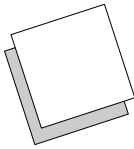


An executive summary for managers and executive readers can be found at the end of this article



Gaining competitive advantage through customer value oriented management

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Abstract *Within the customer value literature there is a lacuna of theoretical frameworks and models that underlie consumers' overall product valuation. This paper addresses this limitation and presents a model integrating consumer values, product benefits, and various costs of consumption. In the proposed model, benefits and costs are defined in terms of consumers' perceptions in the activities of acquisition, consumption, and maintenance, as well as consumers' expectation of value satisfaction before buying.*

Introduction

Developing an effective strategy requires that executives and corporate leaders have the strategic insight and comprehensive understanding of the product-market domain(s) they operate within. This understanding must be sourced not to the firm's own (internally derived) perspective but rather from that of its customers. Recall, for example, that Xerox views itself as a "document processing" company, whereas Schlumberger provides "information" to the petroleum industry. Strategic decisions are also made as to the future direction of the company and the means of increasing the level of customer orientation exhibited. Most strategists agree that creating customer value is fundamental to increased customer orientation (Slater and Narver, 1998). Indeed, creating superior customer value is a necessary precondition for securing a niche in a competitive environment, not to mention a leadership position in the market (Day, 1990). According to Porter (1980), a company can follow two generic routes to compete in a market: differentiation or low-cost. Day (1990, p. 163) argues that both approaches maintain the same objective, to create superior customer value, because:

Regardless of which of these routes is emphasized, the effort will fail unless significant customer value is created.

Day (1990, p. 142) proposes that the concept of customer value can be expressed in the form of an equation: the "perceived customer value" represents in this equation the difference between "customer's perceived benefits" and "customer's perceived costs". Although Day's (1990) interpretation of customer value is intuitively sound, some details regarding

Effective strategy

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consumers remain unclear. For example, the process by which consumers perceive product benefits is nebulous: Day (1990) particularly addresses product valuation by industrial consumers in detail, but this is only in principle a part of a much more complex process of product valuation by consumers. However, a theoretical framework, which underlies the consumers' overall product valuation, is absent from the literature. Such a framework should address the issues of how consumers perceive the benefits and costs of products (evaluation process), as well as what possible benefits and costs consumers may perceive from products in the market (value drivers). The current paper attempts to reconcile these gaps. Following presentation of the process of product valuation for consumers, the paper continues with a comprehensive model of customer value management for the consumer market integrating consumer values, product benefits, and various costs of consumption. In the proposed model benefits and costs are defined in terms of consumers' perceptions in the activities of acquisition, consumption (or using), and maintenance, as well as consumers' expectation of personal values satisfaction before buying. Furthermore this contribution helps managers offering a toolbox to "bring the model into use". Finally, the implications of consumption behavior analysis for a demand oriented customer value management are discussed.

A model of customer value for consumer markets

Describing customer value from a normative perspective

"Value"

The concept of "value" has been applied to many settings in the management, strategy, finance, information systems, and marketing literatures (Wikstrom and Normann, 1994). Although replete within contemporary research and practice in these disciplines, the value concept is multifaceted and complicated by numerous interpretations, biases, and emphases. For instance, the derivations of various value dimensions have been evident from the point of view of "strategic value" (Katz, 1993), "value" as equal to revenue minus purchases (Strassmann, 1990), the economic contribution that "value" makes to profit maximization (Banker and Kauffman, 1991), "value" as manifest in continuous quality improvement initiatives (Richardson and Gartner, 1999), "intrinsic value" created through scientific approaches to organization (Meredith *et al.*, 1994) and, most particularly, the value of customers to an organization (Blattberg and Deighton, 1996), customer values (Engel *et al.*, 1990), and the principles of customer perceived value (Zeithaml, 1988). All these theoretical approaches require unique perspectives and demand specific appreciation of the value concept(s) in question. For instance, the last three customer-based derivations of value dimensions are often confused within the marketing literature but they are by no means synonymous: the value of customers to an organization concerns the direct benefits that an organization experiences as a result of customers' loyalty and continued patronage; customer values reflect the personal values of individual consumers; and, the customer perceived value approach centers upon the utility a customer receives after purchasing a product.

"Customer value"

Many marketing strategists and industrial-organization (IO) economists emphasize that creation of superior "customer value" is a key element for companies' success (Higgins, 1998; Kordupleski and Laitamaki, 1997; Milgrom and Roberts, 1995; Porter, 1996; Woodruff, 1997; Wyner 1996). However, what is meant by "customer value", from this viewpoint, is quite different from the meanings of the "consumer values" or "personal values" that we discussed in the introduction. "Value" to marketing strategists

means a return for something in an exchange. Therefore, the meaning of “customer value” is a level of return in the product benefits for a customer’s payment in a purchase exchange (Normann and Ramirez, 1993). The total amount of payments depends upon the number of customers and the turnover per customer. The literature on competitive strategy argues that the number of customers can be increased by delivering more customer value than the competition (Day and Wensley, 1988; Gale, 1994; Porter, 1985; Woodruff and Gardial, 1996). Therefore, the concept of customer value has by nature a normative perspective, since it is a fundamental concept underlying the competitive analysis in the field of IO, based on economic principles and the customer’s choice in the market. The service marketing literature has extended and refined the notion that customer value is a way to realize financial success by linking it not only to the number of customers, but especially to the turnover per customer. It is argued that companies realize commercial success through the satisfaction of customers by ensuring they perceive the “value” they “expect” (van Raaij *et al.*, 1998; Zeithaml *et al.*, 1990). In the preferred situation therefore the “expected value” is similar to the “perceived value”. Creating more customer value while maintaining this balance will result in long-term commercial success. Expected value and perceived value are strongly interdependent from the customer perspective. As is noted by Voss *et al.* (1998), several studies have demonstrated a positive relationship between expectation and perception (Cadotte *et al.*, 1987; Gupta and Stewart, 1996; Spreng *et al.*, 1996) – which is in line with the concept of cognitive dissonance (Festinger, 1957). Therefore, balancing customer value is a shared interest of both companies and customers.

Describing customer values from a descriptive interactive relationship perspective

Customer perspective

Customer value is a theoretical construct that captures the customer perspective of a product. It has been illustrated that a producer can use customer value as a goal by defining the customer value a selected group of customers is intended to expect and perceive. Since customer value deals with the customer perspective, this does not detract from the fact that it eventually concerns a subjective notion of an individual customer’s judgement of the value of a product (Anderson and Narus, 1998; Woodruff and Gardial, 1996; Zeithaml, 1988). Like other authors, Woodruff and Gardial (1996) assert that the judgement of value results from a trade-off in positive consequences (benefits) or desired outcomes and negative consequences (sacrifice) or costs.

This subjective evaluation task of the individual is the reason why consumer behavior researchers, on the other hand, generally refer to the term customer values. The word “values” represents desirability, usefulness or importance (Peter and Olson, 1990). Consumer research is primarily founded upon a descriptive-study perspective, such as in the fields of anthropology, sociology and psychology. Therefore, “consumer values” refer to the important personal goals that consumers seek (Wilkie, 1990). Furthermore, consumer behavior researchers emphasize that people can achieve some of their personal values through possession or consumption of products. Nonetheless, what is needed is an approach that is able to identify value drivers – drivers the consumer is seeking, which are the means to reach the personal goals established, that should be fulfilled when purchasing a product. A suitable approach which connects the possession or consumption of products and the consumers’ personal values is means-end theory, which has its roots in cognitive psychology.

The operationalization of the customer values concept

Means-end theory posits that linkages between product attributes, consequences produced through consumption, and personal values of consumers underlie their decision-making processes (Gutman, 1991). Means are products or services, and ends are personal values considered important to consumers. Means-end theory seeks to explain how an individual's choice of a product or service enables him or her to achieve his or her desired end states. Such a framework consists of elements that represent the major consumer processes that link personal values to behavior.

Two assumptions underlie the model:

- (1) all consumer actions have consequences; and
- (2) all consumers learn to associate particular consequences with particular actions they may take.

Consumption of products

Consumers obtain consequences from the consumption of products or services. Consequences may be desirable (benefits) or undesirable – they may stem directly from consuming or the act of consumption, or occur indirectly at a later point in time or from others' reactions to one's consumption behavior. The central aspect of the theory is that consumers choose actions that produce desired consequences and minimize undesired consequences (Peter and Olson, 1990).

Personal values are beliefs people have about important aspects of themselves and the goals toward which they are striving. Personal values are the ultimate consequences of behavior for individuals, such as feelings of self-esteem, belonging or other value orientations (Rokeach, 1973). In this sense, personal values are part of the central core of "self". Thus, personal values, as the psychological core of self, are held to provide consequences (consequences refer to the outcomes accruing to the person from behavior, such as consuming a product) with positive or negative valences. That is, personal values determine which the individual desires as consequences and which are undesirable. Naturally, given that attributes produce consequences, one must consider the attributes that products or services possess. Therefore, we must also be aware of attribute-consequence relations. Overall, attribute-consequence-value interrelationships are the focus of this theory. Values provide the overall direction, consequences determine the selection of specific behaviors in specific situations, and attributes convey the essence of the tangible product or service that produce the consequences (Olson and Reynolds, 1983). The most relevant methods available to explore the knowledge structure of the consumer are the: repertory grid approach; laddering interview; content analysis; and, the laddering method (Reynolds and Gutman, 1988; Gengler and Reynolds, 1995). However, in order to obtain an understanding of the concrete attributes, which determine the buying behavior of the consumer, conjoint analysis is an adequate technique (Wittink *et al.* 1994; Green and Srinivasan, 1990).

Summary

In summary, "customer value" normatively focuses on a buyer's evaluation at the time of a product purchase, while "consumer values" descriptively emphasize individuals' valuation of product consumption or possession. Consumer researchers will argue that consumers buy products not for the sake of its "transactional value" but for the product's benefits that will satisfy their needs or personal values. However, in an exchange environment, product benefits alone do not completely explain consumers' product choice. Often, consumers may find products desirable – yet, in assuming that the

consumer has adequate financial capacity, one must not equally assume that a purchase will follow. These cases imply that normative points of view are also necessary in consumer choice research. From an economics perspective, consumers may apply cost-benefit evaluation to a purchase decision, at least when the costs are considered “significant” (Olshavsky and Granbois, 1979). Therefore, with respect to a sound customer value analysis for a consumer market, both the descriptive and normative aspects are essential (Saren and Tzokas, 1998). The current paper proposes a comprehensive model of customer value for consumer markets, which integrates both viewpoints upon consumer behavior, including consumer values expectation before purchase, customer value evaluation at the time of buying, and value actualisation in consumption (Holbrook, 1994).

The model

According to social psychologists, an individual’s perception of objects, and events is influenced by his or her cognitive traits (e.g. personality or attitude), their emotional predisposition, and their demographics.

Customer characteristics

As indicated in Figure 1, these factors of customer characteristics form the background of the customer’s perception. As the perceived benefits are manifest more clearly than personal values, the buyer’s evaluation of a product purchase begins at this point. The matching process on the consumer “value”, “benefit”, and “attribute” level can be described as an experiential judgement of outcomes compared to a set of subjective standards resulting in a sense of fulfilment, including over- (when the perceived value exceeds the expected value) or under-fulfilment (when the expected value exceeds the perceived value). An important distinction should be made here in that product benefits based on consumption or use of the product are not the sole benefits consumers realize. Rather, they may also derive benefits of a purchase from the buying activities *per se*, other consumption supporting features as well as from the recycling of the product. Treacy and Wiersema (1993) claim that today’s customers have, “an expanded concept of value (purchase benefits) that includes convenience of purchase, (and) after-sale service” (p. 184) in addition to the traditional product benefits.

“Perceived customer value”

To evaluate the “perceived customer value” of a product, the costs of obtaining the perceived benefits are usually the major concern of buyers, since consumers may apply principles of costs-benefits to evaluate a purchase (Zeithaml, 1988). The model proposes that the relevant costs of a purchase considered by consumers include the following: monetary costs; time costs; search costs; learning costs; emotional costs; and, cognitive and physical effort coupled with financial, social, and psychological risks. Furthermore, every category of these costs may play a part in purchase, possession, consumption, and maintenance. Consumers encounter risks when they face the uncertainty or potential negative consequences of consumer activities. For example, being cheated, overcharged or misled into buying an unnecessary product or possessing or using certain products, such as unconventional clothes, may incur social costs. Maintenance risks include being overcharged for supplies and or suffering the possibility that they will be discontinued. Nevertheless, all of these costs, like the benefits, are also subject to consumer perceptions.

The model suggests that customer value is a consequence of subjective evaluation which in turn results from the summing of the various elements contributing to the perceived fulfilment of the value, benefit, and attribute level and perceived costs, taking into account subjective weighting factors.

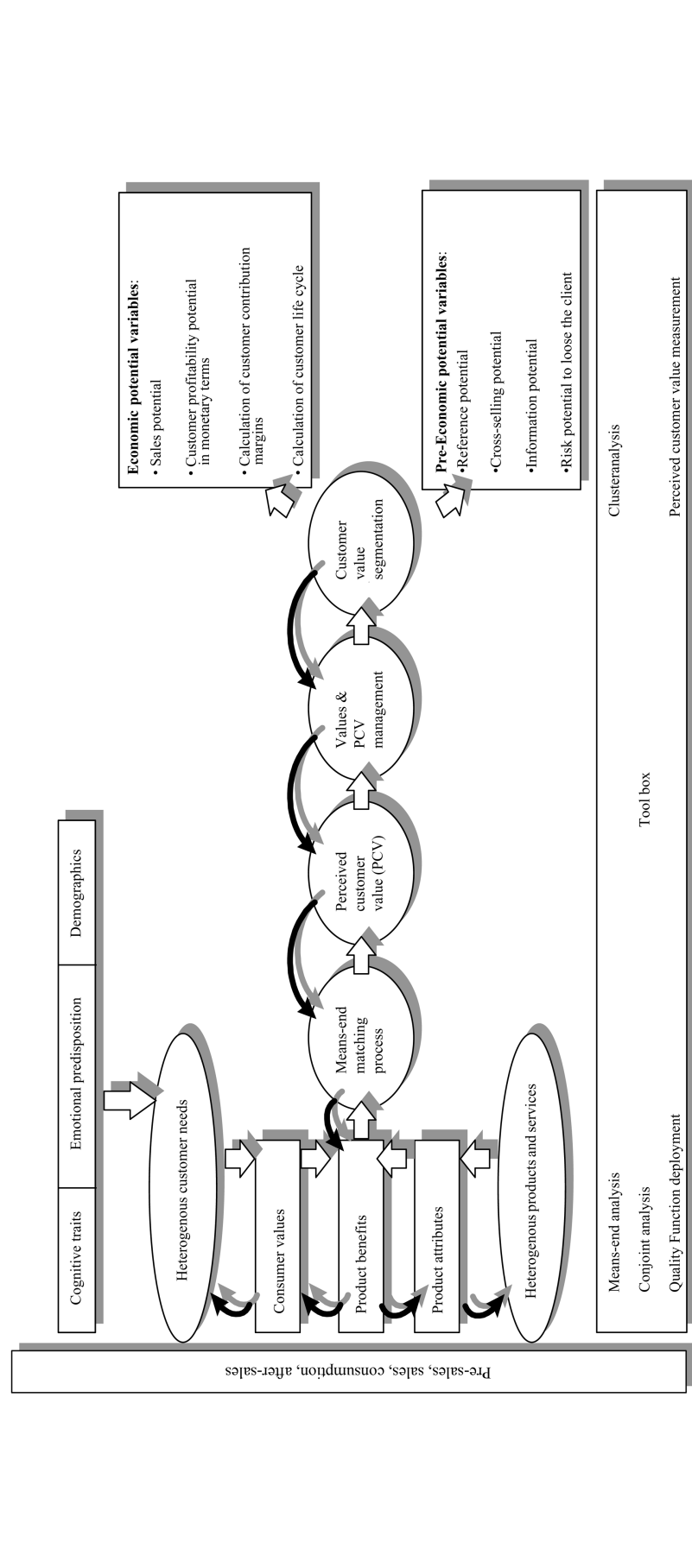


Figure 1. A model of consumer values and customer value

Thus far, in the current model of customer value, benefits, and costs are defined in terms of consumer perceptions in the activities of acquisition, consumption, and maintenance, as well as consumer expectations of personal values satisfaction before purchase. That is, this consumption behavior approach is both holistic and analysis-oriented, advancing beyond traditional “customer-oriented” concepts, which usually focus on the buyer’s economic evaluation at purchase. As emphasized in the model, the importance of benefits and costs varies among individuals due to their personal characteristics and value system.

Phenomena

These phenomena have led in brand and sales management practice to benefit or cost segmentation – the process of dividing consumers into homogeneous subgroups or segments based upon their interest in particular benefits (Porter, 1996). The benefits most important to target customers are a fundamental issue in brand and sales strategies, such as product differentiation and positioning. Furthermore, as the benefit a consumer wants to receive represents a part of his or her value system, the manager should not overlook the relevance of the consumer’s abstract method of structuring his or her behavior. This means nothing else than expanding the brand and sales into “values and perceived customer value” management. However, companies have to go one crucial step further – to obtain a more accurate and complete profile of the customer in respect of his or her characteristics, the direct and indirect (pre-) economic significance of the customer has to be calculated. In other words, based upon the identified personal values and perceived customer value, it makes sense to compute all monetary and non-monetary losses sustained by a supplier, if he or she fails to retain a certain customer. However, customer migration of this kind does not only result in losses in sales, turnover, and profitability: it is more appropriate also to include in this consideration, pre-economic value components such as the reference potential, cross-selling potential, and information potential of customers.

Absolute sales potential

Within the framework of the analysis of absolute sales potential, customers are assessed on the basis of sales, which have been transacted over a certain period, or attainable future sales and, depending upon how promising they appear, classified as A, B or C customers. Differentiated approaches also include in the sales-related customer assessment the life cycle phase in which to position the customer relationship.

The widely held opinion that “high costs mean high profits” has long been discredited. Instead of this, it has been possible to observe dispersion of profits over a generally wide spectrum. In this context the absolute amount of the customer contribution margin is greatly dependent on the total volume of the customer’s purchases – profitability is most certainly not. The immediate need resulting from this is to identify differences in customer value as part of an accounting exercise based on the income generated by an individual customer. What is important in this context is that the revenue generated by each individual customer and the costs incurred by this customer are allocated on an individual basis. An accounting system set up in this way is also the basis for calculating the monetary customer profitability potential. It states the monetary customer profitability potential, which can be quantified with the help of customer profitability accounting, and indicates to what extent an individual customer represents a profit or loss for the company.

Contribution

The contribution made by every customer to the profit over a given period can be determined by calculating the “customer contribution margin” (customer profitability calculation referred to a given period). By allocating

customer-specific profits and costs correctly, the monetary customer profitability potential can be calculated so as to provide detailed statements on which customers are considered to be profitable over a given period and those which are not. In order to plot the different development potential of customers in each case, it is essential to calculate the customer contribution margin on the basis of the planned figures for future accruals.

The customer life cycle can, in principle, be described as the time sequence of a business relationship and operationalized with the help of, among other factors, sales, turnover or customer profitability time series (Dwyer, 1989). In the case of the “customer life cycle calculation” (customer profitability calculation accrued over a number of periods), apart from the costs and revenues of processing the transaction and follow-up, the pre-transaction and subsequent revenues (e.g. disposal revenues) must always be included in the calculation. These costs, which have the character of investment costs, must be paid back over the duration of the relationship.

“Reference potential” is understood to mean the number of potential customers an owner of a product can reach, and influence accordingly, with positive, neutral or negative information in respect of a manufacturer or a certain model within a certain period of time because of his recommendation behavior and power of influence, together with the size, type, and contact frequency/intensity of his or her network of social contacts.

The “cross-selling potential” of a customer is a benchmark to ascertain whether an existing customer relationship can also be used for further products or product groups from the same company. The greater the opportunities for sales or profit expressed as a result of the cross-selling potential, the more valuable the customer has in the eyes of the supplier, all other things being equal.

“Information potential”

The “information potential” of the customer is obtained from the total useful information received by the company from the customer within a certain period of time and which the company can apply appropriately in the production and utilization of the product or service. It is particularly relevant to mention here the customers’ ideas, complaints, and suggestions for improving the product which represent a potential variable in so far as, if they are implemented appropriately within the company, they may result in greater efficiency or cost savings not only in the production process and logistics but also sales and accounting procedures.

Implications

There are several implications for management from this model. With regard to the marketing function, we illuminate the relevance of the means-end approach – its categorization of value, benefits, and attributes may help marketers identify their target consumers’ central and peripheral needs. Then, the typology could help companies design their products and related marketing programs, such as advertising and distribution. The need to take account of sets of values when designing products can also be demonstrated as follows: if it is assumed that the length of the front section of a vehicle is an important criterion for a potential car buyer, the knowledge that this attribute helps to raise the customer’s self-esteem will inspire the product designer to devise a different body shape than if the value associated with the attribute is “safety”. This knowledge of the “why” should thus exert a decisive influence on the development of new seats or on modifications to existing ones. The same may follow for the creation of advertising campaigns.

Product design process

In addition, the demand-oriented part of the model, where we identify values and benefits at a high level of abstraction could be the starting point for a revolutionary product design process (Porter, 1996). When captured, a customer segments' current personal values are projected forward in time. The personal values segmentation scheme provides insight into the future because these values represent customers' enduring beliefs (Johnson, 1998). This is not to say that customers' values are necessarily stable. Two other sources of information must be integrated into the value projection process. Customer values vary systematically with age and value projection must also take into consideration societal, cultural or other environmental value changes (Parasuraman, 1997). This integration of current trends provides a picture of what consumers are likely to demand in the future and what kind of products they may wish to have.

Concerning the supply-side of the model, customer orientation is not only a word but a philosophy and companies have to organize their internal processes in an adequate sense (Brand, 1994; Vantrappen, 1992). This means that personnel who are responsible for analyzing the actual and future values of the social system have to work together with designers, who are best able to transfer the relevant values and benefits into product attributes.

Furthermore, in these cross-functional teams, where we find trend scouts and creative designers, it is necessary to integrate a marketing controller. This individual serves as a conduit to bring together the relevant personal values, perceived customer values and the customer value segmentation approach, based upon criteria the company may define. This incorporation of the marketing controller's role might evoke a *dejà-vu* with the target-costing concept. However, the approach we suggest here goes one crucial step further. This is the reason why we think that the use of the term "target design" represents the notion much better. Based on the relevant consumer data, the marketing controller has to calculate not only the "hard" costs for the financial input and the planned output to satisfy the needs of a profitable segment but also has to evaluate the "soft" factors like the "reference potential", or the "information potential" of these segments and promote a vision of which hierarchy the company should provide, which target product to which target segment.

Conclusion

As a conclusion, we can suggest that while customer value has traditionally been considered an "off the balance sheet" asset, managers are realizing that modelling these issues is a necessary consideration in developing a coherent understanding of company activities and resources. Research on valuing consumers as assets, and on how managers become responsible for developing their value, has not, to our knowledge taken place. Future research and practice has to recognize, that the actual values which managers manage are neither subjective ("in" an individual) nor objective ("in" the object), be they exchange value or utility values. They are interactively established, plural and, as they cannot be reduced to a single measure (Dean *et al.*, 1997), the manner in which they are identified, selected, defined, evaluated, communicated, and managed by interacting stakeholders represents a rich set of research opportunities.

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