Customer Value Management

How do you define value? Can you measure it? What are your products and services actually worth to customers? Remarkably few suppliers in business markets are able to answer these questions. And yet the ability to pinpoint the value of a product or service for one's customers has never been more important.

Customer value management is a progressive, practical approach to managing business markets. In its essence, customer value management has two basic goals:
• Deliver superior value to targeted market segments and customer firms.
• Get an equitable return on the value delivered.

Customer value management relies upon customer value assessment to gain an understanding of customer requirements and preferences, and what it is worth in monetary terms to fulfill them. Although firms may be able to accomplish the first goal without any formal assessment of customer value, it is increasingly unlikely that they will be able to accomplish the second goal without it. Simply put, to gain an equitable or fair return on the value their offerings deliver, suppliers must be able to persuasively demonstrate and document the value they provide customers relative to the next-best-alternative for those customers.

An essential undertaking in customer value management is building *customer value models*, which are data-driven estimates of what a present or prospective market offering is worth in monetary terms to targeted customers relative to the next-best-alternative offering. Some suppliers have built what they regard as customer value models, but these models have the character of being "data light" and "assumption heavy". Quite naturally, customers are skeptical of such models, claiming that they do not accurately reflect their businesses. In contrast, customer value management stresses building customer value models that are "data heavy" and "assumption light". Wherever possible, suppliers gather data to minimize the number of assumptions made and to ensure that the assumptions that are made are reasonable.

Drawing on my experience in working with firms, let me briefly discuss the process of customer value management. This process can be viewed as five phases: translating business issues into projects, customer value workshop, customer value research, constructing a business case for change, and value realization.

Translating Business Issues into Projects

In the initial phase, senior managers think through significant issues that the business is facing, where greater knowledge of customer value would enable them to make more profitable decisions.
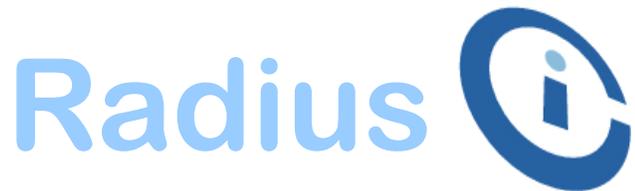
Customer value management has been used to inform and guide a variety of management decisions, such as: which market segment(s) to target; which potential product developments and modifications to make; which augmenting services, programs, and systems to offer as standard (no charge) or for-fee options; and setting pricing strategy and tactics. Customer value management requires investing time and money, from which senior management seeks significant returns in incremental profitability, knowledge and skill acquisition, and cultural change to become truly market-oriented and customer-focused.

To give a broader experience and understanding of customer value management and what its potential is, we counsel firms to engage in a pilot program where they tackle three to five business issues. A project is defined for each issue, where decisions are made about the scope of the project, the definition of success, and the composition of the team that will carry out the customer value research to address the issue.

The scope of each project needs to be sufficiently defined so that the customer value research can be conducted over a three or four month period. we believe it is unwise to overwhelm teams with projects that demand more time than is reasonably available, or to have projects last more than six months. When the nature of the business issue is sufficiently broad or complicated, it is better to conceptualize it as a series of phases, each of which will take three or four months to complete.

Senior management must define at the outset what its expectations of success are for each project. A business case for change that results in $1 million of incremental profitability within twelve months is commonly defined as the principal goal of each project. This represents a relatively quick and attractive financial return on the resources that a business commits to each pilot project, while also gaining the knowledge and skills to practice customer value management. It also ensures that the projects are addressing business issues of sufficient magnitude, yet can be accomplished within the established time frame.

The composition of each customer value research team will vary, depending on the nature of the project, but often includes: someone who most often spends time at the customers solving problems (e.g., field technical rep, field applications engineer); someone from the product marketing or development functional area; and two or three progressive sales persons. Having sales persons involved at the start is crucial. They provide needed expertise on the customer and its use of the offering, and they have knowledge of and relationships with customers that would be willing to cooperate in customer value research. Being part of a customer value management initiative from the outset also builds support for the approach with those salespeople, who then can persuasively relate their experiences to others in the sales force.

Each team should have a leader selected by senior management prior to the start of the project. The team leader should be someone with superior project management and interpersonal skills. we recommend that the manager having primary responsibility for implementing the business case for
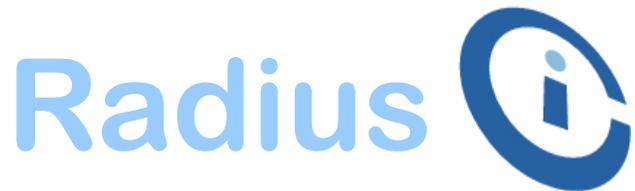
change *not* be the team leader. For example, although the product manager for a new offering who has to decide which market segment to enter initially will be a significant contributor to the team, it is preferable to have another more "objective" manager have primary responsibility for the project management and process aspects of teamwork. Customer value assessments are an intensive analytical effort, which may require up to a half-time commitment by the project leader. Other team members will spend varying amounts of time on the project, with a quarter-time commitment being typical.

For customer value research projects to succeed, the active support of senior management is crucial. Most often, a senior manager acts as a sponsor for each team. This should be decided before the start of the projects. While senior managers should communicate to the teams the importance of the pilot program to the business, they make a more visible statement through how they spend their own time. Making the commitment to attend at least the opening morning of the customer value workshop, monitor the progress of their team, and attend the presentation day for the business cases sends a strong signal to the teams.

Customer Value Workshop

The teams come together for a Customer Value Workshop, which is a two- or three-day session where they gain the requisite knowledge and skills to build customer value models, and plan and launch their projects. During this workshop, they practice building customer value models using one or more proprietary case studies. In breakout sessions, each team begins to: define the value elements for their project, determine the next-best-alternative to their market offering, decide which customers to invite to participate in the customer value research, and create their workplans for accomplishing the project. Coaching support is provided throughout each breakout session, to reinforce the concepts that the participants have learned and to work through the unforeseen issues that the teams inevitably encounter.

To get the most out of this brief time, advance preparation is critical. Prior to the workshop, we work with each team leader and sponsor to pull together what is presently known about each project and to further refine each project.

Customer Value Research

The customer value research that each team conducts proceeds in three phases: gaining initial customer cooperation, gathering the data, and analyzing the data.

Gaining initial customer cooperation.

Prior to contacting any present or prospective customers to participate in the research, the team has

some tasks to perform:

1. Decide upon the market offering and market segment that the team will study.

2. Define the value elements for the market offering to the market segment.

3. Specify customer characteristics that define two subsegments within the market segment on which the customer value research will focus.

4. Decide the customers in each subsegment regard as the next-best-alternative offering.

5. Revisit the list of value elements, and hypothesize points of parity and points of difference for each subsegment with respect to the next-best alternative. Construct an initial value word equation for each hypothesized point of difference. *Value word equations* express in words and simple mathematical operators (e.g., +, ÷) how to assess the differences in functionality and performance on a value element and what those differences are worth in monetary terms.

6. Decide on present or prospective customers that are most of interest to have as research participants in each subsegment. The goal is to have six to eight customers participate in each subsegment.

7. Think through why the customers should cooperate in the research. What are the *Gives & Gets* from the customer's perspective? Customers cooperate in value research for one or more of four basic kinds of reasons: a low-cost resource to better understand their business, an opportunity to benchmark, earlier access to some new product or service, or they seek a meaningfully lower price. Prepare several levels of incentive that could be successively offered to gain customer cooperation, if necessary.

8. Consider what managers at the customer firm the team would like to meet with.

9. Contact the sales person responsible for each customer that the team wants to participate in the research. Explain purpose of research and gain the sales person's support. Gain names and contact information for managers to invite for the initial meeting.

Having completed these tasks, the team is now prepared to contact customer managers to arrange an initial meeting to explain the purpose of the research and gain their cooperation. Depending on company protocol, the sales person responsible for each customer may accompany the team members to the initial meeting. It must be stressed, though, that this meeting is *not* a sales call. At least two team members should visit each customer.

In the initial meeting, the team members should be certain to:

1. Explain the purpose of the research and what the customer might gain from participation.

2. Discuss the hypothesized points of parity and points of difference and gain customer agreement. Determine points of contention. Be explicit in the assumptions made!

3. Reach agreement on value word equations that would capture each point of difference and point of contention. Revisiting the points of difference and points of contention, discuss what sources of data that the customer presently generates or would be able to generate to provide an estimate of each point of difference and point of contention.

4. Discuss timing and resource requirements for data collection. Discuss what sources of data outside the customer firm (e.g., industry association studies) might be worthwhile pursuing.
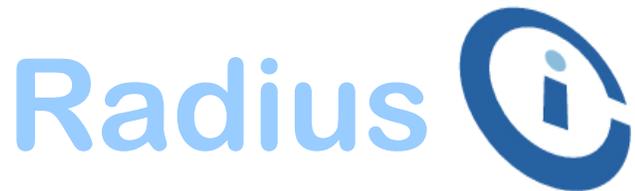
Gathering the data.

Wherever possible, the team relies on data rather than customer perception. If the customer volunteers to collect the data, the team should inquire into the method that will be used. How reliable will the measurement be? That is, how consistent would the measurements be over time, or are there variations that need to be considered? What assumptions are being made? Wherever possible, team members should offer to work with the customer to generate or gather the data.

The team next considers the *value placeholders*, which are value elements that the team believes are worth something to customers but either are too difficult to obtain data for or are social elements. Relying on customer perception, what is each qualitatively worth? How might proxy estimates be obtained? When there is no other source than customer perception, *framing* the worth of the element in the customer's mind is critical. What seems reasonable? Depending on the situation, a second visit to the customer likely will be needed to gather data.

Analyzing the data.

When the data have been gathered, the team estimates what each value element that is a point of difference or a point of contention is worth in monetary terms. The team then calculates the mean and the variance (or standard deviation) for each. How does the estimate for each value element vary across the two studied subsegments?

The team next constructs a value summary – the *customer value model* – that expresses each element in monetary terms. The team should be certain to list any assumptions made in assigning monetary amounts to each element. It performs sensitivity analyses, using the information on the variances around each element. It considers what characteristics might drive the variation in value and whether that variation warrants a new segmentation approach. Finally, it identifies which customers make the most attractive prospects. The teams also consider the value placeholders. What insights can be provided? How should the value placeholders be utilized in light of the customer value assessment?

Constructing a Business Case for Change

Based on the knowledge of value that the team has gained from its research, what does it recommend that the business do differently? What is the *customer value proposition* that will resonate with targeted customers? The business case for change should address:
1. What specific actions does the team recommend based on its customer value research?
2. What resources would be needed to accomplish the recommended changes in doing business?
3. What are the specific concerns in implementing the business case?
4. What milestones can be specified to chart the progress in accomplishing the change?
5. What would be the profitability impact if the business case for change were approved?
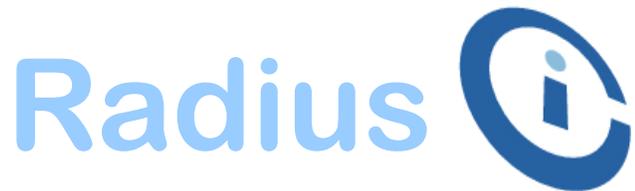
To assist each team in preparing its project report and business case presentation, we provide guidelines. Adherence to these guidelines ensures consistency across teams' business case presentations and reports, which facilitates communication and understanding. These business cases are presented to senior managers who have served as project sponsors and the top management of the business unit. This business case should be viewed as a prospective commitment: if senior management provides the requested resources, the business will deliver the specified results, especially the estimated incremental profitability.

Value Realization

The period following the presentations of business cases for change to senior management is a critical phase for realizing the value, and incremental profitability, identified in the business cases. The teams may need to gather additional data to refine or extend the customer value models presented to senior management. Further work likely will be needed on the action plans, particularly addressing implementation issues. Value-based sales tools need to be created, or refined if initial versions have been constructed in the business case for change phase, and training needs to be devised to give the sales force practical experience using them. Supporting changes in performance review and compensation may be needed. A method of feedback should be put in place to audit the value that customers have actually experienced relative to what was promised to them. Finally, a system for the tracking the incremental profitability actually realized should be put in place.

Value assessment itself can become a value-adding service that suppliers offer as part of a consultative selling approach. The teams develop customer value assessment tools, called *value calculators*, as spreadsheet software applications that salespeople or value specialists conduct on laptop computers to demonstrate the value that customers would receive from their offerings. Although these value calculators are typically quite user-friendly, they may require input data that the customer does not have readily available. To facilitate gathering the required input, the team may develop a worksheet that pulls together the necessary input data.

Suppliers that practice customer value management understand that they must not only *demonstrate* the value that their offerings would deliver to customers, but that they must *document* the cost savings and/or incremental profits their offerings actually deliver to customers purchasing them. Thus, they work with customers to define the measures on which they will track the cost savings or incremental profit produced, and then after a suitable period of time, work with customer managers to document what the actual results have been. They use these tools, called *value documenters*, to further refine their customer value models, create value case histories, enable the customer managers to turn "gray" money into "green" money, and enhance the credibility of the demonstrated value of their offerings, because customer managers know that the supplier is willing to return to document the actual value received.

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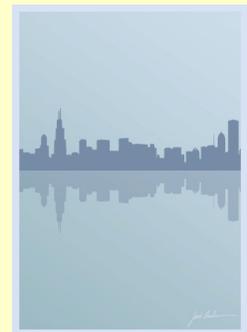
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