Analysis

Leading-edge business strategy or just marketing mumbo-jumbo?

***Phil Allen* finds a formula for businesses to create that elusive entity — customer value**

A market is a group of customers who need products and services which provide a benefit to them and for which they are prepared to pay. The amount they are willing to pay depends on the value of the benefit they derive.

Many chemicals and plastics marketers struggle because they do not define the market in terms of customers with a need and the value they are prepared to pay for need fulfilment. They tend to see the market as an aggregate of sales of their products and those of their competitors. But markets are about customers, not products.

Once this is grasped we can develop a formula for customer value:

$$CV = \frac{DB}{RC}$$

where CV is customer value, DB is desired benefit and RC is relative costs. CV is quantified by the desired benefit (something customers are willing to pay for) divided by what the customer has to give up to get it. Relative costs is more than price; it is what the customer has to give up to gain the desired benefits from your products or services. The formula is a ratio, because the purchasing decision by the customer is a trade-off.

A product or service is perceived to have value when the customer perceives the value ratio to be greater than 1:1. This value really does make a difference to the customer, and so it is more likely to prompt a buying decision. If the ratio is less than 1:1, then you haven't created value or the perception of value for the customer. To increase a value ratio, you have to either increase the desired benefits and/or decrease the relative costs.

Different buyers of the same product will have different value ratios. A high-quality automotive paint shop is more focused on the desired benefits component of the value ratio and is less concerned about the relative costs. A small, family-run automotive body repair shop is more of a price buyer.

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For the second group, price is a big component of the relative costs denominator in the value ratio. These buyers see products and basic services as commodities. They are sophisticated and knowledgeable users. If these are your targets, the challenge is focusing your enterprise to serve them profitably.

Pure price buyers are very rare. For example, the ease of doing business can be more valuable to some customers than lowest price.

In the customer value ratio, price is one factor of relative costs. This means that, rather than thinking of price in terms of supplier costs plus margin, value-based marketers price in terms of value to the customer. The more value you deliver in terms of desired benefits versus relative costs, the more price can be enhanced.

If you cannot establish a positive value ratio for the customer in any aspect of the offering, price is irrelevant. Instead, you must decide if that element of the offering is relevant or appropriate.

To understand the market and to set your price, start with the lowest price offering as the low-point benchmark. Once you have described the lowest price offering, you need to build an argument to justify the difference in your price compared to that. Then determine and quantify how the customer benefits from additional elements of your offering and what those elements are worth to the customer.

Every customer value segment has specific elements of its value set which, if fulfilled, will attract a non-price-sensitive response. The key is to identify these elements. This forms the basis of your pricing decision and your price justification.

Most marketers pay far too little attention to the price in the marketing mix, but price is the only value-creating and value-capturing variable. So spend more time on price if you want to be a value-based marketer.

That does not mean reacting to pressure from buyers to drop the price or competitors' price cutting. You must understand the true value of your offering to your customers and reflect that in your price to them. Spend time working out how to fulfil their unmet needs, reflecting the benefits they derive from that in your price. Spend time working out how and why your offering is better than that of your competitors.

If you cannot make your product look better to your customer, then you have to make the offering look better some other way. If the product and the service is no different from competitors', then seek intangible benefits such as trust or brand image. If this process does not yield results, change the market. Re-defining the market is a bigger challenge, but it has been done in the chemicals industry.

About the author

Phil Allen runs the marketing excellence practice MarketAbility, serving a broad base of clients in the industrial, chemicals and energy sectors in all aspects of improving business profitability through applied practical marketing and customer value management. He has more than 30 years of practical experience in marketing and sales.

MarketAbility operates both globally and locally around the world. With Nicholas de Bonis and Eric Balinski, Allen is co-author of the book Value-based marketing for bottom-line success: five steps to creating customer value *(www.pentadigm.com), published in December 2002 by McGraw Hill.*