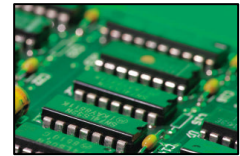


Can Suppliers Afford *Not* to Build Customer Value Models?

By James Anderson & James Narus

An electronics engineer was leading his firm's development effort for a next-generation, electronic control device, which was projected to have a total cost of about seven dollars. An important component of this device was a power factor correction (PFC) integrated circuit (IC). This engineer had narrowed down the potential suppliers for these PFC ICs to two: Supplier A, which was quoting a price of 45 cents per IC, and Supplier B, which was quoting a price of 35 cents per IC. The firm anticipated purchasing 5 million of these PFC ICs for the new control devices.



This electronics engineer happened to be enrolled in a part-time, evening MBA program where he was taking a graduate course in business marketing. Having learned in this course that customer firms should focus on total-value-of-ownership rather than simply purchase price, he decided to build a customer value model, to fulfill part of his course requirements and to determine which of the two suppliers would provide the greater value to his firm.

Pulling together the data and building the customer value model, the engineer estimated that Supplier A's offering was worth 15.9 cents more per PFC IC than Supplier B's. Two value elements emerged as the most critical points-of-difference between the two suppliers. Supplier A provided *earlier access to product samples*, which significantly shortened the time to market for the new devices. Because of the competitive nature of the customer firm's own market, getting to market earlier with new devices affected both the revenue and profit it earned. Supplier A also provided superior *technical engineering support*, which provided design expertise and was a supplementary engineering resource that the customer firm would otherwise have to supply itself. There also were several other points-of-difference that were of lesser monetary value.

Drawing on the customer value model results, the engineer's recommendation to purchasing was that, even though Supplier A's price was 10 cents more expensive than Supplier B's, the firm should purchase the PCF ICs from Supplier A because of the superior value that its offering provided. In



delivering this report to the purchasing manager who was supporting his development project, the engineer related the outcome of his research to the purchasing manager. "That's interesting to learn," replied the purchasing manager with a smile, "But I think that you will be interested to learn that in the meantime, I have negotiated a price reduction with Supplier A from 45 cents to 35 cents per IC!"

Think for a moment about what occurred. By not standing firm on its price in the negotiation, how much incremental profit had Supplier A just given away? \$500,000...on one transaction with one customer. Yet Supplier A's salesperson is not the culprit here. His firm is. Supplier A had done no customer value research, built no customer value models, and constructed no value-based sales tools to enable the salesperson to persuasively demonstrate and document the superior value of his offering relative to Supplier B's.

Interestingly, as part of his research, the engineer interviewed the sales persons from Supplier A and Supplier B, and asked each of them what they thought was the source of their offering's superior value was relative to the other. The sales person from Supplier A did not name either of the two value elements that provided the greatest differential value. Apparently, he was unaware of the extent of the differences between his offering and Supplier B's on these elements. Instead, he stated that he believed that his offering was worth more, attributing it to his dedicated and superior servicing of the account. His superior service was worth something, .2 cents per IC in the engineer's customer value model!

Perhaps sensing that this superior service was not worth the 10-cent price difference between quotes, when push came to shove, he reduced the price to match Supplier B's lower price. Now, even with a value-based sales tool that enabled him to persuasively demonstrate his offering's superior value, as part of the give-and-take of negotiation, he might have reduced the price somewhat and perhaps even split the price difference with the purchasing manager. Even in this latter scenario, though, his firm still would have retained \$250,000 in incremental profit.

This case study brings to life a choice that most often remains implicit for suppliers and, as such, one that they cannot fully know the consequences of implicitly making. They can spend the time and money upfront to persuasively demonstrate and document the superior value that their offerings deliver and capture a more equitable portion of this delivered value. Or, they can choose not to, and give value away unknowingly as price reductions, just as Supplier A did in this case study. Either way, suppliers are going to pay. As this case study amply reveals, can suppliers afford *not* to build customer value models?



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Customer Value Modeling is a proprietary methodology of James C. Anderson, LLC, the William L. Ford Chair in Marketing and Wholesale Distribution and a professor of management behavioral science at the Kellogg School of Management, Northwestern University. Professor Anderson is a faculty affiliate of Axios Partners.

Further reading on customer value modeling:

- Anderson, Kumar, and Narus, *Value Merchants*, Harvard Business School Press, 2007.
- Anderson, Narus & van Rossum, "Customer Value Propositions in Business Markets" *Harvard Business Review*. Mar 2006.
- Anderson & Narus, *Business Market Management: Understanding, Creating, and Delivery Value*. Prentice Hall 2004. Chapter 2.

For more information, please contact:



www.axiospartnersinc.com

Eric Berggren
Managing Director
Axios Partners
2949 West Logan Boulevard
Chicago, IL 60647
+1.312.787.8835
eberggren@axiospartnersinc.com