VALUE FIRST THEN PRICE

BUILDING VALUE-BASED PRICING STRATEGIES

SECOND EDITION

EDITED BY ANDREAS HINTERHUBER
AND TODD C. SNELGROVE

ROUTLEDGE

Praise for the second edition

"A 'must read' for any B2B marketer. These seminal cases not only illuminate the essentials of value based business marketing, but with detailed examples show you how to implement a value based approach in the turbulent world of today's business market. Real, Good, Practical stuff from professionals who've done it."

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"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."

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"The war for value is today's biggest business challenge. *Value First, Then Price* is an invaluable, thought-provoking guide to this debate."

Nigel Barlow, *International Consultant on Innovation and Value*

"In our work with some of the world's industrial manufacturers, we've seen that companies that focus on value from both the buy and sell side enjoy a competitive edge. Top-performing industrials are eight times more likely to take a value-based approach toward pricing, and companies that measure and buy based on total cost of ownership are 35% more profitable. Buyers have never been better informed on the total cost of ownership, and companies that are still talking about features and benefits are getting left behind."

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"My own research confirms McKinsey's, that only 5% of companies have value propositions. No wonder buyers have the upper hand! The world really needs this book and I congratulate Andreas Hinterhuber and Todd Snelgrove on putting together a truly fantastic piece of work."

Malcolm McDonald, *MA (Oxon), MSc, PhD, DLitt, DSc, Emeritus Professor, Cranfield University School of Management*, *UK*

"In business-to-business markets, managers must bridge the gap between those who say that it is only by value that firms can thrive in the long term and those who suggest that buyers will buy on price. Value can be created and captured. The bad news is that it is extremely difficult, but the good news is that a systematic approach is likely to yield dividends. In this important book Andreas Hinterhuber and Todd Snelgrove have harnessed the world's top value creation experts to provide an insightful and complete roadmap."

John Roberts, *Fellow, London Business School, UK, and Professor, University of New South Wales, Australia*

"What a comprehensive way to present value. From the discussions to the articles, a must-have guide for professionals and companies that want to buy, produce, and sell any product or services based on value."

João Ricciarelli, *Executive President America's, Leadec*

"It's not often you read a business book, learn from it and have fun doing so. *Value First, Then Price* by Hinterhuber and Snelgrove is one of those rare exceptions. I don't care whether you are on the buy or sell side of the equation, this book is for you. It is a fantastic engaging read. The material is thought provoking with great integration of theory: from value, to ROI and results. It is simply a very practical business book."

Stephen Kozicki *is on the Advisory Panel for HBR and lectures at business schools including Macquarie University, University of Technology and The Australian Catholic University, Australia*

"Much has been said and written about value in industrial markets. But how to put the idea to practice? This book focuses on what matters most: to 'challenge' customers and help them rethink their assumptions, vendors need data and value quantification. The authors provide a practical, hands-on roadmap for value pricing that both buyers and sellers can follow for achieving better business results."

Wolfgang Ulaga, *Senior Affiliate Professor of Marketing. INSEAD*, *France*

"*Value First, Then Price* is a much-needed work and deserves a place in most CPO and sales offices."

Keld Jensen, *Author of 'The Trust Factor – Negotiating in SMARTnership', Professor and Advisor in Negotiations*

"SAMA research emphasizes that most companies are significantly lacking in internal processes for value-based negotiation, value creation, value-based pricing and value monetization. Snelgrove and Hinterhuber provide great insights and methodologies for companies to fill these gaps."

Bernard Quancard, *Retired President and CEO Strategic Account Management Association (SAMA)*

"Quantifying and understanding the value proposition is key to business success. This book gets directly to the bottom line by taking both a buyer and seller perspective and presenting value based purchasing in a way that all purchasing professionals need to understand."

Wendy L. Tate, *PhD, Associate Professor of Supply Chain Management, University of Tennessee*, *USA*

"*Value First, Then Price* is a timely and rare contribution, providing not only invaluable insights, but also a practical methodology of how to perceive, quantify and capture value. From the perspective of emerging and new market economies, it offers the ultimate answer on how to escape the enduring 'lower cost – lower price' trap, and how to shift towards a sustainable, value creation driven path that leads to business and economic development."

Modestas Gelbūda, *PhD in International Business, Aalborg University, Denmark; Managing Director, Baltic Institute for Leadership Development, Lithuania, and Associate Professor, ISM University of Management and Economics, Lithuania*

"At a time when both customers and suppliers are over focused on product prices as a determinant of business transactions, this book offers a fresh way out by arguing for a new way of looking at the economics of exchange between buyers and sellers where price is just one element in determining the *true value* of what is bought and sold. More specifically, the book informs purchasing officers about the often ignored actual cost and *inherent value* (in total savings, returns on investment, etc.) of what they buy, and provides suppliers with tools to *quantify and communicate* the hidden value in what they sell. I highly recommend this book to professionals in procurement, sales and marketing, and general management."

Kamran Kashani, *IMD, Switzerland*

"The editors and their authors have tackled a problem that has faced buyers and sellers for years: how to define the concept of value that aligns with two different views of the world. Sales claims to sell based on value, and purchasing claims to buy based on value, yet both parties view this concept from fundamentally different viewpoints. This book articulates these differences, and creates a framework that can help resolve the issues, creating a mutually compatible lens for understanding this often misunderstood concept."

Robert Handfield, *Bank of America, Distinguished Professor of Supply Chain Management and Director of Supply Chain Resource Cooperative, North Carolina State University*, *USA*

Value First, Then Price

Value-based pricing – pricing a product or service according to its value to the customer rather than its cost – is the most effective and profitable pricing strategy. *Value First, Then Price* is an innovative collection that proposes a quantitative methodology to value pricing and road-tests this methodology through a wide variety of real-life industrial and B2B cases.

This book offers a state-of-the art and best-practice overview of how leading companies quantify and document value to customers. In doing so, it provides students and researchers with a method by which to draw invaluable data-driven conclusions and gives sales and marketing managers the theories and best practices they need to quantify the value of their products and services to industrial and B2B purchasers. The second edition of this highly regarded text has been updated in line with current research and practice, offering three new chapters covering new case studies and best-practice examples of quantified value propositions, the future of value quantification, and value quantification for intangibles.

With contributions from global industry experts this book combines cutting-edge research on value quantification and value quantification capabilities with real-life, practical examples. It is essential reading for postgraduate students in sales and marketing with an interest in pricing strategy, sales and pricing specialists, as well as business strategists, in both research and practice.

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Second edition

**Edited by Andreas Hinterhuber
and Todd C. Snelgrove**

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Contents

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1 Introduction

Quantifying and documenting value in business markets

Hinterhuber, Andreas and Snelgrove, Todd C.

The essential challenge that sales and marketing managers in industrial markets face is this: converting their firm's own competitive advantages into quantified, monetary customer benefits. Doing so enables business-to-business (B2B) sales and marketing personnel to justify price differences between competing offers with a difference in monetary value. A disguised project example illustrates this fundamental principle of value quantification.

Customer value is the sum of (a) the price of the customer's best available alternative and (b) the subjective, customer-specific value of all the differentiating features that distinguish the supplier's own offering from the customer's best available alternative (Nagle and Holden, 2002). Customer value is thus the quantified sum of the customer-specific benefits accruing to purchasers as a result of purchasing the offering. This sum is the maximum price that rational buyers will be prepared to pay. The price difference between the supplier's own offering and the customer's best available alternative is then related to the difference in value between the two offerings (see Figure 1.1).

Value quantification thus enables suppliers to perform return on investment calculations: The price difference between two offerings is the investment customers make to obtain the quantified, monetary customer benefits identified.

Value quantification is arguably the most important capability in B2B selling. It is also a capability that many companies in industrial markets lack (Anderson et al., 2007); these companies, however, are at least conscious of their lack in value quantification capabilities and recognize the potential benefits of developing them (Töytäri and Rajala, 2015).

The contents of the book

This book is one of the few books – possibly the only book – exclusively dedicated to the topic of value quantification in business markets. Individuals from leading institutions, such as the Kellogg School of Management, Ca' Foscari University Venice, Boston College, Aalto University, the University of Tennessee, the Ohio State University, Case Western Reserve University, Deloitte, and Hinterhuber & Partners, and practitioners from companies including SKF, DHL, Borealis, the Strategic Account Management Association (SAMA), and Parker Hannifin, provide best practices, case studies, tools, and principles of value quantification in industrial markets. The book has two implicit premises. First, selling should be based on value first, then price. Second, procurement should also be based on value first, then price. Buyers and sellers in business markets must focus first on value, then on price, in order to increase performance.

A unique feature of this book is that it explores the topic of value quantification from the perspective of both sellers and buyers in industrial markets.

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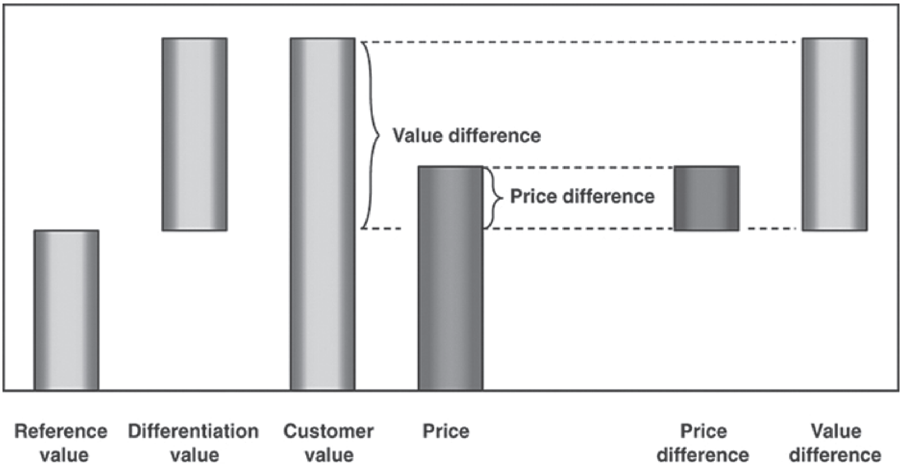

Figure 1.1 Value quantification and value-based pricing

Source: Hinterhuber & Partners

The buyer perspective: in many organizations, sourcing criteria were heavily weighted toward tangible criteria, such as price, quality, and delivery. Practitioners as well as procurement scholars have started to explore procurement models that consider an array of tangible and intangible benefits in sourcing decisions. Several chapters in this book present procurement frameworks that consider the total value of supplier contributions in the offer evaluation process. This book also presents anecdotal evidence that sourcing criteria considering the total value of benefits lead to increased firm performance and allow to create value – for example, environmental benefits – that traditional procurement models typically do not create. We need, however, more research. Specifically, we need research developing these metrics, such as total value of ownership or total value contribution (TVC) models (see Chapter 13) that reflect innovation, management capabilities, sustainability, and other elements beyond quality, price, and delivery. We also need quantitative research exploring the consequences of the use of total value of ownership models by procurement on company performance and on value creation.

On to the perspective of sales: There is now increasingly robust evidence that value quantification capabilities are beneficial for firm performance. The core focuses of this book are case studies, best practices, and recent research findings exploring the factors that enable companies to acquire and successfully deploy value quantification capabilities.

The structure of the book

Part I, "Introduction," contains this introductory chapter by *Andreas Hinterhuber* and *Todd C. Snelgrove*.

Part II, "Selling value: Value quantification capabilities," contains several chapters that address the capabilities needed to quantify and document value in business markets.

The opening chapter, "Value first, then price: The new paradigm of B2B buying and selling" by *Andreas Hinterhuber, Todd C. Snelgrove*, and *Bo-Inge Stensson*, sets the frame for the entire book. Our key argument is this: Most companies today take an inherently adversarial approach to buying and selling in industrial markets, thereby missing out on opportunities for joint value creation with customers and suppliers. Sales and procurement are too obsessed with price and not enough with value. We present a set of principles that put joint value creation at the center of the relationship with customers and suppliers. With respect to customers, the value quantification capability is the most important competency of the sales function, that is, the ability to translate a firm's competitive advantages into one quantified, monetary value reflecting both qualitative and quantitative customer benefits. Several chapters in this book (all in Part III) provide examples of quantified value propositions, for both B2B services and B2B products. With value quantification capabilities (sales) and total value of ownership models (procurement) the key element of relationship with both customers and suppliers is value first, then price.

In an interview, *Robert Russell* and *Andreas Hinterhuber* explore several key issues related to value quantification. First, since pricing is always the result of a chain of prior activities, optimizing pricing cannot involve price optimization alone. Managers should instead map the most important processes related to pricing – in B2B typically the offer development process. Once this process is mapped, once bad and best practices along every process step are described, and, finally, once managers have compared their own current practices with best practices, then opportunities to improve profits via pricing are typically identified very effectively. This interview also explores the topic of change management in the context of value-based pricing and value quantification. Hinterhuber suggests that companies benefit from holding an underlying, implicit organizational change management theory in order to effectively implement value quantification: Useful theories include the influence model by McKinsey & Company (Keller and Price, 2011), Kotter's eight-step model of organizational transformation (Kotter, 1995), the switch model by the Heath brothers (Heath and Heath, 2010), and the free-spaces theory of social movement research (Kellogg, 2008). These theories, examples, and recent research related to pricing strategy implementation are discussed in detail in another book (Hinterhuber and Liozu, 2020).

In the subsequent interview, "Muddling through on customer value in business markets?," *Todd C. Snelgrove* and *James C. Anderson* discuss two key aspects of value quantification: how to develop value quantification capabilities and how to quantify value for weakly differentiated products. The authors first suggest that companies move through three stages when building value quantification capabilities: in the first stage – the prove-the-concept stage – companies undertake several value quantification projects in order to learn the concepts, process, and tools and to obtain the benefits from these pilot projects. In the second stage – the build-the-structure-and-culture stage – companies significantly expand the scope of value quantification: They train experts, build value quantification tools and repositories of case studies, conduct more projects, measure the success consistently, and link value quantification with other projects such as the new product development process. In the third stage – the sustain-the-advantage stage – companies institutionalize value quantification by, for example, appointing champions whose primary responsibility is value quantification. A second insight of this interview is that value quantification differs between strategic and non-strategic products, that is, between products that contribute significantly to differentiating the customer's offering and those that do not: Value quantification is suitable for strategic products. For non-strategic products, by contrast, detailed value quantification is typically not possible and not even desired by customers; instead, suppliers provide customers with resonating arguments such as generic case studies – in the author's terms, with a tiebreaker – able to shift the balance in the supplier's favor. In sum, the more a supplier's product contributes to creating meaningful differentiation in the customer's products, the more value quantification has to be detailed, collaborative, and customer-specific.

In the interview "Nurturing value quantification capabilities in strategic account managers," *Andreas Hinterhuber*, *Todd C. Snelgrove*, and *Bernard L. Quancard* discuss the importance of value quantification capabilities for strategic account managers. Quancard is adamant: Only about 30% of account managers truly create value for customers; the remaining 70% are merely commercial coordinators. In order to truly create value, value quantification capabilities are fundamentally important. These capabilities are valuable and rare: Only 10% of companies, Quancard suggests, are able to translate into monetary terms the value they create for customers. Quancard further observes thoughtfully in what may become a noteworthy quote: "Most projects go to request for proposal (RFP), because there is not a compelling monetization of the value." In this view, a request for proposal is thus nothing else than a reflection of the supplier's inability to quantify value. Quantified value propositions, accompanied by approximate price ranges for competitive products, eliminate the need for a request for proposal and allow the isolation of collaborative customer relationships from competition. This interview also sheds light on the antecedents of value quantification capabilities: active listening skills, cross-functional collaboration, financial acumen, and an unlimited curiosity. CEO support is, like in all cases of organizational transformation, essential. A further element to consider in the process of building value quantification capabilities is the selection of customers. Not all large customers are or will be receptive to joint value creation and value quantification. Those that are not should not be strategic accounts, irrespective of their purchase volume. Account managers thus need to define criteria for determining which large customers are strategic. Only with these strategic accounts should collaborative value quantification occur.

In "Salesforce confidence and proficiency – the main cornerstone of effective customer value management" *Gary Kleiner* presents a case study on customer value quantification. This chapter stresses the importance of sales force confidence in addition to the required technical skills in order to effectively and convincingly quantify customer value.

Part III, "Selling value: Best practices in value quantification," contains six chapters highlighting best practices in value quantification. In "Value quantification – processes and best practices to document and quantify value in B2B," *Andreas Hinterhuber* presents the results of a study on value quantification capabilities in European and U.S.-based B2B companies. This chapter presents five key steps that can guide managers in industrial companies in quantifying value: generation of customer insight, value creation through meaningful differentiation and collaboration, value proposition development, value quantification, and implementation/documentation. This chapter also highlights several case studies of quantified customer value propositions, SKF and SAP among them. SKF is, of course, a special case: *Todd C. Snelgrove* has played a leading role in quantifying and documenting value for thousands of use cases at SKF.

In "Quantifying your value so customers are willing and able to pay for it," *Todd C. Snelgrove* highlights that quantified value that relies on tangible evidence and that has a high likelihood of occurrence acts as a very strong purchase motivator in industrial markets. For sales managers, value-based selling requires two conditions: ability and motivation. The ability to sell value depends on the ability to conceptualize value in a way that resonates with customers, on processes encouraging a focus on value, on the availability of value-selling tools, on initial training, and on ongoing experience in value selling. The motivation to sell value is a function of salesforce compensation, of the ability to build long-term collaborative relationships with customers where both parties are committed to creating mutually beneficial value, of a company culture led by a strong CEO committed to value-based selling and, finally, of customers who recognize the opportunity to work collaboratively with suppliers. This chapter thus takes a nuanced view of the multiple facets that companies can and should control in order to implement value-based selling and value quantification. Todd also discusses a new term, "total profit added," as a measurement for both buyer and seller to quantify total customer benefits. This approach considers not just cost reductions but also includes estimated revenue improvements.

In the chapter "An inside look at value quantification of competitive advantages" *Evandro Pollono* presents best-practice case studies on quantified value propositions. This is an important chapter. Many apparent experts advocate the importance of selling value, as opposed to selling price, without actually specifying in detail the data, the steps, and examples of quantified value propositions. *Evandro Pollono* presents four examples of quantified value propositions, that is, quantified, monetary customer benefits, calculated relative to the customer's best available alternative, from B2B products and B2B services. These case studies convincingly show that value quantification is (a) possible and (b) beneficial in industrial markets, regardless of the intensity of competition or the perceived difficulty to differentiate the product.

In "Value quantification for services" *Todd C. Snelgrove* expands on the prior chapter and presents an example of a value calculator for services. Some managers are reluctant to quantify customer value for services, possibly assuming that value quantification for intangibles is more difficult or less credible than value quantification for products. This assumption is wrong: All products are, in the end, services (Vargo and Lusch, 2004). A product has a performance promise like a service. A product customer co-creates value like a service customer. Value is future-oriented for a product as well as a service. Finally, some products are intangible (e.g., digital goods such as e-books), which means that the distinction between products and services is increasingly irrelevant. The subsequent chapter further expands on these issues.

In "Quantifying intangible benefits" *Paolo De Angeli* and *Evandro Pollono* make the point that intangibles – for example, the value of a brand, sustainability – are also an increasingly important competitive differentiator in industrial markets. Key is to make intangibles tangible by specifying how intangible competitive advantages affect key customer business metrics such as quality, revenues, or cost. This chapter provides a case study on how to quantify intangible elements with a value quantification tool.

In "Toward a shared understanding of value in B2B exchange: Discovering, selecting, quantifying, and sharing value" *Pekka Töytäri* and *Risto Rajala* highlight the importance of conceptualizing value in a way that is shared between suppliers and customers. The authors present a three-step process enabling companies to quantify value: customer insight, value proposition, and value sharing. Value quantification is an iterative process. This chapter also succinctly highlights obstacles that companies face in the process of quantifying value: different assessments of the supplier's value creation potential, inability to quantify value, and inability to defend value vis-à-vis procurement. Procurement is an obstacle for many companies aiming to implement value-based selling and value quantification. Industrial marketing and sales managers thus need to understand and influence the procurement function in order to credibly present value. The procurement function is the topic of the subsequent section.

Part IV, "Buying on value: Value quantification and B2B purchasing," contains several chapters that explore value quantification from the perspective of procurement. This is, as outlined, a unique feature of this book. Sales and account managers frequently perceive procurement as interested in price and price alone and are thus reluctant to adopt the mindset of an explorer that is fundamentally necessary in order to quantify value.

The chapters in this section convincingly debunk the idea that procurement is mainly and solely interest in price: Sales is transitioning from price to value and so is procurement. The fundamental idea is that the procurement function should not evaluate suppliers based only on quality, price, and delivery but should instead evaluate suppliers based on their overall contribution to improved customer profitability.

TVC is the name for a metric that attempts to calculate the value that suppliers create for customers, value that is substantially broader than price or total cost of ownership (TCO). The chapter "Value first, cost later: Total value contribution as a new approach to sourcing decisions" by *John V. Gray*, *Susan Helper*, and *Beverly Osborn* develops the idea in detail. The TVC name by itself promotes attention to value. TVC's structured approach begins with the question: "What do our customers, current and future, value about our products?" The TVC approach builds on insights from the literature on individual and group decision making to offset human biases and organizational incentives that emphasize cost reduction. TVC expands upon on the concept of TCO which considers life cycle costs, not just purchase price, but still is able to capture only cost-related elements. TVC, by contrast, also attempts to include benefits and supplier contributions to improve profits, innovation, or even sustainability. We are at the beginning of a process. Price and TCO are well established as supplier selection criteria but fall short of considering strategic benefits. TVC of procurement is thus a mirror concept of quantified customer benefits of sales. The concept of TVC needs to be more precisely defined – with a clear specification of categories – and it needs to be further researched – with studies documenting the link, and boundary conditions, of sourcing based on value, as opposed to sourcing based on costs, on innovation, and on profitability. To be clear: These studies exist, abundantly, for sales, but these studies do not yet exist for procurement. This is thus a very fertile ground for future quantitative, cross-sectional research.

In the interview "Selling value to purchasing," *Todd C. Snelgrove* and *Bo-Inge Stensson* discuss how to implement value quantification vis-à-vis powerful industrial procurement departments. Contrary to the commonly held assumptions mentioned before, the authors also find that procurement is frequently willing to purchase based on value if – and only if – sellers are able to present a business case highlighting how a higher initial purchase price lowers costs or otherwise yields incremental financial benefits. This interview also highlights that within SKF the procurement function has undergone a substantial change. While in the past, annual price reductions and generic indicators of supply chain performance were primary performance measures, today the procurement function is increasingly measured by indicators relating supply chain performance to the company's overall profitability and to the company's overall strategic objectives such as innovation and sustainability. This change is demanding: both for the company itself and for suppliers who must conceptualize how their performance affects the performance of their immediate customers vis-à-vis their own customers.

In "Using best value to get the best bottom line," *Kate Vitasek* contrasts three approaches that suppliers use to select vendors: price, TCO, and best value. This chapter is valuable: Understanding alternative supplier-selection methods may enable buyers and sellers in industrial markets to change them. Price-based selection criteria consider either short-term or long-term purchase price. TCO calculations consider supplier direct costs, supplier indirect costs, and a premium/discount reflecting the supplier's risk. This approach, however, has drawbacks (Piscopo et al., 2008; Snelgrove, 2012). TCO calculations do not consider the value of tangible (revenue improvements) or intangible (brand value, reputation, competencies) benefits. Total value of ownership (Snelgrove, 2012), total profit added calculations (Snelgrove, 2016), and value quantification tools (Pollono, Chapter 9 of this volume) allow the inclusion of both tangible and intangible benefits, cost, and benefits that make the customer better off. This chapter shows how to perform best value calculations. Best value is defined as the optimum benefits as defined by customers minus total supplier costs. Optimum benefits include, of course, intangible factors, too, such as reputation and quality. Selection based on best value is increasingly common in federal government procurement contracts. The chapter concludes by examining pricing models that align supplier and buyer interests; among these pricing models are performance-based agreements and vested agreements. The difference between these two approaches is fundamental: Performance-based agreements consider key performance indicators (KPIs); vested agreements consider the ultimate outcomes that truly matter to customers.

In "Value selling: The crucial importance of access to decision makers from the procurement perspective," *Rob Maguire* describes the organizational buying process in the following terms: getting the least worst answer to the wrong question from people you've met online. A key task that sellers face is, first of all, to understand what buyers want: price, a benefit, or a solution, in the authors' terms. Second, if sellers want to implement value-based selling and value quantification, they need buyers that recognize the need to purchase a solution – as opposed to purchasing an item at the lowest price. Once buyers recognize the opportunity or need to purchase solutions, sellers should practice the following steps: Investigate value creation opportunities, quantify the incremental value delivered, engage buyers in mutual value creation opportunities, sell value, and, finally, implement value-based pricing via, for example, outcome-based contracting. This chapter is thus a reminder that access to the ultimate decision maker, and not necessarily access to procurement, is a necessary prerequisite to implementing value-based selling and pricing.

In "The sourcing continuum to achieve collaboration and value," *Kate Vitasek* examines alternative configurations of buyer–seller relationships. Transactional, market-based models include basic or approved provider models. Relational models, that is, hybrids between markets and hierarchies, include preferred provider relationships, performance-based contracting, and vested business models. The author discusses the latter two models in detail in Chapter 10. Equity and investment-based models include shared service models and equity partnerships. This chapter describes these alternative configurations in detail and offers guidelines that facilitate the selection of the most appropriate model in buyer–seller relationships.

Part V, "Value quantification and organizational change management," contains two interviews with senior B2B marketing and account managers.

In this section's first interview, "Implementing value quantification in B2B," *Andreas Hinterhuber* and *Matthias Heutger* discuss value quantification for industrial services. Value quantification is, according to Heutger, always beneficial, even if organizations are strongly driven by the procurement function. In other words, even if suppliers do not require customers to quantify their value, suppliers should still do so in order to differentiate themselves from their competition. Heutger makes one point clear: Value quantification requires that suppliers understand their customers' entire supply chains, end to end. Suppliers must be able to understand the effects of their own incremental performance improvements on the performance improvements of their customers' customers. This understanding also enables gainsharing agreements – with a caveat: Gainsharing agreements require a long-term collaboration whereby both parties are committed to innovate and change. The interview also explores the antecedents of value quantification capabilities at the level of the individual sales and account manager: a strong customer focus, the ability to strategize, listening skills, and a willingness to experiment. Another important aspect of value quantification is credibility: The ability to actually deliver on the promised value may require selecting those persons within the customer's business who most appreciate the value created; it frequently entails small tests which are then rapidly scaled up. Value quantification is, in Heutger's words, a true organizational transformation that requires senior management commitment, structural changes, and changes in hiring profiles. Where to start? At the level of the individual customer. Value quantification requires a new way of interacting with customers where "trust, mutual benefits and a willingness to grow together over time" take the place of price as the main element of discussion. These words will, we hope, withstand the test of time.

In the second interview of this section, "The ring of truth – value quantification in B2B services," *Andreas Hinterhuber* and *Pascal Kemps* discuss value quantification in complex B2B services. To start off, the importance of value quantification seems to grow with the importance of customers, to a point where it is factually required by strategic accounts. Second, and more counterintuitively, Kemps suggests: The fact that some customers treat suppliers transactionally does not imply that suppliers should not treat these customers strategically. Transactional customers – customers who bid out every contract – may enable suppliers to standardize their own internal processes or to accumulate valuable competencies and insights. Treating them transactionally or, worse, writing them off would mean, according to Kemps, cutting off profitable business. Next and again controversially, collaborative customer relationships where suppliers quantify value beyond price may yield process improvements that could mean that suppliers end up selling less. This ability to solve customer problems even at the expense of the supplier's own, immediate, and certain sales forges customer relationships which are, truly, strategic. Next, Kemps warns against the folly of managing by KPIs. KPIs are typically related to business processes which have only a random fit with the few business outcomes customers ultimately want to achieve: improvements in profitability, customer satisfaction, or innovation, for example. Kemps suggests that the cultural alignment between traits of customers and traits of the account management team is the most important factor enabling value quantification and effective collaboration. So where should companies start that wish to become fully proficient in value quantification? Kemps offers two pieces of advice: Number one, patience and perseverance – once the direction is clear, perseverance is required; number two, the relentless pursuit of differentiation – the opportunities for joint value creation – is limited only by individual imagination. Finally, the ring of truth – value is a promise; results are all that matter to customers. Kemps suggests that presenting the value credibly in ways that customers can relate to and verify for themselves is fundamentally important in the context of value quantification. Companies that excel at quantifying value cut through the fog of vague data and promises. The ring of truth is thus the metaphor for the ability to summarize the fruits of much thought and labor briefly and clearly.

Part VI, "Buying and selling on value: Value quantification tools," presents three chapters discussing value quantification tools.

In "A question of value: Customer value mapping versus economic value modeling," *Thomas Nagle* and *Gerald Smith* make a strong case against customer value mapping in the context of value quantification: Only a detailed step-by-step analysis aimed at quantifying the quantitative and qualitative benefits of a differentiated product can provide insights into total customer value and maximum willingness to pay. Simply put, customer value mapping assumes (a) that customer willingness to pay is proportional to the benefits provided and (b) that customers weigh benefits and prices equally. Both assumptions are wrong. Only a detailed mapping of the subjective, customer-specific economic benefits of a product – conducted via economic value measurement (Nagle and Holden, 2002), value calculators (Hinterhuber, 2015), or value word equations (Anderson et al., 2006) – allows the quantification of customer maximum willingness to pay. The widespread diffusion of customer value mapping is no indicator of its scientific value: Bad practice, unfortunately, can persist for decades and centuries. This chapter makes a strong case for a scientifically robust (Sinha and DeSarbo, 1998) approach to quantifying value and price in B2B and B2C markets.

In "Why start-ups should consider using value propositions," *Lennart Foos* and *Markus Kirchberger* also make a case for value quantification via the customer value proposition for start-ups. In this chapter, the authors provide a step-by-step guide to developing a monetary customer value proposition. The research underpinning their work suggests that the early development of these value propositions increases the chances of selecting appropriate target markets and of successfully introducing new technologies. The development of quantified customer value propositions is thus a capability that aspiring entrepreneurs must master.

Tim Underhill, in "Creating and sustaining competitive advantage through documented total cost savings," likewise suggests that quantifying customer benefits is necessary and beneficial for suppliers. This chapter provides a case study of value quantification in industrial markets.

Part VII, "Epilogue," contains several short chapters that summarize salient aspects of value quantification and provide an outlook on the shape of value quantification capabilities in the future.

In "A call to action: Value quantification in B2B buying and selling" *Todd C. Snelgrove* invites both B2B procurement and B2B sales managers to quantify value in industrial buying and selling in order to uncover opportunities for mutual value co-creation in B2B exchange relationships.

In "Quotes and statistics to help you on your value selling journey" *Todd C. Snelgrove* presents quotes and summary statistics that attempt to highlight why value quantification is beneficial, both for sales and for procurement.

The final interview "The present and future of value quantification" by *Andreas Hinterhuber* and *Todd C. Snelgrove* sheds light on future capabilities related to value quantification. As outlined by several authors in the present book, value quantification in the future will focus on quantifying intangibles, including the quantification of non-economic benefits – likely even factors such as the value of a lower environmental impact. Value quantification capabilities are, and will be, a key differentiator between high- and low-performing companies. In the future, value quantification will be employed throughout the sales cycle with an increased focus on it in the new product development phase and an increased focus on innovative pricing models and performance-based and value-based pricing models. Finally, if value quantification is a recursive, iterative process, the availability of big data and experience will enable managers to make predictive assessments of customer-quantified benefits based on both human and artificial intelligence.

Sales and marketing are transitioning from price to value. We understand the idea of value and its multidimensional nature. In the context of quantifying value from the perspective of sellers, value is equal to the sum of quantified, monetary customer benefits, that is, the sum of quantitative customer benefits – revenue/gross margin increases, cost reductions, risk reductions, and capital expense savings – and qualitative customer benefits – such as ease of doing business, customer relationships, industry experience, brand value, emotional benefits, or other process benefits – expressed as one figure equating total customer benefits received (Hinterhuber, 2017). We know what value quantification capabilities are, and we know, via numerous, independent, converging studies, that value quantification capabilities increase firm performance. This is the perspective of sales and marketing. Here, academia is clear and ahead of practice: The research, the examples, and best practices presented in this book can help companies still selling based on price or features to transition to selling based on value. Academic research is very clear: This will improve company performance.

Procurement is also transitioning from price to value. We do have an initial understanding that traditional metrics, such as price or TCO, are unable to capture the full spectrum of benefits that suppliers bring to customers. We also have an initial idea of a metric able to quantify tangible and intangible supplier benefits – TVC, discussed in this book, is one example of such metric.

Ideally, the metric that sales managers use to sell value to procurement – quantified, monetary customer benefits (Hinterhuber, 2017) – is the same metric that procurement uses to evaluate alternative offers from sales managers. The further development of a metric able to capture all tangible and intangible benefits of alternative offers in sourcing decisions will thus, in the end, build on the value quantification and pricing literature that has already produced them.

This is extraordinary and fantastic.

This is spectacular since the development of all – well, at least a good part – of what we know in strategic pricing – the idea of customer value as sum of reference value and differentiation value (Nagle and Holden, 2002) – that is, the big bang of strategic pricing, originated from research in procurement – value engineering – in the 1950s aimed at calculating maximum purchase prices. This is the lasting contribution of Nagle, who almost single-handedly created the field of strategic pricing as we know it.

This spectacular journey started in procurement; it inspired the nascent literature on strategic pricing which now, in late adolescence, inspires the mature literature on procurement in developing strategic sourcing models. Procurement, pricing, procurement – this is the beautiful journey, based on a very simple idea. Value first, then price.

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8 Quantifying your value so customers are willing and able to pay for it

Snelgrove, Todd C.

How does one get paid for value created? The question has been asked by every premium player in every market of the world. Given that the financial benefits of value creation and pricing are well known, why do so many companies fail to achieve the desired results after they've done the work to create something of value? For those that do invest and create customer value, it's time to do the work to get paid for it!

PV ≥ Cost = Action

I have begun to look at this as a formula. If the perceived value (PV) of a good or service is greater than or equal to the cost of buying it, then an action such as a purchase should occur. In more detail, it is the PV from the customer's perspective; however, if that value can be expressed monetarily, it will be a harder value than a PV that is not. Cost includes the asking price, plus all other associated costs (shipping and handling, research time, cost of capital, etc.). If I perceive that I will obtain more value than the cost of doing so, it probably will result in a purchase. The greater the difference between PV and cost, the higher the percentage of people who will buy. For example, if the quantified customer-specific value is $100, and the cost of acquiring it is $42, then a value surplus or incentive to buy of $58 exists and for most that surplus is large enough to motivate most people toward the desired action of purchasing. However, let's assume that PV is a feeling (no number is assigned to it); in this case, fewer people would buy. Finally, if the PV were only $43 and the cost were $42, far fewer people would invest in buying to receive the one dollar of benefit.

Looking at the example in Figure 8.1 of an offering for a tool called a laser alignment system, we see a list of PVs; let's assume for each item there's a value that, based on industry averages or customer-specific numbers, totals $10,000 and that the total costs of acquiring the tool are $4,200, leaving a value surplus or "incentivization" benefit of $5,800. If the numbers are a hard value, believable to me as a buyer, then I will find a way to get the $4,200. In general, the harder and more monetary the value numbers are, the less value surplus is needed to get an order.

Companies that employ a good value-based pricing strategy are 20% more profitable than those that have weak execution on value pricing, and 36% more profitable than those that are good at executing a cost- or market-share-driven strategy (Hogan, 2008). Thus, I would argue that value pricing works only if additional areas are also addressed. A company must create value, communicate that value through sales and marketing, and quantify that value in monetary terms; only then can it get paid for the value created.

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	Perceived value ≥ Costs = Action	
Less energy consumption		
Faster installation	Price of tool	
Longer machine life	Cost of adding or using existing vendor	Order or no order
Easier installation	Time to wait for delivery of tool	
Less machine vibration		
\$10,000	\$4,200	\$5,800 value surplus

Figure 8.1 Example of perceived value calculation for a laser alignment tool

Think about it for a second: if a company is great at three of these but not the fourth, it won't get paid for value.

As I travel the world, I hear too often from CEOs the refrain "I want our salesforce to sell based on value but they do not . . . why?" The answer is "simple." No one size fits all, and no silver bullet exists. Selling on value takes focus, management support, tools, and training, and product or service differentiated attributes to see the results. In talking with other thought leaders in the value space, I have come to realize that numerous other things need to happen to make value-selling work for a company.

For a salesforce it comes down to two main focuses: Do they have the ability to sell value? And do they want to sell value? I find that most companies focus on the ability area and assume that the salesforce wants to sell value and that they just need to go and do it. So what's needed?

Why spend the time and effort to quantify your company's value?

The first step in the journey is to realize that quantifying value is something your customers want and need you to do, something that will allow them to justify buying your option, unless you're consistently the lowest-priced offering. In the world of buying and pricing, two competing forces exist. From a customer's perspective, these are the *willingness to pay* (WTP) for value and the *ability to pay* (ATP) for that value. In the days when the user of a product or service was the decision maker, and purchasing was more of a clerical function, the process was easier – easier in the sense that the user of the solution you were offering could justify in their own mind what better, longer, easier, faster meant because they were the ones who would receive the benefit. However, in the last two decades, the activity of "purchasing" has evolved into the strategic focus of "procurement." The difference is important: now procurement decides what is of value, what they are willing to pay for – and because they are not the ones who will see and receive the benefits, they are less likely to pay for them. Second, in today's budget-constrained world, the question is whether the customer has the money or budget to buy the better offering. The case studies, research, and anecdotal stories that follow show that if value can be quantified in the universal language of dollars and cents, then obtaining new budgets or reallocating money from another budget can easily happen, and procurement will be willing to invest.

For example, I might say to a potential customer (user of a product or service), "This solution will allow you to do the job 22% faster, and the quality of the job will be 10% better" (assuming data exist to reinforce this). How willing and able would that customer be to pay for that value? It would depend on what those impacts would mean to them and on comparing this buy with other competing purchases. They might sense that mine is the better solution, and then they would have to take this argument to their boss, procurement, and finance and explain that time is money, for example. However, what if a customized business case showing that the company's solution would save their company $225,000 a year in overtime, parts, reduced scrap, and less rework? Which scenario has a better chance of getting the order? Now they would know what the solution was worth and where it would rank with competing requests for the two very scarce resources of time and money. In today's world, where your offering is competing for funding and priority over other options, the one that has the best business case, with the hardest values, and the highest probabilities of realization, will be the offering that is purchased. If you cannot quantify the value of your offering, it will be placed in the dreaded no decision, or low-priority, bucket. Or the purchase will be seen as a commodity and you will be compared with your competitors based on price and delivery. Instances of decision-by-committee have increased, and "let's not make the wrong decision" seems to be a dominant driving force. It's easy to point to "we got all the minimum requirements at a lower unit price" to support a bad supplier selection if ultimately things don't work out. However, with a vetted business case, all functions involved in the decision can point to the payback, ROI, and cash flow of the business case provided to justify why that project or solution was approved over the other options. Even when there is no budget, if the payback is believable or guaranteed, money can easily be reallocated or found when a quantified business case exists.

So once you see the need for and benefit of quantifying your value, what else needs to happen to enable your company to sell and get paid for that value? Let's look at the internal and external resources, requirements, and focuses needed (see Figure 8.2). These are not ranked by order of importance; however, you need to address all of them to be truly successful. Over the last decade I have had the chance to sit with the Guru of Value, Professor James C. Anderson, and discuss what's working, what's not, and why, in our company and others' "Value Merchant" strategy. After one discussion, Jim created the diagram shown in Figure 8.2. I was amazed at how clearly he was able to represent the main

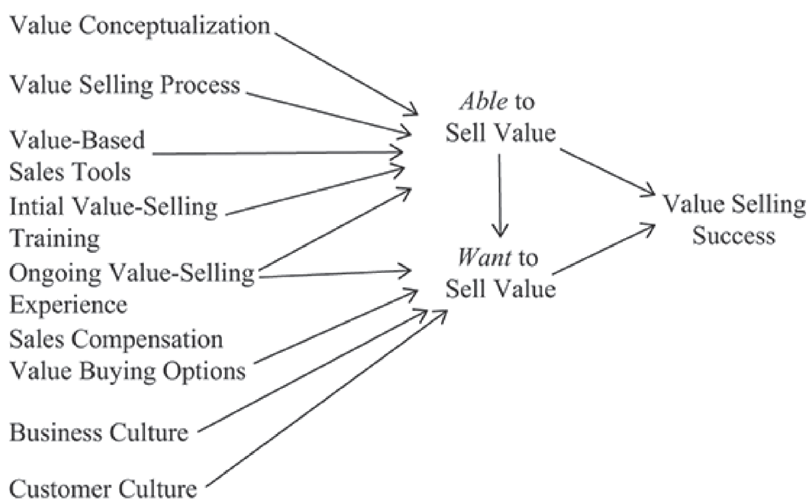

Figure 8.2 What causes value-selling success?

points and show how they support the two areas of ability and willingness to sell value. Checking to make sure we address all areas listed in this diagram ensures that we cover all the basics for a vital, ongoing, robust program based on value that allows a company to differentiate its offering from that of the competition.

The ability to sell value component

Value conceptualization

What is your company's value to your customers? What does it help them do better than the other options? Value selling begins with the basic step of making sure your company creates something of value. Whether it's a product or a service, it needs to have an attribute that is not only different but also of value to someone within your target audience. Most academics use the term "unique selling proposition" or USP; however, just because something is unique doesn't mean it is of value. At our company's 100-year celebration, our CEO took the stage and memorably said, "Value is not in the minds of our engineers and what we think value is; value is what customers value."

Years ago, while interviewing for my job at SKF (a Swedish-headquartered global leader in industrial engineered products), I asked our Canadian president why customers would choose to buy an SKF bearing over a competitor's offering, when we had a price premium. I will never forget the stone-faced glare of our Swedish president, who said – almost in disbelief that I didn't already know why – "We are Swedish." I began to chuckle and then realized that he wasn't joking. So our head office is in one country, whereas our competitors' are in others. This is unique, but it's not something of value (to me, at least). What I heard him say was that our head office is in Sweden. What he meant was that we make the highest-quality products in the world and that we've generated more innovations and patents than all our competitors (Swedish culture is highly innovative and focused on quality). So the first phase of value selling is to make sure that you create something that is of value to your customers – whatever that may be.

Since publicly traded companies have a shareholder responsibility to create sustained profit, let's make sure we help them do this in the right way by adding real value and taking out real cost. To get buy-in, this value must be quantified.

Value-selling process

Second, value has to be part of your selling process. Are you merely reacting to customers' requests, or are you proactively engaging customers, solving problems, and articulating that value during your sales process? The Corporate Executive Board (CEB, 2015), a U.S. think tank, recently found that of more than 1,400 B2B customers' sales interactions, those customers completed, on average, nearly 60% of a typical purchasing decision in researching solutions, ranking options, setting requirements, benchmarking pricing, and so forth before they even talked with a supplier. So if the customer has decided that three suppliers meet their minimum criteria, then price is the only measurable thing of difference. In this case, it's hard to come in and say, "Hey, you need to rethink your requirements: what you really need to do is measure value or total cost of ownership." However, based on experience, we've been able (although it's harder when it's later in the sales cycle) to say,

> Should we be discussing the $5,000,000 in annual parts that you buy and a price savings of 5% on that if you give me an additional $2,000,000 in business ($350,000 theoretical price savings), or the $4,000,000 in CAPEX and OPEX savings (hard EPS improvements) our company can help drive to your bottom line by getting your facilities to a world best-in-class average? An opportunity for profit that is 11.5 times bigger.

All the customer can now ask are questions like "Has this happened before? What's the probability that it will happen? How will we measure it? What happens if you hit or miss your target? What payment relationship should we have?" These all move into the discussion of implementation to realize value.

Can your salesforce have an intelligent discussion with procurement, finance, engineering, and even the customer's CEO to explain how lowest price is not the same as lowest cost? Can your company affect, measure, and reduce costs and increase value in using your product or service during the phases of acquisition, installation, operation, maintenance, and disposal? Can your company also increase the benefits your customer receives, such as increased production, reduced risk, increased safety, increased sell-through? By looking at the total cost of ownership (reduction of costs) along with the total benefit of ownership (increase in benefits of value), you can now understand and demonstrate in numbers how you can affect and measure the impact of your offering on their total value of ownership – which is the difference in reduced costs plus increased benefits minus any price difference – thereby making them measurably more profitable. Actually a better term to use is "total profit added" (TPA). This would be the most holistic measure of all the costs saved (total cost of ownership [TCO]) and all the increased benefits created, thereby allowing for a clear demonstration if the price being charged will lead to the highest profit for the customer, versus other options, over the total life of the product or service. TPA is the next evolution measuring and choosing based on best value (see Figure 8.3).

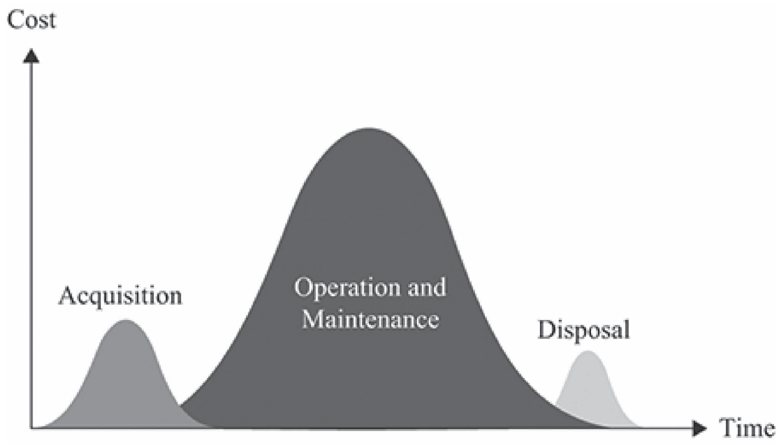

Figure 8.3 Total cost of ownership

Value-based sales tools

Most companies mistakenly think that having a value-based sales tool is the holy grail and the end of the value journey. As companies have said to me in the past,

> If we just had a methodology to sit down with customers and document for them where and how much more money they can make or save using our offering versus the next best alternative, all our problems would be solved.

This is one of the foundational building blocks; however, it is only part of the journey.

At SKF, in the early 2000s, we realized that all the superior technical benefits in the world of our products wouldn't matter to a VP of finance or procurement unless we could convert what those features and benefits meant into cold, hard cash. With that in mind, we created a tool called Documented Solutions Program™ (see Figure 8.4). It is our methodology for sitting down with the user of the solution and running an expected and eventually an actual business case ROI. This financial justification for the customer can now be used to show their bosses the benefits in hard cash of choosing to work with SKF or to buy a specific solution. We are not the lowest-price provider in our industry, but we can help customers realize the lowest costs by using our services and products. These tool and methodology have become a mainstay of our business, and each year we report the numbers generated. At the end of 2015, we had over 66,301 accepted or verified cases with customers, with savings of over U.S. $5 billion, covering all five of our technology platforms. You can imagine the power of sitting down with a customer and demonstrating how this same offering has helped their own company at a different location in the world, or someone within the same industry, save so many dollars by implementing this solution. The conversation goes from "how much does it cost?" to "when can we get this started so I can start saving money and solving a problem?"

For a value quantification tool to really work, it must be easy for the technical and financial person to understand. Remember, a good TCO tool is not a sales tool in and of itself. It's a process and methodology for benchmarking, finding, prioritizing, customizing, and quantifying expected values in financial terms so that customers can see if it makes sense for them to invest in your solution. Too often I see company-made templates that are really just a sales tool called something else.

Characteristics of a good TCO quantification tool:

1. Benchmarks data ranges and reference points.
2. Allows customers to change input data.
3. Is clear and concise. Sometimes engineers overcomplicate things and think the more detailed, the better.
4. Shows the results as your customer would like to see them, for example in terms of ROI, net present value, cash flow break even, dollars saved.
5. Is functional – allows users to save cases and work through a process to go from proposal, to accepted, to verified.
6. Builds in an archive so that cases can be saved, searched, and sorted by industry, application, country, distributor, customer, and so forth.
7. Provides live updates when connected to corporate server; links to reference material.
8. Is easy to use – available in a light version such as for an iPad (SKF launched in 2015), multiple languages and currencies, and so on.

Figure 8.4 SKF documented solutions

Initial value-selling training

Now that you know your offering has value, your sales process incorporates value, and you have tools for demonstrating and quantifying value, you'd better make sure your salesforce is comfortable with selling based on value versus price or technology. During initial training, spend time discussing why this is a good strategy for them and your company and why customers want and need proof of value. Programs that come as edicts from the head office usually encounter resistance in the field that is not needed. Bring the team along on the journey; don't ram it down their throats. Of course, they need to understand and practice with the tool's functionality. Also, if your salesforce is technical, then you will need to spend even more time getting their buy-in. For SKF this has been an issue, because we hire engineers, for whom the technology itself explains the value. They tend to be happier talking about product features and benefits such as the hardness of the steel or the precision of the manufacturing process – and if the solution proves the value, why would one need to convert that value into dollars and cents? When talking to other engineers, they're right; they understand what these things mean – but finance does not. Over the years, we've launched and used a great outside global sales consulting group to ensure that our teams feel comfortable with and know how to sell based on value and that they're comfortable with terms like "return on investment," "return on equity," and "net present value," and how we affect a customer's earnings per share. If your salesforce doesn't understand these terms or know how your company's offering can affect your customer's profit, then some training is required.

In the ability-to-sell-value stages we focused on the basic underpinnings needed. Next we discuss what else needs to happen to keep the culture change program alive and thriving with your team and with your customers.

The want to sell value component

Ongoing value-selling experience

However, training is not a one-and-done thing; it must be ongoing. Just as athletes train daily, so should salespeople. At SKF, we have just begun to do roleplaying in which a senior manager acts as the customer and challenges our salesperson's presentation and offering and asks, "What's the value for me, the customer?" You will only be good at and comfortable with value selling when you know and have answered similar questions hundreds of times. What will procurement's response to this offer be? Let's practice and think through what their possible objections might be so that we're prepared on game day. I also like regions and countries of the world that include the discussion of value during every meeting, where someone presents a case, what numbers were used, how the process worked, and key learnings.

Sales compensation and value buying options

If you can prove value, companies can pay for it. Sales compensation will have an impact on how your people behave. Do you incentivize volume targets? If so, then you shouldn't have to ask yourself why your salespeople are so eager to cut prices. In some organizations I have seen sales targets set as a threshold, with no consideration of whether a deal was struck by providing discounts. Some companies might think of themselves as advanced because they reduce the sales amount to the net discounted price. However, for a company with a 10% net profit margin, a 5% price cut is the equivalent of realizing only half the profit dollars. Also, remember that free services, free samples, free training, extended terms, and so on are just other more creative ways for a salesperson to discount your offering. I suggest that the salesperson who sells less but at full price should be rewarded more than the salesperson who spends most of their time with internal management justifying that a particular customer needs to get a discount.

We've looked at how you pay your salespeople, but we should also look at whether you've given your customers an option to buy based on value realized. In other words, do you use pay-for-performance models that allow customers to pay once value is realized for them? If not, then they might not be able to buy based on promises of potential future value. At SKF we use a few different methodologies: for large customers we might enter into a guarantee of annual cost savings. As a CEO once said to me, "I have 25 different ways to offer a discount, such as volume, competitive issues, industry, new business, etc., but I don't have a way to guarantee the value we create . . . that has to get fixed."

It's great to offer customers value, but have you offered them ways to pay for that value that fit their particular situation? Before moving on, let's be clear about what it means to get paid for value. It's not about "extracting" all the incremental value delivered to the customer in a price premium, for example. To do so would leave the customer with no incentive, or value surplus, to incentivize them to choose your option. Second, I believe most companies have a "buy my product or service at a price" option only. However, a whole set of options needs to exist based on the customer's situation and what they value. The extreme is a "buy my products at a certain list price all the way to a 100% pay-for-performance" option. Within SKF we call this integrated maintenance solutions (IMS) (see Figure 8.5). As with many outsourcing agreements, we focus on where we can drive the most immediate customer savings. So we might say, "Mr. Customer, what did you pay last year for all the parts, people, and operating expenses to run these factories?" "X." "Okay, we will do it better (measuring these deliverable KPIs and doing it for an immediate savings of Y). However, as we make you more money, we get a reward as those benchmark targets are exceeded (e.g., increased production)." I would say that outsourcing IT in general follows this model, and it can make sense. Corporate experts focused on just information technology delivery should be better at it because it's their core expertise. This is a great offering; however, a few issues could arise, and I have seen companies try this, along with other pay-for-performance agreements. If all the offsets are not listed, something that looks good (increased production, less inventory, etc.) might be a short-term win, but if assets are pillaged to do this (they were run with no proactive maintenance), actual losses – not savings – will result. Just think what a pump will really be worth in a few years if the proper maintenance isn't done. All those proposed or even realized savings will be more than offset by increased future costs. With that in mind, pay-for-performance agreements work if they are long-term so that no one is incentivized on such short time frames. However, in between these two options, other getting-paid-for-value formats should exist. A simpler version is, "Mr. Customer, although our products might have a higher average initial price of X, we guarantee an annual hard savings of X." The benefit is that the customer is getting value for paying more, and the value becomes ongoing, whereas price reductions are one-time (suppliers won't or can't offer a 5% per year incremental price savings, but they can offer a new 5% guaranteed savings in another area). As a customer, as long as the savings are hard, measurable, and don't force other costs up, I am willing to keep paying more as these savings compound and make me more sustainably profitable.

A question I've been asked by procurement professionals is, "Which is better: an acquisition price savings or ongoing annual cost savings?"

Imagine you're presented with the following choice: a 5% upfront price savings on a contract for 5 years or a 5% annual cost savings over 5 years (see Figure 8.6). Which is

Figure 8.5 Pay-for-performance options

the more valuable option? First, let's assume something that rarely happens – that the 5% price savings will actually make it to your company's bottom line and that no unintended increased costs will occur elsewhere. Let's also assume that the 5% annual TCO savings are real and measurable – lubrication savings, for example.

Given these two scenarios, some procurement people might assert that because both are 5%, they are worth the same. This analysis would be correct after year one, but not after year two. Switching to a new supplier may bring a 5% price savings, but that supplier would not offer and would not be able to deliver that incremental price savings every year thereafter.

From a TCO perspective, however, during year two an additional 5% savings would be generated by focusing on a new area of opportunity such as energy savings. The magic

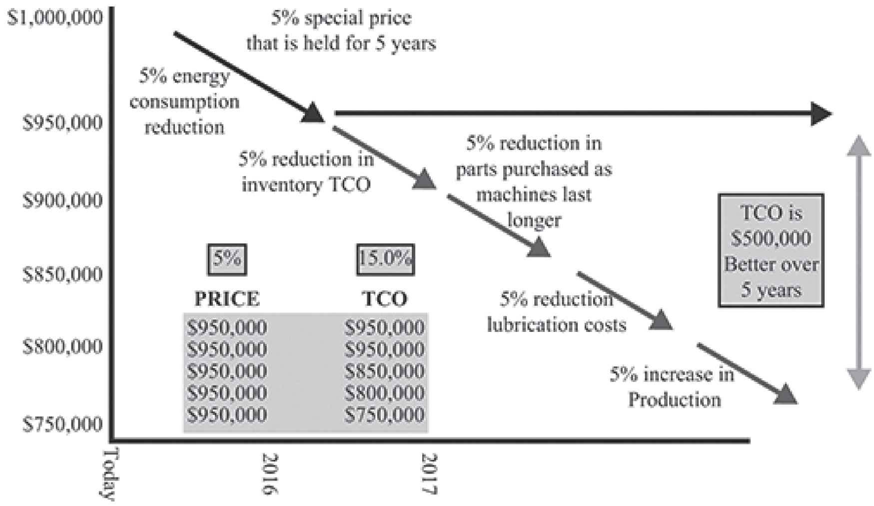

Figure 8.6 5% price versus 5% annual TCO improvements?

Source: Todd C. Snelgrove, Aberdeen Procurement Conference, March 2012, Boston, MA

of compounding and ongoing annual savings would allow a TCO annual 5% savings to be worth 15% versus the 5% price savings over a 5-year period or three times as much. Remember, we assumed the best-case scenario for the substituted product based on price.

> IACCM research shows that a focus on price concessions undermines the value achieved. For example, the probability of a poor outcome increases by more than 50%, compared with agreements that focus on performance. This translates into significant increases in cost and missed or lost revenue – at levels far exceeding the theoretical savings from the low negotiated price. SKF has provided thought-leadership in this area for more than 20 years, having successfully resisted "commoditization" by switching instead to delivering market-differentiating value.
>
> (Tim Cummins, CEO, International Association of Commercial and Contract Management, quoted in SKF, 2014: 2)

Business culture

Are you really a value company? Does your CEO talk nonstop about the value you create for your customers? Do you reward and recognize the people who create the most value or the newest ways to save customers money? Or are you just using a few buzzwords on a Power Point slide or corporate brochure? Value needs to be part of your company's DNA. Does sales get mixed messages like "Get every order and sell value"? Unless your message is clear, you will end up rewarding and motivating sales to cut prices, and volume will be the underlying dimension that's rewarded. If you're unable to prove your value you might get a short-term order based on lowest price, but over time it will not translate into more sustainable orders as someone comes along and undercuts you. We are lucky at SKF to have as our leader a CEO who continually focuses on value as our main differentiation.

Customer culture

Does procurement see you as a commodity and therefore assume you can be bought using certain tactics, or do they see your offering as strategic for them?

As a company you can do all these other things well, but if procurement sees you as a commodity, and buys your product or service as such, much effort needs to be exerted by everyone to get procurement to rethink where and why they have chosen to treat you that way. In my experience, most companies have an issue here. Let's begin with the way procurement chooses how to select suppliers and negotiate with them based on the Kraljic 4-box matrix. The Kraljic Matrix (see Figure 8.7) is a well-respected thought process introduced in 1983 in the *Harvard Business Review* article "Purchasing Must Become Supply Chain Management." Although the concept has since been modified (to a 9-box or a 36-box matrix), and procurement's implementation of it has evolved over the years, the thoughts and resulting actions of procurement still follow this concept. Too often there is a mismatch between how we perceive ourselves as sellers and how buyers perceive what we are selling, leading both sides to wonder why they cannot communicate.

A key driver of procurement is to increase spend under management (they control a higher percentage of the company's procurement dollars spent) and to buy from fewer suppliers (to increase leverage and to reduce transaction costs). When I am at a Strategic Account Management Association (SAMA.org) conference, and I ask senior global strategic account managers, "Where do you see your company on this matrix?"; in general I get the following feedback.

I get comments like "We are not the small, unimportant **Nuisance** offering, where transaction costs are the most important differentiator." However, I say, for suppliers in this realm, ease of use and ordering efficiency are the most important characteristics and decision-making criteria for procurement, with unit price being most important. When thinking about spend, we need to look at what percentage of the customer's total spend we are. In general, suppliers will focus most of their efforts on direct material spend, as that is where the most money is spent. When companies rank suppliers on spend they tend (of course) to place direct materials (all the products that go into making their primary product – steel, for example) on the right-hand side of the matrix because a small savings on a big number would seem to have a bigger effect on company profit. As

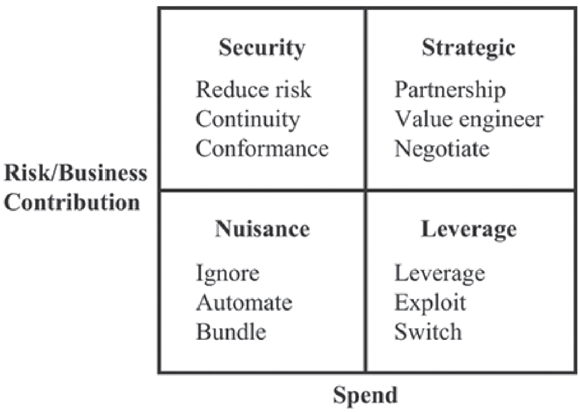

Figure 8.7 Kraljic Matrix

we will see, the spend with a supply category is probably not the primary indicator of where efforts should be focused or the biggest hard savings and benefits can be realized. Although the y-axis represents the business contribution, if you cannot quantify the business contribution, procurement will assume that all offerings are the same and will push you into the lower two quadrants.

Most of us are not in the top left quadrant, either, at least not in the long term. This quadrant is where a supplier exists that is not a huge percentage of the customer's total spend but that has a product or service that cannot be easily substituted. Remember, the ease of substitution is based on the customer's assumptions, not ours. If you happen to have a patent on a product or service that they need or access to a chemical or raw material that no one else has, or if demand exceeds supply in a market, then you are in this position. However, in general, this is not a long-term realistic position to be in. If what you sell has an ISO specification, competitors are reasonably the same size and offering, and the perceived risk is very low or zero. I recall Robert Maguire, whose chapter appears in this volume, saying that people are confused about what an ISO standard is: "It's a conformance standard . . . not a performance standard." Yes, both products are the same size, fit the same hole, and so forth; however, that doesn't mean they'll produce the same results or perform the same way.

We suppliers want to think that we're strategic – that if the customer would really work with us, we could offer a lot of value, savings, benefits, risk reduction, and innovation. Talking with procurement professionals at numerous global conferences over the past decade, I find that they would place none or only a handful of suppliers in the top right quadrant as Strategic. However, after I discuss how often that's a mistake – that a lot of suppliers could really help their companies be more profitable by doing things differently – the standard retort is, "Then why don't they come to us and demonstrate and document how they would do that, and what the impact would be?" Sales and procurement functions both need to take responsibility for placing suppliers in the wrong quadrant and therefore not getting the possible or desired results.

The segmentations mentioned earlier are the backbone of a value-selling organization and culture; however, if the customer still perceives that the dollar spend with you is not significant (the x-axis in the Kraljic 4-box matrix) and you are not strategic enough to spend the time or effort to treat them like a partner and demonstrate the value you could bring, then much of the segmentations given earlier won't help. When you get to the procurement person or team at your customer and they are aggregating volume, threatening with low-priced offerings of competitors, contemplating the use of a reverse auction, employing some sort of benchmark pricing that shows, somewhere, one time your product price was less, asking you to explain your cost breakdown to justify a final price, then you should know that your customer sees you in one of the bottom two boxes and will focus on leveraging you. Most people forget that the x-axis label represents financial contribution, and they focus on dollars spent instead. This is a major issue that sales needs to address. Our company has made it a focus, and we have people whose job is to get customers to understand that even though the relative dollar spend might be low (versus direct spend such as raw materials), the impact can be huge. I think the x-axis should measure financial opportunity dollars (money saved using existing TCO or financial improvements Total Profit Added™). For example, supply risk might be low because other global players exist and products have an ISO specification. Dollars spent is relative. Customers might purchase $10 million of industrial parts to keep their plants running, but when their total spend is $5 billion some might assume that this "supply bucket" should be treated as non-critical or as a nuisance leverage buy (0.2% . . . not even close to 1% of total spend). However, when looking at how value can be created by reducing operating machine costs (less energy, water, lubricant, repair parts, labor, and/or increases in machine production, throughput, or quality), one customer saw that our impact could be worth $128 million in savings. We were then moved immediately to the Strategic quadrant.

To help the market evolve, you need to do some research and work like a consulting organization that talks about the results you can impact and by how much. Don't just discuss the technical features of your widget. We need procurement around the world to challenge their assumptions. I spend a lot of time at procurement and academic conferences presenting our thoughts and methodology. This has proved very helpful in moving our market to change how they measure and choose suppliers, the most advanced being on hard value generated. A nice reference and study that I use is from Manufacturers Alliance for Productivity and Innovation (2012), a U.S.-based think tank that represents industrial manufacturers. A study they conducted with the procurement representatives of member companies found that companies that had a structured way to buy on best value were 35% more profitable than companies that had no structured methodology for measuring and understanding value.

To keep the program alive and flourishing

As I have shown in the focuses or requirements needed, a value quantification tool needs to be the output of the strategy of creating, communicating, quantifying, and getting paid for value; however, numerous other issues need to be addressed: "A fool with a tool is still a fool." For value quantification to become a company focus, a mantra, a part of who your company is and the reason for your being, other supports must be in place. Some suggestions follow.

Who will drive this program internally and externally? A program without a driving person is destined to fail. Baker and Lizou (2013) observed,

> Whenever this question is posed to a group of businesspeople – "Who's in charge of value in your company?" – someone will inevitably shout out "Everyone!" Really? If everyone owns something, no one does. Adam Smith demonstrated that the *division and specialization of labor* were a central cause of the wealth of nations; they are also the central cause of the success of a business. Not everyone can be good at everything.
>
> (p. 104; italics in original)

Will the ability to quantify the value of new products and services be part of your new product development process, so that when a new "solution" is presented to the market you can quantify its financial impact for customers?

External marketing should consistently reinforce this as part of your brand image. I'm not a fan of hearing how old a company is, or how big it is, or how many people it employs. What's in it for the customer to buy your company's offering? Spend time on the "so what is the benefit" and less on the how (the how can be discussed in face-to-face meetings). A tagline of mine is "Making Industry More Profitable." I might employ the smartest people, I might be the most knowledgeable, I might have more patents, I might have the best products, and so on; these are just things I can apply to a customer's business, with the result that I make them more profitable. Say what the result is; don't make the customer assume what those benefits will be for them. Trade shows, magazines, brochures, and company speeches should have a dedicated "section" where your company can summarize the hard value your company has delivered.

The value journey is never ending; an almost-as-good competitor will always be ready to copy your latest innovation. To stay out of the commodity game, and to make yourself and your customers more profitable, demonstrate and document when, where, why, and how you can affect how much money your customers make. It's not a zero-sum game if you can quantify your value; then you will be remunerated with an equitable portion of that value.

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24 Quotes and statistics to help you on your value-selling journey

Snelgrove, Todd C.

Selling on value

Companies that price for value are 24% more profitable than their industry average, 36% more profitable than those that price to cost.

Monitor Deloitte 2012
Closing rate increases of 25% by developing customized business case
Confidential B2B industrial company
Shorten sales cycle by 33%, reduce discounting by 18%, increased deal close 15%
B2B global software company

Buying on value

Bought and rewarded suppliers on TPA™ were 35% more profitable than industrial companies that did not.

Manufacturers alliance for productivity and innovation 2013 chief procurement officer survey

A 2007 study sponsored by the International Association for Contract and Commercial Management and the Strategic Account Management Association found buying companies realized 40% more value from their most collaborative suppliers than their least collaborative suppliers. The same report also found suppliers reported an average delivering 49% more value to their most collaborative key customers.

Memorable quotes

It is not how little you pay its how much you get
– Todd Snelgrove, Experts in Value

Suppliers often don't come to us with a business case. But it's what we want. Sell your value in our numbers to get our attention. But if you can't quantify your value – don't be surprised at the failure of procurement to do so.
– Paula Gildert President; Chartered Institute of Procurement and Supply

Even at Half the Price it can be Twice the Cost
– Todd Snelgrove, Experts in Value

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Customers don't just want to know that you can help them make money or save money. They want to know how much and by when.
– Mike Wilkenson, Axia Value

Price Does Not Equal Cost.
– Todd Snelgrove, Experts in Value

Being different is not differentiation. Differentiation is being different in ways the customer values.
– Mike Wilkenson, Axia Value

Too many value propositions are high on proposition but low on value.
– Mike Wilkenson, Axia Value

Procurement and sales sometime confuse what ISO really means. . . . It's a conformance not performance standard.
– Rob Maguire, Maguire Izatt

My offering can be the highest price, but the lowest cost, and bring you the most profit.
– Todd Snelgrove, Experts in Value

Companies are not in the business of buying and products and services for no reason, the exists to do something of value for their clients. Can you help then m add value and sell that value?
– Todd Snelgrove, Experts in Value

Price is only an issue in the absence of quantified value.
– Todd Snelgrove, Experts in Value