

## CONNECTING THE DOTS ON CUSTOMER VALUE...

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### ABSTRACT

This paper connects the dots of findings which I have discovered through my research and the research of others to better understand the customer value paradigm. It begins with a basic perspective of the importance of customer value in today's competitive marketplace, followed by two of my studies conducted early in my academic career and then concepts developed by other researchers that have profound implications for understanding customer value. The purpose of this paper is to assist other academics in teaching what students need to know about customer value.

### MANAGING CUSTOMER VALUE TODAY

The creation of customer value is based on knowing what consumers expect, what competitors are doing, how much change they are willing to accept, and how to control costs. These activities lead to a process of blending together quality, design, features and style into a need-satisfying bundle, which if costs are controlled can be sold for a reasonable profit. For buyers, customer value is the relationship between the bundle received and price in terms of monetary outlay as well as time and effort expended. What is unacceptable to one customer may be perfectly acceptable to another. It all boils down to how customers perceive the offering's benefits and the price they are paying. A customer's perception of value for an offering will probably differ from reality, but to each customer, perception is reality. Customers seek out value by comparing the offerings and prices in the marketplace to make a purchase by conceptually using the value equation below to make comparative evaluation of market place offering.

Perceived Customer Value =

$$\frac{\text{perception of offering's benefits}}{\text{perception of price}}$$

Firms who excel at creating customer value almost always have the following traits (Dodds, 2009):

#### Extraordinary Customer Intelligence

These firms pursue customer intelligence to shape offerings to specifically provide a superior customer experience. In a backward process, these firms vision the consumer experience and then work back

to discovering the need set that will deliver this experience. By not committing the mistake of being all things to all people, these firms focus on a viable value proposition and execute the development of an offering with laser precision to deliver value which leads to satisfaction, loyalty, and long term relationships.

#### Superior Competitor Intelligence

Knowledge gained from how their customers and competitors' customers perceive competitive offerings as well as the awareness of competitors' offering strategies allow innovative, value oriented firms to anticipate competitive changes that affect the comparative value of the offerings in the marketplace.

#### Expect and Accept Change

What is value in today's market could be the "dinosaur" in tomorrow's market, for example portable tape players (*Walkman*) were replaced by CD players (*Discman*) and then by mp3 players (*iPod*) in fairly rapid succession. Apple, with major innovations such as the iPod and iPhone, shaped the product quality paradigm as a competitive advantage by anticipating change and at times defining the new future to up the ante against the competition.

#### Control Costs

Active management of costs and productivity can produce a potential for enhanced "focused" quality and lower prices for the consumer while solidifying a strong base for long-term profitability. Consumer intelligence and innovative thinking leads to providing attributes most valued by consumers, where unnecessary costs are "engineered out" to deliver value to customers.

### THE CUSTOMER VALUE PARADIGM IN THEORY

#### The Initial Inquiry

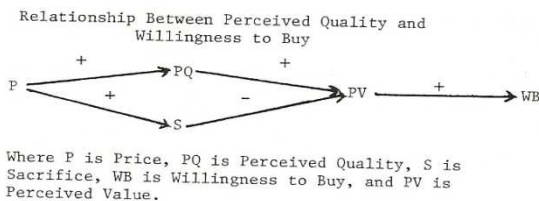
Dodds and Monroe (1985) looked at four relevant issues discovered in the literature at that time:

- Is there more to the phenomena of a price-quality relationship?
- Do buyers use price as an indicator of quality?
- If so, how does this affect the intention to buy?

- Are there intervening constructs between price and willingness to buy?

The research was guided by a conceptualization by Monroe and Krishnan (1985) that discussed the relationship of three constructs: perceived quality, perceived value, and willingness to buy. Arguing that perceived value and perceived quality are distinct constructs, these early pioneers viewed quality purely as an evaluative measure whereas perceived value was represented as a trade-off between perceived quality and sacrifice. In my research, an empirical investigation found, as shown in Figure 1, price plays a dual role in this trade-off. Higher prices lead to greater perceived quality and consequently, to a greater willingness to purchase based on perceived quality. At the same time, the higher price represents a measure of what must be sacrificed to purchase the good and leads to a lesser willingness to buy.

**FIGURE 1**  
**Early Model of the Price Value Relationship**



Monroe and Krishnan's conceptualization that perceived value represented a trade-off between the two variables, perceived quality and sacrifice, lead to the belief that there may be a quadratic relationship between price and perceived value and willingness to buy where a low price would produce low perception of value and low willingness to buy, a higher price would lead to higher evaluations, but as price increased too much these evaluations would decrease. While a consistent price-perceived quality relationship was confirmed, no evidence of the curvilinear relationship between price and value was found.

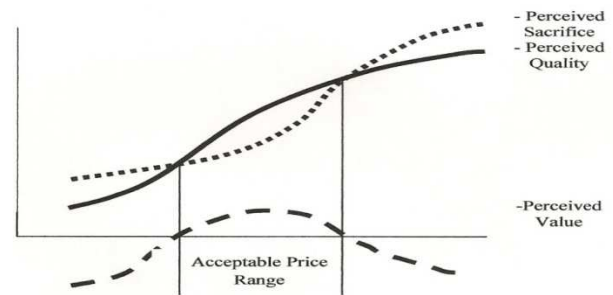
**The Defining Inquiries**

These were two important studies which lead to understanding of customer value as we practice it today. The first study (Dodds, Monroe, & Grewal, 1991) was a comprehensive empirical testing of the market cue-product evaluation paradigm but still fell short in finding if there was a quadratic relationship between price and value.

The link between price and value is conceptually explained by the concept of the acceptable price

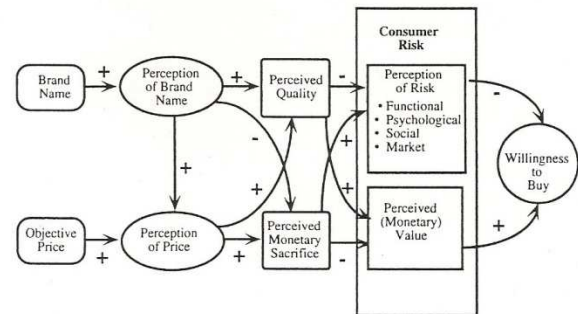
range. Buyers generally have a set of prices acceptable for a considered purchase, where a price may be unacceptable if it is perceived to be either too low or too high. If a price is unacceptable, the buyer infers that there must be little or no net perceived value in the offer. This conceptual relationship between price and the perceptions of quality, value, and sacrifice is illustrated in Figure 2 (Rao, 1989).

**FIGURE 2**  
**Perceived Value**



Rao's conceptual argument was later confirmed in a second study by Dodds (1996) when the idea of value was expanded to include the concept of risk and where curvilinear relationships were found between price and perceived risk/value (Figure 3).

**FIGURE 3**  
**Effects of Price and Brand Name on Product Value and Willingness to Buy**



The empirical research provides a theoretical basis to explain how customer value influences business practices today. What follows are concepts developed by other researchers as well as this author which have had implications for understanding customer value.

## THE CUSTOMER VALUE PARADIGM IN PRACTICE

### The Value Cycle: Creating and Maintaining Value Advantage

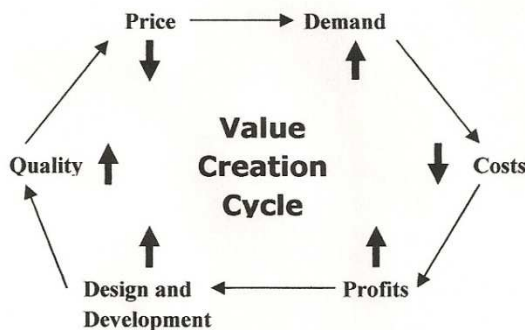
The origins of the value cycle can be traced to Treacy and Wiersema's book, *The Discipline of Market Leaders* (1995), which provided an understanding of how price, costs, quality and demand are at the very center of the value decisions. These drivers that lead to value were becoming the new definition of competitive advantage. These four issues provide the basis for six connective links<sup>1</sup> related to how value is created (Figure 4).

**FIGURE 4  
The Value Managers**



The cumulative interaction of price, quality, cost and demand is manifested in the value creation cycle that is shown in Figure 5. If a firm were to pursue the concepts and strategies discussed here, they might find a better position in the eyes of the customer and in their bottom line.

**FIGURE 5  
The Value Creation Cycle**



Cutting price may increase volume which may further hasten the reduction of cost through the experience effect. This experience is found through economies of scale, learning, sourcing, and marketing. The reduction in cost may enable further lowering of price that will stimulate further increases in demand. The bottom line is that this process will add to profits that will make more money available for design and development activity which can lead to higher levels of quality. Companies that have adopted this philosophy are the ones competing successfully in the “more for less” market with high volume and quality at a low price.<sup>2</sup>

The following example illustrates how a company manages the linkages effectively to gain and maintain a value advantage.

A computer firm offering a particular model at \$900 may only be perceived as a fair value at that price. The financial structure might look like this:

Volume	40,000 units
Price per unit	\$900
Cost per unit	540
Contribution per unit	\$360
The total contribution margin is:	\$14,400,000

After a few iterations through the value creation cycle, the firm may arrive at the point where their financials might look like this:

Volume	80,000 units
Price per unit	\$720
Cost per unit	300
Contribution per unit	\$420

The total contribution margin is \$33,600,000 and one can assume the increased profitability is invested in enhancing quality where the “new” product was better in terms of quality and lower price. Clearly, finding the way to create value is a competitive strategy that drives the leading companies in their industry.

### The Value Profit Chain

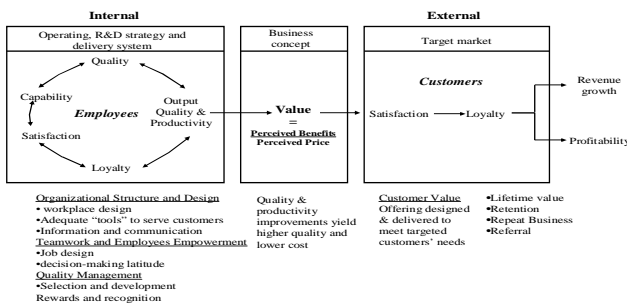
Imbedded in the process of creating value is a rock solid philosophy that respects the importance of employees as well as the customer. Southwest Airlines (SWA) prospered on a “less for less” philosophy where SWA employees come first, followed by the customer. Herb Keller of Southwest Airlines always insisted that happy and productive employees will undoubtedly deliver superior service

<sup>1</sup> These six linkages are explained in detail in Dodds (2009), *Managing Customer Value*, University Press.

<sup>2</sup> A more complete example is offered in Dodds (2005).

(Freiberg & Freiberg 1996). His philosophy is clearly connected to the value profit chain model conceptualized by Heskitt, Sasser and Schlesinger (1997). They found that paying close attention to the employee-customer relationship will enable any organization to gain a competitive value advantage. Their core assertion is that employee satisfaction, loyalty, and commitment strongly influences tomorrow's customer satisfaction, loyalty, and commitment and ultimately the organization's profit and growth. While their focus was on service organizations it is clear that their model was not lost on innovative companies such as Apple where, as adapted by this author, value sits in the center of the model (Figure 6).

**FIGURE 6**  
**Value Profit Chain**



Apple invests scarce resources in creative people to "push through the box" to create new products (iPods) and services (iTunes) without the constraints that many traditional firm place on research and development. Steve Jobs, the soul of Apple's thinking as well as their CEO says (*Business Week*, 2004):

We hire people who want to make the best things in the world. ... I get asked a lot why Apple's customers are so loyal. It's not because they belong to the Church of Mac! That's ridiculous. It's because when you buy our products, and three months later you get stuck on something, you quickly figure out how to get past it. And you think, "Wow, someone over there at Apple actually thought of this!" And then three months later you try to do something you hadn't tried before and it works, and you think "Hey, they thought of that, too." And then six months later it happens again. There's almost no product in the world that you have that experience with, but you have it with a Mac. And you have it with an iPod.

Apple and many others achieve profitability and growth by leveraging the ingenuity of its employees to deliver differentiated offerings at the lowest cost.

Figure 6 illustrates the integral relationships in the value profit chain. At the center of the figure is the value function which defines the business concept for a particular offering. On the left hand side is the attention paid to employees where output quality and productivities (cost efficiencies) feed into the creation of value. Organizational structure, teamwork and employee empowerment as well as quality management are the structural elements that leading value oriented firms pay attention to in the operation of their business. This structure fosters capable satisfied employees who are loyal and quality conscious in carrying out their work. These are the critical elements to the creation of customer value. On the right side is the end result of value creation where customer satisfaction is derived from the offering designed and delivered to meet their needs. Customer satisfaction leads to loyalty behaviors such as retention, repeat business and referral of others. All of this leads to increased revenue and profitability for the firm.

## SUMMARY

This exploration of value from theory to practice is not intended to be comprehensive nor fully conclusive but is intended to give students a connection between early research and current practice as it pertains to customer value.

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