

Value-based Marketing Strategy

Pricing and Costs for Relationship Marketing

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www.vernonpress.com

In the Americas:
Vernon Press
1000 N West Street,
Suite 1200, Wilmington,
Delaware 19801
United States

In the rest of the world
Vernon Press
C/Sancti Espiritu 17,
Malaga, 29006
Spain

Library of Congress Control Number: 2014942085

ISBN 978-1-62273-020-9

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Chapter 3

The Value Concept

3.1 Definition of Value

The concept of Value bridges marketing and economics into one framework useful for developing strategy and setting prices.

From a marketing standpoint, Value can be defined as the set of benefits perceived by the customer in relation to the price and effort invested in obtaining it²². Consumers only buy products that have Value for them.

It is worth noting the difference between Value and positioning: Value expresses a logical relationship between benefits and price; and positioning, although it contains the same elements, simply refers to the image, or perception, of a product, brand or firm.

The current trend is that sales should not ignore the customer's needs in a quick and fleeting exchange of money for product (transactional marketing); what is really sought is to establish a long-term relationship that simultaneously benefits the customer and the company (relationship marketing). The reason is that securing new customers costs more than retaining them²³; it is not enough to just satisfy their needs, a step forward is required: retaining them long-term must be achieved (customer loyalty); this is the purpose that links relationship marketing with the concept of Value.

A key issue in relationship marketing is that a product's price must achieve customer loyalty, and be justified by the benefits it offers. This is only possible with a clear understanding of his needs, habits and

²² Thomas Nagle, Reed K. Holden, *"The Strategy and Tactics of Pricing"*, Pearson, Prentice Hall, 2002, pp. 7-8

²³ M.W. Johnston, G. Marshall, *"Relationship Selling"*, McGraw-Hill/Irwin, 2005, p. 79

preferences; thus, the product must satisfy them, without losing sight of the market context, the competition and the goals of the firm.

Value may be represented as follows²⁴:

$$\text{Value} = \frac{\sum \text{Benefits}}{\text{Price} + \text{Effort}}$$

Value is the relationship between the sum of all the perceived benefits with the price and effort required to obtain the product. Value is the force that drives sales and market share and provides the customer with a strong incentive to make a purchase.

Effort is a subjective non-quantifiable variable, which points to the fact that obtaining a product consumes time, energy and work.

Value is also a way of representing the Value proposition: The firm promises customers a set of benefits at a given price. Value is aimed directly at customer satisfaction: it is the bull's-eye.

Consumers will always want to maximize their gains; this means to obtain the maximum while investing the least. The firm provides output in terms of benefits and consumers provide the input in terms of their economic sacrifice (price paid) and effort. Value is therefore a marketing output / input ratio which measures the consumer's gain, or "profitability" he obtains from his purchase.

This ratio suggests that Value increases when benefits increase or when the price and/or required effort decrease. If the price increases in greater proportion than the benefits offered, then Value decreases and the quantity demanded by the customer segment is reduced. Value remains unchanged if lower benefits are balanced by lower prices, or if higher benefits are balanced with higher prices. Negative benefits subtract from positive benefits; this reduces the Value of the product.

²⁴ Carlos Raúl Sánchez Sánchez, "*Administración del Precio en Mercadotecnia*", Thomson, 2003, pp. 51-56

This definition of “Value” can be equated with the definition of “Utility” in classical economics, which corresponds to the level of satisfaction an individual obtains from a good or service. From a Marketing standpoint, Value or “Utility” may even be quantified, as will be shown in section “8.1 The Value Matrix”.

Value is an orientation model that facilitates understanding the underlying mechanisms at play, and guides towards forging appropriate strategies.

Orientation models are useful in marketing and sales because responses tend to be non-linear, which means that a certain change in one variable will not necessarily trigger a proportional change in another. For example, a decrease in price may not trigger an instant, or even proportional increase in quantity sold: The market's response is loaded with uncertainty and time lags.

A thought experiment may come in handy here. Imagine an elastic string pulling a brick on a flat surface. A constant pulling force may be exerted on the string to pull the brick, but that does not necessarily mean that the brick will move steadily in proportion to the force applied. In fact, it probably will not move until a precise threshold force is applied; at that point, it may not even move slowly: it will jump abruptly and then stop, despite the constant force; then, after a little extra pull, another jump takes place, and this can go on indefinitely. This analogy illustrates the non-linear action-reaction situations commonly found in business.

It is easy to fall into the trap of applying too strong a force on the string to expedite results; but it may turn out to be excessive, leading to unwanted results; as may easily happen in pricing, or marketing in general. Each product is a universe in itself, so there are no solutions with fixed rules, or recipes; let alone magic formulae.

This can be hard to understand in business, because it may seem that the market does not respond to cause-effect. Just as this can apply to a price change, it applies to changes in Value: it may take some time, but the jump can occur at any moment; therefore, some patience is required because the response time, or lag, may be highly uncertain.

The brick analogy is of particular importance when making price changes, given that customers' responses can be delayed; it takes time, perhaps months, or even years, until the market gradually responds and stabilizes itself. This makes it tempting to push up prices constantly

with the expectation that somehow –as if by magic– this will also increase profits, when, in fact it may well have the opposite effect.

Non-linearity and lags are dangerous in business and need close attention: management can make truly logical and reasonable decisions, but, in a short-term managerial horizon an observable result may not be seen; in fact, even a negative result may appear; reactions can take time, or even years to materialize.

This is also a frequent pricing problem: when prices are too high and management reduces them, the result is an instant loss of revenue and profits. This prompts management to avoid reducing prices, despite the fact that signals like lower than average inventory turnover and loss of market share clearly indicate low Value (few benefits or a price too high); benchmarking with the competition can provide useful clues.

Management then wrongly believes that not much more can be done, and instead of solving the real problem (benefits and/or price), they attempt to compensate the loss of revenue by adding other products and diversifying the product line; this adds inventory and costs. Consequently, high prices are a common problem, which frequently paves the way for new competitors and further market share loss.

Many marketing opportunities appear because a given level of Value ("utility" or satisfaction) can be delivered in an almost limitless number of combinations of benefits and prices.

The Value relationship is static, dynamic, and relative. It is static because at any moment the customers must perceive that the benefits received outweigh the price and effort required to obtain the product. It is dynamic in the sense that a price change should be justified by a proportional change in benefits. It is relative because the Value of a product can be compared against its competition, or with different purchasing alternatives.

In fact, if the product's Value is V_p , and the competing product's Value is V_c , then its relative Value (or Value differential, V_r) is even more significant: $V_r = V_p - V_c$. This differential is the driver that will determine customer preference and the product's behavior during its life cycle. This issue is explored further in section "7.3 Value Life Cycle".

Let us look at an example: If a Coke has a price of \$ 1.00 at store X and \$ 0.80 at store Y, which offers exactly the same benefits, then the Coke will have a greater Value (V) for the customer at store Y: $V_y > V_x$.

However, if X were to offer far greater benefits than Y, then the Coke would have a greater Value at X, then $V_x > V_y$.

If the price at store Y is increased, then its Value (V_y) decreases; the Coke now has a greater Value at X due to the price increase at Y, then $V_x > V_y$. Given the choice, the customer will very likely select the one with higher Value.

However, a Coke might even cost \$ 5.00, or more, at an upscale restaurant that offers many more benefits than a store, such as status, service, prestige, etc. The higher price would be fully justified by the benefits.

Moreover, if the benefits offered by the restaurant are sufficiently attractive to the customer, then the Value of the Coke in the restaurant may be greater than its Value at the store. Given the choice, the customer may prefer to drink it at the restaurant even though it may cost more.

This example clearly illustrates how benefits may be more important than price in the demand for a product. (Notice that in the classical model of supply and demand quantity is determined only by price).

If another store offers the same Coke for \$ 0.30 (very low price), then the customer might hesitate buying it, as he might think something is wrong: this would probably signal low quality in some way, thereby reducing its Value for him, or even lead him to abstain from purchasing altogether. This low price conveys to the customer confusing signals regarding the product's positioning.

Prices function properly within the customer's expected and reasonable price range. In this particular case, the price of the Coke is outside the price range expected by the customer and therefore he might doubt its quality (negative benefit); this reduces its Value despite the low price.

Effort has an interesting relationship with the time factor: if obtaining the product is too difficult, or involves an exaggerated investment in time, it might lose Value as it could easily be replaced it with another one that requires less effort.

The purchase of a product in the shortest time possible, or an agile service, can be highly valued; a good example lies in the fast food business that, as its name implies, requires fast service.

There are other cases, however, in which slowness may be highly valued, as may happen in an upscale restaurant; here the customer does not value or desire a fast service, in fact, he actually wants to prolong his purchasing experience; the benefit here is that slowness will be associated with status, elegance and prestige.

It may also happen that if the product, or service, is very "exclusive", the benefits associated with a greater effort may be prestige and a sense of belonging; hence the importance of user clubs, VIP cards, etc.; not everyone has the privilege of having them.

It should be noted, as in the prior Coke example, that care must be exercised with changes in the variables of Value, because they might send mixed signals to the client and alter the product's positioning. A drastic reduction in price might negatively affect the associated benefits of quality, status and prestige; the positioning may change and probably reduce the customer's trust in the brand; this can decrease the product's Value.

A product is purchased only if customers perceive Value in it; this means that the benefits offered must fully justify the price and effort sacrificed in order to obtain it; if Value is not perceived, then it will probably not be bought.

High Value is perceived when benefits outweigh price and effort; the consumer recognizes here a chance to "win" and his purchase therefore becomes an attractive deal; high Value induces greater demand.

Value is the real "engine" for increasing market share²⁵. Sales volume is the direct result of the Value offered, and the higher it is, the faster the company can reach its earnings and profitability target.

The demand for a product is directly proportional to its Value.

A product ceases to have Value when the price is too high relative to its benefits, and therefore the customer may be unwilling to pay for it. If

²⁵ Donald R. Lehmann, R.S. Winer, "*Product Management*", McGraw-Hill, 2007. pp. 303-304

a product has no significant benefits relative to its competition, then the only possible differentiation is that given by its price.

A product may be very expensive, but, that does not mean that it necessarily has low Value; on the contrary, if its associated benefits are sufficiently attractive, then it can be a high Value product. A fine brandy or scotch provide good examples: their price may be very high, but their buyers attach great importance to the prestige that they provide in their social circles.

Similarly, a low quality product may have few benefits, but, if its price is low enough, it can also have a high Value. A cheap ball pen may do its writing job reasonably well, and if its price is sufficiently low to attract buyers, then it has Value for them.

As an example in the practical use of this concept, let us examine the reaction to a new competitor attempting to enter an established market with a low-pricing strategy; one obvious response would be to react with discounts, or even reduce prices. But, how about responding with a promotion that offers some extra benefit? One option is to add a free item to the product, which may be very pleasing to the consumer; this is likely to be more effective and cost less than reacting with discounts, or low prices.

Another option is to increase the quantity delivered without changing the price. This may have the same financial effect of a discount; but, it is perceived by the customer in a completely different way; it is clearly viewed as something better in the product; in fact, the customer is already used to the ongoing price; there is no need to confuse him.

These actions may thwart the efforts of competitors to gain entry into the market with low prices; indeed, this promotional strategy can be executed in precisely the same places where the competitor attempts to enter market, and thus avoid price erosion in other markets. The customer perceives something "better", the product's positioning remains intact, and future earnings are not threatened; this may also help avert a "price war".

3.2 Resistance in sales

Value was previously defined as a force that drives sales. Nature, here comes to our rescue in order to understand the concept of force and apply it in marketing.

Sir Isaac Newton was first to understand a force and explain it in the language of science –mathematics. He concluded that force acting on a body not only moves it; it makes it go faster and faster; in other words, it accelerates it. However, he also noticed something else: larger bodies require more force to set them in motion. It seemed that matter somehow possesses a mysterious property, which makes it "resist" being moved.

As strange as this property was to him, it still is to us today, almost four centuries later. He described this property of matter in his first law of motion as an innate force of matter, or the power of resisting being moved; this is known as inertia.

If somehow inertia can be decreased, a body's resistance to being moved is reduced; therefore, it can increase its speed faster – acceleration. If resistance can be decreased, an object can move much faster in less time.

Newton also noticed that a body with more mass had more inertia; he expressed this in his second law of motion with his equation $F = ma$, or, force equals mass times acceleration: more force means more acceleration. For a given constant force, more mass leads to less acceleration, or conversely, less mass (less inertia and less resistance) leads to greater acceleration.

Interestingly, a similar law governs electricity. From Ohm's law: electromotive force (electric "pressure" or voltage) = resistance (ohms) x current (amperes), commonly expressed a $V = I \times R$; this simply means that more current flows through a circuit when it has less resistance.

Something similar happens with the flow of a fluid through a pipe: for a given amount of pressure, when there is less resistance more fluid flows.

This seems to be a universal law; marketing should be no exception.

Value is a force that pushes sales: more Value = more sales = more market share. Let us now apply this law of force to revenue (sales):

$$\text{Value (force)} = \text{Resistance} \times \text{Sales (Orientation model)}$$

The relationship between sales and Value becomes clearer when presented as:

$$\text{Sales} = \text{Value (force)} / \text{resistance}$$

This indicates that as resistance increases, sales decrease; therefore, sales are inversely proportional to resistance: more resistance, less sales; and directly proportional to Value: more Value, more sales.

Evidently, Value cannot be delivered to its full potential if resistance does not allow it to act freely; it must act without it to increase sales and profits faster.

Therefore, the question is: What issues create resistance to sales and profits within and outside the firm? The first step is to identify them, and then propose solutions to mitigate or eliminate them.

It is important to identify resistances; otherwise, it is easy to fall into the trap of thinking that a sales –or profit– problem may be due to pricing, when in fact it may be for other reasons. From a pricing standpoint, resistances may originate from the market, the product, the economy, or the firm.

The following sections present some frequent sources of resistance.

Market resistance

Customer segmentation

Money, like time and energy, is a limited resource; no firm can concentrate on all markets simultaneously because this requires almost infinite resources; therefore, it must focus on the specific market segment that holds the best sales and profit potential; this is its target.

Advertising and promotion, in particular, must be aimed at the selected target in order to spend limited funds efficiently.

A profitable market segment must meet at least four requirements: it must have a clear need for the product; a sufficiently large number of customers; a minimum buying frequency, and the required purchasing power. If these requirements are not met, resistance is encountered

(lower sales); therefore, a well-chosen target decreases resistance and allows Value to increase sales.

Brand or Product positioning

A strong brand is like an airplane on automatic pilot: it flies by itself and sells as if by magic; this reduces resistance and increases revenue. It not only carries customer trust and loyalty, but can also contribute towards selling other products.

If the product has a strong brand, it may be applied to other product categories that may benefit from it; this is known as "brand extension" or "brand stretching". The sale of these diverse products is leveraged by virtue of the brand's power.

The set of messages conveyed to the selected target must be sufficiently clear to highlight the product's competitive or complementary advantages.

The firm has two options: it can either attempt to capture the competition's customers with similar products, or it may seek to attract a slightly different market segment with products that somehow complement those offered by its competitors.

Either approach requires an effective positioning message, and a communications strategy that enhances the product's Value and its brand; this increases demand and revenue.

Distribution Channels

These are divided into two main categories: direct and indirect. Indirect channels include intermediaries such as distributors, wholesalers, agents and retailers. Direct channels provide a direct means of selling from producer to consumer: these include manufacturers' own retail stores, telemarketing, mail order, phone, Internet, or even company salesmen selling door to door.

A wide array of distribution channels increases sales, but it must be balanced against the investment required and its operating cost. Long distribution channels decrease the firm's profit margin, or may pressure upward its prices, as each intermediary takes his share of the profit.

Global competition has placed intense downward pressure on prices; this has led to increased preference for direct distribution channels, with the Internet playing a major role.

The target customer segment, the product's price and its positioning, must be aligned with the choice of the distribution channels; improper selection leads to sales resistance.

Competition

Revenue may decrease even though Value may remain unchanged; this is possible because competitors can also have high-Value products, as they may offer better benefits for an equivalent price, or similar benefits at a lower price; this can change customer preferences towards substitute products.

This reduction of revenue, and possibly of market share, suggests a resistance exists somewhere; its source needs to be identified and corrective action must be taken.

The first step to identify the source of the resistance is to analyze the product's Value; that is, its benefits to price combination, and compare it with the competition. This may require adjusting the price, or changing benefits, until a more competitive combination is found. If this has a cost implication, it also needs to be analyzed in order to maintain profitable sales.

This analysis may lead to an increase in benefits, a reduction in price, or a combination of both; either one is an increase in Value; the increase in Value should make the firm more competitive and increase sales (resistance reduction).

If a more profitable solution cannot be found, the product may be substituted, or complemented by additional product categories, in order to make up for the reduction in revenue.

Product resistance

Purchasing experience

Value is not limited to tangible products; it may also apply to intangible products (services). A high level of pleasure may be derived from the purchasing experience as if it is a product in itself; this relates not only the product and its brand, but also to the service delivered and its ancillary benefits.

This explains why the interest in a highly desired product may wear out after some time: the pleasure is not really obtained from the product; it is really derived from the purchasing experience itself.

An enhanced purchasing experience increases Value, decreases customer resistance, increases buying frequency and thereby sales. The lesson is that the interaction with the customer must be set up so that he obtains a high degree of pleasure and satisfaction from the act of purchasing.

This may explain the success of shopping malls; they have made great strides in improving the entertainment side of buying; evidently, pleasure decreases resistance.

Diminishing returns

Value remains unchanged as long as benefits and prices remain constant. The law of diminishing marginal utility in economics suggests that a consumer will continuously purchase a product as long as his additional (marginal) satisfaction is greater than the additional (marginal) cost of obtaining it (its price); in other words, the customer continues purchasing only as long as the pleasure exceeds its cost.

For example, a steak purchased at a restaurant provides the benefits the customer desires, but to receive them he must make a financial sacrifice by paying its price. However, if he desires a second steak, he would still have to pay the same amount, although one of the benefits (hunger satisfaction) is now less significant; this means its Value for him has somewhat decreased: fewer benefits at the same price. Therefore, it is quite likely he will not request the second steak and much less a third.

Resistance may set in, but that does not mean it cannot be mitigated: the fact is that the customer may still be hungry, yet he will not sacrifice more money for a marginal amount of pleasure. However, what happens if the restaurant has a "seconds" policy? The second order may then cost less, either by quantity or by price; this certainly adds Value; the customer may then feel enticed to go for seconds (more consumption); this, of course, not only enhances his buying experience (or pleasure), but also increases the restaurant's revenue.

Resistance can therefore be mitigated by continuously adding Value to the customer, either by additional benefits provided by added variety and service, or even by lower prices; this also builds customer loyalty and brand image.

The key is to properly identify the source of the resistance and then proceed to diminish or eliminate it.

Product packaging

Packages contribute significantly towards product differentiation and contain a substantial amount of information: brand, quality, price, quantity, instructions, etc.

The main marketing function of a package is to encourage buyers to purchase the product; this involves a package that conveys its positioning, and is specifically tailored for the target segment.

Humans are visual; therefore, the product's packaging must exhibit the key signals that equate the product's benefits with the customers' needs.

Deceitful packaging prompts customer resistance; this leads to lost sales, which quite likely cost more than the short term gain from the deceit.

Price

In many cases, a product's price may be the main source of resistance; that is why setting prices properly is such a high priority. A price out of line with the product's benefits, or with comparable substitutes, will discourage potential buyers and prompt them to pursue other alternatives, thereby leading to lost sales.

Customers are patient when it comes to searching for opportunities: when a high price entices them to shop for other alternatives, there is a good chance they will find them, especially if they believe the price is not justified by the product's benefits, or that better choices are available elsewhere.

It is not uncommon to see food spoil in supermarkets, restaurants, bakeries, butcheries, etc., simply because of poor pricing practices. This not only costs inventory money; it also takes its toll in customers and lost sales.

Businesspersons frequently fear price discounts because they do not realize that the price itself does not have to change; what really changes is the product's Value. Discounts and promotions increase Value temporarily, until supply and demand come into balance; once the sales goal is met, price and Value remain unchanged.

Quality

From a marketing standpoint, quality is not only adherence to a product's specifications, but also how it compares with the customer's expectations.

The customer makes an appraisal of the product's Value: he weighs its features and benefits against the price; if he feels that it matches his expectations he interprets this as "good" quality.

If the customer is not satisfied and believes that the product or service has "low" quality, he voices his opinion via word of mouth to all his family and social circles; this has a very significant impact on the market as it spreads exponentially.

Sellers sometimes may not realize that a cost savings, which sacrifices the quality of a product, may be more than offset by the loss of sales to the customers that perceive low quality. This can happen because estimating savings is actually very simple: all it takes is determining the cost savings per unit and multiplying it by the number of units sold.

In contrast, estimating lost sales is a completely different story, because determining the number of disenchanted customers is almost impossible. If we add to this the exponential word of mouth effect, the numbers could be very large. Perhaps this can explain why sometimes a product, or a business, can fail so quickly.

In general, quality below customers' expectations leads to lost sales, as it decreases their purchasing frequency, and induces them to search for alternative options.

Negative benefits

As pointed out in Section "2.10 Benefits", just as positive benefits add Value, negative benefits reduce it. They work against sales by creating resistance and leading customers to reduce their purchasing frequency, or explore alternatives that are more competitive.

Resistance from the economy

Monopoly and oligopoly pricing

The lack of competition in monopolistic markets tends to drive up prices, which may prompt buyers to reduce or limit their purchases; this adds resistance to the free flow of goods and services.

In oligopolistic markets, competition exists among a few companies, but it may not be related to prices, as comparisons are relatively easy to make, and therefore they tend to be similar. The prices may be relatively high, but this is compensated by a wider selection of products; this promotes a greater flow of goods than in monopoly (less resistance).

When the price of a product is not justified by the benefits it offers, the customer segment (target) may feel it receives less Value, particularly if the price is perceived to be high, unfair, or abusive.

A customer may feel compelled to make the purchase anyway, but his buying frequency decreases, as he may have other needs, such as food, clothing, transportation, etc. The sellers may not realize that competition is not only amongst products in the market, but also for the customers' disposable income.

Customers can restrain themselves from buying, and perhaps may not even experience any pleasure from compulsory purchases, particularly when there are no other available alternatives. This resistance will not allow the sellers to achieve the full revenue potential that their target segment can deliver. Moreover, their financial statements may seem fine to them, but they will never know the amount of lost revenue and profits.

Taxes and tariffs

These are, unfortunately, interferences with the forces of supply and demand and with the free flow of goods worldwide; this, as was shown previously, leads to inefficiencies in the form of shortages or surpluses.

The purchase of a product that carries a high sales tax requires a greater financial sacrifice than the same product with no tax; this decreases its Value and creates resistance.

Tariffs and other taxes that increase costs, lead to price increases and therefore have a similar effect: they decrease Value and sales.

Resistance within the firm

Financial services

Inflexible credit policies may restrain revenue. Customers not only need products and services, they may need financing for various reasons: they may have reached a credit limit with their banks; perhaps they do not have credit available, or they may feel that supplier

financing is more flexible, easier to obtain and less expensive (or perhaps even free!).

The firm can make loans, just like it can provide any other service that increases its capacity to compete in the market, and thereby increase revenue and profits.

Providing money in the form of "loans" is analogous to selling goods: money is "sold" to be repaid at some future date, and when payment is received, it includes "interest", which corresponds to the commission charged for the service rendered, or to the profit earned by the lender.

However, when a company provides credit, it does not deliver money: it delivers goods and services to be paid at some future date; this is termed "credit sales".

Credit increases revenue as it offers many alternative payment options; it can be tailored exactly to the customers' needs; it increases their purchasing frequency, and may aid the firm in reaching other market segments. The credit service contributes to add Value to its products, and may increase its financial return on assets.

The firm, of course, must compute the financing cost. Since it is an additional benefit for the customer, it may or may not be added into the product's selling price, depending upon the marketing strategy.

The firm may also offer support to its customers in obtaining credit from financial institutions; this may even leverage their capacity to obtain credit, not only due to the firm's experience and connections, but also from its knowledge of the customers' business.

Some customers may not have the administrative capacity to fulfill the credit requirements of banks, or may not even have the personnel needed; the firm can supply this. Its reward: less customer resistance and more sales.

Inventory turnover and logistics

"Sorry sir, we're out of stock". This phrase certainly does its job of discouraging any customer, and sends him flying directly into the open arms of competitors. This is not only a lost sale; it is a strong source of resistance in the selling battleground.

Inventory costs money in terms of the investment required, its carrying costs, financial and otherwise; therefore, inventory turnover is an important financial metric that needs to be tracked.

The slowest vehicle determines the speed of a convoy; something similar happens with inventory turnover; the slow-moving products drag down the total average inventory turnover, and therefore increase costs and logistical problems; this adds resistance and restrains sales.

If a high price is not accompanied by additional benefits, Value decreases and this has a negative impact on the product's demand. Low inventory turnover is a signal indicating low product Value; that is, low benefits, or a price too high.

The term "low" inventory turnover relates to products whose inventory turnover is lower than the average turnover of the product line or category. This is very significant in perishable goods, food in particular.

There is a good chance that a product with relatively low turnover may not be fresh; once customers become aware of this, they may not wish to purchase it again; this further reduces turnover. A dangerous vicious circle looms overhead: this can kill a good product if corrective action on its price is not taken promptly.

If the company experiences low turnover, it may be tempted to extend a product's expiration date in order to reduce returns. Customers, however, may perceive a lack of freshness and can confuse this with low quality; this arouses their resistance and decreases sales. The proper solution is to increase the product's turnover by increasing its Value, either through improved benefits, or lower prices.

Service and warranties

Warranty and service support play a key role in building consumer confidence in the brand, and in their willingness to pay its price. Conversely, low quality service and insufficient warranties create purchasing resistance from customers.

Products may be copied or imitated; service is not so easy: it requires in-depth knowledge of the firm's organization, its hiring practices, employee training, compensation and motivation. This has important implications for product quality, positioning, and manufacturing efficiency.

Service can be a very effective tool for differentiating a product or brand, as it may be a strong competitive advantage to reduce resistance and enhance customer loyalty.

Cost accounting methods and interpretation

A product's cost may have an important influence on its selling price, as it is useful for determining its profit. A misinterpreted cost may lead to a high price that creates customer resistance, and it may even kill a profitable product.

Costs have a purpose: A cost used for determining a product's profit may not necessarily be the same cost required for filing an income tax return, or for reporting financial results to stockholders.

Costs used for determining profits when setting prices must have a fair level of independence from sales volume, which may vary significantly throughout the product's life cycle, and during normal business ups and downs.

This issue is analyzed further in *Chapter 5. Costs*.

Cooperation and teamwork

Teams tend to be better thinkers than individuals; perhaps that is the reason why companies have a board of directors; democracies function better than dictatorships, or even why free markets are more efficient than monopolies and oligopolies. However, serious danger may lurk inside the team, or the company for that matter.

Internal competition amongst employees may not exactly harmonize with cooperation, and this may create resistance to sales. A good example might be two sales representatives eagerly competing for a customer in an auto showroom: if they cooperate instead of competing, it is very likely that their joint sales effort will be much more productive. The outcome is beneficial for both of them in this win-win situation. This is also referred to as positive-sum game; the outcome for each player is positive. The firm's compensation policy should be aimed at rewarding this selling strategy.

Another example is a restaurant in which a waiter will not tend a table that is not in his section; this projects a poor business image to the clientele, and certainly has a negative impact on its sales.

Many functional areas of companies tend to work independently of one another, thereby interfering with the coordination required to deliver the constant quality and service customers need; this can be another source of resistance in the selling process.

Human resources

Companies are no too different from sports teams: they need to win. However, getting good players is not easy: they must be both capable and honest; no firm survives if its employees do not meet these two minimum requirements.

Competition also exists in the labor market; the best companies may get the top players. However, "best" may not refer only to pay; it is also closely related to the working environment and its organizational climate. There is hardly any possibility that demoralized workers can deliver constant quality and reliable service; in fact, they can even become a source of resistance.

Of particular importance is employee selection, training and motivation. This relates not only to sales personnel, but to all company employees as well. Lack of understanding of marketing and sales fundamentals by administration and production personnel, can lead to major restrictions that hinder the selling process.

A highly qualified salesperson has the capacity to turn a sale into a memorable moment for the customer; this reduces his resistance, increases purchasing frequency, and may increase the word of mouth activity – "free" advertising!

Selection, training and motivation play a key role. Winning in sales is not circumscribed to the sales and marketing departments; everyone in a company has a role to play for scoring points in the market; this is what the business game is all about.

Salespersons

A chain breaks at its weakest link; this is certainly true in business. Firms invest large sums of money on marketing plans; however, the entire strategy may end up depending on a single salesperson that may not be qualified to sell the product; at this point the chain breaks and all the money invested in this effort is lost. This is certainly a good source of resistance.

Machinery and equipment

Managing prices is a good method for matching supply with demand; however, a point may be reached when prices cannot be increased any further to cope with very high demand pressures. At that point, output capacity must be expanded; otherwise, a bottleneck will surface,

thereby adding resistance to sales. This, of course, requires investment in fixed assets and working capital.

This outlay is feasible only if the additional quantity to be sold yields enough cash to pay for the added investment, within a timeframe in line with the firm's financial goals.

All resistances have opportunity costs associated with them. If the opportunity costs can be identified and diminished, or eliminated, both sales and profits instantly increase.

3.3 Supply and Demand with Value

In section "1.1 Supply and Demand" the mechanism of supply and demand was analyzed; it was noted that the quantities supplied and demanded were balanced by virtue of price, which, if allowed to act freely, acts as a self-adjusting efficient mechanism for allocating and rationalizing the use of limited resources.

In contrast to "perfect competition" (compare with section "1.2 Markets and the Economy"), the market under the Value framework is characterized by:

- *Non-homogeneous products.* Substitute products, which are equivalent and directly compete with one another, are clearly distinguishable (differentiated) due to marketing mix (4P) strategies, such as branding, positioning, segmentation, benefits and price.
- *Large numbers of buyers and sellers.* Although there are indeed a large number of firms, markets have become "localized", and in each locality there are firms that can individually influence the price of the goods and terms of sale; for example, stores in shopping malls.
- *Dependence.* Firms are apparently free to make decisions; but, in reality they are not, because they are being influenced by the media, and by the actions of their competitors.
- *Imperfect information.* Even though customers do possess very good market information, branding strategies may lead them to make subjective decisions that, from a pricing standpoint, may not seem economically "rational". A well-positioned brand may sell successfully a product at a high price, although an equivalent

product, with the same quality, may be available from brand X at a lower price. In effect, the customer is paying a premium for enjoying the use of the brand.

- *Constrained entry and exit.* In fact, there are myriad barriers for entering or exiting a market: monopolies, oligopolies, red tape, business permits, complex tax and labor regulations, to name a few.
- *Transaction costs.* Buyers and sellers do incur many trading costs, mainly in the form of taxes: sales (value-added tax), banking, property, withholding, custom duties and tariffs, among many others.

All these market characteristics represent interferences that are reflected in the Value of the product, either in its benefits or in its price.

However, an unsolved problem remains: the truth is that the demand for a product depends not only on price as assumed by the law of supply and demand; from a marketing perspective, the supply and demand for a product depends mainly upon the marketing mix (4P).

The marketing solution requires developing a model that takes into account the marketing mix (4P) within the mechanism of supply and demand. The 4Ps have something in common: benefits. Upon review of the list of benefits suggested in section "2.10 Benefits" it can be seen that, one way or another, they are all included in the 4Ps.

The concept of Value and its relation to the demand for a product in terms of its benefits, price and effort was studied in the previous section. It was determined that the demand for a product is directly proportional to its Value.

$$\text{Value} = \frac{\sum \text{Benefits}}{\text{Price} + \text{Effort}}$$

This formula indicates that Value (benefits, price and effort) contains all the elements of the marketing mix (4Ps).

If the law of supply and demand is adapted to include Value as the key variable that determines the quantity sold, instead of price, it becomes a very practical tool for developing marketing and pricing strategies, as will be shown below.

In classical economics (see Figure 1.1) changes in the quantity (Q) demanded due to price are represented as *movements* along the demand curve; however, there are other determinants, aside from price, which can change demand; those changes are represented as *shifts* of the demand curve.

These shifts may result from changes in marketing variables such as advertising, branding, positioning, etc., as they increase the demand for a product at all price levels; changes in non-marketing variables such as the income level of consumers may also shift a price-based demand curve.

Similarly, in classical economics movements along the supply curve are due to price; however, the price-based supply curve itself may shift when there are changes in variables other than price that affect supply, for example: harvests, disasters, competition, seller expectations, costs, price of substitute products, etc.

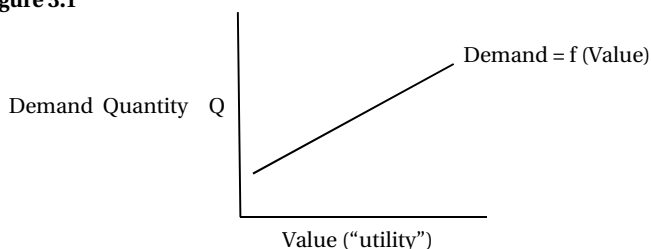
From a marketing standpoint, demand reflects the desire or willingness to purchase a product; Value (4P, benefits/price) is a determinant that can clearly change demand: higher Value leads buyers to purchase more units (Q).

If Value is plotted along the horizontal scale instead of price, then changes in demand (Q) in response to marketing changes (Value) can be represented as movements along the Value-based demand curve (refer to Figure 3.1), instead of shifting curves. For example, more benefits, or lower price, increase Value; this increases the quantity demanded (or purchased) in a given period; benefits may include advertising, improved distribution, personal sales, branding, positioning, service, etc. Fewer benefits, or higher price, decrease Value; this decreases the quantity demanded.

If demand is determined more by Value than price, then it is possible to develop a demand function in which demand is directly proportional to the product's Value; this indicates that as Value increases so does demand (Q).

This suggests for demand, as a function of Value, the following graph:

Figure 3.1



The quantity demanded (Q) is directly proportional to the product's Value (or from economics, "utility"). Buyers are meticulous, well informed, and they react to changes in the marketing mix (benefits and price); in other words, they respond to Value.

A shift in the Value-based demand curve is possible when a change in demand is due to non-marketing variables; for example, changes in disposable income²⁶, demographics²⁷, competition, and expectations.

Movements along the price-based supply curve are due to price changes; the higher the price of a good, the greater the willingness of suppliers to produce a larger quantity and sell it; this is because sellers expect higher profits from higher prices.

From a marketing standpoint, the willingness to supply a product not only depends upon price: it is certainly a powerful incentive to make a profit, but, in order to sell (or supply) a product successfully, the seller also has to deliver benefits to his customers. Sellers know very well that they must convince their buyers; otherwise, they may go to the competition.

²⁶ Household after-tax income.

²⁷ Studies the composition of a population, such as age, race, sex, education, income, employment, etc.

A product can be sold at a higher price only if its benefits justify it; a seller will not be willing to market a product that has a low chance of being purchased; a high price necessarily requires benefits; this suggests that supply, like demand, also has a close association with Value; this makes it a useful concept in marketing.

However, nothing comes free: higher Value requires delivering more benefits, which adds costs, or setting lower prices; either way this reduces profits and therefore the willingness to supply or sell.

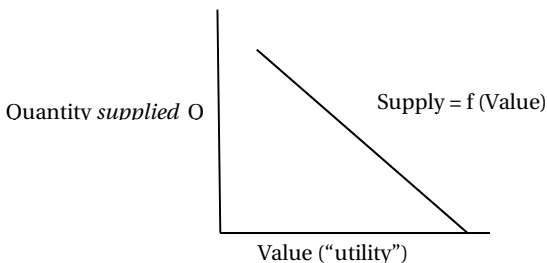
The more Value a seller delivers, the smaller the profit on each unit sold; this suggests an inverse relationship between supply and Value. If Value is plotted along the horizontal scale, then the changes in supply (Q) can be represented as movements along the Value-based supply curve (refer to Figure 3.2).

As a product's Value increases, its unit profit decreases by virtue of the increased costs of the added benefits, and/or its price reduction. The result is that the firm will gradually reduce its output as the product's attractiveness (profit) decreases; eventually, there will be a level of Value when production will cease altogether, simply because there is no longer profit in the units sold.

A shift in the Value-based supply curve is possible when a change in supply is due to changes in non-marketing variables; for example, harvests, disasters, weather, taxes, subsidies, substitute goods, production efficiency, costs, competition, and expectations.

This suggests that supply, based on Value, is function of the following type:

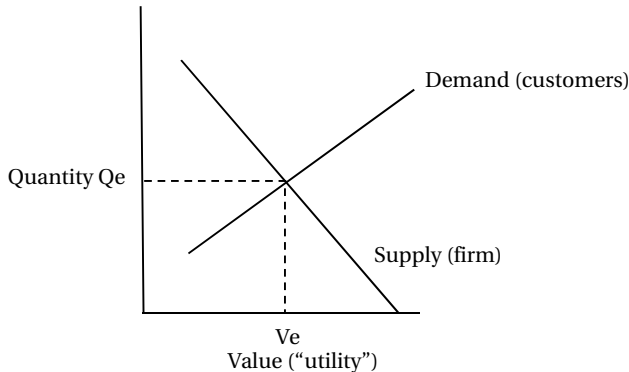
Figure 3.2 Quantity as a function of Value



Notice that supply Q is inversely proportional to Value. There is a level of Value such that if it is too high, no quantity whatsoever is supplied to the market; its cost may equal, or even exceed, the selling price.

By overlaying both graphs, we obtain a representation of supply and demand in terms of Value, as follows:

Figure 3.3 Supply and demand based on



At a Value lower than V_e , supply exceeds demand; with this level of Value, the firm is interested in supplying the product to the market; but, the customers are not very interested in buying; this eventually leads to a surplus. This can happen because the Value offered may seem very low to them (few benefits in relation to the price).

It is worth noting that surplus product (at a Value less than V_e) indicates low inventory turnover, or "slow" sales (low purchasing frequency). This suggests either that the price is too high, or that the benefits being offered are insufficient; therefore, sales opportunities are lost. Customers may even refrain from buying at all, or possibly buy from the competition. This creates a pressure to increase Value.

When sales are slow, and an inventory surplus appears, this gives rise to an opportunity cost because the opportunity to sell more is lost and so are its corresponding profits. This creates pressure to increase Value.

To deliver greater value and increase sales requires improving the benefits and/or reducing the price, this puts pressure on the company to increase Value with greater benefits and/or lower price.

At a Value greater than V_e , customers are indeed interested in buying (many benefits in relation to price). They demand much more product than the firm may be willing to supply, because it is unprofitable to produce and sell it; this may be signaled by shortages and higher than average inventory turnover. Again, as in the previous case, the firm loses sales giving rise to the opportunity cost of lost profits; this puts pressure on the firm to decrease Value.

It may seem counterintuitive, but the model suggests that at this point the best solution is to raise prices, or, if more practical, cut back on benefits (less cost); this reduces Value until it returns to the V_e level.

These pressures, or forces, lead to a single level of Value (V_e), which makes it as attractive for customers to purchase, as it is for the company to sell. At this level of Value –marketing mix (4P)– supply and demand are in balance; the firm is willing to offer the maximum combination of quantity (Q_e) and Value, which just matches the combination of quantity and Value (V_e) that customers are willing to buy. This is an equilibrium point, or the level of Value that balances supply and demand. It is the only point in which there are no opportunity costs; therefore, profits are maximum.

Given that this happens to all competitors simultaneously, they must make the same decisions regarding Value, in order to minimize shortages or surplus; any different level of Value reduces sales and income (profit).

This effect of aggregate demand and supply between sellers (competitors) and buyers (customers), gradually stabilizes a level of Value (V_e) that represents the multiple combinations of benefits and prices available in the market for a given product.

Success finally arises because not all competitors can achieve the Value (marketing mix, 4P) necessary to be profitable; only the survivors remain in the market.

Non-marketing changes can also be analyzed. Under the classical model of supply and demand, an increase in consumer disposable income leads to an upward shift in the demand curve; this increases the market price (equilibrium price); it makes sense: with more money, at every price level people are willing to buy more; or equivalently, more quantity is purchased at higher prices as customers have more money.

In Value-based demand, an increase in consumer disposable income should also shift upwards (left) the Value-based demand curve; at every level of Value more quantity is desired.

From Figure 3.3 it can be observed that an upward shift in the Value-based demand curve decreases the equilibrium level of Value (V_e); it also makes sense: with more money, people are willing to buy more quantity with fewer benefits, or with higher prices; this is equivalent to more quantity sold with lower Value. Affluent people are less concerned about prices and consume more.

The seller's response to a general increase in income is to deliver lower Value by reducing benefits and/or raising prices. This is illustrated in Figure 3.3, when the demand curve is shifted upwards. His strategy will depend on how sensitive is his product mix is to price changes; this is known as the price elasticity of demand.

In products with high elasticity, a small increase in price may trigger a large decrease in the quantity sold. In contrast, in a product with low elasticity, an increase in price may have little or no effect on the quantity sold. (This subject is analyzed further in section 4.3 Price Elasticity.)

One thing is clear: raising prices or reducing benefits will increase the product's unit profit. The seller will have to decide by how much to increase prices and by how much to reduce benefits. If his products are very sensitive to prices, his strategy will be not to increase them, and instead reduce benefits; on the other hand, if his products are not very sensitive to prices he can increase them, and add little or no benefits.

On the supply side, something similar happens with non-marketing changes. Under the classical model, an increase in production efficiency (just like a good harvest) leads to an upward shift in the price-based supply curve; this decreases the market price (equilibrium price); it makes sense: with more output, at every price level more quantity is offered; or equivalently, more quantity is sold at lower prices.

In Value-based supply, an increase in production efficiency should shift upwards (right) the Value-based supply curve; both Value and quantity increase. From Figure 3.3 it can be observed that an upward shift in the Value-based supply curve indeed increases the equilibrium level of Value (V_e); it also makes sense: with more quantity available, more quantity is sold.

At this point, the seller has to make an interesting decision: How is he going to deliver higher Value? He has to define a strategy with greater benefits, and/or with lower prices.

With a good harvest, he could simply go ahead and respond by cutting prices; but does it really make sense? What about the price elasticity of his product mix? Does he have other options?

Imagine for a moment, just for illustration purposes, that the seller is a corner store retailer that stocks food products with high price elasticity. This suggests that his response to a good harvest would probably be to lower prices and/or perhaps increase benefits.

Lowering prices is quite clear, but what about increasing benefits? Does this suggest that if he adds some extra benefits perhaps he need not lower his prices as much as would be expected? Certainly; this is what the Value model suggests; after all, customers seek “gains”; these can also be obtained through more benefits, and not necessarily through lower prices.

Customers may be willing to pay a little more, if they receive something valuable in return; for example, good service, variety, quality, etc. Adding some key benefits may be more effective, and perhaps even cost less than simply lowering prices.

The retailer may have to lower prices, but only to some extent, depending upon how creative are his compensating benefits. This strategy may even turn out to be more profitable; it can also help build customer loyalty.

In contrast to the retailer, suppose that the seller is a manufacturer of consumer goods. If, for some reason, an increase in production efficiency leads to much greater output (like a good harvest) he is then confronted by the same decision as the retailer.

His response to this good "harvest" may be entirely different from that of the retailer: Classic supply and demand dictates that under abundance prices tend to fall. In contrast, Value-based supply and demand suggests that under abundance Value increases, and this is probably what the manufacturer may do, but without touching prices. How?

The manufacturer will not lower prices; instead, he will promote his product through increased advertising, larger distribution, personal

sales, etc. This will increase his volume of sales, and he will profitably benefit from greater production efficiency without sacrificing price.

Costs play an interesting role in the supply function (this subject is covered in Chapter 5). First, they can be classified into two major categories:

Fixed costs.

These are closely related to *time* and they bear no relation to sales volume. For example, rent, depreciation and wages are generally paid, or accrued, on a monthly basis. Independently of how much is sold, they tend to remain fixed in the short term; in the long run they may vary to the extent that the company requires more investment.

Variable costs.

In contrast to fixed costs, these are costs closely related to *sales volume* and they regularly increase in proportion to the quantity sold, although the unit variable cost tends to remain stable. Raw materials provide a good example: If sales double, the total cost of raw materials also doubles, but the unit cost remains constant.

Let us now return to the case of the manufacturer and examine how increases in costs can affect his willingness to supply. An increase in fixed costs may reduce his output capacity; an example of this could be an increase in taxes, wages, or rent; this may force him to reduce output due to his financial limitations (less inventory or fewer workers). This suggests a downward shift of the Value-based supply curve; less output at all levels of Value.

A downward shift of the Value-based supply curve leads to less output and less Value. This means that the manufacturer has two alternatives in response to higher fixed costs: either raise prices, which seems quite logical, as he can transfer to his customers his added costs, or he can reduce benefits, which would, of course, enable him to compensate to some extent the added costs. However, either course of action will constrain his selling capacity.

Conversely, a reduction of fixed costs might encourage him to increase output (supply); this would point to an upward shift of the Value-based supply curve, which would lead to higher output and higher Value: he can reduce prices or add benefits. In this case, either course of action will increase his selling capacity.

What happens when the change is in variable costs? Price is a marketing variable, and as such, its changes are movements along the supply curve. This begs the question: Is there any difference between a change in price and a change in variable costs? From the point of view of profit, there is no difference, since an increase in profit may arise from an increase in price or from a decrease in the variable costs; therefore, a change in variable costs would cause movement along the Value-based supply curve.

An increase in variable costs operates just like a price decrease; it leads the seller to either raise prices and/or reduce benefits. A decrease in variable costs stimulates the seller to increase output and increase Value: either lower prices and/or increase benefits. His final decision will be based on the product's price elasticity: high elasticity will point to prices; low elasticity will point to benefits.

This analysis leads us to conclude that variable costs behave like marketing variables, as their changes can be represented as movements along the Value-based supply curve.

Fixed costs, on the other hand, behave as non-marketing variables given that they cause shifts, instead of movements, in the Value-based supply curve.

This links marketing strategies with variable costs. Let us again address the question of how the manufacturer can respond to an increase in fixed costs. The prior conclusion was that he could raise prices or reduce benefits. Since raising prices can be substituted by variable cost reductions, then the strategy might be to reduce benefits by decreasing their related variable costs, thereby avoiding price increases.

This option should always be open, as tinkering with sale prices is in general a risky move as they are difficult to implement; revenue is very sensitive to their changes; and, customers may react unpredictably. These pricing and cost issues are explored further in the next chapters.

This analysis indicates that price elasticity is the key for determining the best course of action; what is clear in all cases is that pricing is only a part of the strategy as benefits also play a major role. Again, these are orientation models, not success formulae; the final course of action depends upon the product, the company and the specific market circumstances.

It is interesting to see that when all the marketing variables come into play, the graphs of supply and demand seem to be the opposite of classical economics (see Figure 1.1). This, however, does not mean that the classical model is not valid; it merely reflects the special case of assuming that price determines quantities, or that quantities determine price. If in the Value-based demand and supply functions, the benefits remain constant, while varying only prices, the result is the same as in the classical model.

The demand function based on Value illustrates that when the price increases, while benefits are kept constant, Value decreases, and consequently demand also decreases; this means that it would still be inversely proportional to price, as in the classical model.

In the supply function based on Value it can also be observed that if the price is increased, while benefits are kept constant, Value decreases (higher profit) and, consequently supply increases (more output); this means that supply would still remain directly proportional to price (profit) as in the classical model.

The classical model of supply and demand describes the special case of analyzing the market, assuming that the price variable is the sole determinant of quantity (or vice versa). In Value-based supply and demand, this restriction is eliminated; therefore, the supply and demand functions include not only price, but also all the other marketing variables (4P) that influence the supply and demand of a product.

In fact, this model is a reflection of the world around us in which brands, advertising, distribution channels, discounts, promotions, and personal sales, among other things, decisively influence the market forces of supply and demand.

The model also indicates that there is a unique level of Value (V_e) that works for both the firm and its customers; at that precise level of Value there is no surplus or shortage of a product; but, at other levels there are shortages and surpluses; this translates into slow sales of some products and lost sales of others.

This also suggests that there must be a particular price which yields the precise level of Value required to maximize revenue and profits (this is discussed further in section 4.4 Optimum Price).

Today's customers are keen at making comparisons of benefits and prices between different competitors, mainly due to the free flow of information available in the digital media such as the Internet, TV and cell phones; betting on the assumption that today's consumer is uninformed can be very costly in terms of lost sales.

The use of this model is facilitated by classifying products into the following three categories:

Products with high elasticity

Generally, these are markets characterized by relatively low-priced products that can be easily substituted, and where brand loyalty plays a minor role. Included here, among others, are essential goods such as food, water, fuel, etc., in which price is an important consideration at the time of purchase; in these cases, in order to change Value, the strategy that might yield the fastest response is to adjust the price. (Applying the Value Matrix is suggested. Refer to "Chapter 8. The Value Matrix").

Products with low elasticity

These are markets characterized by products in which the brand and price play a key role in the product's positioning; included here we mostly find, among others, luxury items in which the benefits offered are most important for the customers; in these cases the strategy with the greatest impact is to change the benefits. (See "Chapter 8. The Value Matrix").

Products with uncertain elasticity

Elasticity should be taken into account even though its interpretation may be more qualitative than quantitative; not knowing it does not mean it should be ignored. For practical purposes, it is sufficient to have an intuitive idea about whether it is high, medium or low. The first step is to classify the product in any of the previous categories. This task is facilitated by replying to the following questions:

- Is the brand important at the moment of purchase?
- Does brand loyalty exist?
- Is it difficult to replace the product with one from another brand?
- Are prestige and status important benefits for the customer?

- Does the product have limited distribution to some stores, either owned or franchised?
- Does the customer spend time researching the product before purchasing?
- Is the product differentiated by quality?
- Does the sale of the product require well-trained salespeople?
- Does the client expect to be professionally advised by the seller?
- Does the sale of the product require any supporting services?
- Does the customer perceive in the price a signal of quality?

If the answer to most of these questions is yes, this means that the product probably has a low elasticity, and therefore benefits will predominate in the decisions. (See "Chapter 8. The Value Matrix"). If the answers are not conclusive, then the safest strategy to modify Value would be a combination of both benefits and prices.

In "Appendix 1. Optimization of the Demand Function" it can be observed that the level of sales is very sensitive to price changes; because of this, price adjustments require enormous caution. When modifying Value, changing benefits rather than prices should be considered first, as long as this is feasible.

This analysis suggests that the resource allocation mechanism in the economy is not really price; it is actually Value, as it involves all the marketing variables in addition to the competition. Clearly, there is a relationship between Value and price and it is provided by the benefits. Ultimately, it is Value and not price what gathers sellers and buyers in the market.

The Value-based supply and demand mechanics can be a valuable tool for analyzing how the firm should respond to market changes, and for determining its pricing and marketing strategy.

3.4 Value: Questions and Answers

Several questions need to be addressed in order to clarify the concept of Value.

Can Value be quantified?

Yes. The representation of $\text{Value} = \frac{\sum \text{Benefits}}{(\text{Price} + \text{effort})}$ behaves like a regular fraction: the quotient is Value, the numerator is $\sum \text{Benefits}$ and the denominator is (Price + effort). If the denominator increases the quotient decreases, or if the numerator decreases the quotient also decreases and vice versa. A quantification method is presented in Chapter 8. *The Value Matrix*; this facilitates the use of Value for setting prices and developing strategies.

What is the effect on Value of a price increase?

A price increase without a proportional increase in benefits decreases Value.

What is the effect on Value of a price decrease?

A price decrease, without a proportional decrease in benefits, increases Value; however, if the price decrease has a negative impact on benefits, then Value may decrease. Example: a price decrease that diminishes the prestige of a product.

Can the actions of competitors change Value?

No. The Value of a product does not change unless its benefits, price and effort are changed; however, the actions of competitors may change customers' preferences.

Is price the driver of market share?

Price is not the only driver of market share because it can never be isolated from the benefits attached to a product. A potential customer never loses sight of the benefit/price relationship; in fact, the best way to increase market share is to execute a benefit/price combination superior to that of the competition; this translates into offering greater Value; adding Value increases sales.

Is the economic concept of "utility" the same as Value?

Yes. "Utility" is an economic term that refers to the satisfaction derived from consuming a good or service. A customer will not be

satisfied if he experiences the so-called "cognitive dissonance"²⁸: a feeling of discomfort and skepticism about a purchase.

If a customer perceives a product as "expensive", he may abstain from buying it; but if he buys it anyway and feels he paid "too much", this means that a competing product would have provided him with greater satisfaction. He then understands he made the wrong choice and he feels unsatisfied; therefore "utility" is tied not only to the benefits of a product, but also to its price; the same as in Value.

Why use the word Value instead of "utility"? Simply because the term Value (noun) can be clearly related to something a person "values" (verb); on the other hand, "utility" (noun) can easily be confused with profits, or even with benefits, especially in other languages.

What is the role of "effort" in Value?

A customer not only sacrifices money when purchasing a product: he also expends "energy". This consumption of energy can be "good" or "bad". It is "good" if it provides the customer with an added benefit; for example, the prestige of belonging to a VIP club, or having a "Gold Card". Obtaining this takes trouble and effort, but it is desired, and it also provides self-esteem; it can be "bad" if the added effort does not provide any added benefit.

A product with inadequate distribution (requiring greater purchasing effort) will have less Value than one with a good distribution. A greater effort without any added benefit reduces Value.

Is Value constant?

Value changes only if benefits, price, or effort, change.

What are the Practical applications of Value?

Value is useful for devising marketing strategy and setting prices within the context of relationship marketing. The method and its development are covered in Chapter 8. *The Value Matrix*.

²⁸ K. Douglas Hoffman, J. E.G. Bateson, "Essentials of Services Marketing", 2nd, Harcourt College Publishers 2002, p. 87

It is also helpful for:

- Developing a strong and coherent Value Proposition.
- Redesigning a product when its benefits, or costs, need to be changed in order to achieve an acceptable profit.
- Structuring the communications strategy for positioning a product.
- Understanding what benefits customers truly need, desire and value.
- Analyzing the competition.
- Developing an optimum product mix.

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