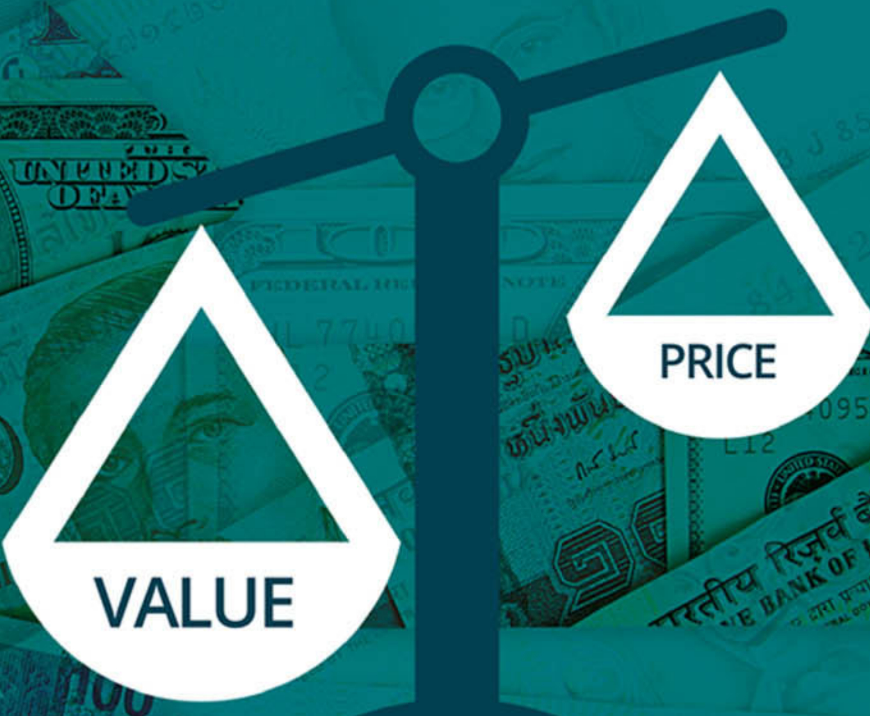
VALUE FIRST THEN PRICE

QUANTIFYING VALUE IN BUSINESS-TO-BUSINESS MARKETS FROM THE PERSPECTIVE OF BOTH BUYERS AND SELLERS



'By combining an impressive list of expert analysts with real-world case studies, *Value First then Price* gives businesses the latest strategies and tactics needed to improve company margins and profit performance. Because the focus here is on customer quantifiable values, the book correctly shifts emphasis from a producer's features to an end-user's benefits.'
Kevin Mitchell, *President, The Professional Pricing Society, Inc.*

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3 Muddling through on customer value in business markets?

Todd C. Snelgrove and James C. Anderson

Jim and Todd have had many conversations about customer value management (CVM) over the years. Todd's company, SKF, has graciously contributed best-practice examples to Jim's management practice work (e.g., Anderson, Kumar, and Narus 2007; Anderson, Wouters, and van Rossum 2010).

IMPLEMENTING CUSTOMER VALUE MANAGMENT IN A BUSINESS

TODD C. SNELGROVE: What do companies seeking to implement customer value management (CVM) need to do to make this strategy work?

JIM ANDERSON: We find that businesses seeking to implement CVM, in order to make it really work, progress through three stages: prove the CVM concept, build the CVM structure and culture, and sustain the CVM advantage. In the *prove the CVM concept* phase, a business undertakes several CVM projects to better understand the monetary value of changes in its market offerings to target customers. While the business obtains specific results for the offerings that it studies, along with learning the concepts, process, and tools of CVM, the overarching goal is to demonstrate that CVM can work in the business. The experience with CVM at this stage provides proof that CVM will improve profitability and that it's practical for the business to do. Teams working on the projects create "success stories" which create momentum and enthusiasm within the business for CVM change.

It is often viewed as a cliché that senior management commitment and support is needed to bring about any enduring change in a business, but it's nonetheless true. Even more critical, though, is gaining the commitment and support of first-level managers and those who work for them, such as field sales reps and tech reps. We find that there are three sorts of folks in businesses: progressive thinkers, open-minded individuals who need to see change demonstrated in their own setting, and laggards. The progressive thinkers are a small minority who can look beyond their own business and envision how developments in other industries or geographies can be adopted or adapted for use in their own business. They "get" what CVM could do for their business from others' experiences.

The majority of individuals in a business are open to change, but they want to see evidence that the proposed change works in their business, often in the form of pilot programs, before they are willing to implement it. These are the individuals who are critical to win over during this first stage. Finally, there are a minority of laggards in any business who are not open to change. They've seen it all and want to continue doing what they've been doing. "We tried that twenty years ago and it didn't work!" is a typical laggard reaction to whatever new is proposed. Never mind that the business likely is significantly different from what it was twenty years ago or that whatever was tried then is not the same as what is being advocated now. Fortunately, persuading the open-minded individuals that it is worthwhile doing more CVM enables a business to move to the next CVM stage.

In the *build CVM structure and culture* stage, the business expands its CVM capability by designating and training customer value experts or specialists who can assist others with CVM projects. The business undertakes more projects, builds more customer value models, and begins a repository of value word equations for others to use, which makes their task of conducting customer value research easier. The business provisions value-based sales tools that its salespeople are *able* to use and *want* to use. The business establishes linkages between CVM and existing processes in marketing, sales, and new product development. There may be interest, for example, in applying CVM earlier in the new-product development process. Finally, the business defines success metrics and designs training for the CVM rollout.

In the *sustain the CVM advantage* stage, the business scales new CVM capabilities across the organization. CVM champions work throughout the functions and geographies of the business. Most of them will have this CVM work simply as part of their responsibilities in their positions, but it's essential that several individuals in the business have CVM as their sole or primary responsibility. Some individuals need to have ownership or stewardship of CVM in the business, where their mission is to keep CVM vital, renewing and updating the CVM capabilities and culture.

What critical incidents can you share, Todd, about progressing through these stages at SKF, and what are you doing to keep CVM vital at SKF?

TODD C. SNELGROVE: It's an ongoing program, but when I look back I can clearly see the three stages you refer to. In the *prove the CVM concept* stage, I remember two different situations that were powerful. I had become increasingly excited in the late 1990s about the rise of procurement and the need to convert our technical value into monetary terms for procurement. A new product was created called System 24 that had some unique features that created customer cost savings. However, with a price premium of 35% or so, I needed to demonstrate that the annual actual cost would be less. I was at a call with a large customer, who was using thousands of our competitor's version of the product. Given a 35% price premium, I needed to demonstrate the benefits in dollars of switching to our version. On the back of a piece of paper, I showed how, because of the increased number of flow-rate options our system offered (the technical feature), the customer in some instances would increase the accuracy of the product delivery, and in other cases reduce the number of units required. The net result was that the customer got a better product and spent 18% less on the system in dollars per year. We got an order. That night I sat with my laptop and created a calculation in Excel. Management got very excited about this, so we created a calculator for one product, with the goal of adding other new solutions as they were getting ready to launch. Over the next two years I was a fanatic! I acquired the name Bulldog, as I kept pushing this concept to become more of a company focus for all that we do.

It was 2001 and the global recession was in full swing. A large industrial customer had a new VP of procurement who was demanding a price reduction to keep the contract for the next 5 years (let alone no price increase). Since large, spherical bearings (costing six figures or more) have very long lead times, our business was in jeopardy. Our North American president gave our key account manager the authority to offer a 5% price discount to keep the business. A few days later he said, "Snelgrove, why don't you go down and see if you can find a way to guarantee the value instead of the price discount." Long story short, we agreed that we would guarantee a 5% annual cost savings (not price savings) and that if we failed to do so, we would write them a check. For a customer that buys $4,000,000 a year over 5 years, the savings to us—if we could deliver and prove our value—was enormous. The $1,000,000 price difference would fall to our bottom line. All we needed to do was make it happen.

The *build CVM structure and culture* stage happened right after the large value deal was signed. Within a week I was told by the North American president, "Guess what? That is all I want you to focus on." At the time no structured tools existed, and we knew we needed to have a better system for calculating and logging our value than just an Excel template. Our company uses Lotus Notes, a back-end system that runs our corporate email, but also a place where a database could be created. It allowed us to have one system for the whole company, constant live updates, new solutions pushed out when created, and a way to log the cases that were created, and eventually accepted. As the programmers were working on the system, I was busy with product divisions, challenging them to help me convert technical features and benefits into monetary savings. We needed the formulas and some realistic numbers to put in the opening templates. Our industry and application engineers were a great support. Eventually the story and news of the tool spread in the company across geographies and I was placed in a global role to develop, champion, roll out, and support our value initiative for our end-user accounts and industrial distributors.

The *sustain the CVM advantage* stage is a never-ending focus and journey. First off, our CEO bought into the concept that if we create value we must be able to prove that value, and even get paid based on the value being created. He also realized that value is different for our different divisions (what is of value to an original equipment manufacturer is different from what is of value to an end user, or to an automotive or aerospace customer, but they all want to receive value). Therefore, my role was moved from being a global role for one division to a role supporting the whole company. To keep the focus and everything at front of mind, I've focused on a few things. First is to make sure the tool is easy to use and includes the right information. In 2015 we launched an iPad version, which is simple and quick to access. I've made the value quantification logic part of our new product launch creation, rollout process, and pricing. We started a Key Accounts group a few years back, and those people have helped push the need to keep the system full of cases for their customers. We have or we want to have agreements around value, so we need the examples and proof. Finally, I spend a lot of time in the marketplace trying to get customers to rethink how they segment suppliers. I need customers to see us as a strategic buy and to choose suppliers based on best value, not on lowest price that meets a minimum criterion or specification. In sustaining the focus, it doesn't hurt that our CEO talks about the concept constantly, that we announce the number of cost-saving cases and value created in our annual report, and that each division president has it as part of their scorecard. We don't want to just focus on creating cases; we want to find ways to really save customers hard money and for us to get paid based on that value.

CUSTOMER VALUE MANAGEMENT FOR VALUE SELLING VERSUS TIEBREAKER SELLING

TODD C. SNELGROVE: In a recent piece, "Tiebreaker Selling" (Anderson, Narus, and Wouters 2014), you discuss the difference between value selling and tiebreaker selling. Can you explain how the practice of CVM varies between these two approaches?

JIM ANDERSON: The management practice research for "Tiebreaker Selling" was a revelation for us. We have been emphasizing for many years that suppliers practicing CVM should demonstrate and document the value of their offerings to customers relative to the next best alternative for those customers. *Demonstrate* means persuasively showing the customer before purchasing the offering what cost savings or added value the customer could expect from the offering. *Document* means working with the customer after a suitable period of time using the offering to find out what cost savings or added value the customer actually has received from using it. Demonstrating and documenting superior value each require that customers actively participate and share their data on comparative use.

What we found in the management practice research is that customers in business markets have become more strategic in their purchases. They make a fundamental decision about each purchase: is it strategic or not? Simply put, strategic purchases are ones that the customer has decided contribute significantly to differentiating its offerings to its customers. Not surprisingly, most purchases turn out to be non-strategic. Most of us in marketing and sales have heard of the "20–80 rule": 20% of our customers should account for

80% of our sales and profits. What we have heard from purchasing and supply managers is that they now are following an "80–20 rule": 80% of their time should be spent on the 20% of the purchases they consider to be strategic, and 20% of their time spent on the 80% of the purchases they consider to be non-strategic!

As one can imagine, there are considerable time constraints in making non-strategic purchases. Purchasing managers and other customer managers simply do not want to spend the time it takes to demonstrate and document the value of non-strategic purchases. Instead, they initially seek suppliers that can meet their basic specifications at a competitive price, and then they ask the finalists for "something else" (other than price concessions) to justify choosing one offering over the others. That is why we coined the term *justifier* for this: it enables the purchasing manager to justify to others in the business why one supplier's offering was selected, and, through getting a noteworthy extra that the customer finds valuable without analysis, it justifies the purchasing manager's contribution to the business.

Although customer managers are not willing to take the time to find out what the specific value of a non-strategic offering is for their business, they nonetheless appreciate the supplier giving them a rough estimate of what it might be. This realization suggests an approach to CVM that will be essentially the same early on, whether the supplier's offering is strategic or non-strategic. Later on, though, what the supplier does will diverge dramatically.

We contrast value selling with tiebreaker selling in Table 3.1. As the table makes clear, these two kinds of selling are dramatically different from each other. Nonetheless, conducting customer value research during a pilot program before the commercial launch of the offering (or updated versions of it) will be worthwhile. Learning the value of the offering relative to the next best alternative by working with a handful of customers in a pilot program will teach the supplier about the points of difference between offerings and what they are worth to the pilot-program customers. What these points of difference are, though, will vary depending on whether the core offering is highly differentiated and strategic or undifferentiated and non-strategic.

For the highly differentiated, strategic core offering, the estimates of the monetary value of the points of difference will be used to provision a *value calculator* (Anderson, Kumar, and Narus 2007). For the undifferentiated, non-strategic core offering, the estimates of the monetary value of the points of difference will be used to provision what we call *justifier value cases,* which are named or unnamed case studies from pilot-program customers that broadly suggest the monetary value of the studied justifiers. Each of these becomes a sales tool that salespeople use in their selling efforts. Each of these kinds of selling tools enables the salesperson to provide the kind of proof of superior value that the customer managers want. The result is that these tools enable the salesperson to achieve a better price, whether it is a significant or a slight price premium.

Do you find that the justifier concept and tiebreaker selling are applicable at SKF? What challenges does SKF face in putting them into practice?

Table 3.1 Value selling versus tiebreaker selling

	Value Selling	*Tiebreaker Selling*
Supplier's core offering	Highly differentiated: The product or service has unique features that customers appreciate	Undifferentiated: The customers want only their basic specs met at a competitive price
Customer's view of purchase	Strategic: The purchase significantly contributes to differentiating the customer's offerings	Not strategic: The purchase is not critical to differentiating the customer's offerings
Customer willingness to extensively evaluate offering's value	High	Low
Deal winner	The offering provides quantifiably higher value than that of competing offerings, which more than compensates for its higher price	The supplier offers a justifier—a noteworthy extra that the customer finds valuable without analysis and shows the purchasing manager's contribution to the business
Supplier's goal	Gain business at a significant price premium (>5%)	Gain or retain business, at a slight price premium (3–5%)

Source: Adapted from "Tiebreaker Selling: How Nonstrategic Suppliers Can Help Customers Solve Important Problems," by J. C. Anderson, J. A. Narus and M. Wouters, 2014, *Harvard Business Review* 92(3), 90–96.

TODD C. SNELGROVE: Great question. I've thought about this research for a while. I think the first thing SKF needed to think about is "what are we actually selling?" If it's a specific engineered product, then you're right; either it's demonstrably better and we can quantify the value to allow the purchaser the customized business case to justify the investment, or we have general business cases with industry numbers that we can present if the customer doesn't want or need a customized business case. However, sometimes, in certain product ranges either the differences are minor or, more important, the performance differences are less about the product itself and more about the implementation of a program. In these cases we say to customers, if they are of sufficient size and so forth to justify the resources, let's not focus on the specific product being better or different; but through—as you say, Jim—applying our Systems, Support and Implementation Programs, we can guarantee a hard annual savings. We then explain the program—the SKF Document Solutions Program—that is tied to our system and where we document our value. The savings might be not in a specific bearing, for example, but in which bearing was chosen, how they were installed, if the right lubrication has been selected, if the correct seal has been applied that keeps the dirt out, or in the maintenance practices around the machines to help them last longer and run at a lower total cost of ownership.

Also, I think that many times procurement makes assumptions about how they should source a certain category. They base it on dollars spent or on risk (see chapter 7, which discusses this in detail). The takeaway is that if procurement assumes you are easily substitutable with another competitor because you have an International Standards Organization product and other suppliers are almost as good, and your spend is low compared to other things they buy, then they might look for the differentiator. I spend a lot of my time challenging this assumption. It might not be the client's biggest dollar spend, but the impact that a supplier can have on your profitability is huge. To do this, though, I need to inform and engage procurement way before they make this decision, not in the middle of a negotiation or in response to a request for quote, as they have already decided what they will measure, and it's tough for them to open up and say, "Wait, I should re-think this."

MUDDLING THROUGH ON CUSTOMER VALUE

TODD C. SNELGROVE: Do you notice a trend in the practice of CVM and value selling?

JIM ANDERSON: Recently I did a search for large-scale, management practice studies that have been done on CVM and value selling. I expected to find at least several studies but I could find only one, done by the Aberdeen Group (2011). They surveyed 214 businesses about their value-selling practices. Aberdeen aggregated the businesses' responses on three performance measures to segment them: customer retention rate, average year-over-year growth in overall company gross profit, and average year-over-year increase in average closed deal size or annual contract value. Based on their aggregate responses to these three measures, Aberdeen grouped them into three performance classes: the top 20%, which they term "best-in-class"; the middle 50%, which they term "industry average"; and the bottom 30%, which they term "laggard."

Juxtaposing the findings that they report in two sections of the report produces some surprising comparisons. I share this juxtaposition of findings in Figure 3.1. On the left we see the results for the statement "We clearly translate features/benefits of our solution into economic value we can articulate to customers," and on the right we see the results for the statement "Sales process includes distinct steps, activities, tools to reinforce value delivered to customers."

Notice the considerable percentage decrease for each performance class on these two measures. For example, 74% of the best-in-class performers agree with the statement that their business is translating features or benefits to economic value it can articulate to customers, while only 51% agree that their sales process has some distinct means to reinforce the value delivered to customers—a decrease of 23%! What accounts for these differences, we can only speculate on. Perhaps the technical or marketing folks are doing the translation on the left, but

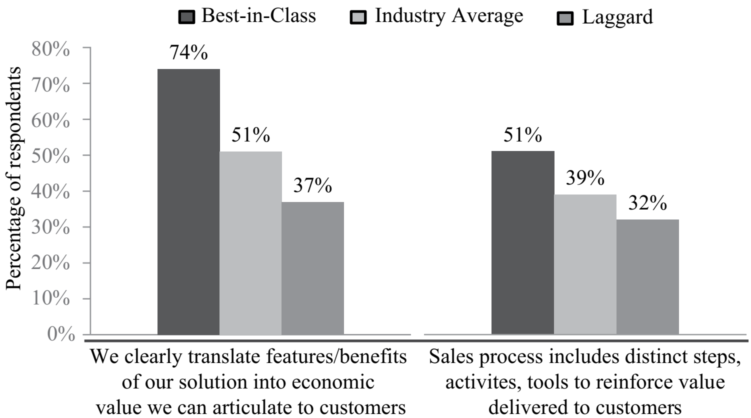

Figure 3.1 Value realization: Muddling through on value.
Source: Adapted from Value-Based Selling: Building a Best-in-Class Capability for Sales Effectiveness [Research Brief] by Aberdeen Group, October 2011, retrieved 26 Oct. 2015 from http://www.zsassociates.com/publications/whitepapers/aberdeen-study-value-based-selling.aspx.

are not providing value-selling tools that salespeople find persuasive and want to use. If one regards the results on the right as reflecting where "the rubber meets the road" in conducting business on value, we would conclude that most businesses are muddling through on value. Barely half of the best-in-class businesses agree that they have the means to reinforce the value that their offerings deliver to customers. Looking on the bright side, most businesses that believe they are doing poorly in CVM and value selling can take comfort in knowing that they are not alone, and that there's considerable room for improvement!

JIM ANDERSON: Todd, do you know of any other studies done on CVM and value selling?

TODD C. SNELGROVE: One of my favorite pieces of research was conducted by Deloitte and published in April 2013 in *Harvard Business Review* as "Three Rules for Making a Company Truly Great." They looked at data for over 25,000 publicly traded U.S.-based companies over 44 years to see what characteristics made them the most successful. They found a way to strip out other factors. They came up with three rules for companies that continually were more profitable than others in their industry. They found the number-one quantitative reason was a focus on being Better Before Cheaper—on creating a product or service that is of value versus being "a me-too, almost as good copycat." The second rule was Revenue Before Cost—working on getting paid for value before focusing on stripping away internal costs. We all know that internal waste should be avoided, but the research shows that having ways to get paid for value is significantly more important than cutting internal costs. Finally, rule number three was There Are No Other Rules; nothing else—such as R&D spend, number of patents filled, or brand recognition—was statistically significant. In focusing on creating something of value, we use value quantification or engineering for value, as others call it, to see what attributes we should focus on new products having that create the most customer value. The ability to quantify our value and sometimes enter into agreements to get paid based on the customer realizing that value helps improve our top line, and allows customers to buy our solutions.

JIM ANDERSON: Do you have an explanation you would like to offer for the difference in results in Figure 3.1?

TODD C. SNELGROVE: I think your conclusion is correct. Someone at the head office sent a PowerPoint presentation that shows some global success for some customers. It might even show the breakdown of how the value was created; however, there's no systematic tool that allows the salespeople to run the calculation for their customer in their country using the customer's own numbers. Either that, or the calculations were so complicated that no one understood how they worked. Sometimes I find that engineers feel that more information is better. If people don't understand or believe the value quantification, then it doesn't matter that you have a spreadsheet that has numbers on it.

Why are CVM and doing business based on value not more widespread?

JIM ANDERSON: CVM and doing business based on value isn't easy. It takes time and money, knowledge and skill, visible senior management support, persistence, and creativity. These last two—persistence and creativity—are especially critical to overcoming the obstacles that inevitably arise in doing CVM, particularly in customer value research.

Many suppliers in business markets believe their offerings are so complicated that it's impossible to express their value in monetary terms. But think about this for a moment. If we do believe our offerings are so complicated that it's not possible to express their value in monetary terms, then how can we expect the customers to adequately understand their value in monetary terms? And, if that's the case, how can we expect to get an equitable return on the value that our offerings provide to customers?

Believing that their offerings are so complicated that they cannot adequately express their value stops many suppliers before they even start with CVM. That's why we counsel suppliers to start small, with a pilot program of several projects, to prove the CVM concept for their business. Selecting the projects for this pilot is critical. We believe it's best for a supplier to start with projects for new or significantly improved offerings, which the supplier believes are differentiated and that have demonstrably superior value for target customers, but the supplier does not know what that's worth in monetary terms. Suppliers need to resist the temptation to put "problem child" offerings in this initial pilot program. Similarly, trying to use a CVM research project to obtain a higher price for the superior value that the supplier has already given away at a low price is a non-starter. Simply put, there must be something new or different about the offering that the supplier believes would be valuable to persuade customers to participate in the research.

To even start with CVM requires a champion at the business who advocates giving CVM a chance. You played this role at SKF, Todd. What compels this individual to become a CVM champion? It may be a critical incident that occurs in the business, someone coming to the business who has had success with CVM elsewhere, or a progressive thinker who simply becomes tired of muddling through on value.

Why do you believe doing CVM and business based on value is not more widespread? Based on your vast experience, what advice can you offer for how suppliers in business markets might do better?

TODD C. SNELGROVE: Yes, it does take someone to drive the program. If it had just been an idea that I'd had, and it sat in one of numerous projects I am involved with along with my daily job, it never would have worked. Any culture change project—which selling on value is—requires a long-term shift in people's thinking, motivation, and skills. To make this happen, a person or team needs to drive it. Too often I see sales saying they want this, and then throwing it over the fence to marketing to say "Build it." A tool might get developed, but it won't be used and become robust if that's the case. We have had four different versions of our tool, and numerous updates and ongoing improvements. As the retired CEO said, "Todd, you will always have a job, as this is a never-ending journey to show customers that best value is more important than lowest price." Also, I think sometimes sales wants something perfect. You have to start and say, "We think this should last twice as long based on these engineering studies"—this then becomes a proposal; over time something actually happens and you were either right or wrong. Or during product development you run test cases so you do have benchmark data. If I could guarantee every customer that my option would last twice as long as a competitor's, then I wouldn't need salespeople. Start with reasonably defendable assumptions, then track what actually happens. In 2001 we had one case in our system that was approved by a customer; now we have over 64,500 vs 58,000 signed off on by customers. So now I have enough data to do probabilities, share best- and worst-case scenarios, show numerous examples, but that all started somewhere. What's that saying—"Every journey starts with one step"?

JIM ANDERSON: From your experience at SKF and talking with other companies, what advice comes to mind on how to spread the practice of CVM and doing business on value?

TODD C. SNELGROVE: Well, as we've discussed, it starts with having a corporate directive that says that we're going to be the value player in our industry. If your company is not a value player, then creating a tool to prove value will not solve this, and eventually customers will realize that your "value program" is really just a sales and marketing strategy with no meat on its bones. Next, have someone drive it as a full-time job; no one can become an expert on something doing it part-time. I live, eat, breathe this stuff. I believe in it, and my having the freedom to focus on one strategy has allowed us to realize the benefits of value selling based on our ability to quantify value. Start in a region with one product so that when you're ready to roll it out you have some stories, and some examples, to show other salespeople that it does work. Don't just focus on the tool; think of all the other things that are needed to support and move your company in this direction. What do they say? "A fool with a tool is still a fool"? I remember our CEO in the early days when I sent reports of wins saying a few interesting things. He asked, rhetorically, "How many ways do our salespeople have to offer a discount or do something for free? Too many! How many tools do they have to prove our value? Guess that's our answer: we need to create the tools and processes." During another meeting when I was demonstrating the measurable effect I was having for our company, he said to me, "Every minute you spend documenting the sales you have created, the agreements to guarantee value versus discounting, you're not out doing what I want you to do [i.e., quantifying and documenting value]. I trust you, and I know the value in what you're doing." Finally, he asked if I would speak at a conference that had nothing to do with our business, as another CEO was chairing the event and had asked him for the favor. He said, "Do not always look directly for 'What's in it for me (or SKF)?' to do something. Get the message out anywhere, to anyone, about buying on value, and the benefits will come somewhere." I can truly say that he was right.

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