# Value Propositions

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## Introduction - Understanding the real meaning of customer value

Understanding more about value propositions will help make strategic marketing plans much more powerful.

**What is value?**

The very word 'value' is highly contentious, because it totally depends on whose point of view is being taken and the context in which the word is used.

Before we give you our own interpretation of the term, (which will be used through the remainder of this white paper), let us share with you some common definitions of the term. We will do this as briefly as possible and only in the interest of not wishing to be labelled as biased marketers.

**Value chain analysis**

Firstly, there is Michael Porter's ( 1980 ) well-known concept of value-chain analysis. Porter's concept of value added is an incremental one; he focuses on how successive activities change the value of goods and services as they pass through various stages of a value chain. The analysis disaggregates a firm into its major activities in order to understand the behaviour of costs and the existing and potential sources of differentiation. It determines how the firm's own value chain interacts with the value chains of suppliers, customers and competitors. Companies gain competitive advantage by performing some or all of these activities at lower cost or with greater differentiation than competitors."

**Shareholder value analysis (SVA)**

Secondly there is Alfred Rappaport's equally well-known research on shareholder value analysis (Rappaport 1986). Rappaport's concept of value added focuses less on processes than Porter, and acts more as a final gateway in decision-making, although it can be used at multiple levels within a firm. Is the process of analysing how decisions affect the net present value of cash to shareholders. The analysis measures a company's ability to earn more than its total cost of capital. Within business units, SVA measures the value the unit has created by analysing cash flows over time in relation to the cost of capital. At the corporate level, SVA provides a framework for evaluating options for improving shareholder value by determining the trade-offs between reinvesting in existing businesses, investing in new businesses and returning cash to stockholders.

**Customer value**

A third way of looking at value added is the customer's perception of value. Unfortunately, despite exhaustive research by academics and practitioners around the world, this elusive concept has proved almost impossible to pin down: What constitutes [customer] value – even in a single product category – appears to be highly personal and idiosyncratic. Nevertheless, the individual customer's perception of the extra value represented by different products and services cannot be easily dismissed. In the guise of measures such as customer satisfaction and customer loyalty, it is known to be the essence of brand success, and the whole basis of relationship marketing.

**Accounting value**

Finally, there is the accountant's definition of value added: "value added = sales revenue – purchases and services". Effectively, this is a snapshot picture from the annual accounts of how the revenue from a sales period has been distributed, and how much is left over for reinvestment after meeting all costs, including shareholder dividends. Although this figure will say something about the past viability of a business, in itself it does not provide a guide to future prospects.

One reason that the term 'value added' has come to be used rather carelessly is that all these concepts of value, although different, are not mutually exclusive. Porter's value chain analysis is one of several extremely useful techniques for identifying potential new competitive market strategies. Rappaport's SVA approach can be seen as a powerful tool which enables managers to cost out the long term financial implications of pursuing one or other of the competitive strategies which have been identified. Customer perceptions are clearly a major driver (or destroyer) of annual audited accounting value in all companies, whatever strategy is pursued.

However, most companies today accept that value added, as defined by their annual accounts, is really only a record of what they achieved in the past, and that financial targets in themselves are insufficient as business objectives. Many companies are now convinced that focusing on more intangible measures of value added such as brand equity, customer loyalty, or customer satisfaction are the new route to achieving financial results.

Common sense (and with apologies for this quasi-academic discussion), might argue that developing strong product or service offerings, and building up a loyal, satisfied customer base will usually require a series of 1-2 year investment plans in any business. Also, such is the universal distrust of marketing strategies and forecasts, it is common practice in most companies to write off marketing as a cost within each year's budget. It is rare for such expenditure to be treated as an investment which will deliver results over a number of years, but research shows that companies who are able to do this create a lasting competitive edge.

So we will quantify what a value proposition is from the customer's perspective. A definition of a value proposition is given later in this paper.

**Differentiation**

For any organisation today, differentiation that is wanted by the customer is more challenging than at any time in history, but it remains at the heart of successful marketing. More importantly, it remains the key to a company's survival.

The truth is that if you are in an overcrowded market where you don't stand out, all lowering prices will achieve is to erode your margins and unless your business costs are lower than anyone else's, discounting is a losing game.

The alternative, of course, is successful differentiation. If you can't come up with something genuinely different and better, there isn't much future for your company.

Differentiation will result from the way you relate to your customers, because having excellent products is no longer enough today. As Dryburgh A says ( 2014 ), all products today are excellent and in any case, technology enables competitors to catch up technical developments very quickly. So, differentiation is essential to corporate success and must somehow be encapsulated in financially-quantified value propositions.

For now, however, all we want you to understand is that differentiation is the key to commercial success and must be encapsulated somehow in value propositions.

# The benefits of financially-quantified value propositions

Table 1 below summarises the case for financially-quantified value propositions

**Financially quantified Value Propositions**

Will help you increase profitable sales for a number of reasons:

- Only 5% of companies have financially quantified Value Propositions ((McKinsey) and developing them will differentiate your company.
- Even if you DON'T have any differentiation, the very act of financially quantifying quantifying the benefits, even if they are standard benefits, will give you an advantage over your competitors.
- You will close more deals (typically an additional 2% to 10%)
- The sales cycle will be reduced by 10% to 25%
- It will help reduce discounting by 20% to 30%
- It will help make marketing campaigns more productive
- Improved customer relationships; referrals from satisfied customers

Table 1

Additional benefits , which are harder to quantify, are:

- Avoidance of no/delayed decisions to buy
- Improved customer relationships
- Referrals from satisfied customers
- Longer-lasting relationships

Let us give a quick summary of just one of the above benefits--- sales velocity--- illustrated in tables 2, 3, and 4 below

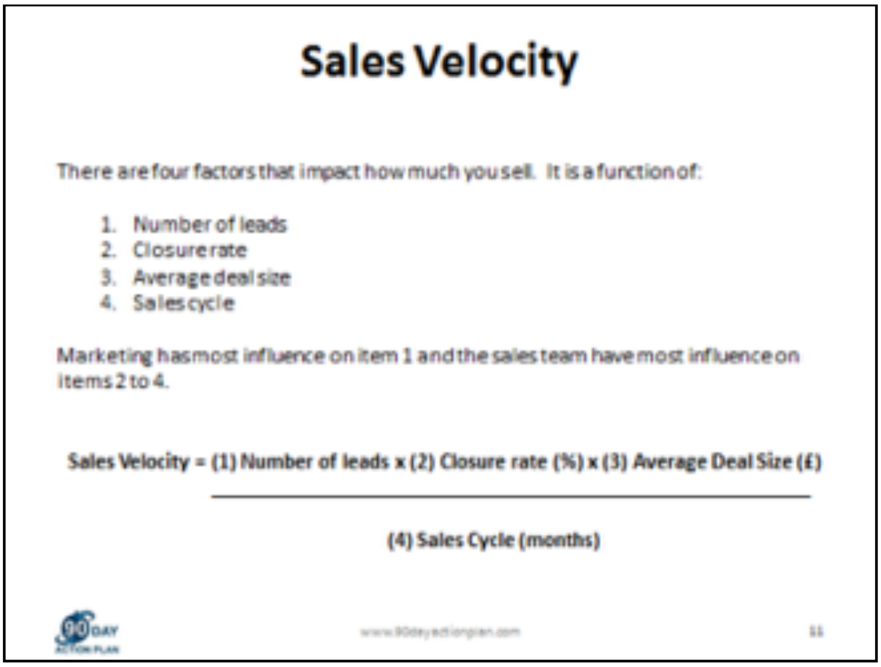



Table 2

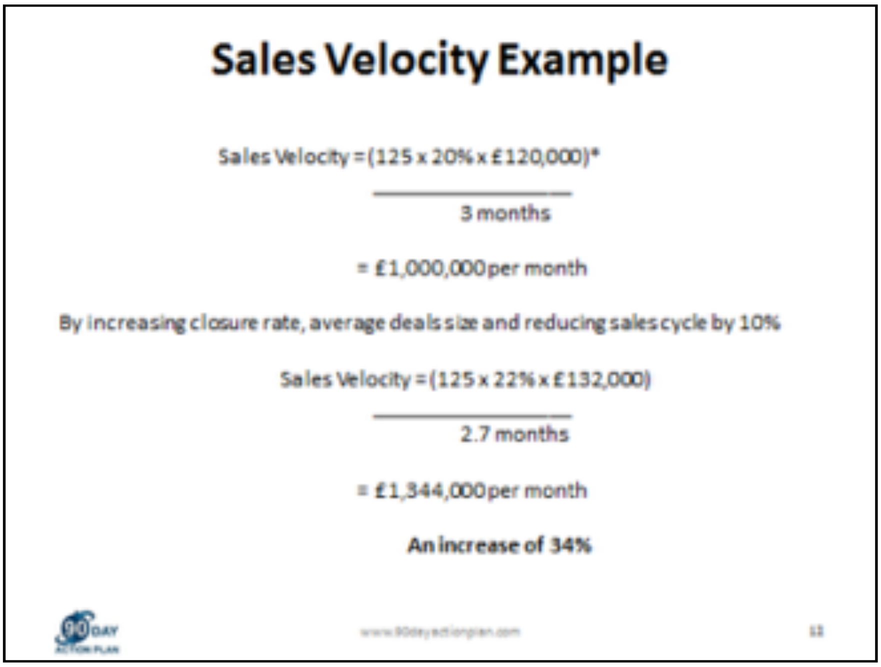
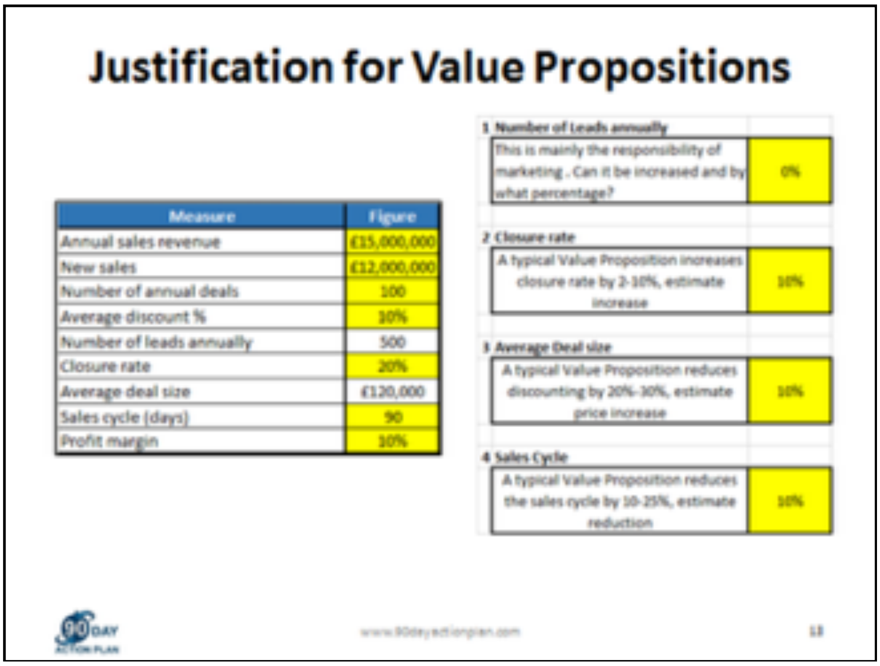



Table 3



## Justification for Value Propositions

| Measure | Figure |
|---|---|
| Annual sales revenue | £15,000,000 |
| New sales | £12,000,000 |
| Number of annual deals | 100 |
| Average discount % | 10% |
| Number of leads annually | 500 |
| Closure rate | 20% |
| Average deal size | £120,000 |
| Sales cycle (days) | 90 |
| Profit margin | 10% |

| | |
|---|---|
| **1 Number of Leads annually** | |
| This is mainly the responsibility of marketing . Can it be increased and by what percentage? | 0% |
| **2 Closure rate** | |
| A typical Value Proposition increases closure rate by 2-10%, estimate increase | 10% |
| **3 Average Deal size** | |
| A typical Value Proposition reduces discounting by 20%-30%, estimate price increase | 10% |
| **4 Sales Cycle** | |
| A typical Value Proposition reduces the sales cycle by 10-25%, estimate reduction | 10% |

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Table 4

Now let us have a look at figure 1 below.

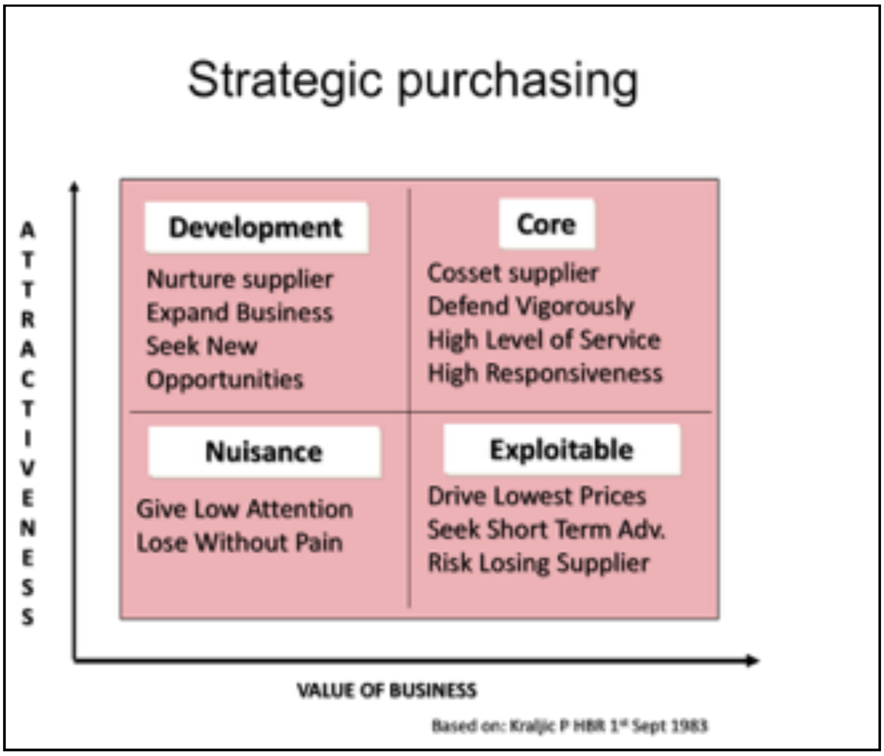



Figure 1

It is used by most buyers in most markets, the only difference being that the vertical axis is sometimes labelled 'differentiation' (high or low). The most important box to look at is the bottom right box. Here, the buyer orders a lot and they can get it from virtually any supplier, so not surprisingly, they buy on price.

The bottom left box, (low differentiation and the buyer does not purchase a lot), represents a great opportunity for small companies to take responsibility from the customer by means of outsourcing.

The top left box, providing a company offers something different that the customer really value, is an even better opportunity, because even though they don't buy much, price is rarely important.

By far the best box to occupy is the top right one. Buyers order a lot and they really value the differentiation offered. Here, it is not unusual for them to pay up to 20% premium to deal with such suppliers.

The bad news, however, is that the low differentiation axis nearly always leads to very low prices and margins for suppliers. This is OK, however, providing at least some of the main products or services you supply are differentiated and it is to this, that we now turn our attention in the context of value propositions.

Start by having a look at your own website. Typically they say things like:

- We are innovative
- We have better quality
- We have a great reputation
- You can trust us
- We are the leading provider of ...
- We get good results for our customers
- We are very responsive
- Blah, Blah, Blah .........

Everybody sounds the same and in the main customers just don't care. Next take a look at Figure 2 and we defy you to see any difference in what these suppliers claim to be offering.

# Definition of a value proposition

The Investopedia definition of a value proposition is: "A business or marketing statement that summarises why a consumer should buy a product or use a service. This statement should convince a potential consumer that one product or service will add more value or better solve a problem than other similar offerings". McKinsey's definition is: "A clear, simple statement of benefits – both tangible and intangible – in the company will provide along with the price which a customer in that segment will pay for those benefits." our own definition is "Relative value = perceived benefits minus costs".

A value proposition should be:

- Distinctive. It must be superior to competitors'.
- Measurable. All value propositions should be based on tangible points of difference that can be quantified in monetary terms.
- Sustainable. It must have a significant life.

Customers expect their business to be better off as a result of dealing with you and you must be able to prove that dealing with you will create advantage for the customer, not merely help them to avoid disadvantage,. This is summarised in figure 3 below and please note the key words: "creating advantage ", not just " avoiding disadvantage".

| | STRATEGIC | HIGH POTENTIAL |
|---|---|---|
| CREATING ADVANTAGE | | |
| AVOIDING DISADVANTAGE | | |
| | KEY OPERATIONAL | SUPPORT |

**Key:**

<u>**Strategic**</u> = Issues that will ensure the customer's long term success.
<u>**High Potential**</u> = Issues that, whilst not crucial currently, could potentially lead to 'differential advantage for the customer.
<u>**Key operational**</u> = Issues that, unless solved reasonably quickly, could lead to disadvantage for the customer.
<u>**Support**</u> = Issues that, whilst of a non-urgent nature such as information availability, nonetheless need to be solved to avoid disadvantage for the customer.

Figure 3

A value proposition has four potential parts, as follows:

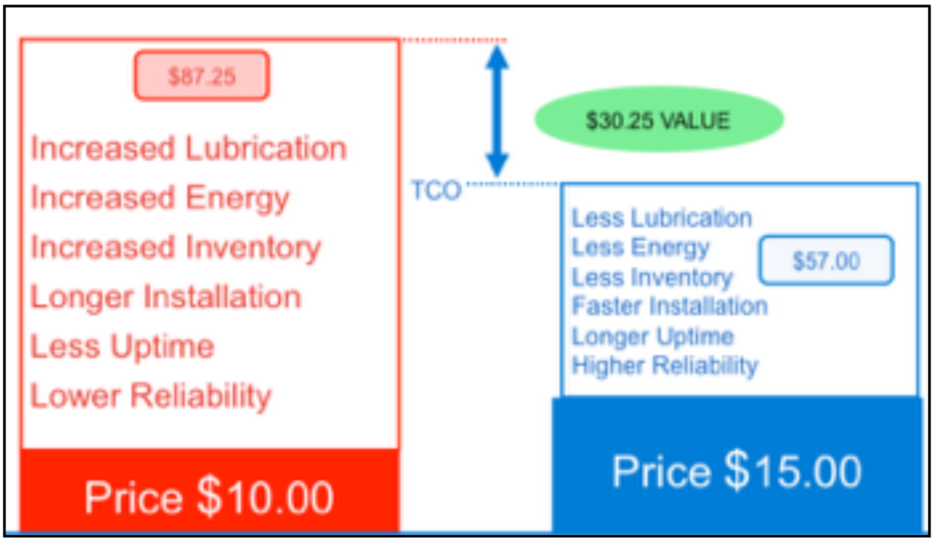
• Added value (eg. Revenue gains, improved productivity, service enhancement, speed, etc.)
• Cost reduction
• Cost avoidance
• Emotional contribution (eg. Trust, 'feel-good factor", confidence, self-esteem, risk reduction, etc.)

The first three are comparatively easy to quantify, the last one less so, although particularly with well-known brands such as SKF, IBM, GE, 3M and the like, they are often high on the business agenda.

An excellent example of this is SKF, the Swedish bearing company. They have a global President of Value Propositions. They tailor them to each customer, but figure 4 below shows a generic value proposition (reproduced with the kind permission of SKF).

# Examples of value propositions

**SKF quantified value proposition**




Source: SKF
Figure 4

From this it can be seen that over the life of the bearings, the significant premium over the bearings of competitors saves the customer $30.25, representing the quantified added value.

This of course is a simple example and value propositions can be more complex.  Look, for example, at Michael Porter's well known value chain, referred to earlier and shown in figure 5 below:

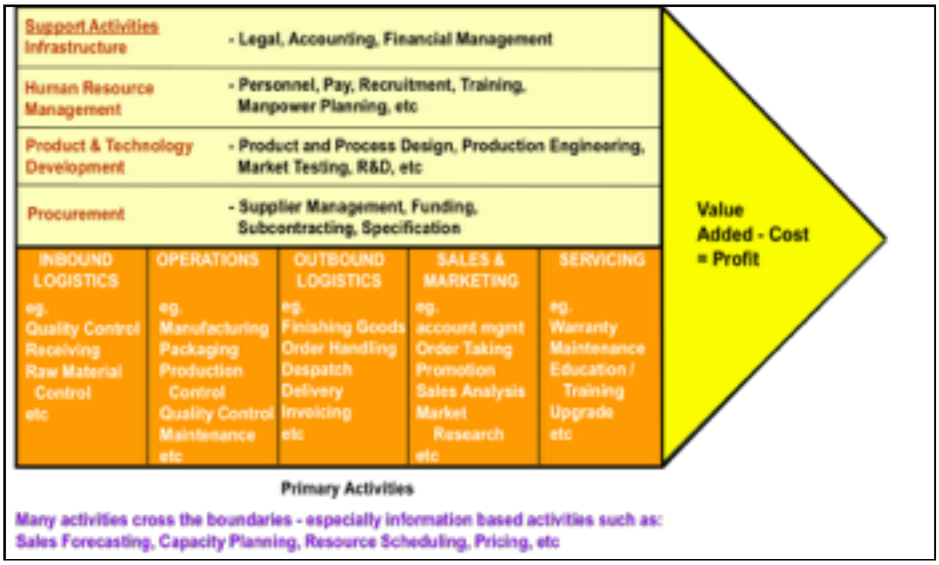



Figure 5

It will be seen that, particularly for a large, complex customer, the opportunities to add value, reduce or avoid costs, are substantial.  But this will require the supplier to spend time understanding the intricacies of how the customer's business works from end to end.

Figures 6 and 7 below give some examples of how this is possible, whilst figure 8 gives a real example from a global plastics packaging company.

**Sources of differentiation in the value chain**

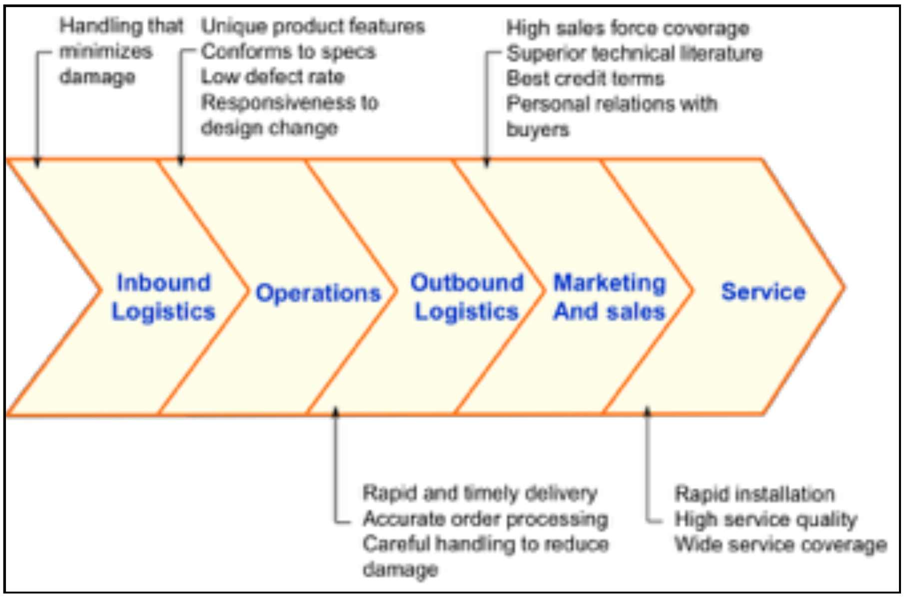



Figure 6

**How do you add value through key support activities?**

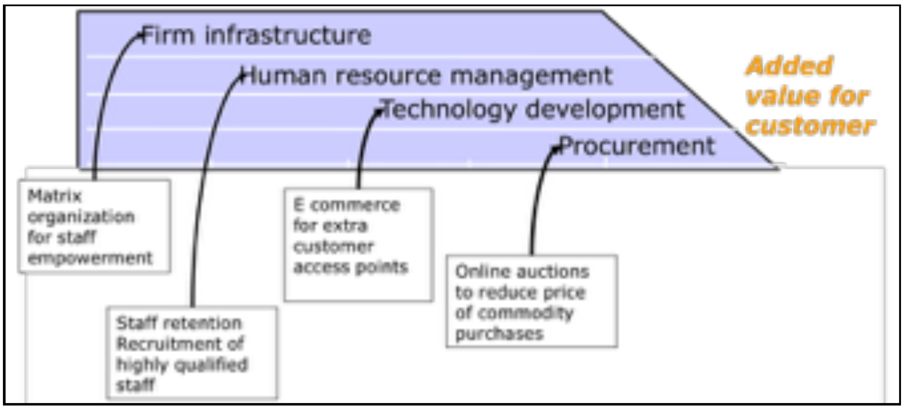



Figure 7

**An example of a multi-stage, multi-level partner**

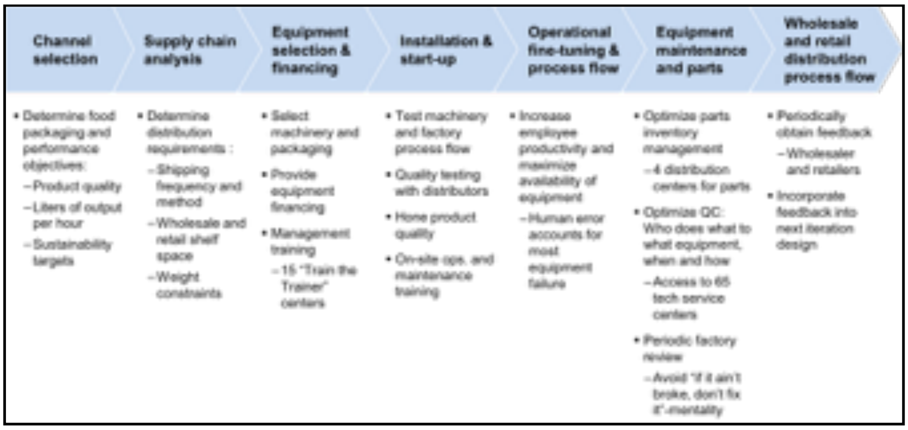



Figure 8

Although this example is of a large organisation, it nonetheless is involved with a technology that hundreds of competitors also understand. The difference is that customers value this company more highly because of their attention to detailed financial value quantification throughout the value chain.

An example of a small label company is shown in table 5 and the benefits are shown in table 6

Example of a label company to food manufacturers taking over responsibility for almost eliminating their stock-holding.

They quantified all of the following:

- It reduces your inventory from 6 to 2 weeks
- It reduces the cash tied up in inventory
- It reduces the problems when you have a stock-out
- It reduces stock-put costs (downtime, expedited shipping, overtime)
- It reduces inventory-carrying costs
- It reduces inventory obsolescence
- It increases sales when you can make quick changes
- It eliminates the need to place orders
- And all at the same price

Table 5

**Advantage to the label company**

- They answer the question: "Why should I buy from you"
- They are different from their competitors
- They reduce the risk of losing a customer to a competitor offering a price reduction
- They make it more difficult for a customer to leave
- They become better at the production and distribution processes
- They can then gain new customers
- Their sales and profits increase

Table 6

**The process for developing value propositions**

The authors of this white paper have developed and tested the process shown in figure 9 below

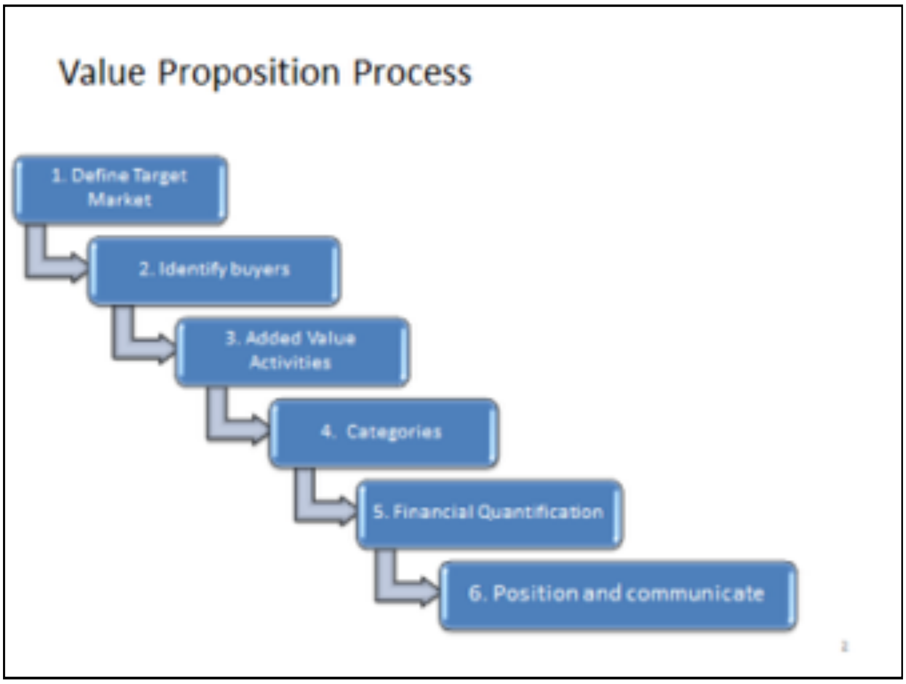



Figure 9

This, however, is not the place to go into this in more detail and this will be the subject of another white paper

In conclusion, we hope we have convinced you that differentiation and quantifiable value propositions are crucial to profitable growth. There is one final point, however. Everything an organisation does, from R and D through to after-sales service, manifests itself in the value proposition offered to the customer and of course this value proposition has a name on it – either a brand name or the name of the supplying company. Typically, brands are at least 25% of the total value of a company, so it can be appreciated, we hope, why this under-researched and undeveloped topic is becoming increasingly important

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January 2015

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