

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