# 2. Customer Value: What business is all about

All customers continually strive to attain maximum purchasing value, and the products perceived as providing the best value for money are favored. The winner of the comparison is rewarded with the customer's confidence and given the business. These companies will grow at the expense of their competitors. The market is brutal, and those companies that cannot deliver a high enough level of customer value will be knocked out of the contest.

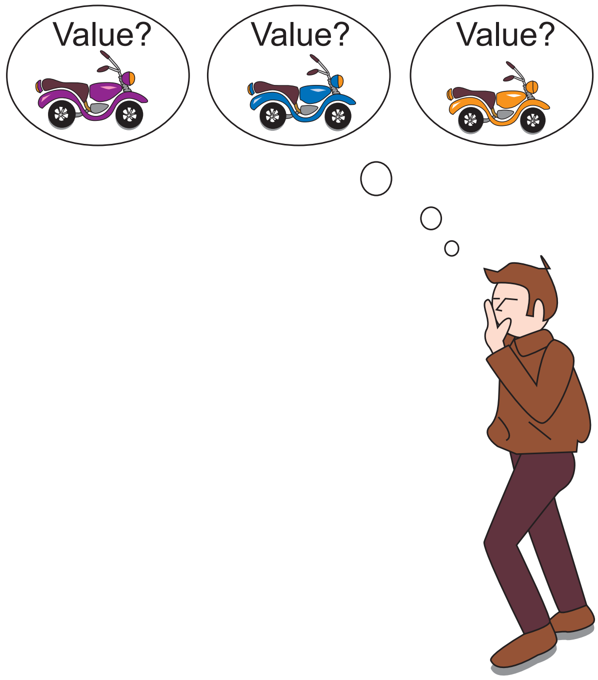
Here are a few examples of products and companies that have been knocked out:

- Facit, mechanical calculators
- Blockbuster, video rental
- Kodak, film photography
- Nokia, mobile phones
- Borders, bookstores
- Toys "R" Us, toy retail
- MySpace, social networking
- Digital Equipment, Minicomputers
- Tower Records, Music Retail.

Many of these companies were highly successful and extremely profitable. Some were clear market leaders and dominated the global market. What happened? What went wrong? Can this happen to my company?

What all these companies have in common is that they were knocked out because their product did not deliver enough customer value. There is no line in your company's balance sheet or income statement called customer value. However, I am convinced that your accounting department can give you an exact price for the cost of your product.

I don't think anyone in your company can give you an exact measure of value, even though it is the most critical metric for all companies. This is a deficiency that this site can solve for you and your company. I will help you with two things. The first is to get a handle on value and measure it. The second is to make it a practical tool for driving all R&D operations.




Correctly applied, it will help your company stay in the race and avoid being knocked out by competition. At best, it will help you create a WoW product.

Unfortunately, decisions are made only too often, which, in practice, results in lower customer value. For example, what decision would you make in the following situation:

- Assume that selling spare parts is a very profitable part of your business.
- The possibility of changing the material in a quickly worn-out component arises.
- The new material would give the component eternal life and never have to be replaced.
- The changes to the new material would not affect the cost, complicate manufacturing, or cause any other drawbacks.
- The current lifetime of the component is on par with your competitors.
- There are no known complaints from customers about the lack of durability.

In this situation, people will fall into any of the following two categories:

**A.** Some people will argue that the material should not be changed. It is obviously in the company's interest to maintain the profitable sale of spare parts.

**B.** Others will argue that the customer will get a better product for the same price. Sales of spare parts will be reduced, but they are convinced that higher customer value is more important.

Are you an **A** or **B** person? Change the material in the component, or leave it in its current form? For me, it is not a question if it is only a question of when! And when is the sooner, the better. The material in the component must be changed.

I will argue that the decision must be perceived as part of a larger picture. Every year, not just one but hundreds of product decisions are made. The cumulative effect of all these decisions will ultimately dictate the organization's ability to deliver products with unrivaled customer value.

The adverse effects of sub-optimization can only be avoided by constantly focusing on customer value. In the long run, the aspiration to increase customer value in all decision-making situations will guide the company to the best possible business opportunities. Business opportunities that would not otherwise arise.

All companies are in a cause-and-effect situation. A company will fail if it believes it can increase or maintain profitability by not changing the material. You can't focus on profitability if you wish to increase profitability. Profitability is an effect of the customer value of the products you make. If you don't change but your competitors do, and eventually they will, your product may be knocked out of the contest.

The logic is quite simple:

- If you take care of the customer value, the profits and growth will take care of themselves.

Every organization convinced to maximize customer value in every decision-making situation will become unbeatable adversaries. To my knowledge, it is the only tool with this intrinsic power. It is an excellent tool for guiding your organization to benefits for customers, employees, and shareholders.

Two essential aspects for turning customer value into a practical tool are discussed in this chapter:

2.1 Definition of customer value
2.2 The S-curve.
2.3 Summary

## 2.1 Definition of the Customer Value Concept

Some people instinctively understand customer value. They make the right decisions but cannot articulate or describe why. However, the capacity for a whole organization to make the correct decision demands more than the good instincts of a few individuals. Defining customer value is the first step in turning it into a practical tool. Customer value is defined in the European standard EN 12973 as:

$$\textbf{Customer Value} = \frac{\textbf{Satisfaction of customer needs}}{\textbf{Use of customer resources}}$$

The definition is an excellent start to understanding customer value. The beauty of the standard is that it makes no distinction between needs and wants. The standard treats emotional needs as being just as important as physical needs. Nobody, neither I nor your customers, is one hundred percent rational. Emotions influence all decisions, even in B2B markets.

The definition is an abstract concept that describes the two fundamental strategies to increase customer value. One strategy is to satisfy more customer needs better, and the other is to reduce the use of customer resources. While endless opportunities exist to satisfy more customer needs, reducing customer resources has limits - it can only be minimized to zero. WoW products often strike a balance between quantum leaps in satisfying customer needs and reducing customer resources.

Many individuals in your organization may not know or understand that customer value is a ratio. This may impede or halt numerous development projects. This ratio reflects the balance between what the customer receives and what they are required to pay. There is a common misconception that price increases are unacceptable to customers. However, a significant improvement in customer value can justify a higher price point.

A prime example of this is the smartphone revolution, where devices were priced 4 to 5 times higher than their predecessors and yet achieved remarkable success. Customers embraced these price hikes because their increased satisfaction outweighed their cost concerns.

Suppose your team were to develop a product that is five times more expensive than the previous generation. In that case, you will probably encounter stiff internal resistance, even if the leap in customer satisfaction is substantial. This resistance often arises from a lack of established practices for measuring customer value, paired with a prevailing culture focused on measuring costs down to the last penny.

Apple launched the iPhone in 2007, and the companies dominating the market then were Nokia, followed by Motorola and Samsung. Nokia had around 40 -50 % of the global phone market in 2007. Five years later, it was under 5 %. The iPhone is a good example of the power of a WoW product.

When understanding customer value, it's essential to recognize that it's a subjective concept in the customer's mind. Customer value is a perception. This perception is not necessarily tied to the actual performance of a product or service but rather to how the customer perceives it. The value is in the perception, not the performance. A more accurate term would be perceived customer value. However, I will use the term customer value for simplicity to mean the same thing.

It's a common misconception to assume that customer value is an inherent property of a product or service. Believing that the most advanced product with the most features and best quality has the highest customer value. Customer value is not a property of a product. It's about being perceived as satisfying needs best at the lowest resource consumption. That's where the value lies. That's where WoW products are found.

It is possible to create many combinations of satisfaction of needs and use of customer resources, all of which can be perceived by customers as having the same value. This may all sound a bit abstract, but it is as simple as this:

- A cheap and simple tool and an expensive professional tool can have the same value. The ratio between the satisfaction of customer needs and the use of customer resources can be the same. The expensive professional tool is outstanding in satisfying customer needs, but the higher cost reduces the value.

Some companies overuse the simple strategy of focusing product development on reducing costs. Running cost-cutting projects may result in advantages, but these advantages soon disappear. Lowering costs alone will lead to shrinking revenue because the company must continually lower prices as competition is launching new products with higher value. Running many cost-cutting projects is not sustainable for any company. When you cut costs, you're not just trimming the fat, you are also trimming your chances of success. You will erode customer value.

**Customer value is a perception in the minds of the customers and not a property of your product.**

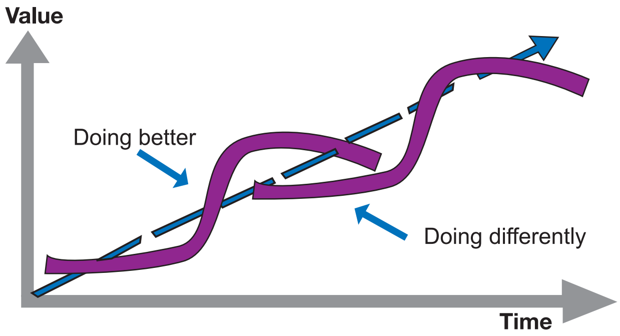
History has also taught us that if the satisfaction of needs remains the same, no price is low enough to guarantee sales in the future, not even a zero-price tag. Sooner or later, new products and services will be launched, offering so much more value that existing products become obsolete.

The contest for customers fueled by technological development forces into motion a continual increase in customer value for all products. A race that all companies are part of. This site tries to teach you how to become a winner in this race.

### 2.2 The S-cure

There are two completely different strategies to increase a product's customer value:

- One method is to break the existing paradigm and radically change the product, resulting in a quantum leap in customer value. Simplified, we could call this "doing differently".




- The other method is to refine, polish, and improve the product. Simplified, we could call this "doing better".

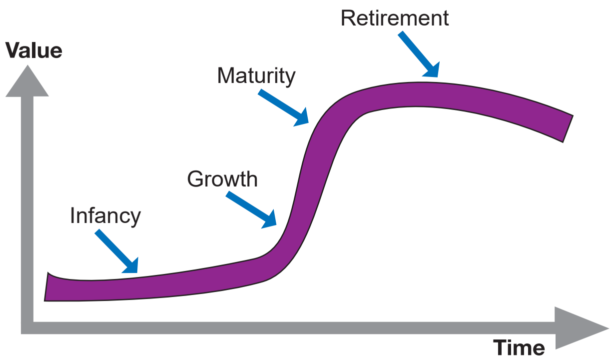
Most products typically exhibit a blend of both approaches. Certain aspects of the product may be innovatively transformed, introducing new functionalities or design elements, while other components or design elements are retained.

However, all products eventually undergo a more radical change that redefines the value proposition. One example is the mobile phone market, which followed the "doing better" method between 1990 and 2007. The launch of the iPhone in 2007 is an example of "doing different."

A diagram describing the value development for a product category over time usually takes the shape of a S-curve. This S-curve can be broken down into four phases:

- Infancy
- Growth
- Maturity
- Retirement.

The biological analogy is justified because of the remarkable similarities between the two systems. For example, when a product is in early infancy, it is often immature and has childhood illnesses.




A lack of knowledge, experience, and resources causes these imperfections. As time passes, companies learn how to fix these problems in the product, and value increases. Work in this phase should focus on making the system's Main functions robust and durable. After all, these functions are the most important ones to the customer. It is also important to divide the product into natural subsystems with well-chosen interfaces to support and simplify continued development.

Growth can only commence when the product has worn out its baby shoes and matured somewhat. Efforts can then be turned towards successively complementing the product with Additional functions and eliminating Unwanted ones. Together, these activities lead to a speedy increase in customer value. At the same time, all accompanying production, distribution, and marketing processes are refined and developed to ensure the successful management of increased volumes.

The maturity phase is often the most treacherous. Success is now at its peak. Companies are lulled into a false sense of security. Profitability is good, and production, distribution, and marketing have all taken proper shape. The only problem is that the value increase has stagnated. Just about everything has been refined and polished to perfection. New Additional functions are too expensive to implement, and Unwanted functions have been reduced to a minimum. It's no easy task to set aside feelings of security, question what is working, and search for something new and unknown when the current product performs so well.

I call this phase the complacency phase. Companies have become fat and lazy. All metrics on the CEO's financial sheet are green. Why create a new WoW product when we already have one? They refuse to realize that they are at the peak and that the only direction from there is down. They do everything in their power to protect what they have. Not surprisingly, most patents are filed in the maturity phase. However, most of those patents are tweaks of little or no customer value.

Resistance to change is so much stronger than the desire to survive. The inability to break free from the shackles of past success lays the foundation for future failures. A company's past success can be hazardous to its future health. Side effects usually include complacency, stagnation, and catastrophic failure. This is why most companies only survive one S-curve.

Finding a balance between concentrating on the current product and searching for something new is essential to the maturity phase. Now is the time to get going. Stimulate the desire for experimentation and challenge the paradigms.

Retirement can take two completely different courses. In one of these, the product disappears quickly and is replaced by a different product with considerably higher customer value. When put in motion, this change can sometimes go surprisingly fast.

In the other scenario, the product lives on by one or two suffering players who missed the disruptive change. The product has become a niche product and is far from the glory it used to have. Knowing where your product is on the S-curve means you can avoid making common mistakes and formulate guidelines for product development. To do that, several different metrics have to be analyzed, such as:

- The number and type of patents filed over the years.
- How has the number of players on the market changed over the years?
- Variations in profitability over the years.
- Plotting the increase in customer value over the years.
- Changes in subsystems and functionality over the years.

The S-curve defines what happens but doesn't tell you why it happens. A detailed study of how different products change towards greater customer value will identify several development trends that explain the S-curve. These trends form a complex pattern because they are simultaneously parallel, competitive, and coincidental. This complex pattern demands training to be seen and understood. Some of these development trends are discussed in the chapter Create the Solution.

### 2.4 Summary

Customer value is not an unknown concept in most companies but rather something that circulates in various contexts. It is often used as a cliché empty of meaning and defined content. Anything good or bad for the customer can be justified based on customer value. It sounds good, but the lack of concrete content makes a deeper analysis impossible.

Success is about transforming customer value from a cliché into a concrete and practical tool to guide and lead all activities in product development. It needs to be broken down and concretized so that individual development engineers can use it to make the right decisions in their daily work. I really like the European definition of customer value. It is a brilliant formulation that I strongly recommend everyone to embrace. The fact that it is a standard also means that one can avoid all the fuss about what it is and how it should be defined.

There is no doubt that all WoW products have fantastic customer value. More is required to succeed, but you can never succeed if you do not have a product where the ratio of satisfying customer needs to the use of customer resources is superior to everything else on the market. Let unrivaled customer value be your guiding star towards which you should strive.

Frame it and make it the office mantra:

- **Customer value is the reason why customers buy our product, and customer value is the reason they don't.**