VALUE FIRST THEN PRICE

QUANTIFYING VALUE IN BUSINESS-TO-BUSINESS MARKETS FROM THE PERSPECTIVE OF BOTH BUYERS AND SELLERS

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.

Ralph A. Oliva, Director, *Institute for the Study of Business Markets and Professor of Marketing, Smeal College of Business, Penn State University, USA*

EDITED BY ANDREAS HINTERHUBER AND TODD C. SNELGROVE

ROUTLEDGE

Value First then Price

Value-based pricing—pricing a product according to its value to the customer rather than its cost—is the most effective and profitable pricing strategy. Buyers need to evaluate the monetary benefits of a product against the price of its competitors. Sellers justify their price points through documenting the value of a product, emphasizing its superiority against competitors and therefore justifying the premium price.

Value First then Price is an innovative collection which proposes a quantitative methodology to value pricing, and road-tests this methodology through a wide variety of real-life industrial cases. It provides a state-of-the-art and best practice overview of how leading companies quantify and document value to customers. In doing so, this book provides researchers with a method by which to draw invaluable data-driven conclusions, and sales and marketing managers the theories and best practices they need to quantify the value of their products to demanding, hard-nosed industrial purchasers.

With contributions from global industry experts this book provides cutting edge research on value quantification and value quantification capabilities with real-life, practical examples. It will be essential reading for sales and pricing specialists as well as business strategists, in both research and practice.

Andreas Hinterhuber is a Partner of Hinterhuber & Partners (www.hinterhuber.com) and a Visiting Professor at the University of Bolzano, Italy. He has led consulting projects in pricing in B2B and B2C companies worldwide, including Lufthansa, Tieto, International Paper, Continental, SPX, Fercam, Swarovski, Würth-Hochenburger, Ecolab, British American Tobacco, and many others. He has published articles in *Industrial Marketing Management*, *Long Range Planning*, *MIT Sloan Management Review*, *Journal of Strategic Marketing*, *Business Horizons*, and other journals.

Todd C. Snelgrove is the Global Vice President of Value at SKF and supports executive MBA classes at Northwestern University, London Business School, and the International Institute for Management Development. He has been the lead architect and driver in SKF's Value Quantification journey.

First published 2017
by Routledge
2 Park Square, Milton Park, Abingdon, Oxon OX14 4RN

And by Routledge
711 Third Avenue, New York, NY 10017

Routledge is an imprint of the Taylor & Francis Group, an informa business

British Library Cataloguing in Publication Data
A catalogue record for this book is available from the British Library

Library of Congress Cataloging in Publication Data
Names: Hinterhuber, Andreas, editor. | Snelgrove, Todd, editor.
Title: Value first then price: quantifying value in business to business markets from the perspective of both buyers and sellers / edited by Andreas Hinterhuber and Todd C. Snelgrove.
Description: Abingdon, Oxon; New York, NY: Routledge, 2017. | Includes bibliographical references and index.
Identifiers: LCCN 2016014896 | ISBN 9781138101623 (hardback) | ISBN 9781138101630 (pbk.) | ISBN 9781315656816 (ebook)
Subjects: LCSH: Pricing. | Value. | Industrial marketing.
Classification: LCC HF5416.5 .V35 2017 | DDC 658.8/04—dc23
LC record available at https://lccn.loc.gov/2016014896

ISBN: 978-1-138-10162-3 (hbk)
ISBN: 978-1-138-10163-0 (pbk)
ISBN: 978-1-315-65681-6 (ebk)

Typeset in BemboStd
by codeMantra

Contents

1 Introduction

Quantifying and documenting value in business markets

Andreas Hinterhuber and Todd C. Snelgrove

The essential challenge that sales and marketing managers in industrial markets face is this: converting their firm's own competitive advantages into quantified, customer-specific value. Doing so enables B2B sales and marketing personnel to justify a difference in price between two 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 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).

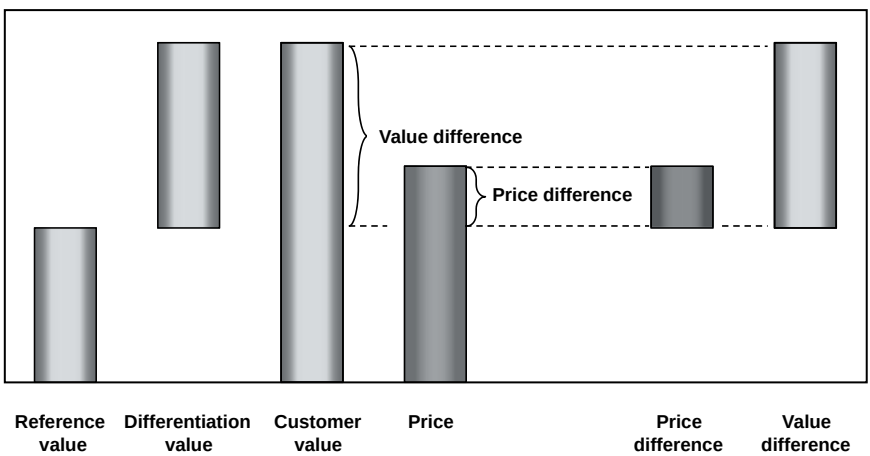


Figure 1.1 Value quantification and value-based pricing.
Source: Hinterhuber & Partners

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, monetized value outlined.

Value quantification is arguably the most important capability in B2B selling. It is also a capability that many companies in industrial markets lack (Anderson, Kumar, and Narus 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, Boston College, Aalto University, the University of Tennessee, Karlsruhe Institute of Technology, Deloitte, and Hinterhuber & Partners, and practitioners from companies including SKF, DHL, 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, sellers must quantify value before discussing price with customers. Second, buyers focusing primarily on price miss out on opportunities to create value with customers. Buyers and sellers in business markets must focus first on value, then on price, in order to create value with suppliers and customers.

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. While value quantification for industrial sellers is its key focus, several chapters explore how industrial purchasing managers benefit from purchasing based on value, as opposed to purchasing based on unit price or total cost of acquisition. As procurement tries to become a trusted advisor to its internal clients it must demonstrate the value it brings the business. Hoping that price savings materialize and hit the bottom line has proven not to drive the desired benefits. Procurement must help evaluate which supplier can deliver the most sustainable value.

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.

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). This interview specifically discusses how to apply the eight-step model (Kotter 1995) to pricing and value quantification in order to successfully lead organizational change management efforts.

In the subsequent interview, "Muddling through on customer value in business markets?," *Todd C. Snelgrove* and *James 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 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.

"Part III—Selling value: Best practices in value quantification" contains three chapters highlighting the capabilities and practices of companies that excel in value quantification. In "Value quantification—Processes and best practices to document and quantify value in B2B," *Andreas Hinterhuber* presents the results of an empirical survey 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 that 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 the new holistic business term Total Profit Added™ as a better measurement for both buyer and seller on dollars and value created. This takes into consideration much more than cost reductions, but also includes

benefit improvements. The chapter also illustrates vividly the difference between a given price savings and Total Profit Added™ savings of equal amount. If total cost of ownership savings occur year after year and if price savings occur just once, then the effect of the former will by far outweigh the benefits of the latter.

In "Best practices for defining, 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 also 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. The procurement function is the topic of the subsequent section.

"Part IV—Buying on value: Value quantification and B2B purchasing" contains several chapters about buying based on total cost or total value of ownership as opposed to buying based on price.

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 commonly held assumptions, the authors 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, total cost of ownership, 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. Total cost of ownership calculations consider supplier direct costs, supplier indirect costs, and a premium/discount reflecting the supplier's risk. This approach, however, has drawbacks (Piscopo, Johnston, and Bellenger 2008; Snelgrove 2012). Total cost of ownership calculations do not consider the value of tangible (revenue improvements) or intangible (brand value, reputation, competencies) benefits. Total value of ownership calculations (Snelgrove 2012), value quantification tools (Hinterhuber 2015), or best value approaches allow the inclusion of both tangible

and intangible benefits. 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; 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, 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," *Matthias Heutger* and *Andreas Hinterhuber* 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," *Pascal Kemps* and *Andreas Hinterhuber* discusses 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 key performance indicators. The latter 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, Narus, and Van Rossum 2006)—yields insights into 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 article 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* make a case for value quantification via the customer value proposition also 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 the final chapter, "A call to action: Value quantification in B2B buying and selling," by *Todd C. Snelgrove.* The author 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.

REFERENCES

Anderson, J. C., Kumar, N. and Narus, J. A. (2007) Value Merchants: Demonstrating and Documenting Superior Value in Business Markets, Boston, MA: Harvard Business School Press.

Anderson, J. C., Narus, J. A. and van Rossum, W. (2006) "Customer value propositions in business markets," *Harvard Business Review 84*(3), 90–99.

Heath, C., and Heath, D. (2010) Switch: How to Change Things When Change Is Hard, New York: Random House.

Hinterhuber, A. (2015) "Value quantification—The next challenge for B2B selling." In A. Hinterhuber and S. Liozu (Eds.), Pricing and the Sales Force (pp. 20–32), New York: Routledge.

Keller, S. and Price, C. (2011) Beyond Performance: How Great Organizations Build Ultimate Competitive Advantage, Hoboken, NJ: Wiley.

Kellogg, K. C. (2008) Not Faking It: Making Real Change in Response to Regulation at Two Surgical Teaching Hospitals, Working Paper, MIT Sloan School of Management.

Kotter, J. P. (1995) "Leading change: Why transformation efforts fail," *Harvard Business Review* 73(2), 59–67.

Nagle, T. T. and Holden, R. K. (2002) The Strategy and Tactics of Pricing: A Guide to Profitable Decision Making (3rd ed.), Englewood Cliffs, NJ: Prentice Hall.

Piscopo, G., Johnston, W. and Bellenger, D. (2008) "Total cost of ownership and customer value in business markets," *Advances in Business Marketing and Purchasing* 14, 205–20.

Sinha, I. and DeSarbo, W. S. (1998) "An integrated approach toward the spatial modeling of perceived customer value," *Journal of Marketing Research* 35(5), 236–49.

Snelgrove, T. (2012) "Value pricing when you understand your customers: Total cost of ownership—past, present and future," *Journal of Revenue & Pricing Management* 11(1), 76–80.

Töytäri, P. and Rajala, R. (2015) "Value-based selling: An organizational capability perspective," *Industrial Marketing Management* 45, 101–12.

2 Interview

Processes and capabilities for value quantification

Andreas Hinterhuber and Robert Russell

ROBERT RUSSELL: Andreas, you've been working with companies for many years on pricing. What's the first thing you do when you have a new client?

ANDREAS HINTERHUBER: I have a lot of respect for the medical profession: Excellent consultants are like doctors—they improve the lives of their clients. The most important part in this process is diagnosis. If we get the diagnosis wrong, even the best, scientifically most advanced treatment will lead nowhere.

ROBERT RUSSELL: How do you apply this insight to the world of pricing?

ANDREAS HINTERHUBER: Over the past years, we at Hinterhuber & Partners have invested a very substantial amount of time and intellectual effort to develop state-of-the-art diagnostic instruments in pricing. We use rigorous pricing tools and checklists to analyze what we term the "3Cs": customers, competitors, and the company itself. To understand customers we use the customer needs profiler to gain relevant insights; to understand and map competitors we use the competitive advantage profiler. To understand the client company we use the competitive advantage profiler and our value quantification tool. We further assess company pricing capabilities via a scale, PRICECAP, that we've developed, and we map all processes that involve pricing decisions, typically the sales process in B2C and the offer development process in B2B. We complement this with structured interviews with key executives in marketing, sales, and pricing; with interviews with customers and distributors; and with an analysis of company documents on profitability by product, sales rep, region, customer, and segment. This provides us with, first, very important insights about the current situation of the client …

ROBERT RUSSELL: … but does not yield any specific insights related to pricing?

ANDREAS HINTERHUBER: Correct, in principle. To understand why, we have to remember that pricing decisions are usually the result of a chain of prior decisions, typically either horizontal chains, i.e., different departments within an organization, or vertical chains, i.e., different hierarchical levels. We cannot improve pricing by changing prices. We have to work on the chain of effects to understand which prior decisions, which structural configurations, or which other elements influence the effectiveness of pricing.

ROBERT RUSSELL: Maybe you could provide an example to illustrate this point.

ANDREAS HINTERHUBER: We recently completed a pricing project with a German B2B company with sales in excess of €5 billion. As part of the diagnosis, we mapped the key processes where pricing decisions were made. The key process in B2B is, as mentioned, the offer development process—most industrial companies have a similar process in place that covers the following seven elements: generation of customer insights, identification of market opportunities, evaluation of market opportunities, offer development, quotation, negotiation, and, finally, offer delivery. Figure 2.1 provides an overview.

The client illustrated in Figure 2.1 had an offer development process in place, but the analysis revealed that profitability suffered as a result of a poor design on nearly all elements in this process.

Customer insights, for example, were not shared between sales managers and regions, so the salesforce was perceived as out of sync by some customer segments. Likewise, executives did not systemically collect, let alone share, information on price levels or offer configurations of competitors.

Sales managers responded passively to requests for proposals rather than actively developing new markets and cross-selling new products to existing customers.

Sales managers used revenues and not gross margins to evaluate market opportunities, meaning that the company's best available technical talent was regularly assigned to large but unprofitable deals.

Also, the offer development reflected what salespeople thought customers wanted instead of taking customer insight to develop the value proposition; solutions were thus frequently over-engineered or quoted at rock-bottom prices unnecessarily.

Quotations were strictly done on a cost-plus basis: the company had a pricing tool, which upon close inspection was nothing but a revamped costing tool. Sales managers thus did not have the capabilities or tools to incorporate considerations on customer value—how much customers were willing to pay—into the price quotation. Furthermore, there was no follow-up on quotations the company did not win: sales managers could not indicate, even if

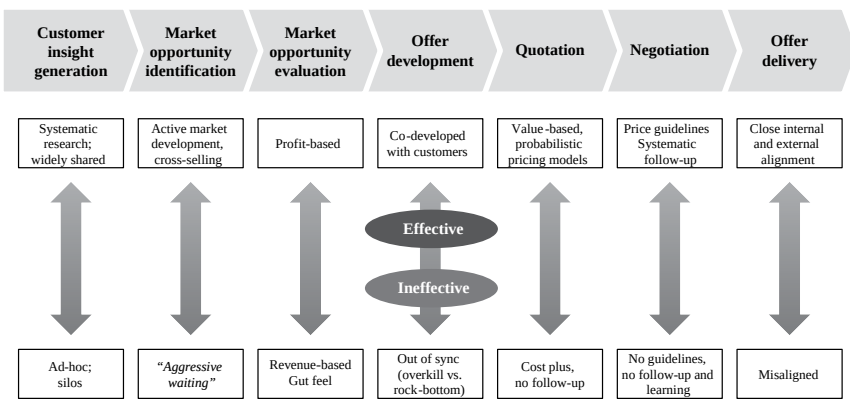


Figure 2.1 The offer development process in B2B: Effective and ineffective practices.
Source: Hinterhuber & Partners

they wanted to, why any given tender was lost. To state it clearly, best-practice companies understand why deals are lost and analyze the relative frequency of, for example, reasons related to product, price, availability, relationship, quote speed, project cancellation, service, or quality. This win/loss analysis is a fundamental part of improving pricing in competitive bidding situations, but it was completely absent in this case.

Negotiations were sometimes ineffective, simply because sales managers did not know how to sell and price-out supplementary services to customers. Furthermore, discounting guidelines did not exist: sales managers were simply encouraged to "do their best" to sell at list prices, but there was no follow-up, no learning, and no improvement in net price realization. In this process alone, our analysis identified several million € in profit improvements.

Delivery was the only element in this process that worked really well—that was the only part in the process we recommended not to touch at this stage.

In summary: in order to drive profits via pricing, we frequently need to examine the entire chain of effects, and in this case the offer development process was probably the single best starting point. While this situation is unique, I would contend that the quality of the diagnostic part is a fundamental aspect of all pricing projects.

ROBERT RUSSELL: What specific improvements in the area of pricing do you then implement?

ANDREAS HINTERHUBER: In 2012, we published an article in the *MIT Sloan Management Review,* "Is It Time to Rethink Your Pricing Strategy?" This article distinguishes between "price setting" and "price getting": combining these two elements gives us our pricing capability grid (see Figure 2.2; Hinterhuber and Liozu 2012).

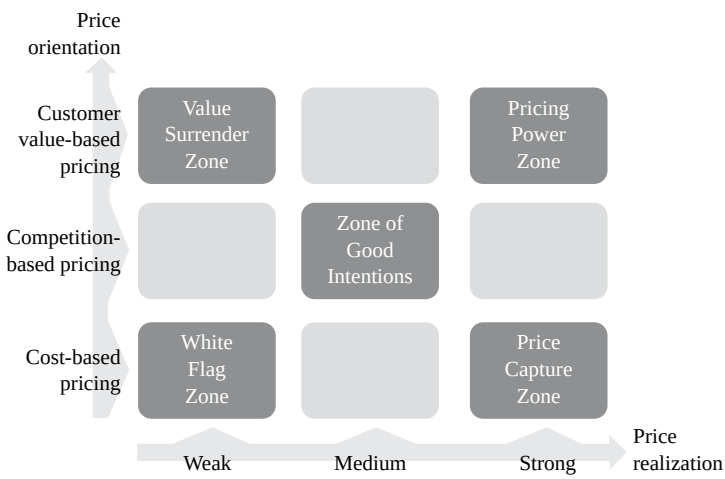


Figure 2.2 The pricing capability grid. Reprinted from A. Hinterhuber and S. Liozu, 2012, "Is It Time to Rethink Your Pricing Strategy?" *MIT Sloan Management Review* 53(4), 69–77. © 2012 from MIT Sloan Management Review/Massachusetts Institute of Technology.

Price setting refers to the different approaches companies use to determine selling prices: cost-based pricing, competition-based pricing, and customer-value-based pricing. Price getting refers to different abilities to actually get the price set out in the first place: some companies are very good at realizing their list prices, via, e.g., value communication, customer value quantification, or price controlling. Other companies are less effective, and prices erode as a result of poor negotiation, poor value communication, or weak price-realization capabilities. Salesforce incentives may play a role as well.

We use this framework to map where our clients stand today—that is, where they stand today in terms of price setting and price getting—and we use this framework to jointly define a one- to two-year target: together with senior executives we define where the company as a whole should be in terms of price setting and price getting. This typically leads to very specific actions and projects in these two areas.

ROBERT RUSSELL: Does pricing need to be customer-specific?

ANDREAS HINTERHUBER: Yes. Many companies have pricing processes that are, counterintuitively, both too rigid and too flexible. Too rigid, because many companies basically have a one-size-fits-all pricing strategy. Too flexible, because there are too many price exceptions.

On the former: Take the case of how airline companies set ticket prices until about 30 years ago. They sold tickets like bus companies sell tickets today: one price for one destination. And this, of course, fails to capture the value that different customer segments may place on a ticket. For some, value means evening return flights; for others it may mean flexibility, or service quality, or status miles. Today the airline companies use an understanding of customer willingness to pay in order to set prices differently based on differences in value provided to their customers. Revenue management is, of course, practised nearly universally by the airline industry, and it is a key contributor to profitability also in a number of other industries, like the hotel industry, the rental car industry, and even in some B2B contexts. So, yes, pricing needs to be customer-specific and thus flexible.

But pricing needs an element of rigidity as well: we need rules, guidelines, and policies. Tom Nagle—a pioneer in pricing—defines pricing criteria as the requirements that customers or orders must meet in order to qualify for lower prices (see Nagle and Holden 2002). The key insight is this: sales managers implement pricing policies, but they cannot have primary responsibility for defining these policies in the first place. In this respect and in this respect only, pricing needs to become more rigid, especially in B2B companies where prices are generally negotiated.

ROBERT RUSSELL: You were asked at a recent event at the Institute of Chartered Accountants of England and Wales (ICAEW) about service pricing. Services account for 60% to 80% of GDP in advanced economies. Services do have specific traits which may pose challenges for pricing. The value may be intangible. Determining relevant costs is frequently arbitrary. So in many service industries the hourly rate is frequently the dominant pricing approach, be it

in law firms, advertising agencies, or even top-tier management consultancies like McKinsey, BCG or Hinterhuber & Partners. But you suggested, then, that this was an outmoded method. How easy would it be to go into a company and suggest that they radically reform their pricing? This may mean, of course, massive cuts to their costs.

ANDREAS HINTERHUBER: This question is excellent because it implies that changing pricing practices involves far more than changing list prices. I agree: Changing pricing practices is, in many cases, a case for a true organizational transformation. It's a bit like changing the company DNA. Pricing is part of the company culture, and changing pricing practices requires a change in capabilities, in culture, in structure, in incentive systems, and in how the company interacts with customers.

This applies also to the change from hourly rates to value-based or outcome-based pricing. Any company aiming to change from cost-based to value-based pricing is well advised to treat this change as a true organizational change management program. Here, the eight-step change model of Kotter (1995) can provide a useful framework for kick-starting this organizational transformation related to pricing (see Figure 2.3).

Companies need to establish a sense of urgency, they need to form powerful guiding coalitions, and they need to establish a compelling vision. They also need to communicate this vision, remove the inevitable obstacles to change, and they need quick wins able to demonstrate that pricing works. Companies need to build on these quick wins and they need to, finally, institutionalize the new approach to pricing in their culture.

	MAIN STEPS	KEY ACTIVITIES
1	Establishing a Sense of Urgency	Examining competitive realities Identifying crises or major opportunities
2	Forming a Powerful Guiding Coalition	Assembling a group with enough power Encouraging the group to work together
3	Creating a Vision	Creating a vision to direct the change Developing implementation strategies
4	Communicating the Vision	Using every vehicle to communicate Teaching new behaviors by example
5	Empowering Others to Act on the Vision	Eliminating obstacles; changing structure Encouraging risk taking
6	Planning for and Creating Short-Term Wins	Planning and creating key improvements Rewarding employees involved
7	Consolidating Improvements and Producing Still More Change	Using increased credibility to changing structures that don't fit; adding projects
8	Institutionalizing New Approaches	Articulating the connections between the new behaviors and corporate success

Figure 2.3 The eight-step change model.
Source: Kotter, 1995

A change in pricing practices is an organizational change management program. As such, it needs CEO support. In a recent research project (Liozu and Hinterhuber 2013), we polled 358 CEOs of mostly medium-sized companies and documented that CEO championing of pricing leads to both increased pricing capabilities and improved firm performance in industrial firms. CEOs thus can play a very important role by acting as champions of pricing and the pricing function. This is something that few companies have fully understood.

ROBERT RUSSELL: If I were, say, a lawyer delivering a service at a rate per hour and if I had an existing customer who was used to paying so many thousand pounds a year who then said, "Okay, we want you to tender now," and I said, "Okay, I'll give you value added," how would I know the value?

ANDREAS HINTERHUBER: There is one golden rule. If you are a lawyer you should not ask what you do for your client. What you should ask is what the client is able to do as a result of working with you—as opposed to working with your closest competitor. You have to ask what your competitive advantage is incrementally worth to customers in monetary terms. In your example, this lawyer could thus tie the professional fees to quantifiable outcomes, jointly defined with clients: relevant outcomes could be the level of compliance achieved, lawsuits won, or other indicators which matter to clients.

I need to make one point clear. Value-based pricing requires differentiation. One of my favorite quotes—our clients say that we actually coined this quote—is "If you are not perceived as being different, you will be benchmarked on price." So the idea that you can define outcomes, implement value-based pricing for standardized, fully commoditized products or services, is wrong. Although I strongly believe that commodities do not exist, I do recognize that, in any industry, there may be products or services where differentiation is not economically feasible, at least not in the short term. Take a supply contract for a ton of standard-grade office paper. In these or similar cases, after a conscious decision on whether or not to participate in a bid, I suggest reverting to competitive pricing, adjusted to reflect differences in offer quality, if relevant.

ROBERT RUSSELL: Microsoft has decided that Internet Explorer is basically dead. So, they're going to kill it off metaphorically and replace it with a new interface for the Internet to compete more effectively with Chrome. So the point is: some companies may have to decide that their product line does not have value.

ANDREAS HINTERHUBER: Fair observation.

ROBERT RUSSELL: I don't suppose they would call you in and you would say there's no point to have a price for this because it has nothing left.

ANDREAS HINTERHUBER: I think I would make two observations. End-of-life-cycle pricing frequently allows price increases. Take the pharmaceutical industry as one, representative, example: once a product goes off patent and before literally dozens of generic competitors rush to the market, the patent holders increase the price. A back-of-the-envelope calculation with the three variables *contribution margin, break-even sales analysis,* and *post-patent price elasticity* shows

that pharmaceutical companies lose more margin by dropping prices than they do by increasing prices. This pattern holds, I suspect, also in other situations where products reach the end of their life cycle and where a small but loyal segment of customers exists.

The other, equally important observation is that killing products is a necessary component of good management practice. Most companies do this too late. Many companies make the mistake of carrying a large product portfolio, which of course also carries the risk that salespeople focus then on the wrong products. And so it takes courage to ask "Where am I truly competitive? In which areas am I able to deliver outstanding value?" It takes courage to then say, "Okay, I withdraw from products or segments A, B, and C because this is not where I want to be in the future and instead I do something else."

ROBERT RUSSELL: There is an example in Britain of a brewing company. They used to make beer, and now they run coffee shops and hotels. So, they killed off their entire product. I find that extraordinary. That they reinvented themselves, presumably by looking at the profitability of beer and the profitability of coffee and deciding that this is a better way to go. But that kind of radical reform isn't something that many companies do.

ANDREAS HINTERHUBER: Yes.

ROBERT RUSSELL: I don't even know if that—I mean I know that if a company calls you in, that means that they are looking at—I don't suppose then they have already made the decision. And maybe the companies don't call you in.

ANDREAS HINTERHUBER: Interestingly, we are called in also at an early stage where companies truly want to understand their strategic direction, including the strategic direction of pricing for the future. And in this case, articulate, analytical, and independent thinkers can be quite helpful. Since we are not attached to a company's history and we don't fully understand the politics, our only concern is the future, and maybe that is an advantage.

ROBERT RUSSELL: Many companies, both in B2B and B2C, struggle when having to set prices for innovations, especially when these innovations are radical.

ANDREAS HINTERHUBER: The pricing of innovations is a particularly interesting and challenging area—simply because for true breakthrough innovations there is no reference value, there is no benchmark against which to compare a new product.

ROBERT RUSSELL: How do you set prices for breakthrough innovations?

ANDREAS HINTERHUBER: We unbundle first, and we aim to increase the perceived value with a strategic approach to pricing in a subsequent step. First we decompose the innovation into the three or four benefits delivered and determine customer willingness to pay for each of these component benefits. This approach, summing customer willingness to pay for the components and adjusting the sum for any interactions if relevant, allows us to quantify customer willingness to pay for breakthrough innovations very, very accurately.

An example will illustrate the principles: A few years ago a major, global tobacco company approached Hinterhuber & Partners ahead of a planned new product launch: a smokeless cigarette. This product is tobacco-based, thus satisfying smokers' cravings, but it does not emit smoke, thus consumable wherever

smoking restrictions apply. We used ethnographic research to understand how this new product could fit into the lifestyles of current customers. This research indicated that the most likely, closest substitutes for this new product were energy drinks and coffee, which potential customers consumed when smoking was not an option and when they felt in need of a boost. This insight and a bit more research, some modelling, and a few other steps allowed us to attach a very precise price point to a product which can be considered a major, potentially breakthrough, innovation: this process allowed us to substantiate that willingness to pay for this innovation was closer to the price levels of energy drinks or coffee than to the price of a single cigarette.

The second step in pricing breakthrough innovations is a conscious effort to increase customer willingness to pay. In a recent article (Hinterhuber 2015) I highlight how companies can favorably influence customer perceptions of value and price without actually lowering the price. Understanding the psychological elements of pricing, understanding how customers perceive prices, allows companies to create and raise customer willingness to pay. Examples of companies that have a superb understanding of the psychological effects of pricing in order to increase customer willingness to pay are Apple in B2C or Xerox and Monsanto in B2B.

Figure 2.4 provides the full overview of how companies can use an understanding of consumer psychology to increase customer willingness to pay.

ROBERT RUSSELL: That is brilliant, and I would like to ask another question. Let us discuss retail pricing. Take food or apparel retailers in the United Kingdom: Many of them are struggling because they are trying to justify the price differences they inevitably have over competing retailers. I think all these companies are now seeing massive changes to the way that customers behave. And I know that I wouldn't like to say this, but everyone will face it at some point: If people don't look at their pricing during times of calm, they may be forced to make radical changes during times of radical change.

ANDREAS HINTERHUBER: This, Robert, is a quotable quote indeed. Executives would be well advised to remember this. I agree: Once you enter rough waters, you lose degrees of freedom. So the best time to change your pricing strategy is when you don't have to.

ROBERT RUSSELL: What are some of these changes in retail pricing?

ANDREAS HINTERHUBER: One is a thing called the Internet, clearly. For retailers this requires a rethink away from standard, fixed mark-ups to mark-ups that reflect the incremental value that store-based retailers provide. When this value is there—because of services, warranties, immediate product availability, assortment—there are margins. When value is absent, margins go as well. The other change is the adjustment of prices based on the role that any given product plays for the customer. Products bought on impulse or as complements allow pricing freedom. Products that customers use to evaluate the overall price attractiveness of a retailer or products where price awareness is high require a different—frequently an aggressive—approach to retail pricing.

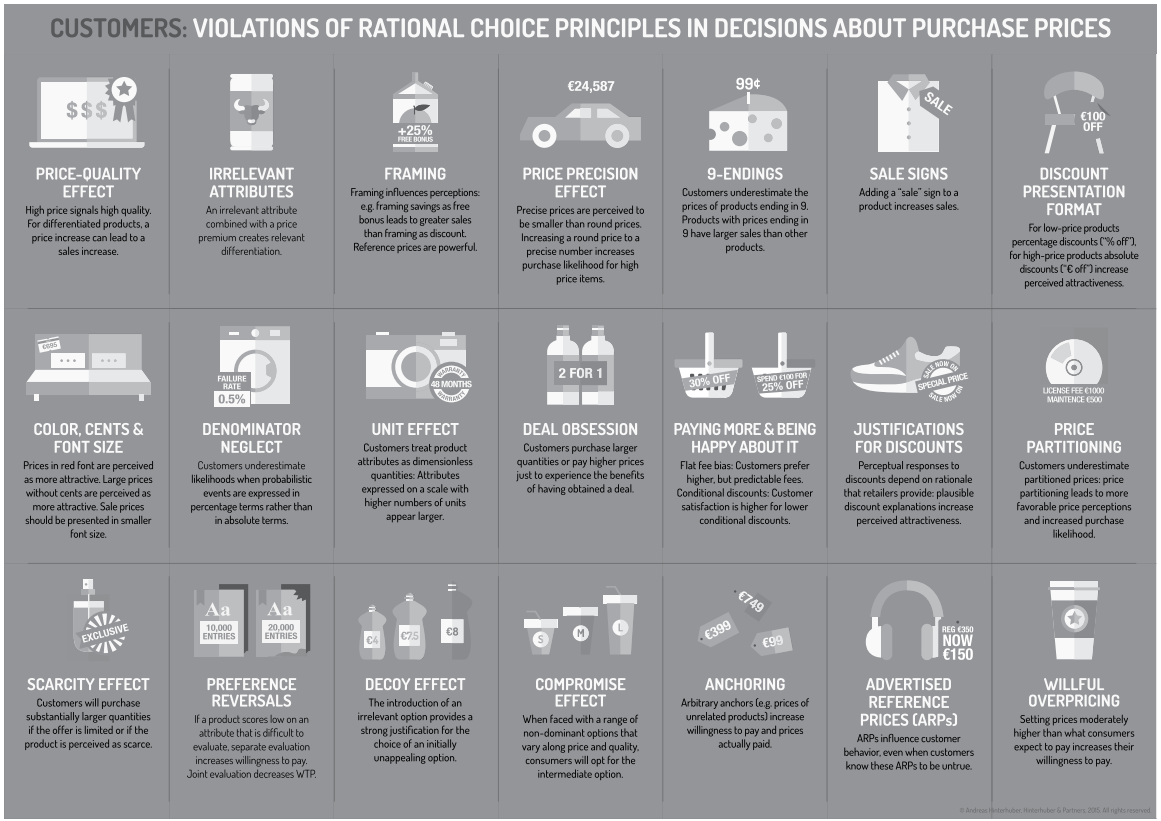


Figure 2.4 An overview of the psychological effects that shape customer perceptions of value and price. Reprinted with permission from A. Hinterhuber, 2015, "Violations of Rational Choice Principles in Pricing Decisions," *Industrial Marketing Management* 47, 65–74. Copyright Elsevier 2015, all rights reserved.

Best-in-class retailers understand very well the role that any given product plays for customers and adjust prices accordingly.

Next is the disappearing middle ground. In many industries we see that the middle ground—companies that are neither the low-cost nor the most-differentiated suppliers—come under pressure, from both the low end and the high end. These companies are not well positioned, and this has a direct reflection on their pricing strategy.

Take the car industry: Opel lost market share both to low-end Korean manufacturers and to high-end, premium car manufacturers. Similarly, in retailing, growth is happening largely at the extreme ends of the markets, in the low price bracket and the premium price segment.

ROBERT RUSSELL: What are the implications for pricing?

ANDREAS HINTERHUBER: The implications are relatively straightforward: Many apparent pricing problems are in reality positioning problems. Companies need thus to understand their strengths and weaknesses, as perceived by customers. They need to understand how much value they create for their customers, as perceived by their customers, and not, I emphasize, how much value senior managers think these companies create for their customers. Once they have clarity on their competitive advantages and the monetary value of these competitive advantages to customers, then we can explore pricing.

And it also links back to what we said before about pricing as the last decision in a chain of prior decisions. For a company such as Marks & Spencer, for example, to change their pricing strategy would probably be ridiculous. They may need to change their pricing, but first they need to change a whole range of other elements in their customer value proposition: probably assortment, maybe store layout, selection, services, loyalty cards, etc. And only after the senior leadership team has established a compelling value proposition—including an understanding of customer willingness to pay—will the time be right to explore adjusting the pricing strategy.

ROBERT RUSSELL: What are some of the emerging issues you see in pricing?

ANDREAS HINTERHUBER: Over the past five years, Hinterhuber & Partners has completed a major research project investigating how companies quantify their value proposition. For many companies the capability to quantify value is the single area where improvements are needed most. Our research also suggests quite clearly that those companies with the most developed capabilities to quantify the value proposition to customers in monetary terms are also the companies that outperform their competitors in profits and sales growth.

On top of the agenda of any B2B senior sales or marketing manager worth her salt is the question of tools, processes, and capabilities to document and quantify value to customers. And this, I think, really is the litmus test of pricing.

ROBERT RUSSELL: You suggest that the ability to quantify value is the true indicator of whether or not companies are truly good at pricing?

ANDREAS HINTERHUBER: Yes. We have to remember that the most important feature of selling in industrial markets is the need of sellers to quantify value:

selling in industrial markets requires the ability to document in monetary terms ($/€/£/¥) how much incremental profit a proposed product or service delivers over the customer's next-best alternative.

Buying and selling in industrial markets is thus increasingly akin to performing ROI calculations. Buyers evaluate the monetary benefits against costs and prices of competing offers. Sellers justify any price premium by documenting that the quantified value to customers is substantially larger than any price premium over the customer's best available alternative.

Surprisingly, very few suppliers have developed the capabilities to quantify and document value. Most suppliers in industrial markets sell features, specifications, or benefits: they struggle to convert their competitive advantage into quantified customer benefits.

ROBERT RUSSELL: Your research suggests that the industrial purchasing function is increasingly forcing companies in B2B to quantify value?

ANDREAS HINTERHUBER: Yes: This is the simple answer with far-reaching consequences. Take SKF, a Swedish company with about €8.5 billion in sales and a leading supplier of industrial bearings and other equipment to the automotive and machinery industry. SKF is operating in a heavily competitive industry, and the company's product range frequently carries a price premium of 20% to 50% over the customer's best available alternative. Yet, SKF is thriving in this industry, with profitability and growth levels substantially higher than its direct competitors. How does SKF do this? SKF has established a function, led by Todd C. Snelgrove, Global VP of Value, in charge of documenting and quantifying value to customers.

Take the following example (see Figure 2.5). SKF uses a value calculator to document to customers that the product of SKF, sold at a premium of 50% over the customer's next-best alternative, is delivering monetary benefits that substantially exceed this price premium (Hinterhuber and Snelgrove 2012).

Industrial bearings are, for the layperson, commodities: apparently interchangeable steel products. SKF is able to document to customers that, despite a substantial price premium over the next-best available product, customers end up paying less and being better off by purchasing from SKF.

ROBERT RUSSELL: This is fascinating.

ANDREAS HINTERHUBER: Marketing, pricing, and sales managers in B2B should take notice: if SKF is able to quantify the value of industrial bearings, so should other companies with products that are frequently even more differentiated than those of SKF.

ROBERT RUSSELL: So you suggest pricing in B2B is all about value documentation and quantification?

ANDREAS HINTERHUBER: At the risk of over-simplification, yes. This is the area where I see a huge investment of many companies in B2B. This investment is directed at equipping their salesforce with the capabilities, the tools, the processes, and the value calculators which enable them to quantify and document value to their customers. And in the past, this was clearly not the case. In the past, the traditional approach was, if we play out the example above: my asking

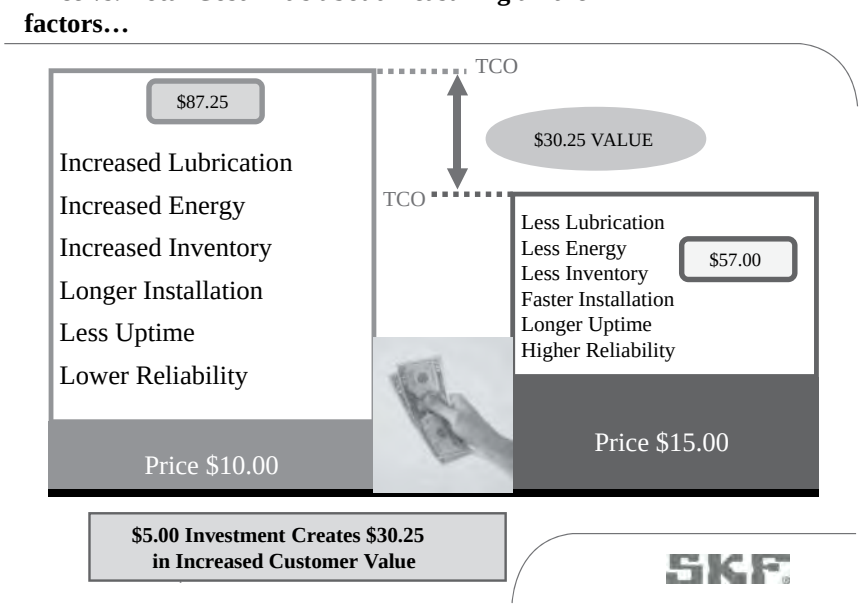


Figure 2.5 SKF case study: A best-practice example of quantifying and documenting customer value.
Source: SKF

price is 15, the competitor is 10, so we meet somewhere in the middle around 12 and we both walk home happy.

Best-in-class companies, such as SKF, DHL, HP, Maersk, SAP, Tieto, Metso, Grainger, Monsanto, pharmaceutical companies, and others do not sell like this anymore. Those days are gone. All these companies have developed tools and processes to convert their competitive advantages into quantified customer value. This increases both profits and customer satisfaction.

What SKF today does is this: the price premium is 5 over the customer's best available alternative, but the company documents, quantifies, and guarantees to customers that the incremental value to customers is 30. The sales message is: It would be an error of omission not to buy the more expensive product since the most expensive product actually costs less. So, SKF phrases this as an investment: "You, hard-nosed purchasing manager, would be doing your company a disservice by purchasing the lower-price product because it would cost you more."

Today and, I would contend, in the future, leading-edge B2B companies will equip their salespeople not only with the confidence, but also with the tools—e.g., value calculators and value quantification tools—that empower them to convert competitive advantages into quantified monetary customer value. The tools and the confidence will help the salesforce resist customer pressure for lower prices.

ROBERT RUSSELL: Many companies struggle to defend their price premiums vis-à-vis Chinese suppliers, for example …

ANDREAS HINTERHUBER: … and the only remedy is investments to develop capabilities and tools to quantify value. As a result of this research, for example, we have built up a database of well over 100 customer value calculators that B2B companies actually use to document and quantify value to their customers. The insights gathered during this research have enabled us to develop our own value quantification tool (VQT) which, in the eyes of a senior vice president of purchasing at a €10 billion B2B company, is today the globally most advanced tool for quantifying value to customers. So I would contend that, at least for some B2B segments, competition comes down not only to the quality of products and services but also to the quality of thinking that enables the sales manager to justify price premiums to customers.

ROBERT RUSSELL: Andreas, thank you. I think we've covered a number of key issues in pricing. That's brilliant. I enjoyed our conversation.

ANDREAS HINTERHUBER: Very well; thank you likewise, Robert.

REFERENCES AND FURTHER READING

Hinterhuber, A. (2015) "Violations of rational choice principles in pricing decisions," *Industrial Marketing Management* 47, 65–74.

Hinterhuber, A. and Liozu, S. (2012) "Is it time to rethink your pricing strategy?" *MIT Sloan Management Review* 53(4), 69–77.

Hinterhuber, A. and Liozu, S. (2014) "Is innovation in pricing your next source of competitive advantage?" *Business Horizons* 57, 413–23.

Hinterhuber, A. and Snelgrove, T. (2012) Quantifying and Documenting Value in B2B, Professional Pricing Society online course, available online at http://www.pricingsociety.com/home/pricing-training/online-pricing-courses/quantifying-and-documenting-value-in-business-markets

Kotter, J. P. (1995) "Leading change: Why transformation efforts fail," *Harvard Business Review* 73(2), 59–67.

Liozu, S. and Hinterhuber, A. (2013) "CEO championing of pricing, pricing capabilities and firm performance in industrial firms," *Industrial Marketing Management* 42, 633–43.

Nagle, T. and Holden, R. (2002) The Strategy and Tactics of Pricing: A Guide to Profitable Decision Making (3rd ed), Englewood Cliffs, NJ: Prentice Hall.

4 Interview

Nurturing value quantification capabilities in strategic account managers

Andreas Hinterhuber, Todd C. Snelgrove, and Bernard L. Quancard

ANDREAS HINTERHUBER: Why and how does value quantification matter for the strategic account manager?

BERNARD QUANCARD: As we speak today, if I look at all the companies that have a strategic account management program or initiative, I would say that unfortunately between 50% and as much as 70% of the strategic account managers (SAM) are actually doing commercial coordination. There is some value in doing commercial coordination, but it's not what we mean when we talk about strategic account management. The core of the strategic account management initiative is the first phase of creating value for the customer. So, as we speak, a dominant proportion of SAMs are commercial coordinators, and only a minority, likely around 30% of account managers, are the actual conductors—the orchestrators—of the value creation process.

So, in the future, the core of strategic account management will be the value creation process. The key capabilities of SAMs will be to drive the value creation process effectively. This requires, first and foremost, that the account manager be an active listener and at the same time a strategic thinker. Although they are pushing products, SAMs must also be listening to customer problems; they need to understand the customer's business model and truly understand customer value. This requires understanding how the output of company activities impact the customer's bottom line.

SAMs thus need to be able to manage the overall strategic customer relationship as well as continuously find new opportunities for value creation.

When we talk about value creation, we obviously have to talk about value quantification. This is where the SAM needs to have experts in the company, whether they come from marketing, or whether they come from expert centers within the company and act as Chief Value Officers. But the fundamental insight is that SAMs need to have a lot of expertise in value quantification in order to be able to monetize the value created through the SAM process.

ANDREAS HINTERHUBER: Value quantification is a key capability. I, of course, agree. But there is a potentially unexplored sideline to this capability: value quantification requires collaborating with customers. Now, some customers

may be very reluctant to share with the SAM what their product/solution does for their profitability because they fear this knowledge could be turned against them. Put differently, once the SAM knows—thanks to their customers!—that their products produce benefits that are sometimes greater than those the SAM had imagined, the SAM factually has an incentive to increase the price. What is your take on that? How do you quantify value with customers who appreciate your offer but do not want to share information?

BERNARD QUANCARD: This is an extremely important topic, and my answer is very, very simple but difficult to implement. The key to a strategic account management initiative is managing critical customer relationships and also having an Executive Sponsor at the customer and an Executive Sponsor in your company. The key is not to have a price discussion. The key is not to have a value discussion. The key is to have a high-level business discussion.

How do you impact your customer's financial model or business results? To take a concrete example: When I am a SAM at Schneider Electric, I am not talking about electrical cabinets with circuit breakers to protect the electrical systems in a plant. I am talking about energy management and the electricity bill. I am having a business discussion with the Executive VP of Operations. I am the SAM; I am with my Executive Sponsor. When I meet the customer, I visit the Executive VP of Operations and I have a business discussion.

Price to value is only a consequence of the business discussion, and the creation of value has to come from solving business issues and business problems. So, that's what makes the SAM approach so critical and so different. It's that from a business discussion you create value, and the price is only a consequence of the value created.

The collaboration is first about a strategy of relationships and business discussions, and then you collaborate, implementing the consequences of that business discussion with multifunctional teams in your own company.

TODD C. SNELGROVE: Value quantification requires information from customers. My take is that in many instances customers do not share information, not because they do not want to, but simply because they do not have the information themselves.

Many times, I have been at procurement conferences and procurement people have said to me, "SAMs seem to think that we have the answers to all these questions." "We do not," is the near-unanimous answer from procurement. So, we don't provide information because we don't know how long that motor will last or what the average mean time between failures is. It's not that we are not giving the information because we know it and don't want it to be used against us. The answer is simple: We are not giving the information because we do not have it. And I think this is plausible. There are many things I don't know about the specific operations of our manufacturing process.

Based on current research, I think you would agree on a pricing model ahead of time. So, it's a model that we agree on. If this does X, then a percentage

of Ys occurs; then we're less concerned about the exact number, because the more value is created, then yes, the price may go up, but because we agree with the structure of that—a percentage or whatever it is—customers will want it to be even bigger because then they get a much bigger benefit. But if the pricing model is discussed afterwards, yes, they can see their unwillingness: if I tell you how good it was, I can end up paying more. But if we agree ahead of time on the model not the numbers, people would seem to be more open.

And, of course, if it is about co-creation, one of the benefits of being part of the co-creation is that we are looking to get a test customer to validate the value proposition, and, of course, in most situations they would get an even greater benefit …

BERNARD QUANCARD: … and the model would often be more efficient and explainable to the customer if it started with a business discussion.

I always take the example of energy management at Schneider Electric, where it's about doing an energy audit of the plant; it's about a plan to remove the energy-leaking equipment, changing old equipment; it's about putting new methods in place. So, we are talking about a complex solution, solving an important business issue, and the issue of value comes before the price. The price is just the consequence of value—and yes, probably the price would have a premium. But as you said, the model, the pricing model, is so compelling in terms of gains to the customer that the price level, then, is far less important.

TODD C. SNELGROVE: From my own perspective at SKF, I would fully agree. We are talking about a bearing that, by itself, seems to be irrelevant. Our take is: How can we make your operation run more efficiently at the lowest total cost? Where are those opportunities, whether it is energy or inventory, or whatever it is? So, starting with the business discussion and saying (a) here's what best-in-class looks like, and asking (b) what it would be worth to move you to best-in-class? And at this point we would then like to start a business discussion. This leads then to the next point that Andreas raised earlier: How do you start this discussion?

The customer might not know the information or they might not be willing to share proprietary information, so I suggest starting with the business case: I find people are much more open to saying "that number is high" or "that number is low." But if you ask a lot of open-ended questions—which people are taught in field training—it actually confuses the customer.

So start with some specific numbers, let's say a best-in-class performance on a given item, and move from there. This seems to make people more comfortable, as opposed to asking 20 open-ended questions which they may be unable to answer.

ANDREAS HINTERHUBER: Bottom line: do your homework and start with some specific data points that you have collected from competitors, suppliers, and customers …

TODD C. SNELGROVE: … or industry benchmarks. I had a conversation once with a person about energy savings, and she didn't know there's a government calculation. And I just pulled it up on the Web, and she said, "that's good enough." So, it's not a closed-end question, but it will help to move the conversation along by having some reference data points that are industry- or application-specific. So, do your research ahead of time to have some sample data points to help move the conversation along.

TODD C. SNELGROVE: Bernard, what other companies do you see that have really embraced the need to (1) have a SAM and to (2) quantify value as part of an effective account management program?

BERNARD QUANCARD: Well, today when you start with a business conversation and a value creation conversation, you won't go anywhere if you don't monetize the value you create compared with your competitors, and that monetization has to be approved by the customer.

Now, how many companies do that? I would say less than 10% of those companies that are involved in strategic account management. It remains a scarcity, and this is why most projects go to request for proposal (RFP), because there is not a compelling monetization of the value.

If there were a compelling monetization where you show that you bring much more money to your customer compared with your competitor's solutions, there wouldn't be any need for an RFP. Really! You would have to show that we are within a price range that makes your value proposition compelling. You could have graphs of price ranges from you and your competitors, but that would be sufficient.

The goal of strategic account management is to eliminate the bidding process, from my point of view. So, monetization is essential to doing that—monetization of the value—but very, very few companies do that. Why don't they do it? Only because the staff does not have the right conversations at the right level with customers, but certainly because there is no real expertise internally on how to monetize the value proposition.

TODD C. SNELGROVE: I fully agree: most companies lack the skills, techniques, and processes needed to quantify value. And I can speak just from my background: at least industrial companies have such a technical background, and they believe that technology automatically will make the business case. So, that's probably one of the reasons why they cannot seem to get their hands around how to monetize value: their background is technical, not commercial.

BERNARD QUANCARD: This is very true. From an organizational standpoint, in many companies there is still a fundamental misalignment between customer-facing people and marketing. Marketing thinks they're the best ones to do the value proposition, and they do it non-collaboratively with the customer because they do it from their desk. And in most cases, customer-facing people will find those value propositions by marketing to be irrelevant, not adapted, or not customized and therefore poorly aligned with real customer needs. So that misalignment might be very painful. Marketing says, "You know, we should do

the strategy; we are the ones who understand." Sales says, "Marketing is trying to impose standard solutions on us that don't fit real customer needs."

TODD C. SNELGROVE: How do you align marketing and sales?

BERNARD QUANCARD: Marketing and SAM should work together, very early, very upstream in the process of value discovery, upstream in the process of the customer's core discovery, when we uncover the customer's problems and the value needs for the supplier. Misalignment occurs because marketing comes way too late in the process.

TODD C. SNELGROVE: What's the role of the CEO in this process? Do you believe the CEO's buy-in, excitement, and involvement are necessary to implement this cultural step change in their organization?

BERNARD QUANCARD: No question. Collaborative value creation with your most important customers is a transformation that companies do not know how to make because they lack the capabilities or because there is internal misalignment. Only top-driven initiatives will transform the organization and align the resources and get results.

I strongly believe in top-driven transformations or initiatives for value creation and value quantification.

TODD C. SNELGROVE: I remember the many SAM conferences where you have a CEO come in from one of the best-practice SAM organizations. And as you see them speak with passion and belief that they must provide value, deliver that value, and quantify that value for customers, it really reinforces the point that a CEO standing behind these initiatives seems to make a big difference.

BERNARD QUANCARD: Absolutely. Organizations are full of people who have their own routine; organizations are silos. Value creation around the customer and value quantification can only be top-driven, because only the top can erase the negative issues of silos, the negative issues of insufficient capabilities, and only the top can change the mind-set and the routines of the key people in the organization.

TODD C. SNELGROVE: Let's return to the "how" of value quantification: Certain things are very quantifiable—energy consumption, for example—but often you get into these subjective, less quantifiable things like brand values, perceived safety, or other intangible elements. Do you have any opinions on or experiences with how companies either quantify those or address those with their customers?

BERNARD QUANCARD: Excellent question. My answer might surprise you. If you don't have a sense of urgency, you're not going to go anywhere.

Let me give you an example. Maersk Line, the big logistics company, sells totally commoditized products. It is impossible to find a more commoditized business, and yet Maersk Line has been relentlessly investing in improving the customer's bottom line. Maersk says, "We, Mr. Customer, we are 97% on time and our competitors are at 93%. That is four points of more reliable delivery on-time for Maersk. This is worth millions of dollars to you, Mr. Customer, and we are computing it."

Or: "We have a much lower carbon footprint than our competitors, and that carbon footprint fits directly within your philosophy, Mr. Customer, of being a green company. We are going to help you on your journey toward becoming the greenest competitor in your industry. Let us quantify it for you: This is the much lower carbon footprint of our ships vis-à-vis our competitors." There's no limit if you have a sense of urgency about value creation and value quantification. It's just that we have to get out of the routine, and we have to be creative, collaboratively with the customer, to discover areas of value and of creating that value.

Take Morton Salt, a company that sells the salt used to melt snow after a snowstorm. Well, the logistics—how you package the salt—will make a huge difference. Customer A may need a little bag, customer B next door may need different packaging, and they have different logistical needs.

So, personally, I am a big fighter against the concept of commodity. There's no such thing as a true commodity. It's the new economy, the Internet, and the sharing economy that are leading to so many service opportunities and so much value creation that no commodity is ever condemned to remain a commodity. It is a mind-set, it is a question of capability, and it is a question of top-driven transformation. It is not a question of "help me, my product is a commodity!"

TODD C. SNELGROVE: It could be that, or that the value you add around the product, the services you add around the product, the implementation, are where the value is created.

BERNARD QUANCARD: Exactly; there's no limit to what you can do. You have to look at the value stream leading from the raw materials all the way to shipping to the end customer.

TODD C. SNELGROVE: Agreed: there are no such things as commodities.

ANDREAS HINTERHUBER: Let's get down to the individual SAM. What are, in your view, characteristics—i.e., personality traits—of SAMs that excel in quantifying value? What are, by contrast, personality traits or behavioral characteristics that make the individual SAM less effective at value quantification? Can you think of some personality traits that differentiate these people?

BERNARD QUANCARD: Oh, absolutely. One is the ability to listen instead of the ability to push a product. Some lone wolves, some big salespeople, will be terrible SAMs because they do not listen. We at the Strategic Account Management Association (SAMA) say that active listening is active only when you listen to things at very low noise levels: listening to some of the things the customer tells you that do not seem important, but are very important. So, when the plant manager out there was telling me, "Well, you know, I have a couple of 15-year-old transformers; they leak energy, but that is not a problem. They are not active." It is a problem. It's a lot of the customer's energy bill going down the drain, just like that.

Listening to the low-noise things, capturing those things, is what we call active listening. Active listeners are a rare commodity, especially among

salespeople. Salespeople are hunters, they jump at you, they don't listen. They want to sell, they want to push the product. So, active listening is number one.

Number two is the ability to collaborate with multi-stakeholders at the customer inside your own company. But again, pure salespeople are very often lone people. They're lone wolves, as we say. They don't collaborate. They're unable to motivate multi-functional teams. There's no value creation if you're by yourself—a lone wolf. Value creation is impossible. Value creation is common at the intersections. Value creation requires the ability to interpret weak signals. Value creation will come at the intersections of things, intersections of technology, intersections of the customer's issues, whatever they are. So, the ability to work with multi-stakeholders is the second key characteristic of a good value creator and a good value quantifier.

Third is having financial acumen, not being afraid of the numbers and the dollars. Again, a lot of salespeople know how to cut prices, but they are frightened by dollars in terms of value quantification. They have no financial acumen. They don't know a darned thing. So, those would be my three key characteristics: active listening, ability to work collaboratively with multi-stakeholders, and financial acumen.

TODD C. SNELGROVE: I couldn't agree with you more on all three.

BERNARD QUANCARD: And it is a culture—it is a culture. It's almost a cultural trait, and it cannot be taught. Some people will never have it in them. I'll talk about myself: I was in sales for many years. I had to really police myself to listen. I slapped my face, and I said: "Come on, listen; you're not listening. Listen! Listen! You're not listening. You're just talking."

The worst enemy of SAM is the inability to listen.

TODD C. SNELGROVE: Very good points. What's your take on customer selection in the context of Strategic Account Management Programs and value quantification? Obviously, value quantification will matter less for some types of customers or purchasing organizations.

BERNARD QUANCARD: You raised a critical point which we call in our SAM organization "the selection of the right accounts." It's a difficult problem and issue. Personally, large accounts can be critical, but they could be 100% transactional. If after a journey of three to five years you don't have a share of these large, critical customers who are open to talking value, you should keep that customer on the list of large customers, but not on the list of strategic accounts. A strategic account has to have some openness to value.

That being said, some strategic accounts will buy a lot of stuff transactionally, but key are the dynamics and the journey: Do I have a share at my strategic accounts that's based on value creation and quantification? Is that share growing out of the total sales to that customer? These are the key metrics you have to look at to encourage you to continue along the value journey. But: if after three to five years you are 100% transactional, you have to cut your costs and abandon value creation and quantification. That is where some organizations

could be hopeless. Even if you go above them or with them at the business management level, the relationship will return to being commoditized and price-only in the end. If this happens numerous times in a three- to five-year journey, get out; those are not strategic accounts. I think it's courageous to recognize that.

TODD C. SNELGROVE: This is very interesting. You have to set a time frame. I see a lot of SAMs not walking away. But what do they do? They try to give their customers even more value, assuming that eventually they'll be willing to pay for that value. So, I think that, as you said, after a preset time, if you can't convince them, you should walk away and stop delivering the value. Don't try to deliver more value where it is not recognized or not being paid for.

BERNARD QUANCARD: This means that when you increase your cost to serve in order to try to deliver more value, most customers start to represent losses. And there's no good strategy built on losses. It doesn't exist and should be banned. A good strategy gives you a return on investment after three to five years.

TODD C. SNELGROVE: There are organizations where procurement is focused on price and price only. Are there things you can do to get them to start thinking that maybe they should do things differently?

BERNARD QUANCARD: I think the key is to find an area in the organization—the customer's organization. Sometimes it might be R&D, sometimes it might be new product development. The key is to find an area that will be hungry for value creation and quantification. And once you have an ambitious business case, even a small one, at the organization, you've got to start a journey to expand into other areas. It has to be what I call a "positive cancer." You start in an area … again, very often my own experience shows that starting in the new product development area offers a big payback, because that area is where you create everything, everything is upstream, you can make the difference very upstream in the value.

I call it positive cancer because you start with a business case of value and then you expand and expand and expand. This positive journey allows you to show that you've grown the bottom line more based on value than on price, and it's the truth.

TODD C. SNELGROVE: Can you think of any industries where value quantification wouldn't work?

BERNARD QUANCARD: It might be when a product is very commoditized. It might be that competitors copy you very quickly. Whatever value you bring, in logistics or whatever—take the examples we discussed before of Morton Salt or Maersk Line—it depends on how quickly your competitors catch up. If your competitors catch up very quickly, then it's really, really difficult. I would look at it more from a competitive standpoint than from an industry perspective alone. I do not believe there is a specific industrial sector. Again, I push back on a commodity. I think commodity is a concept that can be "refused," but if your competitors catch up very quickly, that makes it very difficult.

TODD C. SNELGROVE: If you can have a sustained differentiation in the product, in the processes and services …

BERNARD QUANCARD: … Exactly, if that creates the differentiation that will force your competitors to be slow in catching up, that's the way to go.

TODD C. SNELGROVE: Some value quantification now clearly takes place in B2C, too: take white goods, and cars and houses and things where people take the time and energy to do some research. Do you see a skill set moving from B2B to B2C?

BERNARD QUANCARD: We have a lot to learn from B2C in B2B, frankly. The reason is that the Internet has a much greater impact on the consumer than on the business buyer, although it's catching up with the business buyer. So we have a lot to learn because B2C is more competitive. Competitors are catching up faster, I think, in B2C. In B2B, it's much more complex. The value chain is much more complex. The number of stakeholders and the decision processes are much more complex. So we have the benefit of having a much more complex world in B2B, but if we were to apply some of the lessons we learned from B2C that could have a huge impact. Take crowdsourcing: How do I crowdsource an issue, a value proposition, to make it complete and valuable? How do I use social media and technology in B2B? We could learn a lot from B2C and apply it to B2B.

TODD C. SNELGROVE: This is very well pointed out. Many times, B2B companies do not even think or want to learn, but there's a lot to be learned from B2C.

What other pieces of advice do you have for companies that do create value in their industry but are having a hard time getting paid for it?

BERNARD QUANCARD: I really believe that the question raised earlier—how quickly competitors catch up—is the key element that will lead to what customers value. In the end, demonstrate value; and if you have and bring more quantified value than your competitors, and if you threaten procurement that you will walk out, the business case will keep you in. So, I think the lack of value quantification is about the competitive environment more than anything else. And that is where I believe the SAMs have to be very good and very well trained on what I call strategic negotiations, how to negotiate for value, away from price.

If you look at companies, they typically will tell you that out of 100 SAMs, they have at least half or more who let the price go; they don't find the value because they're convinced that competitors will catch up, but they haven't even checked it. So I would really say that in the end, the art and science of negotiations of value versus price will have the biggest impact on whether the customer recognizes the value you bring.

TODD C. SNELGROVE: The ability to quantify that value gives you the tools to help negotiate based on it?

BERNARD QUANCARD: And understanding your competitors' value and how much more you bring versus your competitors—that's going to be the key to negotiating for value and getting paid for it.

TODD C. SNELGROVE: Very well said. I very much appreciate your time. I would just like to say: I appreciate what SAMA does for the profession, driving the research, driving the opportunities to share best practices, and I thank you for your time today in showing the importance of value quantification.

ANDREAS HINTERHUBER: Thank you both for sharing your time and expertise.

6 Value quantification—Processes and best practices to document and quantify value in B2B[1]

Andreas Hinterhuber

INTRODUCTION

The requirements for a high-performing sales function are changing. In the past, communicating product benefits and features was a key element of sales activities. This is no longer enough: today, the sales function is increasingly asked to document and quantify value to customers. Consider the results of a survey of 100 IT buyers at Fortune 1000 firms (Ernst & Young 2002): 81% expect vendors to quantify the financial value proposition of their solutions (see Figure 6.1).

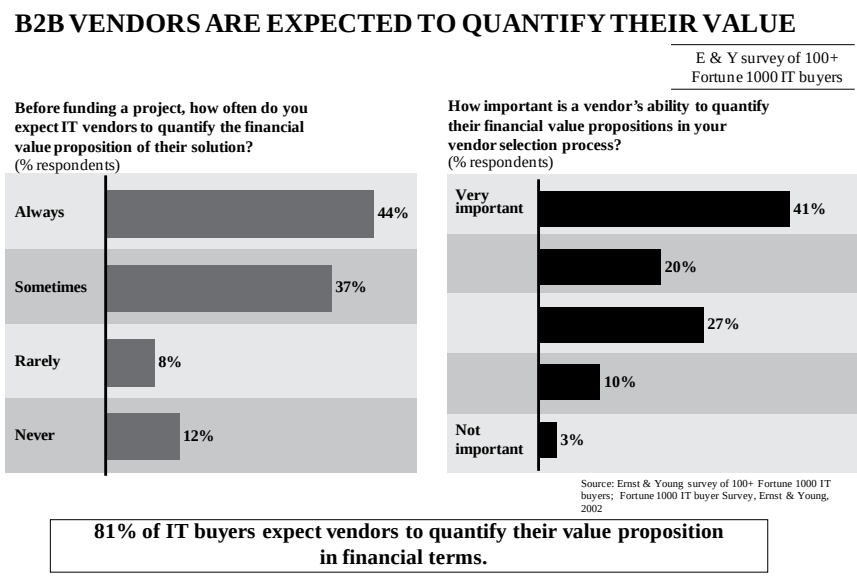


Figure 6.1 Value quantification: A critical requirement in B2B sales.

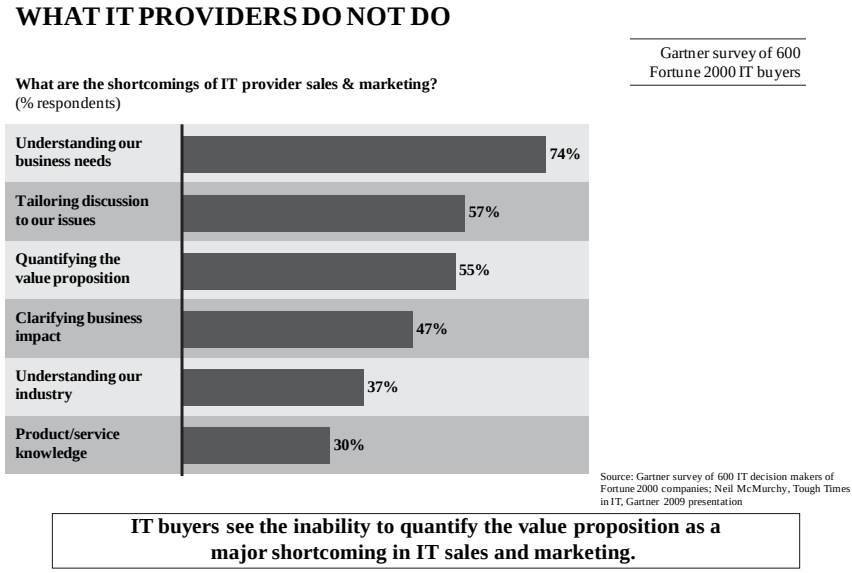


Figure 6.2 Value quantification: A major shortcoming of B2B sellers.

Similarly, a subsequent survey asks 600 IT buyers about major shortcomings in their suppliers' sales and marketing organizations (McMurchy 2008): IT buyers see an inability to quantify the value proposition and an inability to clarify its business impact as important supplier weaknesses (see Figure 6.2).

These survey results suggest that the ability to quantify and document the financial impact of the value proposition is critical for sales executives. How well equipped are today's sales managers in this respect? Extant research suggests that B2B purchasers rate the ability of sales managers to quantify the value proposition as unsatisfactory (Ernst & Young 2002). The conclusion: B2B sales managers must improve their capabilities to quantify and document value.

ABOUT THE RESEARCH

Over the last five years, my colleagues and I analyzed the value propositions of 125 B2B companies: these companies vary in size and include Fortune 500 companies as well as many small and medium-sized companies. We complement this research with discussions at dozens of large and medium-sized companies across a wide range of industries, including automotive, IT services, chemicals, B2B services, pharmaceuticals, forestry, and machinery. In these companies our interlocutors are sales directors, pricing managers, senior executives, and first-level sales managers. Our aim is, first, to collect global best practices in quantified value propositions and, second, to gain insight into the processes that guide the effective development and implementation of quantified value propositions. As a result of this research,

I present below a framework for the effective development of quantified value propositions. I also present selected case studies that—based on this research—are current global best practices.

THE PROCESS

Value quantification requires a process. Based on the research, within high-performing sales organizations this process includes the following steps (see Figure 6.3).

To be clear: in some organizations, the process leading to a quantified value proposition is more complex than the steps outlined below. In other companies the actual process is much simpler than outlined: well-developed salesforce capabilities ensure that the quantification of the value proposition is a routine component in all major sales pitches, done without explicitly performing all steps outlined in every sales call. Nevertheless, we find that all high-performing sales organizations perform the five steps outlined in one way or another.

Customer insight

The first step in this framework is customer insight. Few companies have developed systematic capabilities in this respect. According to our research, companies that master the development of quantified value propositions strive, first and foremost, to achieve leadership in customer insight. A fundamental component of achieving leadership in customer insight is developing the ability to listen to customers. Jeff Immelt, CEO of General Electric, says, "Listening

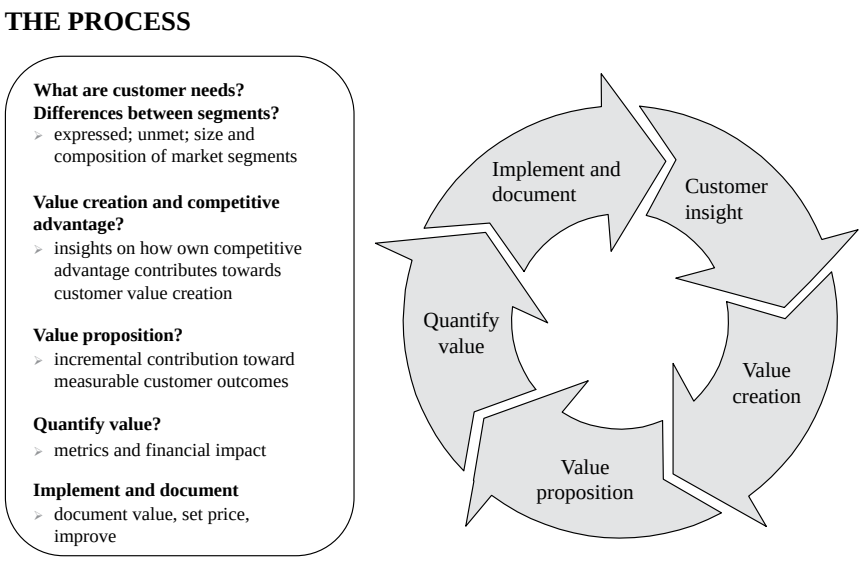


Figure 6.3 The process of value quantification.
Source: Hinterhuber & Partners

is the single most undervalued and under-developed business skill" (Clegg 2014). Carol Meyrowitz, CEO of TJX, states, "In all our training we emphasize the importance of listening" (Meyrowitz 2014: 47)—even for apparently inward-oriented functions such as corporate purchasing.

Listening is a key requirement that leads to performance improvements at the level of individual sales managers (Drollinger and Comer 2013), but current research as well as executives of innovative companies concur that listening to customers does not and cannot imply following customers. The CEOs of Ford, Sony, Apple, and other companies all warn explicitly against taking customer input at face value. Steven Jobs, during his tenure as CEO of NeXT, said, "It sounds logical to ask customers what they want and then give it to them. … You can't just ask customers what they want and then try to give that to them. By the time you get it built, they'll want something new" (Gendron and Burlingham 1989).

Key to generating customer insight is an ability to interpret customers' unmet needs. Two research approaches are noteworthy: ethnographic research and outcome-driven innovation. Ethnographic research is today the gold standard enabling researchers to obtain insight into customers' thought worlds in order to uncover existing, but currently unmet, needs (Cayla, Beers, and Arnould 2014). This research method enables researchers to experience the specific, naturally occurring behaviors and conversations of customers in their natural environments. As a result, insight into unsatisfied needs may emerge.

Outcome-driven innovation relies on a combination of qualitative and quantitative research to uncover latent customer needs in order to develop ideas for breakthrough innovations (Hinterhuber 2013).

Create value

The rule is simple: if suppliers are not perceived as being different, then customers will benchmark them on price. The second step in the process of value quantification is thus differentiation along categories that matter to customers. To be clear, differentiation from competitors does not per se add value. It might lead to a sustained investment in product features that add no value for customers. Product differentiation strategies thus have to be preceded by an understanding of the real sources of value for customers (Hinterhuber 2004). Customer insight—step one in our process—has to guide differentiation.

The objective of differentiation is to increase customer willingness to pay or total customer value. What is customer value? The definition of customer value in B2B must be based on the following five fundamental principles.

Value is, first of all, always defined by customers and their success metrics. Value is thus subjective, customer-specific, relative, and contextual. Customer insight is the first premise that guides the definition of value. Second: value is always created collaboratively with customers and must be recognized by customers if suppliers expect customers to pay for value. Collaboration is thus the second

principle that guides the definition of value. Third: Value is the sum of quantitative, financial, and qualitative, intangible benefits delivered to customers. Value is both hard and soft. Value quantification thus requires that suppliers develop capabilities to quantify the impact of both quantitative and qualitative benefits on key customer success metrics. Quantification of the business impact is thus the third principle that guides the definition of value. Four: All value is based on differentiation. Value is always based on the differentiation relative to the customer's perceived best available alternative. Differentiation is thus the fourth principle that guides the definition of value. Finally: Value must be substantiated. For suppliers, value is a promise. For customers, value is an expectation. Suppliers must convert their promises into credible, verifiable and simple deliverables in order to provide customers a realistic assessment of their abilities to deliver the expected results. Figure 6.4 summarizes these fundamental principles that guide the definition of value in B2B.

Customer value is a multifaceted concept; differentiation can thus occur along a number of dimensions. Most important, differentiation is possible also for apparent commodities. Consider the following project, recently completed (Hinterhuber and Pollono 2014).

Executives at a global basic chemical company assume that they are operating in a commodity industry and believe that—in order to achieve meaningful sales—prices for the chemical product in question need to be lowered to the price levels of a low-cost product from China that recently entered the market (indexed at 100

WHAT IS VALUE?

1	Value is always defined by customers and their success metrics.	Customer insight.
2	Value is always created collaboratively with customers and must be recognized by customers.	Collaboration.
3	Value is always quantified as the monetary value of quantitative and qualitative benefits delivered.	Measurement of business impact.
4	Value is always based on key differentiators and relative to best available competitive alternatives.	Differentiation.
5	Value is always substantiated by case studies and by documented performance improvements.	Substantiation.

Figure 6.4 Customer value—Basic premises.

in Figure 6.5). Workshops with executives and focus groups with core customers and distributors allow us to uncover a number of differentiating factors between the low-cost competitor and the company's own offering. Although in no single area do the two products differ dramatically, we find a number of areas where there are small, albeit meaningful, differences between them. Through internal expert estimates and field value-in-use assessments, we quantify customer value for these differentiating features as follows.

We find that small differences in logistical know-how, in product quality, in ordering costs and complexity, in vendor competence, and in customer knowledge add up to a positive differentiation value of 8%, thus allowing the company to set prices up to 8% above the customer's best alternative. The highest possible price is, of course, not the best price: it leaves no incentive for the customer to purchase. After applying a series of price optimizations, competitive simulations, and estimates of customer reactions, we recommend a final selling price of 105. This represents a price premium of 5% over the customer's best available alternative; but this price is, nevertheless, attractive for customers, since their quantified benefits are higher than the price they are expected to pay.

As main learnings of this short case study, we highlight the following points: (a) even apparent commodities can and need to be differentiated, (b) the sum of many small differences in product characteristics can add up to a significant difference in customer value, (c) small price premiums over competitive products (e.g., 5%) translate to significant profitability differences between companies, and (d) the price and value premium between two competitive offerings needs to be sustained over time via continuous improvement.

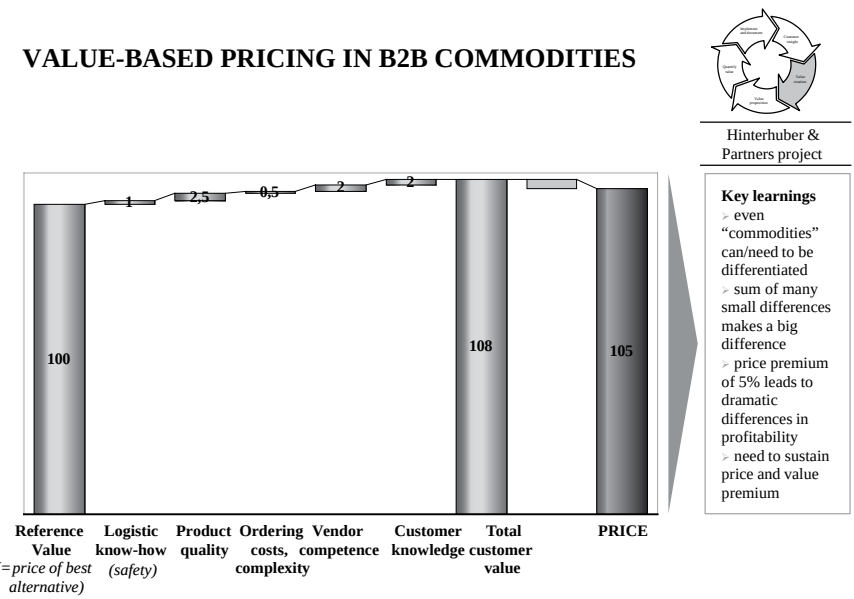


Figure 6.5 Value-based pricing and value creation for B2B commodities.

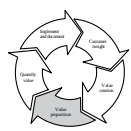
Develop the value proposition

The value proposition (Lanning and Michaels 1988) or, alternatively, the value word equation (Anderson, Narus, and Van Rossum 2006), is an instrument designed to translate customer value into quantified, monetary benefits. Anderson et al. (2006: 96) note that "a value word equation expresses … how to assess the differences in functionality or performance between a supplier's offering and the next best alternative and how to convert those differences into dollars." Numerous studies suggest that very few sellers can quantify the value proposition for their customers (Anderson, Kumar, and Narus 2007; Hinterhuber 2008). The capability to quantify value is, however, essential. Todd C. Snelgrove, chief value officer of SKF, states: "Best in class companies have taken the time, effort, and focus to quantify the value of their products and services. If you can't, purchasing will have no choice but to ask for a lower price" (Snelgrove 2013).

Based on our research, I have developed a checklist of elements essential to best-practice value propositions (see Figure 6.6).

Quantify value

Quantifying value means translating competitive advantages into financial customer benefits. Competitive advantages typically deliver either quantitative or qualitative benefits, or both. Quantitative benefits are related exclusively to financial benefits, whereas qualitative benefits are related to process benefits—they allow customers to achieve the same goals in a better way. Quantitative benefits come in four categories: revenue/margin improvements, cost reductions, risk reductions, and capital expense savings. Qualitative benefits include ease of doing business, relationship benefits, knowledge and core competencies, the value of the brand, and other process benefits.



BEST PRACTICE VALUE PROPOSITIONS

Check	Item	Key issue	Rate
	Is the target customer group clearly identified?	segment	
	Is the key business issue we resolve a real pain-point for this segment?	relevance	
	Is it clear that the value proposition is superior for this customer group?	better	
	Does the value proposition reflect our competitive advantages?	advantage	
	Is the value proposition relative to the customer's best available alternative?	competition	
	Are customer benefits quantified? Is the quantification the result of quantifying both financial as well as qualitative benefits?	quantify	
	Is the value proposition based on sound customer and market research?	research	
	Does it reflect changing customer priorities? Is it relevant … tomorrow?	update	
	Can you substantiate the value proposition with case studies or evidence of quantified performance improvements delivered?	substantiate	
	Can you articulate the value proposition in 1-2 minutes?	short	

Figure 6.6 Checklist for developing a best-practice value proposition.
Source: Hinterhuber & Partners

Customer value is the sum of quantitative and qualitative benefits. Value quantification tools visualize the total customer value, that is, the sum of quantitative and qualitative benefits, the price of the company's own product/solution, and the costs of the best available competitive product. These value quantification tools thus allow ROI calculations: the ROI is the result of relating the price premium to the quantified difference in customer value.

Leading B2B companies routinely perform value quantifications. An example from SKF is illustrated in Figure 6.7 (Hinterhuber and Snelgrove 2012).

Industrial bearings are, for the layperson, commodities: apparently interchangeable steel products used in industrial manufacturer's rotating equipment. SKF is able to document to customers that, despite a price premium of 50% over the next best available product, customers end up paying less and being better off by purchasing from SKF.

Marketing, pricing, and sales managers in B2B should take notice: if SKF is able to quantify the value of industrial bearings, so should other companies with products and services, that are frequently even more differentiated than those of industrial parts.

Implement and document

The final component in the process of value quantification is implementation and documentation of results. The promises outlined in value quantification tools—such as the one in Figure 6.7—account for nothing unless the value is actually realized in customer operations. In high-performing sales organizations, the following guiding principles underpin this process (see Figure 6.8).

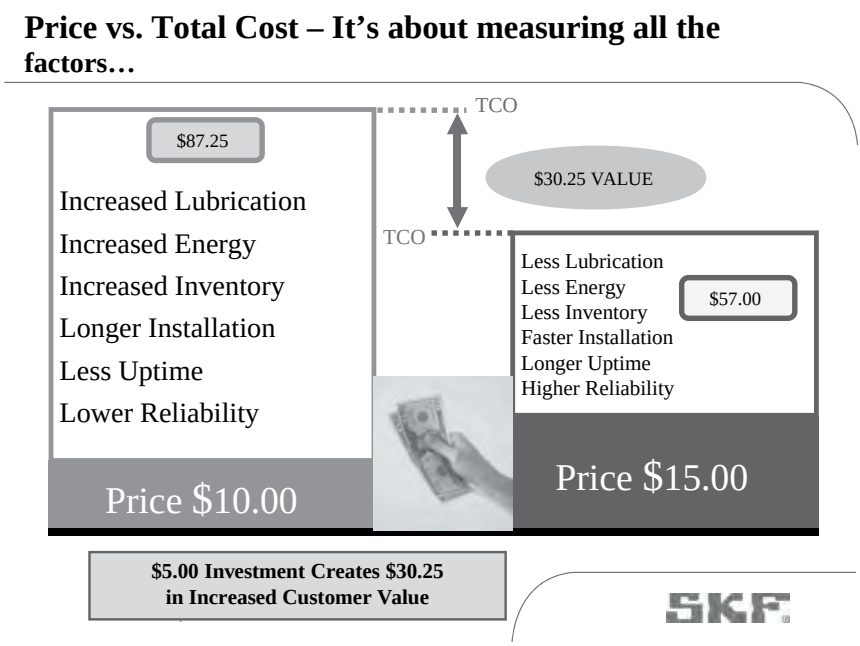


Figure 6.7 Value quantification at SKF.
Source: SKF

IMPLEMENT, DOCUMENT, AND IMPROVE

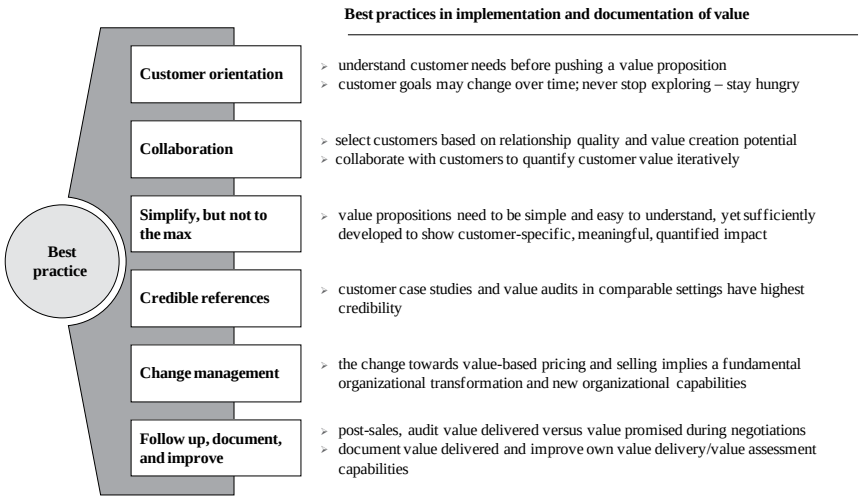


Figure 6.8 Implementing and documenting the quantified value proposition.

Customer orientation

Customer orientation may appear to be a trite attribute of companies that successfully quantify the value proposition, but it is not. Our research suggests that low-performing sales organizations push their value propositions to customers regardless of whether these value propositions apply in the current context: customer needs may have changed, the next best available competitive alternative may have changed due to new competitors, the customer's objectives may have changed, or customer capabilities may have shifted. Nothing, our research suggests, destroys the credibility of sales managers quicker than presenting a value proposition to customers without first having gained an in-depth understanding of current and future customer needs. The adage "seek first to understand, then to be understood" is valid also in this specific context.

Collaboration

Quantified value propositions are the result of a tight-knit collaboration between vendors and suppliers: credible quantified value propositions cannot be developed in isolation and require that customers give suppliers access to the profit implications of the supplier's offerings for customer operations. This is tricky: in some instances the request for access to customer data highlighting the profit implications of supplier offerings on customer operations can trigger a countervailing request by the customer for access to supplier cost data (Rosenback 2013). This request is reasonable. As a result, negotiated prices for differentiated offerings will settle not between the price

of the customer's best available alternative and total customer value, as the literature on value-based pricing suggests (Nagle and Holden 2002), but between (the likely lower) supplier costs and total customer value.

In this context, customer selection is important: rather than selecting customers based on size or reputation, high-performing sales organizations select customers based on the quality of the relationship and the potential for joint value creation. Furthermore, high-performing sales organizations take time and invest resources to fine-tune the value proposition through multiple iterations, whereas low-performing sales organizations tend to take a hit-or-miss approach. Typically, the latter leads to value propositions that are more generic and less relevant to any particular customer.

Simplify, but not to the maximum

The essence of a quantified value proposition consists of translating the company's competitive advantages into quantified, expected performance improvements. This requires an understanding of competitors and their price and performance level, an understanding of the firm's own competitive advantages, and, finally, an understanding of customers, their needs, and their business models (Hinterhuber 2004). Modelling these relationships is complex: effective value propositions, like all models, are thus always a simplification of reality—but not to the point where simplification leads to meaningless generalization.

Credible references

References enhance the credibility of quantified value propositions. These references can take many forms: summaries of pilot projects, customer case studies, value audits, or documented performance improvements countersigned by customers.

Change management

Institutionalizing value quantification as organizational capability requires organizational change management (Liozu, Hinterhuber, Perelli, and Boland 2012). New approaches to selling, marketing, and pricing frequently require new capabilities, a new organizational structure, different goal and incentive systems, new processes and tools, and new organizational priorities. From an organizational perspective, the implementation of value quantification across the organization must be treated like an ongoing change management process as opposed to a project with a finite life (Hinterhuber and Liozu 2014).

Follow up, document, and improve

As a final element in value quantification, high-performing sales organizations rigorously follow up on actual versus expected quantified value delivered in 6-to-12-month intervals. This enables both customers and suppliers to learn, to

analyze causes of performance deviations, and to implement measures to close performance gaps. This documentation also enables suppliers to build up a library of documented and quantified performance improvements, by, for example, client function, industry, size, and geographic area. SKF, for example, has built up a library containing more than 63,000 case studies of documented and quantified value delivered by SKF, countersigned by customers. This library, SKF's Documented Solutions Program, is a very powerful selling tool for sales managers when participating in competitive bids with new customers: extant data can be used to estimate likely quantified performance improvements based on a long history of performance improvements in similar situations that customers have actually realized. This documentation is thus an important enabler of organizational learning within suppliers: suppliers learn about typical roadblocks to the realization of expected quantified performance improvements; suppliers also learn about all those areas of their own offering where the realized value is higher than the value they themselves expected to realize. These positive and negative deviations from initial performance expectations are important foundations for gaining an even better, more fine-tuned and granular understanding of the effect of a firm's own competitive advantages on customer operations. As a result, these deviations will, over time, likely diminish.

EXAMPLES OF EFFECTIVE QUANTIFIED VALUE PROPOSITIONS

In the course of our research, we encountered a dozen or so companies that have highly effective quantified value propositions. These well-crafted value propositions support sales and marketing executives during the bidding phase. The ultimate outcomes of effective quantified value propositions are higher prices and higher win rates. As a further benefit, respondents report that the conversation with B2B buying centers shifts: price is less a central concern and the focus shifts toward the quantified performance improvement. Realization of this performance improvement requires that customers and suppliers work together closely. Effective quantified value propositions thus fundamentally change the nature of the customer–supplier relationship, requiring a tight-knit collaborative attitude whereby barriers between the organizations of customers and suppliers start to fall. This ultimately benefits customer satisfaction and customer loyalty.

Recently, Hinterhuber & Partners has worked with a global IT service company to define profitable pricing strategies. This company had clear-cut competitive advantages, yet managers struggled to translate these competitive advantages into quantified customer value. As a result, aggressive competitors regularly undercut the company on price. The dilemma was thus: Should the company reduce price in the uncertain hope of gaining volume, or should the company maintain price and risk losing even more revenues?

Hinterhuber & Partners helped this company to escape from these self-imposed limitations. After interviewing managers, customers, distributors; after collecting data on competitive price levels; and after, finally, employing a robust process to identify and quantify key value drivers, we developed a customized value quantification tool that

helped the company to understand, precisely, the amount of value a specific product generated for a specific customer segment. Deployment of this tool (see Figure 6.9) led to immediate, substantial profit improvements. A disguised example illustrates the principles: Instead of submitting an offer at a cost-plus-driven price of approximately 400,000€ that sales managers would usually heavily discount, the company is now in a position to confidently offer its solution at 465,000€: this price is low compared with the total quantified customer value of over 800,000€. This process thus enables the company to sell its products with a robust ROI calculation attached: there is a price premium over low-price competitors, and this is graciously acknowledged. The main point, however, is that an investment of approximately 100,000€ (i.e., the price premium versus the low-price competitor) leads to incremental customer benefits of over 400,000€ (i.e., the difference in customer value between the two offers), thus leading to a ROI of 300%.

This is, in sum, a key benefit of value-based pricing and value quantification: turning the conversation from a discussion on price differences to an exploration and documentation of quantified customer benefits.

Value quantification is especially effective and in many cases mandatory when the supplier has a price premium over a relevant competitor. For many suppliers the key question is: Is it possible to convince customers that customers end up paying less by purchasing the most expensive offer? The quantified value proposition of SAP (Raihan 2010) provides an alternative way of presenting a premium-price offer: not as one that will lead to lower costs of ownership, but one that reduces customer risks (see Figure 6.10).

SAP sells enterprise software: in this specific project case the company's price is 20% above the price of a comparable competitor. SAP argues that the true cost of the competitive solution is higher than its own price, mainly because risks have not been accounted for. SAP identifies several categories of risk: solution risk (lower business functionality, regulatory risk), supplier risk (only local presence, long-term viability), technology risk (lower scalability), operational risk (lower flexibility), and, finally, implementation risk (lower experience). These risks can be quantified and should

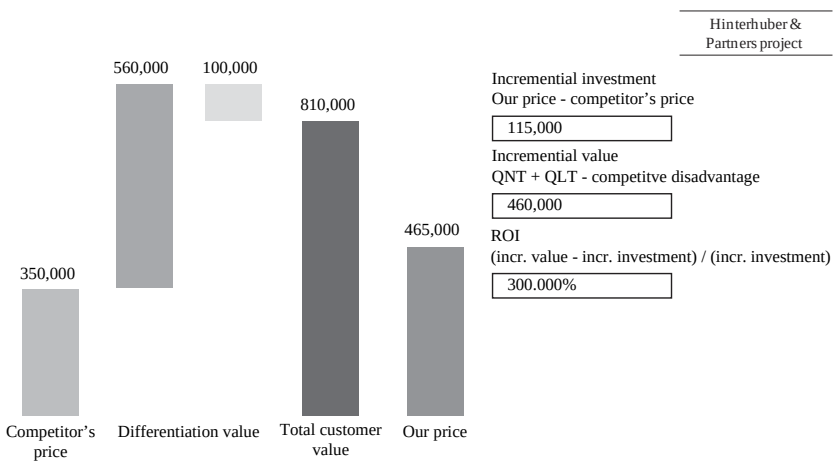


Figure 6.9 Quantifying the value proposition—A case study in B2B services.
Source: Hinterhuber & Partners

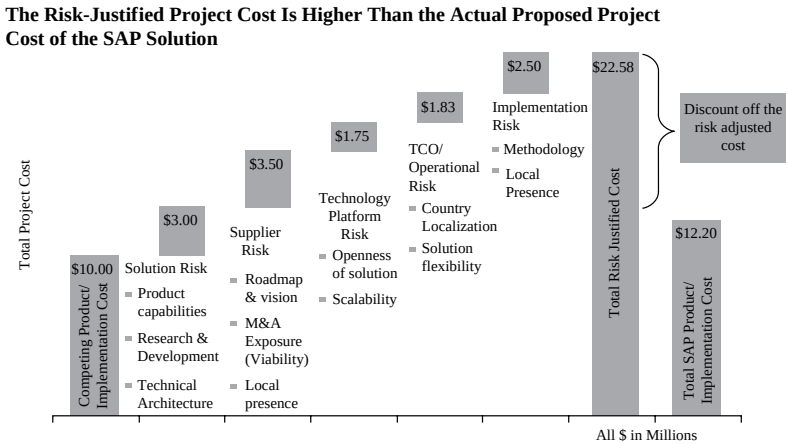


Figure 6.10 Quantifying the value proposition—The example of SAP.
Source: SAP

be, at least according to SAP, added to the price of the lower-cost solution. The risk-adjusted price of the apparently low-cost offer exceeds the price of SAP's solution by a substantial amount. According to SAP's experience, this helps the company win deals even though the list price of its solution is substantially higher than the price of the customer's next best alternative. Lower risks thus can justify price premiums.

FURTHER CONSIDERATIONS

Value quantification capabilities may be the most important capabilities of high-performing sales companies today. Building these capabilities requires a deep personal and organizational change. An interviewee at a global B2B IT service company observes: "What we started to realize was: It is not what your products or services do for your customers. It is what your customers are able to do as a result of using your products and services."

The preliminary results of this research indicate that companies with well-developed value quantification capabilities are able to realize higher prices and higher win rates. Relationships with customers benefit as well: collaboration increases. As companies implement the process outlined here—(1) customer insight, (2) value creation, (3) value proposition, (4) value quantification, and (5) implementation and documentation—customer satisfaction and loyalty typically increase. Thus, developing these capabilities may lead companies to achieve a sustainable competitive advantage.

We lack, however, quantitative empirical studies documenting the link between a company's value quantification capability and performance. This would make for a fascinating study.

NOTE

1 This is a fully updated and expanded version of the article: Hinterhuber, A.: "Value quantification—The next challenge for B2B selling" in Hinterhuber, A., Liozu, S. (Eds.), *Pricing and the Sales Force*, Routledge, 2016. Copyright (c) 2016 Routledge. All rights reserved. Reprinted by permission.

REFERENCES

Anderson, J., Kumar, N., and Narus, J. (2007) Value merchants: Demonstrating and documenting superior value in business markets, Boston, MA: Harvard Business School Press.

Anderson, J. C., Narus, J. A., and Van Rossum, W. (2006) "Customer value propositions in business markets," *Harvard Business Review* 84(3), 90–99.

Arnould, E. J. and Wallendorf, M. (1994) "Market-oriented ethnography: Interpretation building and marketing strategy formulation," *Journal of Marketing Research* 31(4), 484–504.

Cayla, J., Beers, R., and Arnould, E. (2014) "Stories that deliver business insights," *MIT Sloan Management Review* 55(2), 55–62.

Clegg, A. (2014, October 21) "The quiet art of being a good listener," Financial Times, p. 12.

Drollinger, T. and Comer, L. B. (2013) "Salesperson's listening ability as an antecedent to relationship selling," *Journal of Business & Industrial Marketing* 28(1), 50–59.

Ernst & Young. (2002) Fortune 1000 IT Buyer Survey: What could shorten sales cycles and further increase win rates for technology vendors? Economics & Business Analytics White Paper.

Gendron, G. and Burlingham, B. (1989) "The entrepreneur of the decade: An interview with Steven Jobs," Inc. 10(4), 114–28.

Hinterhuber, A. (2004) "Towards value-based pricing—An integrative framework for decision making," *Industrial Marketing Management* 33(8), 765–78.

Hinterhuber, A. (2008) "Customer value-based pricing strategies: Why companies resist," *Journal of Business Strategy* 29(4), 41–50.

Hinterhuber, A. (2013) "Can competitive advantage be predicted? Towards a predictive definition of competitive advantage in the resource-based view of the firm," *Management Decision* 51(4), 795–812.

Hinterhuber, A. and Liozu, S. M. (2014) "Is innovation in pricing your next source of competitive advantage?" *Business Horizons* 57(3), 413–23.

Hinterhuber, A. and Pollono, E. (2014) "Value-based pricing: The driver to increased short-term profits." *Finance & Management* 221(May), 21–24.

Hinterhuber, A. and Snelgrove, T. (2012) Quantifying and Documenting Value in B2B: Professional Pricing Society online course, available online at http://www.pricingsociety.com/home/pricing-training/online-pricing-courses/quantifying-and-documenting-value-in-business-markets

Lanning, M. J. and Michaels, E. G. (1988) A Business Is a Value Delivery System, McKinsey & Company Staff Paper No. 41.

Liozu, S., Hinterhuber, A., Perelli, S., and Boland, R. (2012) "Mindful pricing: Transforming organizations through value-based pricing," *Journal of Strategic Marketing* 20(3), 1–13.

McMurchy, N. (2008) Tough Times in IT: How do you Exploit the Opportunities? Gartner presentation.

Meyrowitz, C. (2014) "The CEO of TJX on how to train first-class buyers," *Harvard Business Review* 92(5), 45–48.

Nagle, T. T. and Holden, R. K. (2002) The Strategy and Tactics of Pricing: A Guide to Profitable Decision Making (3rd ed.), Englewood Cliffs, NJ: Prentice Hall.

Raihan, R. (2010) Leveraging IT to Drive Business Value, Toronto (Canada): Presentation at the Information Resource Management Association of Canada (IRMAC).

Rosenback, M. (2013) Antecedents and Obstacles to Total Cost of Ownership Analysis in Industrial Marketing—A Case Study, paper presented at the 29th IMP conference, Atlanta, Georgia.

Snelgrove, T. (2013) Creating Value That Customers Are Willing and Able to Pay For, Presentation at the Product Management Forum of the Manufacturers Alliance for Productivity and Innovation (MAPI), Rosemont, IL (USA).

13 Interview

Implementing value quantification in B2B

Andreas Hinterhuber and Matthias Heutger

ANDREAS HINTERHUBER: Value quantification is arguably a critically important capability for many companies. Based on your experience, for what type of contract or customer is value quantification especially important?

MATTHIAS HEUTGER: In the world of logistics, value creation and subsequent value demonstration are important for most customers and most contracts. Value quantification is especially important if products are standardized—that is, if customers view them as commodities—and we're in a competitive situation where we need to justify premium prices. It's also essential when we require the customer to make changes or investments; in this case, a solid business case is essential so that customers can quantify the value and justify a solution to the business.

ANDREAS HINTERHUBER: Let's illustrate this with an example. Let's assume that I'm a major customer of DHL and that I tell your account manager, "Your price is 10% to 15% higher than the offer from your main competitor." How do you think your account manager will respond? Are there any best practices you wish to share?

MATTHIAS HEUTGER: All of our account management and sales teams are briefed and trained to make sure they are able to articulate the potential value of our products to each different customer. How we do this varies. For a product in our DHL Express service line—let's say a straightforward shipping product which could be seen as a commodity, at least relative to many other products we offer—we articulate the characteristics of our offer and demonstrate the product's advantages compared with competitive products.

For more complex products, this will change substantially. These types of products include our warehousing, managed transport, and other complex outsourcing solutions. With this complexity, a simple price comparison between competitive offerings is insufficient. So I'm convinced it's essential to analyze what our solution does for the customer's end-to-end costs and value creation.

The most direct benefit we can offer with any solution is cost savings within the supply chain—we achieve this by doing things more efficiently, using our scale and experience. For example, we can help customers by better consolidating and managing their logistics flows, using fewer trucks and reducing warehouse space, so it's very direct.

For our more complex solutions, we tend to create additional direct benefits like reducing the cycle time, improving time-to-market, increasing product availability, and enhancing security so that fewer goods are lost—which is not a direct cost saving per se, but it improves total landed cost and can help to drive revenue growth and raise satisfaction levels among our customers' customers.

So in everything we do for the customer, we are always looking for the customer benefits and value across their whole supply chain.

Does this answer your question?

ANDREAS HINTERHUBER: Yes. What I took away is: For some types of products—I'm not sure I would call them commodities, because, in my view, there are no commodities—you provide customers a kind of scorecard, not unlike the one you get at school, highlighting reliability, on-time performance, etc., without necessarily translating your own competitive advantage into quantified customer value. The customer, in the end, quantifies the value and …

MATTHIAS HEUTGER: … in most cases you don't have to do this quantification. You describe the service quality, on-time performance, etc. to the customer, but the value is so obvious that you don't have to make the value calculation for them. They already know the importance of on-time delivery and reliability; it's common sense, so to speak.

Let's look at another set of products, such as Air & Ocean Freight. If you're smarter, you can offer better consolidation through better routing than competitors. With this you create an advantage for the customer that leads to direct or indirect cost savings. You could recommend using rail instead of ocean services, which might save a couple of days, and which may help reduce customer inventory—all of this relates to end-to-end process optimization.

If you're in a competitive bid but you haven't yet established a level of trust with a specific customer, you will need to quantify and articulate the value you deliver. And even if you're not obliged to quantify the value to get the business, I would still advocate doing it. You can always go to the customer at a later date and say, "Hey! Look, this is what we did for you." This certainly helps to keep customers loyal and increase renewal rates.

ANDREAS HINTERHUBER: You say that value quantification is beneficial also after contract signature in order to facilitate contract renewal and maintain customer loyalty. This relates to the idea of scorecards which we touched upon earlier.

MATTHIAS HEUTGER: It's important to get the customer to recognize and agree with the value quantification. This means that you must have the data to share with the customer; that's the best way to ensure customers appreciate the value you deliver to them.

ANDREAS HINTERHUBER: Value quantification requires collaborating with customers. Now, some customers may be very reluctant to share with you what your product or solution does for their profitability because they fear this

knowledge could be turned against them. Put differently, once the account manager knows—thanks to their customers!—that their products produce benefits that are sometimes greater than the ones the account manager has anticipated, the supplier factually has an incentive to increase the price.

Is this a concern in your environment, or do you say "I'm happy to have the customer take a larger share because this will help us in long-term collaborative relationships anyway"?

MATTHIAS HEUTGER: That's a tricky question. If you really want to achieve a true partnership, both the organization and the logistics provider need to recognize sufficient value to make continued investment worthwhile. And then of course the question is: how should you share a 100% gain? Should it be 50/50 if one party invests more or has taken on higher risk? This is a case-by-case decision and also depends on the maturity of the relationship with the customer. We do enter into gainsharing agreements. These require a certain level of openness: you need the facts and information visible so that gainsharing works for both parties.

If we deal with a new opportunity, we tend to use benchmarks from previous comparable case studies and discuss these with customers. In many instances, these benchmarks help us to get to the center of the conversation with the customer.

ANDREAS HINTERHUBER: Are these gainsharing agreements something you do frequently, or do you do them for a quite narrow scope of contracts which you know very well?

MATTHIAS HEUTGER: We do gainsharing agreements frequently but not for the majority of contracts. Typically, they are a viable option in our contract logistics business when, for example, you enter a multi-year contract that aims at continuous optimization and improvement.

We need a certain project period to make gainsharing work; we would rarely enter a gainsharing agreement in a one-year contract; there needs to be a longer-term agreement such as a fourth-party logistics (4PL) solution or a complex outsourcing agreement. It's also possible to start with an open book contract for the first one or two years, so that we establish transparency and both parties can gain some experience, and so that we establish a baseline. After this, we can move into a gainsharing agreement. For a new customer, new solution, or new product, I would not recommend gainsharing right away; otherwise one party or both might lose.

ANDREAS HINTERHUBER: I would reckon that the advantage of gainsharing also depends on risk perceptions. For contracts that you perceive as low-risk—you know you can do the job—you probably prefer gainsharing. Conversely, if you perceive outcomes to be risky, you probably will prefer a fixed-price agreement over a gainsharing contract.

MATTHIAS HEUTGER: Yes, in some instances gainsharing doesn't make sense. In my view, you enter into a gainsharing contract because the objective is to improve

and change. You will only create more value if there's a mutual agreement that both parties will continue to improve and change things. For something standard—a "this is how we do it" solution—where neither party can bring in new ideas, then gainsharing doesn't work. You need a certain level of innovativeness and an ability to bring in new ideas to jointly create new value.

ANDREAS HINTERHUBER: So you suggest that these gainsharing agreements work for longer-term collaborative agreements where both parties are willing to experiment and to innovate?

MATTHIAS HEUTGER: Experimentation is probably not the word I would choose, but both parties need to commit to a certain level of change and continuous improvement to make it worthwhile, yes.

ANDREAS HINTERHUBER: Do you have any rules of thumb for how you share value with your customers? Let's assume that a complex logistics contract creates €1 million in incremental value for your customer. Are there guidelines for how you split this value with your customer, or is it left to the individual sales managers to negotiate this when it comes to pricing?

MATTHIAS HEUTGER: There are no rigid guidelines. But how value is shared is not left to sales managers; we deal with it case by case, taking into account risk factors, the contribution of each party, and the overall pricing model. There are many different ways you can share gains, and so I can't give you an answer that's valid across the board.

ANDREAS HINTERHUBER: Let's get down to the individual sales manager. What are in your view characteristics—i.e., personality traits—of sales managers who excel at value quantification? What are, by contrast, personality traits or behavioral characteristics that make the individual sales manager less effective at value quantification?

MATTHIAS HEUTGER: I can't tell you all our secrets! On top of having a good product and a good solution, the other key to success is having the right salespeople.

We have invested significantly to identify the ideal profiles of an account manager and a relationship manager. Besides the usual list of requirements, we look for people who can strategize. They must be able to see how a product or service fits into the customer's setup and how that solution adds value for the customer. And they must know how to articulate this value creation to the customer. This approach demands a strong customer focus, some strategizing, and a lot of listening.

ANDREAS HINTERHUBER: You talk about "strategizing": Is value quantification also a matter of entrepreneurial orientation? Do you feel that the sales managers who are more dynamic, more risk-taking, are better at value quantification than other sales managers who are maybe less entrepreneurial or less risk-oriented?

MATTHIAS HEUTGER: I'm not sure I'd call our people 'risk-oriented.' In the end, the operation owners need to sign off on contracts, so risk must be properly

managed. But our managers need to be dynamic, proactive, think about different ways of doing things, and be interested in exploring new ideas.

ANDREAS HINTERHUBER: One obstacle which your sales managers may come across day-to-day is the purchasing organization. In some cases purchasing managers are rotated precisely in order to avoid the development of long-term relationships with suppliers that you advocate.

Furthermore, some companies may be contractually required to purchase based on LPTA (lowest price technically acceptable) criteria, meaning that criteria are defined first and the selection—on price—occurs thereafter. Can you share some insights on how to change these purchasing criteria of hard-nosed B2B purchasing executives?

MATTHIAS HEUTGER: We tend to encourage our sales managers to seek access to decision makers, i.e., to the business, but we need to make sure that we don't lose purchasing people along the way. We also encourage our people to get access to purchasing managers who have a little bit of a strategic view. Value-based discussions require you to access people who appreciate the issues: business owners and purchasing managers who understand supply chain and value creation more holistically.

ANDREAS HINTERHUBER: Once you have access to the business owner, then you can also work on changing purchasing criteria.

MATTHIAS HEUTGER: Yes; at least, that's the first step.

ANDREAS HINTERHUBER: Where does value quantification not work? Are there some types of contracts or some types of customers where value quantification will not work? You could also answer this question from the viewpoint of individual sales managers: Do you encounter instances where individual sales managers say, "Value quantification is a nice idea that works in theory, but I find it not helpful and basically I go on in my old way of selling, whatever that is."

MATTHIAS HEUTGER: I think it does always work. It always helps if you know the value for the customer, regardless of whether the organization is procurement-driven. But—as we discussed earlier—in some cases it takes a lot of effort and a lot of work to get value quantification right. So the questions are: In what situations does value quantification help turn the decision in our favor? And when should we make the effort and investment to quantify value?

Of course in B2C it's different, but in B2B it's all about that value creation. And a simple value creation is cost reduction. Although we pride ourselves on knowing the markets very well, sometimes you are working in the dark—you know your own rate and you bid but you may not know your competitors' current rates, so quantifying the cost difference is difficult. So it is especially important to look at the value creation end to end. But I believe the customer will always do the value quantification for themselves—maybe sometimes in a too narrow scope.

ANDREAS HINTERHUBER: Current research we conducted on value quantification suggests that, broadly speaking, there are four categories of quantitative customer benefits: revenue/gross margin improvements, cost reductions, risk reductions, and capital expense savings. These four types of quantitative customer benefits are undisputable—since they represent hard "green" money, i.e., monetary benefits the customer can touch and see. Now the question: Which type of value is easiest to sell? What type of value messages does your salesforce focus on most in value-based selling?

MATTHIAS HEUTGER: This varies a lot between products. For us the easiest sell is direct cost reductions, by which I mean direct saving of logistic costs. The next easiest sell is service quality improvement—like faster delivery times—which for customers can mean lower inventory and an improved ability to provide better services to their own customers, and this can lead to revenue and gross margin improvements.

Risk reduction and security are also important, particularly in warehousing and transportation. It's important that we help customers to reduce stock-outs, improve customer service, boost customer loyalty, and increase revenue growth. Risk mitigation is very important: think of the life sciences sector and its requirement to keep pharmaceutical products in a certain condition (e.g., an end-to-end cold chain); by achieving this, we help customers reduce costs and protect their brand.

On balance, I think the most important value drivers are cost savings—in all forms: logistic costs, inventory costs, etc.—and service improvements for our customers' customers. Revenue increases are also important: if we give customers a better solution, it may enable them to enjoy an advantage vis-à-vis their own competitors.

ANDREAS HINTERHUBER: Great answer. Are there any issues which you would like to add to the topic of value quantification, value-based selling, and pricing?

MATTHIAS HEUTGER: As you know, we practice value-based selling and we quantify the value to customers. Value quantification is important, especially for complex B2B contracts.

For us, quantifying value in a credible way is very important. It shows that we actually deliver value.

ANDREAS HINTERHUBER: How can you make value quantification credible and plausible to customers?

MATTHIAS HEUTGER: You have to deliver—that's the basic requirement. So we invite our customers to do a test drive—that's an important thing. And we make sure we are talking to the right people on the customer side, the people who can really appreciate the value. To facilitate this type of interaction in support of sustainable value management, we regularly invite customers to our DHL Innovation Centers (located in Germany, Singapore, and the Americas). Here we showcase our latest and future logistics solutions. We also publish trend reports to keep customers informed of the technologies and innovations that are likely to impact their business. And we conduct customized Innovation

Workshops to trigger the co-development of solutions and subsequent proof-of-concept pilots with our customers.

ANDREAS HINTERHUBER: You mention "test drive." You thus suggest that starting small, testing, and scaling up are key elements of value quantification.

MATTHIAS HEUTGER: That depends on how a customer wants to do it. If you say, "Hey, we have an idea here"—and let's assume this idea requires a lot of customer change and implementation effort—in order to manage risk, the customer may say, "Yes, let's test it on a small scale. If we can see the value, then we will expand." This is one option.

Another option is that, if the value of a solution is clear, if we've done it before, then we could start right away—without a test. It's always helpful to bring in case studies or best practices from other customers or other industries to demonstrate that you've done this before and substantiate the value that you've created.

ANDREAS HINTERHUBER: Talking about the organizational transformation toward value-based selling: How did the change toward value quantification and value-based selling come about? Was it driven by top management? Did it start at middle-management levels?

MATTHIAS HEUTGER: Some years ago, we decided to change the way we engage with our customers and the way we sell. That's when we started our consultative selling approach and value-based selling. Once we'd begun this journey, it changed our way of doing business and the way we sell. This decision to change wasn't taken lightly. It required considerable training, new processes, and for senior management to "live it." To do this right required a true change management effort. And then of course we had to define the profiles of key personnel in order to implement this change to value-based selling.

When we began this journey we made a conscious decision—a management decision—to change our selling approach. This profoundly altered our organization, our processes, and the type of people we now hire.

ANDREAS HINTERHUBER: What kind of advice do you have for those companies who have, like DHL, a competitive advantage, but do not have, unlike DHL, processes and capabilities to quantify their competitive advantages into monetary benefits for the customer?

MATTHIAS HEUTGER: My advice is work with the customer. The closer you are to the customer and the more customer knowledge you have, the easier it becomes to do the calculations required for value quantification. If you can't do this because you don't have that access to the data or don't have a relationship with the customer, then I suggest that you obtain a case study of a similar customer or a similar solution and use this as the basis for value estimation. Going in with that estimation will, in many instances, prompt the customer to validate that value with you.

ANDREAS HINTERHUBER: So it really comes down to changing the way you interact with your customers.

MATTHIAS HEUTGER: Absolutely. We truly changed how we interact with customers. We have some really great customer relationships now in which we jointly innovate and co-develop solutions. And that's ultimately what you want to do. The discussion is no longer about price; it's now about trust, mutual benefit, and the willingness to grow together over time.

ANDREAS HINTERHUBER: Mr. Heutger, perfect. I thank you for this insightful conversation and the privilege of this first-hand intellectual exchange.

14 Interview

The ring of truth—Value quantification in B2B services

Andreas Hinterhuber and Pascal Kemps

ANDREAS HINTERHUBER: Let's explore the topic of value quantification in the context of strategic account management. For what types of contracts or customers do you think value quantification is especially important?

PASCAL KEMPS: It really depends on the nature of your relationship with your customers. It's not just black and white, but if I look at certain tele sales and field sales customers, then you're talking about relatively small customers. Our service is often not part of their customer value proposition, so typically they just want convenience. In such a case, it's hard to quantify the value in the convenience of doing business or in the reliability of the service. Certainly you've got to have good tools, the right salespeople, friendly couriers, a smooth and friendly experience, but it's difficult to put a number on it. It's not impossible, but you don't typically have discussions where you actually physically quantify the value.

Of course, if you move up the chain of customers to the key accounts and the strategic accounts, then value quantification is something you need to consider for pretty much every customer. If all is well due to the nature of the strategic relationship, you're playing a significant role in their business. You're delivering part of their service, you're delivering part of their promise to their customers, which essentially means you're part of their value chain, and then of course in every pursuit you've got to come up with your value; otherwise, it turns into a very simple price negotiation. That's the last thing you want in a strategic account setting, although it does happen.

And yes, some customers have become pretty clever at setting things up; there are RFQs (requests for quotations) and there's very little room for value quantification. I must admit, though, that more and more you start to see these big customers realizing that this type of behavior [the focus on price] comes at a relatively high cost of change, with difficulties in implementation and with an inability to achieve the targeted savings. I'll give you one very concrete example. Particularly with Express we've got some big customers, and they actually tell us, "Okay, well, I'm going to split up my business. I'm going to give every possible Express provider a chance to bid for our business. And then, basically, we'll just force the user to always use the cheapest one for each individual shipment." That approach has two fundamental problems.

One: you've got a theoretical savings, which procurement can come up with, but obviously the user is going to sit there and is going to use, for example, different systems from different providers, which potentially causes extra workload and cost.

Two: the service levels will not always be comparable, like how late a collection can be made, how long the lead time is, and so on. So, potentially, inventory levels need to be adjusted. Those are all things that with this type of procurement approach simply get lost, and that's not even talking about how a supplier would position their pricing in this bid, because that type of cherry-picking allows cherry-picking in the other direction as well. Why would you lower rates in areas where there is no real alternative? Or bid low on lanes where your network is full? And what you then see is that although you've got nice savings on paper, they never really get implemented: the actual savings never achieve what's expected.

ANDREAS HINTERHUBER: How do you deal with this type of purchasing organization that tries to create an unhealthy level of competition, i.e., a competition that ends up being counterproductive for the customer?

PASCAL KEMPS: Well, it is what it is—there's nothing we can really do about it. And it's a perfectly valid choice—we do think that it's probably not the best choice, but it is a fair choice and it is their prerogative to do this, so we adapt to it.

You may have heard that we've got our own in-house quality program where we look at process optimization, and this can easily be applied in bid responses. There's value for us in customers who behave in an extremely predictable way in the sense that they can help us streamline our own processes. I personally, years ago, led a project where we knew exactly what the customer's RFQs were going to look like. So we worked out a process that allowed us to respond much more quickly, and each time we met the pricing and the quality benchmarks they set, and we spent 80% less time on it. We could re-use part of that time to quantify whether there is some extra value—like, for example, is the warehouse we're proposing inside or outside a toll parameter, and what does it do to the total cost of ownership? In short, we simply adapted to the customer. Figure 14.1 shows the process improvements we were able to realize on our end after changing the way we respond to this customer's RFQs.

It's the natural flow of things, and it's not the case that just because the customer takes a very transactional approach you shouldn't be taking a strategic approach to it, because that level of predictability is something we can work with quite well and derive value from, in the sense that we know we'll be able to respond within a specified time with limited effort and with a price and a quality that meets the customer's benchmark. I think it's a natural part of being in sales.

There is a second aspect to this type of customer behavior: if you gain a critical mass with the customer—whether due to the number of similar operations or simply due to the nature or size of any individual business you have—you can start to identify opportunities for optimizing costs and services. Part of

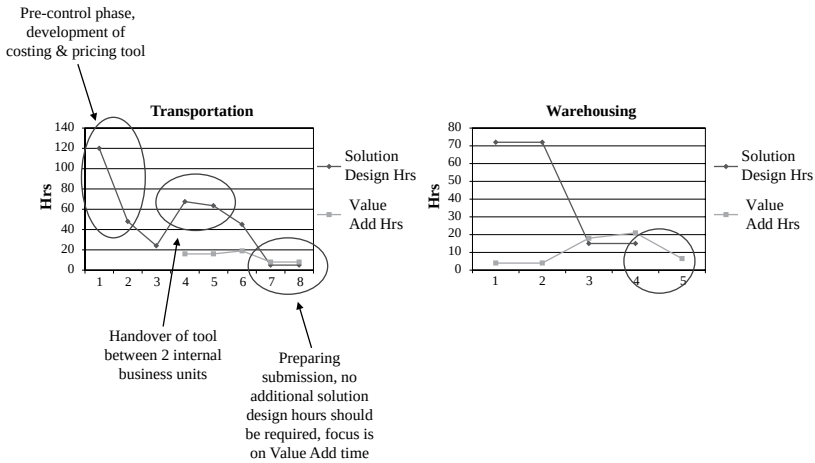


Figure 14.1 Responding to RFQs—Process optimization.

these you keep in-house to improve your own bottom line, and part you give back to the customer. Even if the customer then takes these achievements into their next RFQ, there will still be knowledge and expertise in your business that allows you to be more competitive than the competition and retain healthy margins. To make it concrete: for one customer, we operate a network of warehouses, spread all over the world. They all have the same function, so we've created an internal community that actively shares best practices, tips, and tricks … and meets face-to-face once a year at one of the sites (each time a different one to maximize the learning experience). During our last community call, we had 22 participants from 14 countries all over the world. This is an inexpensive and easy-to-implement way of working, but the results are spectacular: our hit rate on new business is more than two times higher than our average, and retention is de facto 100% (the only exception occurred when a warehouse was closed down due to structurally slow sales in that region). It's hard to beat a competitor that is always on the mark in terms of price, consistently makes cost-savings commitments in the contracts, and consistently wins quality awards—even if the customer has a very RFQ-driven culture. And for us, this is really good business—it's financially healthy—but also because it will earn a good strategic account manager (SAM) access to different customer levels and departments.

Fair enough; it's easier to create value with a customer that has a more balanced approach. But to write off transactional customers is to cut off a very interesting source of revenue and business.

ANDREAS HINTERHUBER: Let's get down to a specific example. Your customer sees your price for a complex service contract and he says that this price is too high because he can get a substantially similar offer for 10% or 20% less. Could you give an example where you were able to overcome these objections with a quantification or documentation of value? In other words, a case where you

show your customer that your higher prices are actually less if considered over the life cycle of a contract or if the customer considers further factors, which actually end up saving him money?

PASCAL KEMPS: Yes, there are plenty of examples. I'll give you a very traditional one which you find in logistics. We deal with logistics departments. We get called in for an RFQ. And, when we do our site visits—*gemba* walks, as we call them—we notice, for example, that the packing is not optimal. We have teams of packaging experts who then help design a significantly optimized supply chain. So far competition can follow, but because very few companies in the world buy more packaging than we do, we can actually say, "Why don't we look not only at this project, but also at your overall usage of packaging in their supply chain? And help you procure it or work out a rental scheme?" That's one example. Another example relates to material handling equipment. We buy a lot of material handling equipment. We're also very good at designing warehouses. We're designing not only warehouses but also their continuous improvement. So, we can throw these types of elements into the mix and say, "If you're after this, that's fine; here's the price—however, have you thought about this? Because right now you're looking for the cheapest rates on an ocean container, for example, but we can tell you that the ocean container is half-full." We can do a lot more than that; here's a real customer example where we did both: we suggested a different way of working as well as optimizing packaging. This relates to an otherwise quite commoditized transport service, Ocean Freight. So when you're doing traditional purchasing, you can save a few percent. But we've actually reduced the total cost of operating these Ocean Freight lanes by 50%, and the trigger in that was not only buying, it was redesigning the entire supply chain as well as the packaging, because that particular company was simply not filling their containers as they should (see Figure 14.2).

That case was a learning experience for us as well. It's one of those situations where value begins when somebody has an idea, somebody who's walking through a place spotting a latent demand who then links that thought to the latent resources within our organization. From the packaging example, we've developed lots of packaging now for our automotive sector that's enabling us to go in and say, "We're not talking about the €4.5 million that your transport is going to cost; we can tell that you're only going to need 70 runs instead of 100, so it's not going to be €4.5 million, it's going to be €3.8 million." That's the type of discussion we can then have.

ANDREAS HINTERHUBER: So this process optimization can then mean that you end up making a lower turnover? This means that you sell less?

PASCAL KEMPS: Yes, true, because that's a sacrifice you have to make, and of course it's not always an easy discussion. Really, I call it a sacrifice, because even if we're in a luxury position where we as DHL can offer (almost) any logistics service, these are not pleasant internal discussions. On the other hand, neither are pure pricing discussions or poor attrition rates, and that's often the only

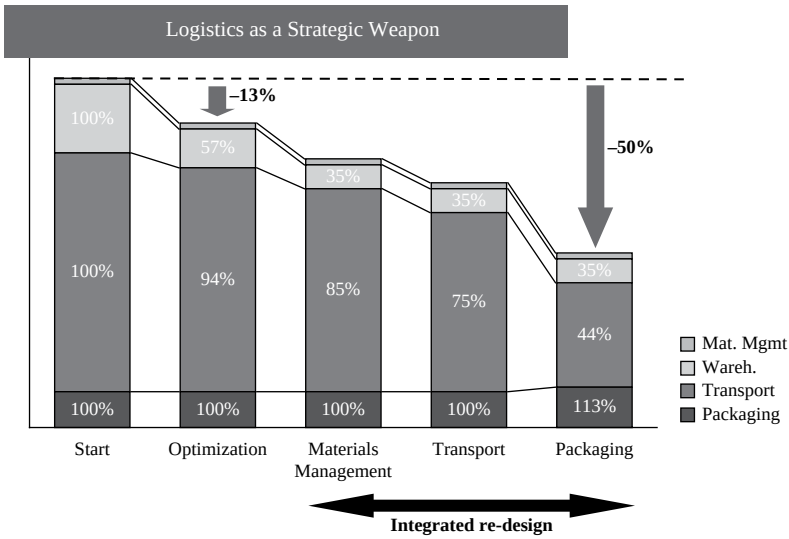


Figure 14.2 Customer value creation in B2B through process redesign.

alternative: if you're just going to offer what the pack is offering, then somebody else will do it cheaper tomorrow. However, if you're the one who comes up with the ideas and you are seen as authentic—i.e., genuinely walking the partnership-talk—then when the customer has a problem, challenge, or a question, they come to you and you have good strategic discussions up front. Your discussion no longer starts with an RFQ, it actually starts with an up-front value discussion: "How on earth are we going to fix this? How can we do this better?" Then you're building something. That's the "strategic" in strategic account management.

ANDREAS HINTERHUBER: Very well: what you're saying is that you care less about short-term revenue losses and more about building consultative or collaborative relationships with your customers.

PASCAL KEMPS: Exactly. I don't know if the expression even exists in English, but in Dutch we say "trust comes on foot, but leaves by horse." It means that it takes time to build trust, so either you can invest in always becoming cheaper and cheaper, or you can invest in building up a meaningful business relationship. Now, I believe both models work, but generally speaking the latter one is more satisfying for the employees and also more sustainable. It's also the more difficult part, because it's a lot harder to create a strong relationship, a value-added relationship through commercial operations, than it is to lay people off or invest in cost-bound technology automation.

ANDREAS HINTERHUBER: Fantastic example! Let me lead to the next question, which is, I think, tricky for many companies. And before I ask the question, I will make a small premise: some companies do value-based selling and they do value-based pricing very well. One obvious example is a company such as

BMW or Audi or Volvo. And of course these companies quantify the value of safety, prestige, or luxury for you. But this does not mean that you pay for your Audi or your Volvo based on the amount of luxury, safety, or prestige you enjoy. You pay up front, and that's a fixed price.

So the question I would like to explore is that value-based pricing for some companies means they quantify the value and then they charge a price, which reflects that value, but this price is fixed.

On the other hand, there are other companies that practice value-based pricing, and these companies interpret value-based pricing as performance-based pricing. They define relevant performance indicators together with their customers, and then price will vary depending on how the company performs against some of these performance indicators. What's your take on this? Do you think value-based pricing requires performance-based pricing, or do you think value-based pricing is also possible by setting a fixed price like, for example, Volvo does?

PASCAL KEMPS: I think performance-based pricing—that is, the performance-based contracting like you find in the public sector—has its strengths and its weaknesses. In my humble opinion, you too often fall into a scenario whereby you manage by statistics, but it doesn't necessarily mean that you're managing what matters.

On-time delivery, for example, can mean absolutely nothing, and I'll give you one example. Let's assume, for the sake of argument, that with a large car dealer we've got an 80% on-time delivery service (which is very, very bad; it's just to make the example easy). If he ordered five boxes of parts, that means that one box out of five didn't get delivered. Now, the way order and pick-and-pack processes work in big warehouses, you don't necessarily have all the parts for one car in the same box—they may be spread out over several boxes depending on, for example, the location of the parts in the warehouse. That means that in that one box that didn't get delivered, there may be parts for every single car that that dealer wanted to repair on that specific day.

Our performance actually looks like it's 80%, but in reality there was no service because the dealer simply couldn't finish any of the cars that he had.

ANDREAS HINTERHUBER: Great example!

PASCAL KEMPS: So, there you've got to be cautious. There is one customer whose name I must keep confidential for whom we don't measure the statistics; he measures the logistics service by the number of customers who didn't receive service, which then creates a totally different discussion because then the 80% would show as zero service basically. And thus you have a more holistic view of things.

I'll give you another simple example of how KPIs can be misleading. Say we try to ship something, but the pickup is too late because the material in the warehouse isn't ready for whatever reason when our driver shows up. The driver does what he can, but he gets to our terminal late and so the shipment doesn't get loaded in the right container, it misses a sort and is delivered late. It looks as if it's us, the transport provider, who's at fault. But in this case it's the

warehouse's fault. As the transport provider we could easily pump up our KPIs by refusing late collections, but that can't be the spirit, surely. Now, we could have been the warehouse and somebody else could have done the transport, but this is just for the sake of the argument. In such a case, when you just measure by KPIs and performance, it just doesn't mean much, to be honest. I'm not saying it doesn't mean anything—it does have value, but it certainly doesn't help anybody in this example.

So, I think the performance-based contract only works if it's properly set up and thought through. And if I'm perfectly honest, I don't know many examples where that's done in such a way that it truly serves the best interests of the customer and their customers, because it's difficult to do. It's not something you can pull out of a hat any time you need it.

And that goes back to the fixed price. There are two aspects to it. In some cases we can get away with it. If I look at our service into emerging markets, then we know we are there much faster than anybody else. So yes, there is a premium, there is a fixed price to it, and it will be more expensive than the competition's. The irony of it all is that often competition even outsources the business to us. So, in that case, you can simply say "here is the price," and that's it. You can't go crazy on it either—it always has to be reasonable—but we do know that there's a very significant service advantage.

If you look at other markets and other areas, it's virtually impossible to use a fixed price, because what you can physically do as a service is too similar to what others can do. Then you've really got to start looking at other options, like the example of packaging I gave. There's no clear-cut answer to this one, at least not in logistics.

ANDREAS HINTERHUBER: You clearly caution against the folly of managing by statistics. Some companies, you find, are excellent at collecting data. But unfortunately, you suggest, you will frequently find that these data don't mean anything to the customer.

PASCAL KEMPS: Well, yes—I mean, the statistic becomes the goal, and that's simply wrong. I'll give you another example I think most people will be able to relate to easily, even if they're not in logistics. Let's imagine that you ship something. Then there could be all kinds of reasons for a delay: it could be totally uncontrollable—like customs being difficult—or totally controllable—like a missort in one of our facilities—or even customer controllable—like a customer's decision to accept shipments only on specific days of the week. Imagine that somebody decides to send a shipment down to, for the sake of argument, Argentina, and that the receiver in Argentina says, "I don't want you to deliver it today, but deliver it to me every Thursday," so we're going to have the shipment there, we're going to fly it out there like it's urgent, and then it's simply going to sit there for X days. And the statistics guy would show this item as an uncontrollable factor, so it's deducted from our gross performance, and therefore doesn't show in the net performance. We can say, "Okay, our net performance is 95% to 96%." But the real question is, "Why on earth are we shipping this urgently?" Obviously, the receiver doesn't need it urgently; there

are better ways—this isn't giving better customer service to ship it quicker. You can start to think, "Let's consolidate several shipments and airfreight it down to that customer; it will be cheaper for everybody." In summary, because they look at net performance, which is 95% to 96%, that statistic doesn't really tell you that actually we're probably spending money on something we shouldn't be spending money on.

Or the example of the late box that I gave you, the 80%—well, that can be very well 0%; the 80% isn't going to tell you anything.

ANDREAS HINTERHUBER: The key in your experience is thus to move from meaningless KPIs to a few business indicators that truly matter to your customers in the sense of being specific to each customer's unique circumstances.

PASCAL KEMPS: You've hit the nail on the head. I think we should start calling it key business indicators and actually measure the impact of the value chain on the customer. The last thing I personally, as a customer, want is the message "service delivered" when I don't have the stuff on my doorstep.

So, how did the value chain perform? I'm sitting at the end. I receive goods from whoever, it doesn't matter. Did I get it, or not? Did I get it on time? Did I get it undamaged? Simple question: yes or no. Did we achieve it, or not? That's the only thing that matters. And behind that, there can be a million key performance indicators. But the only thing that matters is those business indicators, because that's going to determine my satisfaction, my repeat purchase, my loyalty. As a service provider it's crucial to think about these things, because therein lies your potential to create value. If you don't think about it, not only are you missing opportunities, but the customer will get challenged by the market sooner or later and you're just a domino stone in the chain.

ANDREAS HINTERHUBER: There is only one key question: by how much did the profitability of your customer improve thanks to your performance?

PASCAL KEMPS: Yes, exactly—the performance of the value chain—because if you look at just how complex many products and goods have become and how complex the delivery of those products and goods has become, you've got to look at the value chain and work your way backwards: "Okay, this didn't work; this customer did not get what he asked for—why?" How many customers did not get what they ordered and what they asked for? And then, work your way backwards. And then, based on that, determine for the whole value-chain key business indicators. Going back to the earlier example—we get our material one hour after the normal departure time of the courier, so we're going to try to push it through, because if it misses the sort window and it's left behind, it's going to show in our performance because we accepted it and yet we are late. But did the problem happen within our area? No, it's further up the value chain. This is typically an easy one to address, but there are far less easy ones to tackle. And yet, I see examples every day where even the easy ones are not being addressed, because the KPIs drive different behaviors—or no behavior at all ("I'm hitting my numbers—what's the problem?").

ANDREAS HINTERHUBER: Value quantification of course is easier if you can link your own performance to financial outcomes. The classic example is this: if you can say "I saved you one million in inventory costs" you can then say "Let's find a way to share this." Easy. But what about some intangible benefits that you provide to your customers? You could be seen as the most innovative logistics company. You could be seen as the company—turning back to our example earlier—that collaborates and co-creates value in consultative relationships with customers better than anyone else. The key challenge thus is: Is there a way you can put a reliable price premium or value premium on all these capabilities? Or do you attach a value premium intuitively? In the latter case you would probably say: "Okay, I know there's a competitor, I have a feeling for the price levels they practice with my key accounts, and I estimate that whatever we do on top of this competitor has intangible benefits that must be worth around 5% to 10% or so."

PASCAL KEMPS: In order to determine this, you need to understand the buying process within your customers. Some customers have a rule that the buying occurs in the business, which means you're going to be dealing with a guy who's going to run the operation. He's not only buying it, he's also taking the responsibility for making sure that it works. So, clearly there you can have a much more qualitative discussion with less quantification. There you can have these discussions saying, "We're working on this. Why don't we look at that?" And you just can't quantify it, because in the course of the project, you don't have the time, the knowledge, the data, the expertise available to make it happen. But you can simply say, "Fine, as part of our response, here's the financial picture, here are some quantified benefits, here are a bunch of things that we will commit to looking at together with you, and here are the time frames." You can say, "Fine, this is what we are going to do." That, then, is a very concrete application.

Now, if you're dealing with organizations where the buying and the operations are split, it's a completely different situation (although things are never 100% black or white). There, basically procurement will have been given a mandate to buy something, and often they will be shielding potential providers as much as possible from the users because they want to keep full control over the RFQ over the life of the project. It's much more difficult because these folks have to meet a set of user-specified criteria, and obviously they don't contain these non-tangible benefits necessarily. If you know the criteria up front—and this is again where the customer intimacy comes from and what I mentioned about building up a sustainable value relationship with a customer—then you can insert them and you can influence the RFQ. But it's certainly more difficult, especially in the earlier stages of development of the customer, to do this. It's still, then, valuable to do it because those types of intangible benefits open good discussions, they create customer intimacy, and they create a positive atmosphere. The customer will start to think, "Maybe we're not doing much business with them. But let's go talk to them because I remember they have some good stuff when it comes to supply chain risk management, they have

some really good stuff when it comes to packaging. They've been doing some work with augmented reality/vision picking in warehouses."

Then you come to the table and have a discussion. For example, we have an innovation center in Germany, Troisdorf—you are very welcome to visit it one day—where we have a team of researchers who research relevant topics such as crowd logistics. Have a look at www.delivering-tomorrow.com. We've looked at augmented reality, unmanned aerial vehicles, self-driving vehicles. These are big hypes today, but we have really mapped out "What can it mean for logistics?" "How could this work?" and then tested them in real-life operations. Very few companies have done this, but along with the "paper" insights, we allow customers to experience different options in person in the innovation center and talk to subject-matter experts. That makes things tangible, and as a result we're soon going to open another innovation center, in Singapore. We have lots and lots of customers who go there and who really enjoy going there because they actually see what's going to happen in their area going forward. And the beauty of it all is that it's an environment where we have very open, friendly discussions with them about what will be the future of logistics, what projects are running up there, what's on their minds, et cetera. It helps you build a potential value proposition going forward.

ANDREAS HINTERHUBER: Fantastic example! The point is that you show them softly who is the thought leader in the logistics industry and you softly sell them the idea that they could partner with a thought leader, that you could take them in a direction they themselves don't have a full idea about, and that you are the most reliable partner to take them into an undefined future.

PASCAL KEMPS: Exactly. And if these are people from the business and they are the ones who sell you on a project, then they are actually very suitable for these discussions because they will take these considerations into their business decision. If you talk about very procurement-driven types of organizations, then it's a way to create a positive, open atmosphere, to get out from behind the brick wall that's often in place; you get a friendly discussion and you get an early visibility on project needs and requirements. It's your starting point for a value approach; that's it. So, there are two angles to it. With regard to your point on thought leadership: it indeed helps them feel reassured about you as a company. In our case the scale is large because we can offer a broad range of logistics solutions, but for smaller companies there's no reason why this can't be done within a narrower focus. A lot is possible in today's world.

ANDREAS HINTERHUBER: Let's explore the individual characteristics of the SAM. We could argue that selling in the old days was different, and we don't talk about the golf course or the whiskey or the martini at two o'clock in the afternoon, but selling in the old days was all about selling features or benefits.

And if we take our conversation through the natural consequence, then we say selling today and in the future means that at least for some of your strategic accounts, selling is all about co-creating value, quantifying value, and selling business impact. This then leads to the question: At the level of

individual characteristics or even personality traits, what are some of the characteristics that are required at the level of the SAM today? What, by contrast, are some of the behavioral characteristics where you see that they simply don't fit, that these people don't make the cut, and you maybe have to reassign them to a different role because they may find it difficult operating in this new environment?

PASCAL KEMPS: Crucial—and this is rule number one—is being aligned with the customer. You've got very transactional customers for whom you need somebody who's really good at project managing and sales pursuits, in order to be able to standardize and industrialize these responses and work for the procurement—see the earlier example.

Then you've got the ones—customers from Asia, for example—who really work around a trust-based, snowball type of development and whose trust you have to earn by taking on smaller projects and then gradually building them up. They will be very loyal to their providers, and you can really only get in if you come up with new ways of doing things.

Both customer profiles require different account manager profiles. I'm giving you two extremes on the spectrum, but that's number one: there's got to be a good fit between the customer and the salesperson.

The second point, then, is that when you build such a team, you need to look at the different characteristics within that team. At a minimum, there needs to be somebody who can think very much outside the box. The guy who, when you send him to a customer, comes out and says: "These are the five things the customer wants, but here are ten other things we can think about, because I think they need this or I seem to understand they've got this challenge"—really outside-the-box thinking. Now, the trouble with those profiles is that you sometimes need to get them back on track. So in my mind, then, you need to always have a healthy counterbalance with somebody who is more of a day-to-day-like person. The one who says: "Let's roll up our sleeves and get down to business." The variation depends on each customer again, but in my humble opinion, you need a balance between those two. And that then links to the culture of the customer.

If you look at certain Asian customers, some people will have a big problem working with them. Why? Because of the snowball development required. These are the guys who run from one big project to the next, the so-called hunters. They're the ones who essentially score the touchdown after the team has brought them forward. They are, I'm generalizing, not necessarily always a good match with Asian customers—I'm putting it in very black and white terms now. So, you need to have somebody with those traits on a team, but for Asian customers you need outside-the-box thinkers. It's a very simplified view, to be honest, because there are so many dimensions you need to look at and so many character traits that you need to look at. Another profile example is that you need to have, on each and every team, a data miner, because in logistics everything we do is data, so you need to have somebody who can really read within the operations and pull out where the inefficiencies are,

where the service issues lie, how things can be improved. So, you need to have somebody with that type of brain as well—not necessarily in the sales function, but very closely supporting them. When you talk strategic accounts, it's a team pursuit. It's not that you need a dozen dedicated people on each strategic account; you can make a mix. In fact, these differences between customers are a great way to help your people learn/develop new skills by diversifying their portfolio. So, to summarize, the number one point is that you need to align the right team with the customer's culture. Then you will be successful internally and externally.

ANDREAS HINTERHUBER: Yes. And the second point, which you stressed, is this snowball effect, which means that you have to find people who are comfortable developing or investing in long-term collaborative relationships without seeing an immediate benefit.

PASCAL KEMPS: Yes, exactly; that's crucial in the development of any customer, even if you have those customers who put out big RFQs where you can win or lose multimillion euro deals every two or three years, like you see with a number of customers. Then, even there, you need to have such people who can get to a value-based discussion with customers.

Let's put it like this: by using the elements you mentioned—like innovation, like pointing out to users and procurement, "Yes, you're optimizing the container, but you're not optimizing what's inside the container; you can actually be using a lot fewer containers." So, these types of discussions you still need to have. Even with customers who have a transactional mentality, the long-term vision of the strategic account managers is necessary because ultimately they are also there to provide a customer service and to manage their business. At some point, somewhere in the organization, there will be people listening.

ANDREAS HINTERHUBER: We touched upon one constituency, the purchasing function, which may or may not be aligned with the business function. And you mentioned how the relationship between purchasing and the business function on the customer side might evolve. But maybe you could provide one example of how to change the purchasing criteria of the purchasing function. To put it a bit more bluntly, some companies say value quantification is all nice and fine, but you deal with purchasing and purchasing tells you there is one purchasing criteria, which is price, and the second one is price and the third one is price as well. Put differently, a bit more technically again: a number of companies are more or less required to put out RFQs based on LPTA (lowest price technically acceptable), which basically means that they first define the criteria and that once you pass them, then of course they select on price and price alone. What are your thoughts on how to change the decision criteria of the purchasing function?

PASCAL KEMPS: There are a couple of points. First of all, what people sometimes forget about procurement is that it also has a benefit for the likes of us, and that is that we tend to get information and data in a structured, easy-to-work-with way. If you work directly with business owners, they're typically not used to running a lot of RFQs, so what you get is sometimes very difficult to work

with. So I think procurement, which most companies are very good at, guarantees a certain level of quality standardization and clarity that is difficult for business owners to produce.

But, as you mentioned, many organizations—arguably all of them—officially go for the LPTA. This means that at some point procurement will go into the business—they will be starting to gather information from the business—and that's where you actually need to be.

At that point, you will need to have proved your point and exposed them to the potential value so that the RFQ, the technical specifications, is written in such a way that it factors in these value elements. That's it.

And that can take a very long time; it's not always easy to do. It also depends on the state the company is in—needless to say, companies in a financially difficult situation will simply be going much more for the lowest price and won't be bothered too much about changing the technical specifications. I work mostly with the automotive industry, and we know what kind of crisis they've been through. That was a time when (almost) everybody was saying, "Listen, you're absolutely right; we know we can do things better, but right now we just can't afford the time to work on that. Even if your idea brings value, right now we just need to come down with costs and with rates short term. So, we apologize, but it has to go like this."

The beauty of it all is that if you then make the investment to show the customer how they could improve—never waste a good crisis—eventually the times turn. Yesterday I was with a customer I'd spoken to two or three years ago about something, and he said, "Well, actually you mentioned that back then, and we couldn't do it, but I would like to talk to you about it now because we are ready for it, and I remembered that this was something really useful."

In Japan, there's a beautiful expression, "You have to be prepared to sit on a rock for three years," which means that sometimes you have to be in a difficult, painful situation before you get results. I know that's difficult for many of my colleagues, but fortunately I'm in an organization where it's understood that things may take time and it's accepted that sometimes you need to make an investment to service a customer in order to achieve a longer-term sustainable success. I'm well aware that that's not the case in all organizations, which means the SAM organization needs to be more careful balancing the short-, mid- and long-term development activities.

ANDREAS HINTERHUBER: You talk about the cultural or strategic fit with customers: Are there some types of customers who are your preferred customers, whom you would target preferentially? And then, by contrast, what would be some of the cultural traits or strategic traits—whatever we could call them—where you see that there is less of a fit between what you have to offer and how they would like to purchase? What is your take on that?

PASCAL KEMPS: I personally don't have a real preference. Like I said, things are what they are. I understand that individuals, particularly on the sales team, will have certain preferences. The hunter will be totally frustrated with certain types of customers who will only give him small pieces to test and build up trust. The

hunter wants to feel the rush of the big RFQs, sail the waves of adrenaline, and celebrate the big win. That's a great fit for a transactional customer—as long as the hunter is counterbalanced by somebody who's good at project managing and bid structuring. Coming back to what I said earlier: if you've got a very procurement-driven transactional customer, then you have to adapt yourself to it. Certain people will do well with that, certain others won't; but those who do well are probably going to struggle big time with the more relationship-driven customers.

ANDREAS HINTERHUBER: It's a great answer, because you suggest your company is big enough to deal with all types of customers; that's the point.

PASCAL KEMPS: You can look at things negatively, or you can look at positives. For a small company with a transactional customer, for example, it can mean that they can cherry-pick the business they want. It means they can work in a very structured process, which they can align with. If you're small, it allows for very efficient responses on the pieces of business you can/want to do. I'm playing the devil's advocate certainly, but I mean it. Like the example I gave earlier: we've had a customer like this, and we've streamlined our internal response process to it, and we were able to respond in time with the right quality and the right prices every time in the first round already with an 80% reduction in the time spent, so we can free up those resources for somebody else.

ANDREAS HINTERHUBER: Great! Let's talk about your own lessons learned. Some companies will look at DHL and say that DHL is really an excellent example of a company that develops collaborative relationships with customers and that can quantify its own contribution to the customer's bottom line. Some companies, however, are truly at the beginning of this process, either because they sell only based on features or because they have to sell heavily on price, simply because they don't know how to quantify value. So, what are some of the lessons you learned during this journey? What advice would you give to companies that have a well-defined competitive advantage, but in some ways struggle to convert this advantage into quantified and documented customer benefits?

PASCAL KEMPS: One is the Japanese example of sitting three years on a rock. It's going to hurt, you're going to hit a wall, you're going to misjudge customers at times, you're going to misjudge projects, you're going to misjudge your own capabilities, your own competitive strength. It's all part of it. We've had this, too: even if we've always had growth—it's pure fantasy that you can get away without growth—in the last couple years in particular we've seen phenomenal growth. It took us years to actually reach this level, simply because we were also in a learning period; that's true for many other customers, for many people out there. And this is not something that an individual can agree to; this has to come from management. There has to be a firm belief that, yes, this is going to work, we're not going to shut the whole SAM organization down after a year. The SAM management and each individual SAM needs to make deliberate choices about what short-, mid- and long-term development they focus on. We—as SAMs—have got to keep growing, learning from our mistakes as we go forward, and we've got to keep investing in the people to

keep them on board, to keep them motivated. That's the big learning, having gone through the cycle personally myself and together with this organization. I was here when it started back in 2003, so I've pretty much seen every stage of it and learned.

Two is the message I tried to give at the Strategic Account Management Association (SAMA) as well about a very small company, Avonwood. I think it's a beautiful example of a company that's very small on its own, too small to be truly global, to be carrying big investments in innovation. They were in every possible way the complete opposite of our company. Yet, they've been able to piggyback on, in this case, the innovation project that we operated with Volvo, the Maintenance-on-Demand project. They've been getting their funding 100% basically from the European Commission, so basically it cost them nothing; they got 100% coverage plus 20% for fixed costs, and now 70% of their sales is coming from the product they developed out of it. Of course it does take a vision to actually get it, and you have to fall into the right project, but my message there is that there are many resources out there, if you look around, that you can actually leverage.

I could give some examples, which are completely outside the box, of low-cost solutions we've put forward that we've developed which would probably be within reach for other companies, too. For example, we've looked at some customers as there was a crunch in the industry, cash was tight; we've worked with banks where we were offering inventory financing. Why? Because we offer certain standards, there's a certain level of trust from the banks, and they said, "Fine, we're willing to buy the inventory and therefore relief cash on the side of the customer as long as DHL, who is working according to these standards, is the custodian of the goods." That's one example—very concrete. The second one is something I call "startup within our company." It has to do with supply chain resilience, which has built up expertise on scanning hundreds of sources a day on potential supply-chain disruptions, and now our customers can subscribe to it as a service for a very low fee. They then get informed, for example, about an accident that happened on the highway: "Stuttgart has been closed off completely, which means the flows are going from A to B, and on that track you might want to divert them." So, these are the types of products, this could have been a startup somewhere in Silicon Valley or what have you, but it's something that we pulled together.

I think it's a matter of also looking beyond your scope, and sometimes people say we should just focus on our core, but I think the key question you need to ask yourself is "What is your core?" and you need to be willing to look at it. Those are my two pieces. It's going to take time; that's inevitable. Certain things simply take time. You can't force a tree to grow faster than it can. You can give it the optimal conditions to grow in—but you're going to have to wait until it's big if you want wood to build some furniture. It's as simple as that; there's nothing you can do about it, and it's only up to perfect conditions. And the second point I mentioned is that if you start to look around you'll find that there are more ways to differentiate than you probably imagined. The role of SAM is to foster these thoughts and projects within their people; they don't

need to be revolutionary. And, again, it's a great way to motivate and educate people, giving them something different from the day-to-day.

ANDREAS HINTERHUBER: Two great pieces.

PASCAL KEMPS: The guys from Avonwood are more than happy to show that case. For them, it's also free advertising, but I thought it was a brilliant example. It's a very small company with just a handful of people—it's literally a dad with his son and a handful of other people—and they hooked up with us through this Maintenance-on-Demand project, and now 70% of their sales are from this project—they are active worldwide.

ANDREAS HINTERHUBER: Is there anything we missed in the overall exploration of this topic of quantifying and documenting value to customers? Are there any further questions you yourself would like to raise?

PASCAL KEMPS: Well, there are a couple of points. Basically, I think there's a sensibility that you need to bring when you talk about value.

The biggest mistake you often see is that you bring value to the customer, and particularly in a pre-sales, before you sign a contract, and essentially you find out that your competitor can bring the same value. So it won't help you if that value becomes part of the RFQ. If you can apply the law of substitution, you haven't created value, basically. That's something in a pre-RFQ cycle you need to be very cautious with, because clever procurement organizations will simply take it and you will have made your competitors stronger than they were.

The other one is the "ring of truth." I'm sure you get emails in which the claims are just too good to be true. But even if you can't quantify it, can you substantiate how you're going to do it, how you're going to provide it in such a way that the customer will go and you can validate and say, "Yes, this makes sense, I believe what you're saying"?

I regularly spend time with our procurement, and it's a great learning for a sales guy. Very often your suppliers come in and state "We can do this for you," to which the response is "So could the guy before you. And by the way, where's the proof? Can you demonstrate this? Can you—I understand you can't quantify it—but where did you do this? Facts—hard facts: how are you going to handle this?" And then the sales guy walks away, sends in a presentation a week later, by which time everybody has halfway forgotten the message and nobody takes the time to read it anyway. That's fundamental: the value mustn't be interchangeable with your competition.

So: can you demonstrate clearly that you are able to do this? One example: we can leverage our innovation center because we can show what we do there; but we also offer, for example, virtual tours through certain of our operations. It's a robot that drives around between the staff in a live operation, and the audience—wherever they are in the world—can see, live, what's going on. We can actually show them everything we're doing. That's a simple and effective way to prove that what we say is very real.

ANDREAS HINTERHUBER: You suggest: attaching a lot of meat, proof, to your promises is key in this context of value quantification.

PASCAL KEMPS: Yes, but remember: it takes time to write something concise. You don't want a 100-page presentation either. You can simply say "Here's a little movie" or "Here's the process, which we're going to take you through"; "We're going to start on this date. These are the people who are there. This is their background. They are going to do this, this and this. They are going to run through your operation. Look at your packaging. They will deliver the report. And by that date, we will be ready to discuss. And by the way, here is some proof of the procurement of packaging in the past with this or that customer."

It's as simple as that. Blaise Pascal once wrote, "Sorry to write such a long letter; I didn't have time to write you a short one." It's about making it and putting it in there, but you don't end up sending a presentation a week later, which nobody is going to read; instead it's about building it in, in a very concise, easy-to-digest way.

ANDREAS HINTERHUBER: One thing is clear: you don't want to make your competition stronger than necessary. So one dilemma which you face from time to time is: you describe the process, but you probably have to be careful to not describe it in such detail that your customer just takes your description and puts out an RFQ with these requirements.

PASCAL KEMPS: Yes, and sometimes you have to take that risk, and I admit it does happen to us. Sometimes it's the only way to trigger a change, but then at least you were in early and you have access early and understanding early, and your solution will be seen as the benchmark anyway. But you're right, you've got to be very cautious and always ask yourself, "What I'm proposing here—can my competition do the same?" Because if they can, it's not the only proposal you want to go in with; you have to think further and take a conscious decision.

ANDREAS HINTERHUBER: How do you pay SAMs whom you expect to wait on a stone for three years? You probably cannot use only short-term revenue targets. Do you use soft indicators such as customer satisfaction? How do you incentivize them to value-based selling and value quantification?

PASCAL KEMPS: There are two aspects. How do you keep them motivated? You've got to make sure it stays meaningful. You can work around it and give them two types of customers to look after who are at different stages of development, so they can taste success enough—let's put it like this. But the second aspect is exactly like you say: there's a whole host of KPIs—we should say business indicators—that are not only related to revenue. Customer satisfaction—and how that evolves—is a very big one. There's always room for every individual to have some specific strategic targets, which are nonmonetary necessarily. That's all part of the package. Every case will be different, but the only thing that matters is how you keep the individual satisfied. Fortunately, there is so much variety in the world that with a bit of creativity you can achieve a lot for your people, your customers and your organization.

ANDREAS HINTERHUBER: Great! Pascal, this has been a rich and rewarding conversation. Thank you.

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*

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, *Head of Brazil Operations, Bombardier Transportation*

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, *Research Professor & Co-Executive Director, Center for Services Leadership (CSL), Arizona State University, USA*

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.
Kevin Mitchell, President, *The Professional Pricing Society, Inc.*

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.
Stephen Gold, *CEO of MAPI – Manufacturers Alliance for Productivity & Innovation*

Andreas Hinterhuber is a Partner of Hinterhuber & Partners (www.hinterhuber.com) and a Visiting Professor at the University of Bolzano, Italy. He has led consulting projects in pricing in B2B and B2C companies worldwide, including Lufthansa, Tieto, International Paper, Continental, SPX, Fercam, Swarovski, Würth-Hochenburger, Ecolab, British American Tobacco, and many others. He has published articles in *Industrial Marketing Management, Long Range Planning, MIT Sloan Management Review, Journal of Strategic Marketing, Business Horizons*, and other journals.

Todd C. Snelgrove is the Global Vice President of Value at SKF and supports executive MBA classes at Northwestern University, London Business School, and the International Institute for Management Development. He has been the lead architect and driver in SKF's Value Quantification journey.

BUSINESS & MANAGEMENT

an **informa** business

Routledge
Taylor & Francis Group
www.routledge.com

Cover images: © Shutterstock

ISBN 978-1-138-10163-0
9 781138 101630

Routledge titles are available as eBook editions in a range of digital formats