

# Setting value, not price

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*The first task is to map benefits versus price – as the customer sees them*

*Bear in mind that equal value doesn't mean equal market share*

*The key decision: do you stay on the line of value equivalence, or get off?*

## **Ralf Leszinski ♦ Michael V. Marn**

**A**

MANUFACTURER of high-quality medical testing equipment introduces a vastly improved version of its best-selling diagnostic device at a price 5 percent higher than that of the older model it replaces. For three months, the new model is successful, gaining rave reviews from customers and increased market share. One month later, prices in the sector collapse and the company has to discount its superior new product just to maintain its traditional market share.

A highly regarded manufacturer of commercial paper prides itself on delivering extremely consistent quality and service. That consistency notwithstanding, the company is baffled by vacillations in its market share that accompany shifts from tight to loose supply in the industry.

A consumer packaged goods company executes one of the most common business tactics – it matches a competitor's price on a large contract to supply a leading food retailer. In the months that follow, a bitter price war breaks out, destroying almost all of the industry's profitability in this product category.

These disparate cases have at least one thing in common: apparently sound marketing strategies and tactics that produced unexpected and costly results. But could they have been avoided? Here we will explore how these and other common and expensive marketing missteps might be averted by applying a discipline called “dynamic value management” to the pricing and product positioning that are at the core of what most marketers do.

“Value” may be one of the most overused and misused terms in marketing and pricing today. “Value pricing” is too often misused as a synonym for low

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## SETTING VALUE, NOT PRICE

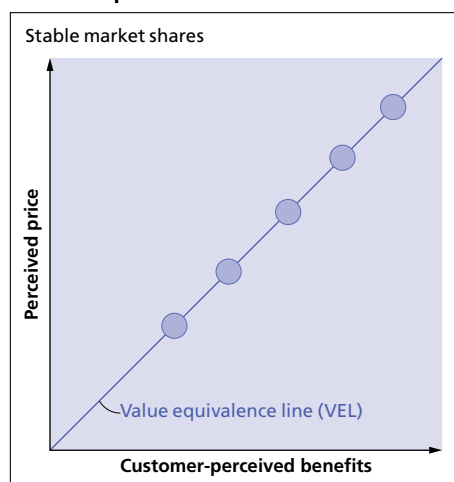
price or bundled price. The real essence of value revolves around the *tradeoff* between the benefits a customer receives from a product and the price he or she pays for it.

The management of this tradeoff between benefits and price has long been recognized as a critical marketing mix component. Marketers implicitly address it when they talk about positioning their product vis-à-vis competitors' offerings and setting the right price premium over, or discount under, them. Marketers frequently err along the two dimensions of value management, however. First, they fail to invest adequately to determine what the "static" positioning for their products on a price/benefit basis against competitors should be. Second, even when this is well understood, they ignore the "dynamic" effect of their price/benefit positioning – the reactions triggered among competitors and customers, and the effect on *total industry profitability* and on the transfer of surplus between suppliers and customers.

To illuminate the nature and magnitude of this missed value-management opportunity, value needs to be defined properly. Customers do not buy solely on low price. They buy according to *customer value*, that is, the difference between the benefits a company gives customers and the price it charges. More precisely, customer value equals *customer-perceived benefits* minus

*customer-perceived price*. So, the higher the perceived benefit and/or the lower the price of a product, the higher the customer value and the greater the likelihood that customers will choose that product. (We will return to this later.)

Exhibit 1  
**Value map**



**Customer value = perceived benefits  
minus perceived price**

### Static value management

Many marketing and strategic assessments can be made by using a simple tool called a value map, and by considering how customers are distributed within the map for a given segment.

The value map explores the way customer value and the price/benefit tradeoff work in real markets for a given segment (Exhibit 1). The horizontal axis quantifies benefits as perceived by the customer; the vertical axis

shows perceived price. Each dot represents a competitor's product or service. Higher-priced, higher-benefit competitors are toward the upper right; lower-priced, lower-benefit competitors are at the lower left.

If market shares hold constant (and if you have the right measurement of perceived benefits and perceived prices), then competitors will align in a straight diagonal line called the value equivalence line (VEL). At any desired price or benefit level, there is a clear and logical choice for customers on the VEL. So competitors aligned on the VEL say in such a market that “you get what you pay for.” The clarity of that choice almost defines a market in which shares are stable. (Note that while market shares might be stable for competitors along the VEL, their shares might not be equal. Again, more on this later.)

If, however, market shares are changing, then share gainers will be positioned below the VEL in what is called a “value-advantaged” position. Competitor A in Exhibit 2 is value-advantaged and should logically be gaining market share. If a customer is searching for a product in the benefit range of A and B, then he or she would be more likely to choose A, since A provides the same level of benefits as B but at a lower price. Likewise, if a customer were searching for a product in the price range of A and C, he or she would probably choose A over C, since A provides greater benefits than C but at the same price. So A, positioned below the VEL that B and C reside on, offers more customer value than B or C, and therefore more customers prefer it.

The opposite is true for competitor E, which finds itself in a value-disadvantaged position above the VEL. Competitor E will be a share loser if the value map has been constructed properly.

While the marketing concepts that underpin the value map are basic, advanced market research techniques (conjoint analysis, discrete choice analysis, and multi-staged conjoint analysis, for example) allow an accurate quantification of the perceived benefit dimension and its tradeoff against price. These advances make the effective application of value maps easier than ever for marketers. That said, examples abound of costly positioning errors that could have been avoided through the use of this tool.

### *Illustrative case: Alpha Computer Company*

The Alpha Computer Company’s experience illustrates the value map’s power, even when applied in a simple, static fashion. Alpha Computer supplied mini-computers for use primarily as servers in network applications. Alpha prided itself on its engineering skills and ability to deliver high levels of technological performance at reasonable cost. In an attempt to diagnose unexpectedly poor

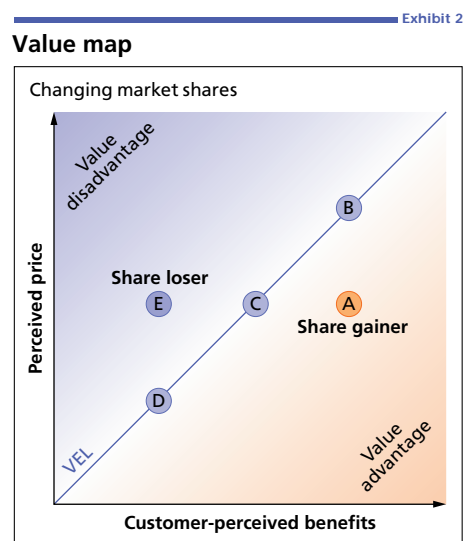
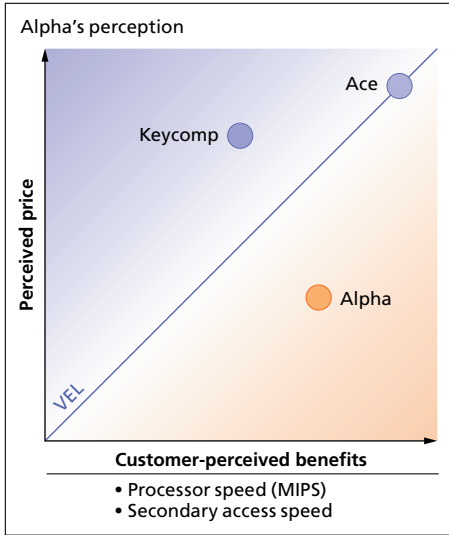


Exhibit 3

**Minicomputer value map**



market acceptance of its new line of mini-computers, Alpha created a value map that reflected its perception of the price/benefit positioning of competitors Ace Computer and Keycomp, and itself (Exhibit 3).

Alpha believed customers chose mini-computers on the basis of two technological attributes: processor speed in MIPS (millions of instructions per second), and secondary access speed, that is, how quickly the computer accessed data from an external storage device such as a hard disk drive. Ace Computer was the premium competitor: it had the highest processor speed and secondary access speed, but also the highest price. Keycomp not only had slower processor speed and secondary access speed

than Alpha but was also priced 10 to 15 percent higher. So, Alpha thought that Keycomp was value-disadvantaged and that Alpha itself was value-advantaged.

If Alpha's perception of the value map in Exhibit 3 were correct, then Alpha should have been gaining market share and Keycomp losing it. The opposite was occurring, however, and Alpha's managers were baffled. They thought their product was superior to Keycomp's at a lower price, and they could not understand why it was not a huge success.

Alpha's problem was a common one. It did not understand the *customer-perceived* attributes that really drove customer choice of minicomputers. Alpha's marketing department commissioned research to try to confirm its hypothesis that processor speed and secondary access speed were indeed the most important features. Sixty buyers were questioned about their criteria for selecting a network minicomputer supplier.

Much to Alpha's surprise, processor speed and secondary access speed ranked only fourth and sixth on their list. Software and hardware compatibility, perceived reliability, and quality of vendor technical support ranked above raw processor speed. Even quality of user documents (the manual that accompanies the hardware) ranked above secondary access speed.

As it turned out, processor speed was indeed important, but most customers had a minimum processor speed requirement that all competitors easily exceeded. However, the nature of most network applications made secondary access not that important. In fact, Alpha was understood

by customers to be slightly better than Keycomp on processor speed and secondary access speed, but these features just did not matter that much to them.

The research also showed that Keycomp was highly rated on compatibility, reliability, vendor support, and user documents. Alpha, on the other hand, fell short on these. Its operating system software and hardware plug configuration created compatibility problems for many customers. Some remembered reliability problems with an earlier generation of Alpha's minicomputer that tainted their perception of its new product. Alpha's technical support was considered difficult to get hold of and its user documents were seen as the weakest in the industry.

Exhibit 4 shows how the value map was redrawn to reflect customers' perceptions of benefits and performance rather than Alpha's. It showed that Keycomp performed so well on the attributes most important to customers that, despite its higher price, it was value-advantaged and therefore justifiably gaining market share. Conversely, Alpha performed so poorly on attributes most essential to customers that, despite its low price, it was still value-disadvantaged and predictably losing share.

The insights from this properly constructed value map prescribed a clear course for Alpha. It mounted a crash program to correct the important attributes on which customers had rated it so poorly. A minor rewrite of operating system software and a simple redesign of the hardware plug configuration fixed the compatibility issue. The company then mounted an aggressive market information campaign to demonstrate the improved reliability of its latest model. Additional service representatives and toll-free access lines were put in place to enhance technical support, and user documents were redrafted.

The results are shown in Exhibit 5. In only six months, Alpha increased customer-perceived benefits so much that it was able to increase its price by 8 percent and still gain its fair market share. The price and volume increase more than doubled Alpha's operating profits.

The Alpha Computer case illustrates several important points about value management:

Exhibit 4  
**Minicomputer value map**

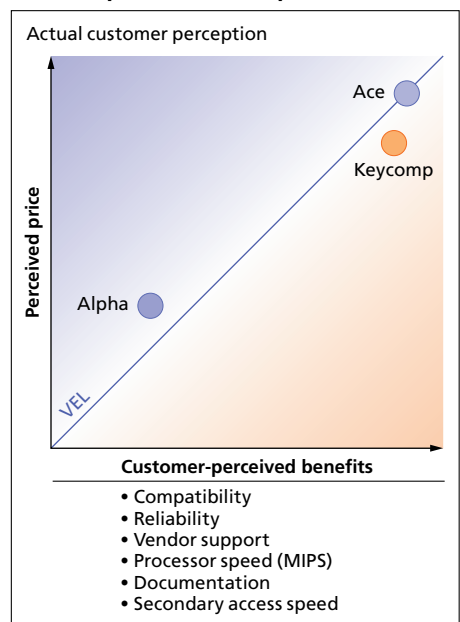
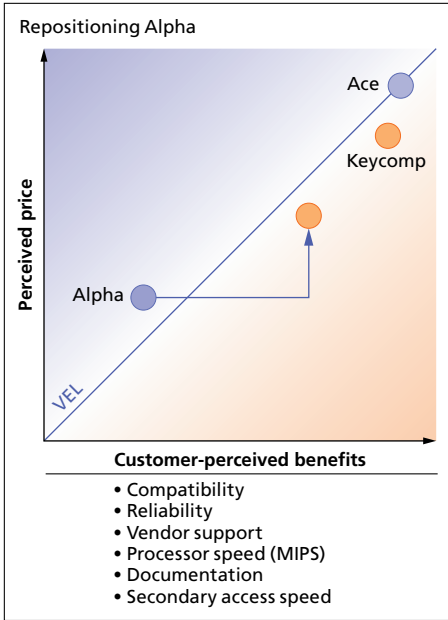


Exhibit 5

**Minicomputer value map**



◆ The key to success often resides in gaining a clear understanding of the real attributes driving customer choice and their relative importance.

◆ “Softer,” nontechnical attributes (perceived reliability, quality of vendor support, ease of doing business) are often as or more important than precisely measurable technical features.

◆ Trusting internal perceptions of which attributes drive customer choice can be a fatal mistake; rely on customers for this critical information.

The case also shows the opportunities value maps offer value-disadvantaged companies to understand their markets better. Another case, that of car maker Mazda’s experience with its Miata sports model, demonstrates the

kind of opportunity that a value-advantaged company can easily forgo if it does not fully appreciate its position (*see* the boxed insert, “US economy sports car market, 1990”).

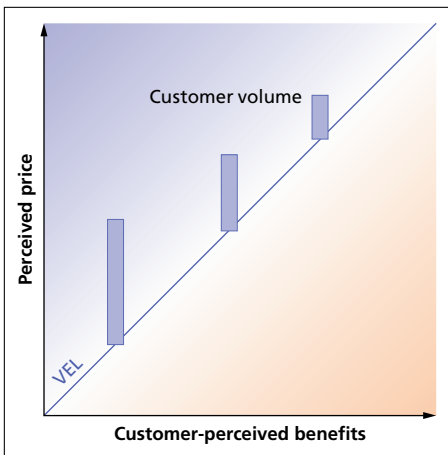
*Distribution of customers on the value map*

In discussing the stability associated with a position on the VEL, and the effects of competitive moves away from it, we have implicitly assumed that all positions along the line are equally attractive. This is not the case. Even for

a well-defined segment, customers are not spread evenly along the line; if they were, every competitor on the VEL could be expected to have the same market share. Sometimes this can be explained by historical reasons; mostly, however, it is due to the distribution of customers along the VEL (Exhibit 6).

Exhibit 6

**Customer volume distribution**



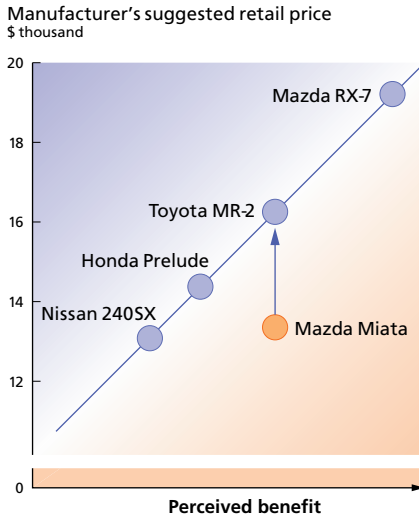
History plays an important role: how long a competitor has held its position with customers often explains large market share differences among companies with otherwise the same value proposition. This phenomenon, also called “order of entry,” can be seen in its extreme form in deregulated utilities.

## US ECONOMY SPORTS CAR MARKET, 1990

Introduced to the US market in 1990 at a manufacturer's suggested retail price of \$13,800, the Mazda Miata was a retro-sports roadster that captured the imaginations of ageing baby boomer car buffs who originally fell in love with the classic British roadsters of the 1960s and 1970s made by MG and Triumph. As much fun as its British predecessors but better built and more reliable, the Miata was an instant hit in the United States.

Mazda underestimated the appeal and the high perceived benefits of the simple but unique Miata. The price was disproportionately low for the perceived benefit. Mazda dealers, however, recognized this price/benefit imbalance and claimed the surplus for themselves in the form of \$2,000–3,000 "market price adjustments" that they added to the suggested retail price (and which customers gladly paid).

### Mazda Miata



A new competitor offering similar or even slightly better value than an incumbent telephone or electricity company will not provoke the significant changes in consumer purchasing that might be expected.

A more important and probably more common explanation of market share differences among competitors on the VEL is the distribution of customers along this line. Typically they are not distributed evenly, but clustered. There are several reasons for this. Sometimes consumers are not equally aware of the true nature and availability of competing products. Companies might use different channels to reach consumers, or their salesforces might not adequately communicate benefits to customers. If so, a gap can exist between customers' perceptions of a product's benefits and the benefits that it actually delivers.

Even in a perfect world, consumers would be unevenly distributed along the VEL because they do not necessarily view benefits and prices in a linear way. There are **benefit-bracketed customers** who explicitly want minimum or maximum benefit levels and find positions on either side unacceptable. Market research shows that break-points exist for some products and services at which a small increase in the benefits offered will lead to a large increase in the value a customer perceives. Some buyers of automotive components, for example, will not accept delivery reliability below a minimum level. Some computer buyers, on the other hand, do not value additional memory beyond a certain level because existing memory more than satisfies their needs.



A second group is **price-capped customers** who are unwilling to spend more than a fixed amount for a particular product or service. The price of the average home PC has held at about \$2,000 for several years, even though performance has improved sharply. This could indicate that there are price-capped customers at around this level who are unwilling to spend more even if they could get more features. Only customers who fall into neither category, benefit-bracketed or price-capped, are actually willing to consider the full range of tradeoffs along the VEL.

Understanding volume distribution along the VEL is therefore crucial to making an intelligent decision about product position. In many cases, however, it is poorly understood, leading to wrong decisions. Typical mistakes are:

- ◆ Positioning an apparently competitive product at a low-volume part of the VEL and not getting the expected volume gains. A maker of metal-coating machinery positioned a new product technically half way between two competing products, hoping to pull in customers not entirely satisfied with these. What it had not realized was that there was no significant volume between the two extremes, because each answered a specific speed requirement of downstream customers. Failing to understand that there was no demand for a medium-speed machine, even one that was competitive on technical specification and price, forced the manufacturer to take a multi-million-dollar writeoff.
- ◆ Positioning a product too high or too low on the VEL, thereby inadvertently excluding a large portion of price-capped or benefit-bracketed customers. The drastic fall in demand for one company's supercomputers is an example of this. Even though the company's ever more powerful machines remained on the VEL, there was no longer a customer imperative for all that processing power to be concentrated in one machine, as more broadly distributed processing had become preferred by most users.

### Dynamic value management

Alpha Computer and Mazda Miata illustrate the pitfalls of failing to understand the "static" value positioning of a product or service. But getting a product to the right position on a static value map is only part of managing value effectively. Unfortunately, neither competitors' positions on a value map nor customers' perception of products and suppliers are frozen in time. Value maps are not static but dynamic, constantly changing in important and often predictable ways.

Any change in product positioning by one competitor, be it cutting price or improving features, will lead others to move, either to preempt shifts in market share or to react to them. We apply the term "dynamic value manage-

ment” to the discipline of managing price/benefit positioning not just in a static fashion, but with explicit and thoughtful consideration of likely changes in competitive value positions and customer value perception. Companies that master this discipline can reap huge rewards and avoid equally huge pitfalls.

### *Illustrative case: MTE*

MTE is the manufacturer of high-quality medical testing equipment mentioned at the beginning of this article. Its primary product was a blood diagnostic testing machine used in high-volume hospital laboratory applications. MTE was the recognized premium supplier (with the highest price and benefits) in a stable market that included three other leading competitors (Jackson, PZJTech, and Labco) positioned squarely on the VEL (Exhibit 7).

As is often the case, MTE, as the premium supplier, was the real innovator in this market. The improved version of its blood diagnostic testing machine was more accurate and had faster testing cycle times. But MTE was in a dilemma over how to price its terrific new model. Research showed the added benefits would justify a 10 percent price increase and still keep the model on the VEL – that is, MTE would hold its market share. But, equally, it could keep the price the same and position the new model in a highly value-advantaged position in the hope of gaining significant market share.

MTE decided on a compromise, raising its price by 5 percent, a meaningful increase that still kept it in a value-advantaged position (the dotted circle in Exhibit 7). The response was instant and positive. Customers recognized the 5 percent increase was a small premium to pay for enhanced accuracy and cycle times. The machine sold well and immediately increased MTE’s share of the market.

This success, of course, was at the expense of Jackson, PZJTech, and Labco, none of which had the expertise or resources to introduce products to rival MTE’s new model. Faced with falling sales, they took the only measure they could to defend their market shares – they lowered their prices by at least 5 percent (Exhibit 8). The market shares of all four companies quickly returned to their previous levels, but at the lower prices. As Exhibit 8 shows, the VEL had simply shifted downward and MTE’s value-advantaged position was

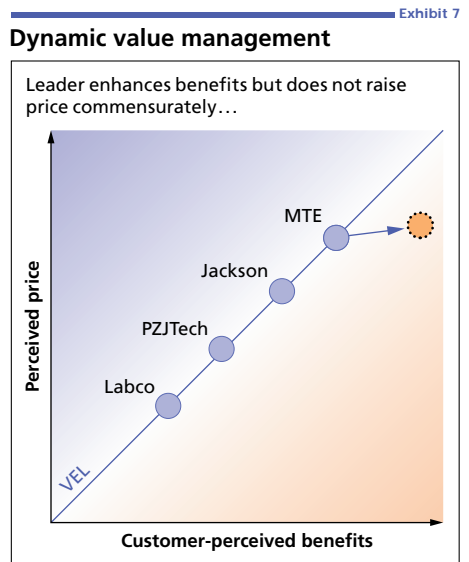
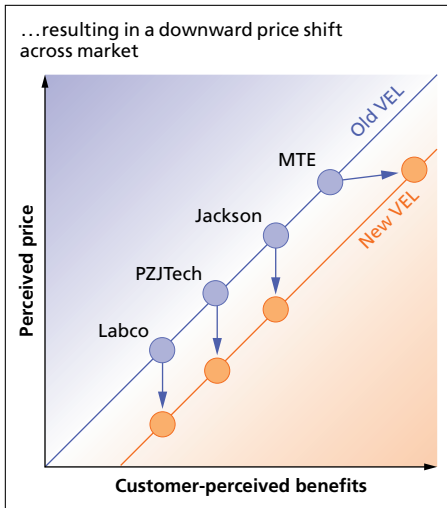


Exhibit 8  
**Dynamic value management**



essentially nullified. The lowered VEL was good for customers because they got more for their money, but the suppliers got less for their products. It represented a wholesale transfer of market surplus from suppliers to customers.

Could MTE have managed the value dynamics of this situation better? Possibly. If it had raised the price of its new model by 10 percent and positioned it on the existing VEL, it would have held its traditional share but at a 5 percent higher price. Jackson, PZJTech, and Labco, experiencing no loss of market share, would probably

not have reacted at all. Industry prices would have been maintained, and MTE’s profit would have risen significantly.

### Changing your position in a dynamic world

Marketing managers have two basic options for improving their products’ position, regardless of whether they are in a proactive or reactive situation. They can reposition their product along the VEL, or move off it. These different moves engender very different outcomes – different competitor and customer reactions and different prices, volumes, profits, and risks.

#### *Repositioning along the VEL*

Repositioning a product along the VEL, usually a less aggressive move, requires a company to understand where customer clusters are on it, and how other competitors are positioned in relation to them. The decision of *whether* and *how far* to move should include the following steps:

**Understanding and weighing the risks and opportunities.** Repositioning a product is likely to lose some customers who preferred the old positioning. Equally, it will gain customers who prefer the new positioning. Failure to understand this tradeoff could lead a company to surrender a good customer franchise in exchange for a reduced, and probably more competitive, new franchise.

**Being smart about choosing the right attributes to vary.** Customers do not consider all product attributes to be equally important; there is therefore more “bang for the buck” in changing some attributes rather than others. The knack is to select the features that will attract new customers without

losing old ones, that have the greatest impact on customers, and that the company can provide cost-effectively.

**Knowing what price change is appropriate for a given attribute change.** If the aim is to stay on the VEL, any change in benefits must be accompanied by a price change. Not increasing the price enough will force competitors to match the new positioning, leading to an unwanted industry price decline (as with MTE); raising the price too high will lead to a volume loss. Market research tools such as conjoint analysis can determine the magnitude of change required.

**Choosing those changes least likely to provoke undesirable competitive reactions.** If the repositioning is successful, or looks as if it will be, competitors will react. The likeliest, and least desirable, reaction is a price cut, which often leads to price cuts across the industry and lower profits for all. One manufacturer of medical supplies always reacted to competitors' price cuts by improving benefits. Every time a competitor dropped its price, the supplier countered with an improved version of its product at the same price, but on the new VEL. In this way it gained a distinctive market position, offering increasingly superior benefits over competitors that chose to move only along the price dimension.

**Choosing the new position along the VEL.** There are two options: either to move to a new position within the extremes defined by current competitors, or to move to a new position beyond the current extremes. There are differences in risk and potential competitive moves between the two:

- ◆ The success of a new positioning within current competitive extremes depends on locating the right customer concentration and standing out from competitors. As this approach seldom expands a market, competitors will probably react to their declining sales.
- ◆ Moving to a new position along the VEL outside the existing extremes can expand a market. While the upside opportunities can be greater (and the threat of retaliation lower), success depends on a thorough understanding of the size and needs of the latent demand that the new product or service is designed to meet.

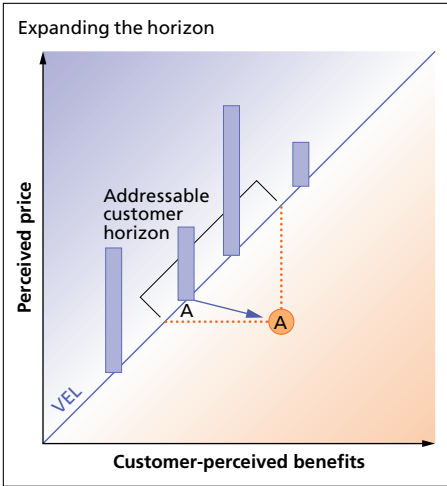
### *Moving off the VEL*

A move off the VEL into value-advantaged territory might seem attractive on the surface. As the experiences of many companies show, however, such a move requires an even better understanding of the dynamics, risks, and opportunities than do moves along the VEL.

What is different about moves off the VEL? A repositioning along the VEL is likely to threaten only one or two neighboring competitors currently on the

line. Moving below the VEL often threatens all competitors, because such moves usually define new and lowered VELs that force them to reconsider their own positions. Only rarely does the VEL move upward; to do so would require customers to accept the actual value reduction and most suppliers to move in the same direction.

Exhibit 9  
**Repositioning off the value equivalence line**



When a product is repositioned below the VEL, its “horizon” of potential customers grows (Exhibit 9). Take, for example, an electric drill whose power was increased but which was sold for the same price. The new product appeals not only to customers who initially bought it, but also to those who had previously paid more for a drill with the higher power rating.

Just moving off the VEL to expand the horizon of customers does not guarantee success, however. Market research must first establish that the expanded horizon does indeed include new concentrations of customers, not just empty space.

*Likely competitive reactions to moves off the VEL*

In today’s highly competitive markets, rivals seldom passively accept volume or market share losses. They usually react by trying to improve their products by selectively adjusting attributes, or by dropping price. How they will react is a function of a number of parameters, including:

**The type of change that set the whole process in motion.** The typical reaction to a competitor’s move is to try to counter along a similar axis. If the salesforce reports massive price cuts by a competitor, they will want to reciprocate. If a competitor introduces a new service, the salesforce will want to offer something similar. A first mover’s repositioning along the benefits axis tends to damage profits less than price reductions would. It is also easier to retract benefits that are rejected by the market or are uneconomic to provide, than to try to raise prices after a round of reductions.

**Competitors’ strategic mindset.** The degree of volume and profit pressure a competitor is under and its understanding of the economics of price changes (for example, how price and volume trade off against profit) will drive the type of reaction it makes.

Even in commodity-like industries, there are examples of manufacturers successfully improving their products and services rather than cutting prices.

In a US specialty chemical segment, for example, the two leading companies have about 40 percent of the market. They and their customers recognize that there are no real technical differences between the two suppliers' products. So when one competitor increases its support services, the other improves its services too. While the industry is competitive, and the level of service high and rising, prices have also risen and profits have remained strong. In the past five years, neither leader has reacted to a competitor by reducing its price – a move that would surely have made the industry less profitable.

*Effects on demand and volume distribution*

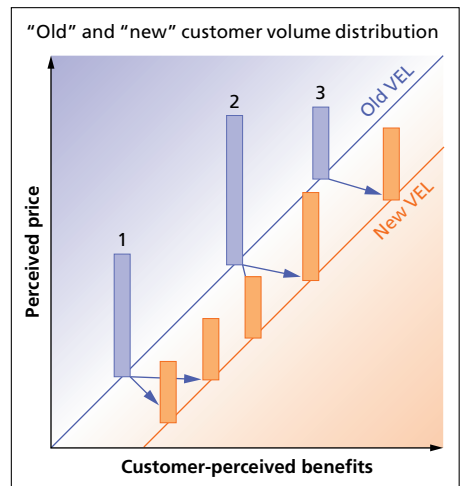
Competitors' behavior can actually shift the distribution of demand along the VEL (Exhibit 10). As the line is shifted downward through improved combinations of price and benefit, it is not automatic that the "old" pattern of customer distribution follows suit. Some customers might be benefit-bracketed, others might use the changes to rethink their own price/benefit tradeoffs, and, finally, new offers could stimulate latent demand.

If the distribution of demand changes, a shift off the VEL will not always bring the desired volume increase. The established manufacturers in one consumer durable industry assumed most customers were price-capped, and therefore had not offered increased benefits. But when a new competitor introduced a new product at a significantly higher price, 30 percent of the volume shifted to that new product. Some consumers *had* been looking for more benefits after all.

A move off the VEL has to be large enough for customers to notice and attractive enough to make them want to try the repositioned product. Marginal moves often backfire. If consumers do not perceive enough difference to make them switch supplier, but competitors, which follow such moves closely, decide to copy it, the VEL can quickly drop without affecting market shares, but lowering price and profit.

In the case of a company that installed heating equipment, the information that its key competitor had cut the cost of installation labor by 5 percent led it to cut its own price too. Unfortunately, this company did not adequately consider the basis on which architects and contractors compare bids – that is, the total installed costs. The selective 5 percent drop in labor reduced the

Exhibit 10  
**Repositioning off the value equivalence line**



## SEGMENTATION THEORY

In classic marketing and segmentation theory, a segment is defined as a group of customers with identical needs and buying behavior. In theory, all customers constituting a precisely defined segment would be equally receptive to all products positioned anywhere along the VEL. Therefore, all products positioned on the VEL should have the same market share.

In practice, this is clearly not the case. There are two ways to resolve the conflict:

- Define each segment so narrowly that it contains only one customer.

- Define a segment (and the products positioned in it) so that it contains all the realistic and feasible alternatives customers consider for a given purchase, and accept that there will be some differences in buying decisions.

We will take the second approach, as it makes the concepts in this article easier to apply in the messy “real” world, without compromising the quality of the answer.

total installation cost by less than 1 percent – too slight a difference for the market to notice.

Moving off the VEL therefore requires two decisions about the direction and the distance:

◆ **Direction.** What are the customer volume elasticities of moves along the price axis and the benefit axis (by attributes)? Do I want to increase my benefits, lower my price, or both?

◆ **Distance.** How far do I have to move from the VEL to expand my horizon of customers sufficiently? How far do I have to move to differentiate myself from competitors in the eyes of a group of potential customers? How strong will competitors’ reactions be? How many additional benefits can I afford to deliver and what price cut am I willing or able to absorb?

Moving below the VEL is always a risky strategy that can, if executed well, reap some benefits. In many cases, however, too little thought is given to what customers actually want, how competitors will react, and how demand might change as a result of competitors’ moves. This negligence can lead to profit declines where once there were high hopes.

### Using dynamic value management to respond to external changes

Dynamic value management can also be a powerful tool to help prescribe reactions to changes in competitive position or customer needs. A competitor’s actions can set in motion the same set of dynamics. Dynamic value management is as useful in determining reactions to such moves as it is in initiating them.

#### *Competitors’ moves*

Being on the receiving end of a competitive move demands an approach similar to the proactive stance above. It also requires a cool head. If the

salesforce is sending panicky messages about competitive price cuts, pressure is created to act quickly. In most cases, the easiest lever to pull in the short term is price. And in all too many cases, this would be a mistake. A series of thoughtful decisions using the dynamic value-management approach can help formulate a more effective and less costly response. A set of questions should be answered:

- ◆ Do customers perceive the competitor's move as a move off the VEL? To find out, ask the customer. Too often this question is answered hastily and wrongly on the basis of hearsay from the field. If the move is not perceived to be a wholesale jump to a new VEL, there may be no need to react.
- ◆ If the competitor has moved off the VEL, has its "horizon" expanded sufficiently to draw in new customers? If market research shows it has not, again there is no need to react.
- ◆ If new customers are buying the competitor's offering, are they our customers or somebody else's? The answer to this question determines not the need for a reaction, but the speed and extent of it. If the primary threat is to somebody else's customers, let them react. All competitors will be likely to react eventually, but timing is important. A gradual cascade of reactions not only will prevent panicky overreactions, but can also create opportunities to observe informative customer buying behavior.
- ◆ If a reaction is needed, how strong should it be? Should it be a surgical strike on one product, channel, or market, or across the board? Should it entail price changes, benefit changes, or a combination of both?

### *Cyclical markets*

In cyclical industries, the value map can change not only because of competitors' moves, but also because of changes in customer needs over the course of the cycle. The following case illustrates the enhanced challenge of dynamic value management in highly cyclical businesses.

#### *Illustrative case: Pace Paper Company*

The Pace Paper Company produced high-grade paper for business forms, brochures, and corporate annual reports. Pace and its two main competitors, Marco Paper and Valentine Paper, sold directly to large regional and national printing companies. Demand for this high-grade paper tended to vary wildly with the overall economic cycle.

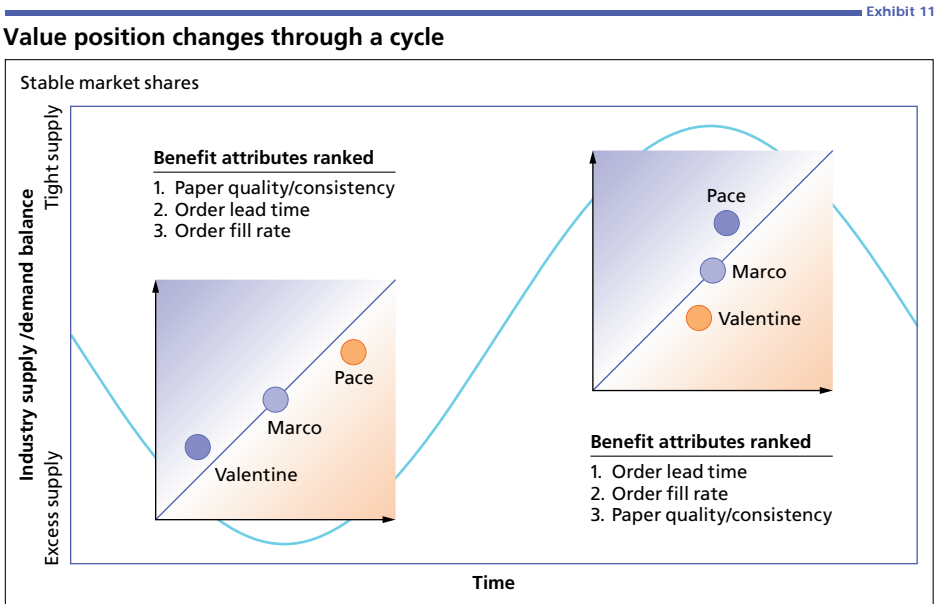
Pace produced paper of unsurpassed quality and consistency and provided equally consistent delivery service. But it found itself gaining market share in down markets when there was excess supply and losing it sharply in times of tight supply. Given its consistency and quality throughout the



## SETTING VALUE, NOT PRICE

economic cycle, Pace could not understand the drastic market share shifts it regularly experienced.

The problem was that while Pace stayed the same, customers changed through the cycle. Exhibit 11 shows the value map for this market at different stages of the cycle. At the bottom of the cycle (when supplies were plentiful),



customers had no problem obtaining enough paper. They therefore demanded high and consistent quality so that printing jobs would run efficiently through their plants with minimum rejects. Order lead times (the number of days between an order being placed and the paper being delivered) and order fill rates (the percentage of the total order carried on the first shipment) did not much matter, since printers usually had ample safety stocks of paper in their own warehouses. Despite being slightly higher priced than Marco and Valentine, Pace's paper quality and consistency were so superior that it was value-advantaged in times of excess supply and gained market share – as shown at the lower left of the value map in Exhibit 11.

As supplies tightened, however, printers often found their stocks depleted. They became increasingly concerned about running out and having to shut down their printing plants temporarily. They therefore relaxed quality and consistency requirements in favor of delivery performance. As the value map at the upper right of Exhibit 11 shows, paper quality and consistency slipped to third place behind order lead time and order fill rate. Valentine Paper could not match Pace's quality and consistency, but its order lead times and fill rates were better than Pace's. The result was that in times of tight supply, Valentine would shift to a position of value advantage (and thus gain market

share), while Pace would slip to a value-disadvantaged position (and, of course, lose share).

Armed with the insights provided by the value maps in Exhibit 11, Pace's managers embarked on a project to determine how they might improve their order lead times and fill rates in times of tight supply. They discovered that if they relaxed their product consistency slightly (in a way that was almost imperceptible to customers), they could increase plant throughput enough to cut order lead times, increase order fill rates, and return to value equivalence in tight markets. When supplies loosened, Pace reverted to its original level of paper consistency to reinforce its traditional value-advantaged position. This fine-tuning over the course of market cycles enabled Pace to maintain its share in tight markets without cutting prices or jeopardizing future positioning in down markets.

## Looking ahead

With product life cycles shrinking (measured in months rather than years in the computer industry, for instance), customers becoming more sophisticated and demanding, and tougher local and even global competitors emerging in most markets, value maps are shifting at faster rates than ever. Fortunately, advances in market research techniques make the execution of effective dynamic value management easier than ever.

The discipline of dynamic value management not only promotes sustainably improved market performance and profitability, but also yields a number of attractive side benefits, including:

- ◆ More genuine closeness to customers, thanks to a richer, more externally driven understanding of the benefit attributes that really matter to customers
- ◆ An enhanced understanding of competitors: their strengths in the eyes of customers, their strategies, and their likely reactions to price and benefit moves by your company
- ◆ More integrated product/market strategy formulation, where the linkages between price, benefit delivery to customers, competitor capabilities, and changing customer preferences are explicit.

The payoff for getting dynamic value management right has probably never been higher; the consequences of getting it wrong, never more devastating. For a growing number of companies, dynamic value management is providing a compass for navigating the increasingly unstable seas of change and uncertainty that challenge most marketers today. 