

# Measuring and Managing Customer Value in the Marketplace

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## Definition

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Customer Value Measurement (CVM) is a strategic market research tool for identifying the factors driving purchase decisions in a selected market, quantifying the *importance* of these factors to the buying decision, and establishing the relative *performance* of the competitors in a market. CVM output can establish broad strategic directions and then guide planners to greater and greater levels of specificity in implementing strategic initiatives. The basic rationale behind CVM is the now widely accepted principle that offering greater perceived value attracts more customers, increases market share, and pays off on the bottom line.

## Description

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### ***Introduction***

Over the past 15 years<sup>1</sup>, customer value measurement has become perhaps the single most powerful strategic market research tool available to guide companies to greater market share and increased bottom-line performance. It can not only guide the selection of strategic directions at the boardroom level, it also provides the context within which new product development can play a critical role in achieving the company's overall strategic objectives. In this article we will present the basic concepts inherent in CVM, discuss how it can be implemented in a market research framework, describe how strategic conclusions are derived from CVM results, highlight where new product development fits in, and briefly describe some recent work on monetizing the features offered by a set of competitive products.

### ***CVM Basic Concepts***

In the marketplace, buyers want the “best deal” they can find, or, if not that, then a “good deal.” They don't want to pay more than they have to; they don't want to get less for their money if they can avoid it. The shorthand term for this is **value**.

Over the past 15 years, terms like “value” and “value proposition” have become commonplace in business parlance. Aspiring suppliers are asked by a prospective buyer “what's your value proposition?” A manager focuses his team's energies by asking “what's our value prop – in

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<sup>1</sup> Gale, Bradley T. 1994. Managing Customer Value: Creating Quality and Service that Customers Can See. New York, NY: Simon & Schuster.

Kordupleski, Raymond E., Roland T. Rust, and Anthony J. Zahorik, "Why Improving Quality Doesn't Improve Quality (Or Whatever Happened to Marketing?)," *California Management Review*. 35/3 (Spring 1993): 82-95.

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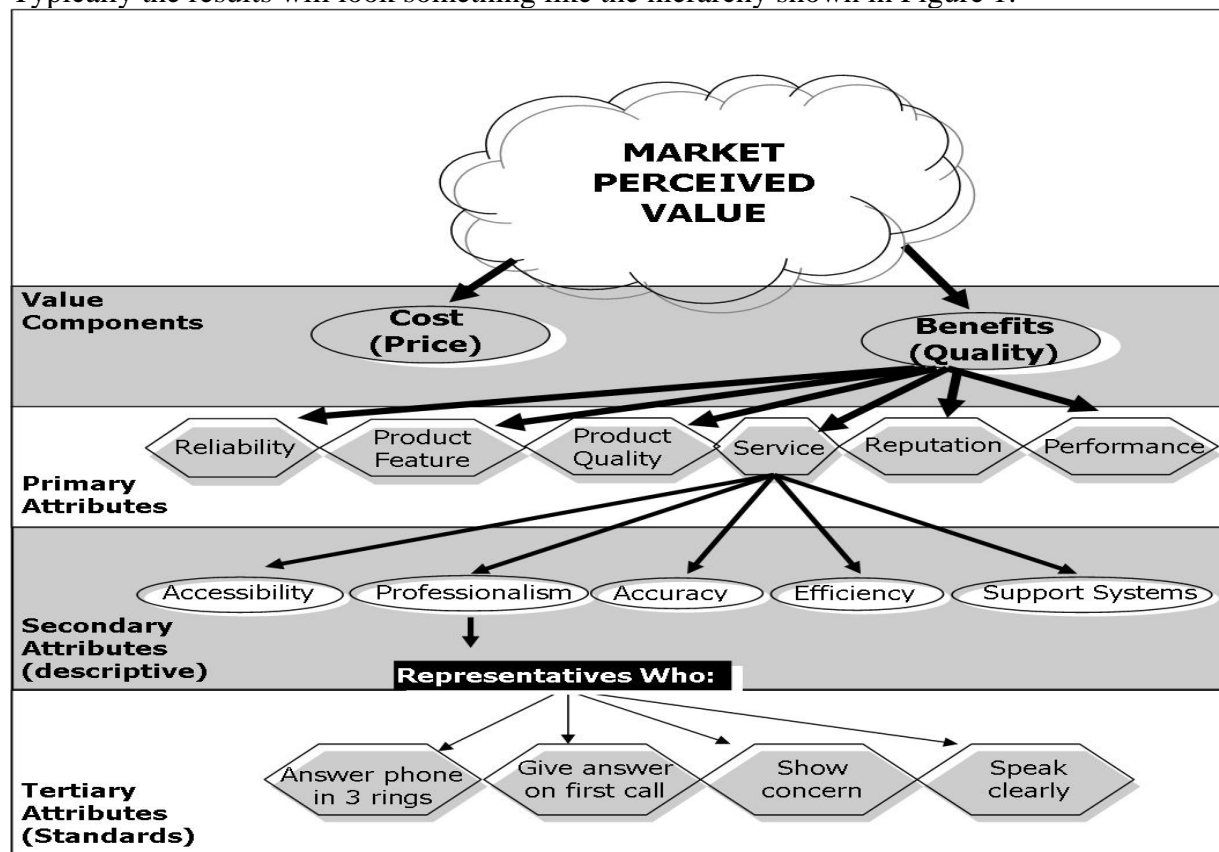
which markets?” The development team for a new product is put to the test: “What is it about this product that offers value to the customer?”

Value, as is said of beauty, is in the eye of the beholder. Value is a perception of the attractiveness of a product or service on the part of the buyer, taking into account all of the factors that are important to the buyer. More precisely:

- Within a market, customers buy on *perceived value*.
- Value is based on the *benefits* customers are expecting to get...
- Compared to the *costs* they anticipate paying.
- Customers evaluate their market choices against these benefits and costs, and then
- Choose products and services that offer the *best overall benefit-to-cost ratio*

If value is based on perceived benefits vs. perceived costs, what exactly are those benefits and costs? To answer this question, we need to create a **mental map** of the buying decision process for a particular product or service. There are several ways to identify the benefits and costs that go into a CVM map; the most straightforward solution is to conduct focused qualitative research in which buyers describe the issues they take into account when making a purchase decision.

Typically the results will look something like the hierarchy shown in Figure 1:



In this example, based solely on customer and market input, “benefits” are made up of five primary attributes (the typical range is 3 to 8 benefit or cost primary attributes):

- Product features
- Product quality
- Service
- Reputation

- Parts availability

Each of the primary attributes is driven by a set of *secondary* attributes that describe the meaning of the primary attribute. Here, “service” is composed of:

- Accessibility
- Professionalism
- Accuracy
- Efficiency and
- Support systems

In turn, each secondary attribute is composed of several third-level attributes. At this level it is possible to establish standards for each secondary attribute. For example, in this illustration, “professionalism” (in a call center setting) is established by:

- Answering the phone in 3 rings
- Answer the caller’s question the first time they call
- Show concern for the caller’s situation
- Speak to the caller in a clear and understandable way

Costs can be mapped out in a similar fashion. The cost side of the map is typically somewhat simpler, often consisting of:

- Acquisition cost
- Operating costs
- Maintenance costs
- Financing costs

Sometimes *non-financial costs*, such as “supplier risk,” are part of Costs.

### ***The Measurement Process***

Once the map of the buying decision process is drawn up, the process of quantifying CVM begins.

Respondents in a CVM quantification process should include a firm’s own customers, its competitors’ customers and likely prospects. This is a market study, not just a customer study. The respondents should only be deciders and their key influencers; individuals who don’t play a part in the decision process are not of concern here.

Two types of data from deciders and their key influencers are needed:

- How important are each of these buying decision factors, starting with the top-level attributes?
- How well does each of the players in a market perform in delivering each of purchase decision factors in the mental map?

Importance ratings can be obtained by directly asking the respondent to allocate 100 “importance points” to the attributes (initially at the top or primary level). (Alternatively, we can derive the importance weights using a regression approach, a more efficient but also riskier method.) To obtain performance ratings, rating scales are used to evaluate how each organization in the decision set delivers on the attribute (typically, 1-10, 1-100 or similar scales).

Once importance weights are obtained for both costs and benefits, along with the performance ratings on all of these attributes for each of the companies involved in the study, one more critical piece of information is needed. The question is: “Taking into account all the *benefits* you’ve evaluated, and all the *costs*, overall which is more important to you in your purchase decision – the benefits – what you get – or the costs – what you pay?” Typically 100 points are allocated between these two categories. (This step takes into account that some buyers are inherently more price sensitive than others.)

### The CVM Summary Table

Figure 2 is an example of a CVM table from a B2B situation. A discussion of how to read this table follows.

Benefits (What the Customer Gets)	Market Importance Weights	Your		Ratio	Weight x Ratio	Variance
		Company Ratings (n = 400)	Competitor A Ratings (n = 200)			
<i>A</i>	<i>B</i>	<i>C</i>	<i>D</i>	<i>E = C/D</i>	<i>F = E x B</i>	<i>F = F-B</i>
<i>Service</i>	0.14	9.33	4.54*	2.06	0.29	0.15
<i>Product Features</i>	0.27	6.11	7.26*	0.84	0.23	-0.04
<i>Product Quality</i>	0.15	6.79	7.06	0.96	0.14	-0.01
<i>Reliability</i>	0.05	8.72	3.43*	2.54	0.13	0.08
<i>Reputation</i>	0.23	8.43	8.54	0.99	0.23	0.00
<i>Performance</i>	0.16	8.97	7.84*	1.14	0.18	0.02
<b>Sum of Weights</b>	<b>1.00**</b>			<b>MPQ Ratio:</b>	<b>1.20</b>	<b>0.20</b>

Costs (What the Customer Pays)						
<i>Acquisition Cost</i>	0.36	7.14	8.57*	0.83	0.30	-0.06
<i>Maintenance</i>	0.33	6.90	7.58*	0.91	0.30	-0.03
<i>Installation</i>	0.31	6.69	6.43	1.04	0.32	0.01
<b>Sum of Weights</b>	<b>1.00</b>			<b>Price Competitiveness Ratio:</b>	<b>0.92</b>	<b>-0.08</b>

**Overall Weights for Quality (45%) vs. Price (55%)**

**Quality Advantage: +20% Price Advantage: -8%**

**Customer Value Ratio (CVR): 1.05**

Column A: Lists the key buying attributes measured at the primary level. In this example, purchase decisions are made based on attributes such as Product Quality or Reputation or Performance.

Column B: The relative attribute importance weights, summing to 1.0 (“100 points”) separately for Benefits and Costs. What’s the most important Benefits weight? (Product Features = 0.27). Least important? (Reliability = 0.05). The double asterisk (\*\*) indicates that the Benefits weights differ significantly (chi-square test) from one another. For the 3 Cost attributes, the weights don’t differ significantly.

Note that the table heading says “Market Importance Weights.” In this example, we have used the attribute weights of customers and prospects representing the entire

market. This comparison shows what it takes to literally “win in the marketplace.” Alternatively, we could use “Competitor A” weights, e.g, just the weights of a specific competitor whose market share is coveted, to see what a company might have to accomplish to take share from that specific competitor. (It is also possible to construct a composite of competitors in the market, weighted by their respective market share.)

Column C: These scores are average (mean) performance ratings on a 10-point scale (10 high) of “Your Company” vs. “Competitor A” on each Quality and Price attribute. What do you see? “Your Company” has great Product Quality (9.33) but mediocre Product Features (6.11). Product Features and Options are Quality attributes where “Your Company” can improve. On Price, there is room for performance improvement in all 3 attributes.

Column D: These are “Competitor A” scores. They range from a low for Reliability (3.43) to a high for Acquisition Cost (8.57). Overall, not a great set of scores. Note that there are single asterisks (\*) next to some of the attributes. This indicates whether the performance scores are significantly different between “Your Company” and Competitor. Thus, this particular analysis approach shows “Your Company” how you can compete more strongly against “Competitor A” in the market as a whole.

Column E: This column presents the relative performance scores for “Your Company” and “Competitor A”. These results show, on an attribute-by-attribute basis, the percentage that “Your Company” and “Competitor A” are perceived to perform better or worse than the other. The percentage is obtained by dividing “Your Company” and “Competitor A” rating by the Competitor's rating. For Reliability, “Your Company” is viewed in the market as 2.54 times as reliable. But “Your Company” performs 17% worse than “Competitor A” on Acquisition Cost.

Column F: Now we take the importance weights from Column B into consideration. We want to adjust the relative ratings in Column 5 by the attribute's weight (if we didn't take this step, we're assuming that all the weights are equal).

We sum the values for the Benefits attributes and obtain a Market-Perceived Quality (MPQ) of 1.20. In other words, customers view the benefits of “Your Company's” products and services as 20% superior to those provided by the competition. For the Price attributes, however, “Your Company” receives a Price Competitiveness ratio of 0.92 or 8% less than “Competitor A”.

The formula for calculating a Customer Value Ratio (CVR) is:

$$\text{(Market Perceived Quality x Overall Quality Weight)} \\ + \text{(Price Competitiveness x Overall Price Weight)} = \text{CVR}$$

For this example, the CVR is **1.05**. This is the summary number to focus on in the chart. Therefore, taking into account all the benefits and costs customers anticipate in a purchase decision, “Your Company” is perceived to offer about a 5% value advantage – a good result but not enough to move the market toward “Your Company's” favor.

## ***Developing Business Strategy from CVM Results***

There are 2 basic approaches to developing business strategy recommendations from CVM results. First, you can test the results against “Your Company’s” current strategy and identify any gaps or complementarities. Hopefully, the two are in synch, but if not, this needs to be addressed. Second, you can develop new strategic directions and test them out hypothetically, using the CVM results as the starting point.

What are some of the business strategy implications of the results shown in Figure 2? Here is how to tease them from the data:

- **Compare the overall weights for Benefits and Costs** (here, 55% vs. 45%). This result provides customer data on the market's price sensitivity and can make an important contribution to business strategy (Here, there is a bit of truth to: “We could sell more if we could just lower our prices”). Understanding the market's price sensitivity is a critical element in developing a comprehensive business strategy from CVM data.
- **Review the individual Importance weights.** Which weights are high? Which are low? How do the “Your Company”’s current sales and marketing approaches support these weights? Do they work together or are they at odds? Consider these weights in light of the organization's culture. For example, companies often put great faith in their reputation (“we’ve been in business for 75 -- 100 -- 150 years and customers buy because of our reputation”) and these results show that reputation does have an important effect.
- **Review the performance scores.** Where are the areas where improvement is needed? Look for areas where the greatest amount of “headroom” for improvement exists. This is not in performance ratings in the 9.0's or perhaps even the 8.0's. But 7.0's or below look promising. What is feasible?
- **Set CVR targets.** Some companies are happy to achieve a positive CVR in selected markets. If their CVR is 1.01 or better, they are content. But in the end, to gain market share and grow the business, more aggressive goals are needed. The benchmarks for this performance, derived from the PIMS (Profit Impact of Marketing Strategies) database, are reported in Gale's Managing Customer Value. These data suggest that a sustained CVR of **1.20** will yield the market dominance that so many organizations seek. So, the strategic goal for the organization? Achieving – and maintaining – a perceived 20% superior value perception in the market place.
- **Explore alternative scenarios.** Once a goal is set, the CVM table can provide guidance on high-payoff strategic directions. There are several avenues to pursue:
  - *Which set of attributes offers the greatest multiplier to any improvements “Your Company” makes?* (In the example, Price is weighted higher than Quality, so any improvement in a Price attribute has its impact multiplied at a 55/45 rate.)
  - *Where can “Your Company” boost performance ratings most readily?* For example, if “Your Company” increases satisfaction with Maintenance from 6.90 to 8.20, how much will that increase “Your Company”’s CVR?
  - *Are there ways to change the market's importance weights?* “Your Company” might choose to differentiate on Product Features (not uncommon in today's economy). By adept combinations of communications and performance improvements, “Your Company” can elevate the importance of Product Features from 0.27 to something higher, thus increasing CVR.

In the current example, the best approach appears to be a combined Product Features and Maintenance strategy. In the short run, Product Features can become a highly visible testimonial to “Your Company's” newly invigorated approach to the market. Product Features here has the largest importance weight (0.27), but the worst relative performance (0.84, 16% worse than the competition), and thus is a good candidate. In the longer run, Maintenance offers high-payoff potential. “Your Company” begins at a disadvantage (0.91, worse by 9%); there is room for performance improvement (6.90 on up), and Maintenance's role as a Price attribute (with an 0.33 weight) yields additional leverage from the relatively greater importance of Price over Quality (55%/45%).

## ***Product Development and CVM***

Where does Product (and Service) fit into CVM? CVM provides a context for assessing the role of Product Features in the purchase decision process. If Product Features are an important part of the buying process – and they often are – the importance of developing and marketing new products or upgrades of current products with new features is highlighted. Concentrating resources on developing and marketing products offering new features becomes an important part of overall competitive differentiation, and CVM results provide a rationale for the needed investment. Some industries, such as consumer electronics, concentrate much of their competitive strategy around the features their products offer. They may concentrate their resources and efforts primarily at the specific feature level and just maintain parity against the competition on the other buying decision attributes.

Of even greater importance to the field of New Product Development (along with other areas of a business), some recent developments discuss the concepts and techniques of *monetizing product features* – of calculating the relative “worth” specific product features in competitive products. In other words, this approach can yield the dollars-and-cents advantage or disadvantage of a given product feature of one product against a competitive product. This opens up interesting possibilities for comparing the costs of engineering and deploying one particular product feature (or amount of the feature) vs. another.

## **References**

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The five references above, all published in the mid-1990s, offer similar perspectives on customer value and were part of the initial dissemination of the CVM concept. Of these sources, the Gale book has had the greatest impact.

Gale, Bradley T. and Donald J. Swire. 2006, 'Customer Value Accounting for Value-Based Pricing,' *Journal of Professional Pricing*, 15, 3, pp. 30-33.

Gale, Bradley T. and Donald J. Swire. 2006, *Value-Based Marketing and Pricing*, 19 pp., available at [www.cval.com](http://www.cval.com).

The last two references provide more details on the concepts and techniques of monetizing product features.