



# Manufacturing Beyond the Margin: Changing the Customer Conversation from Price to Value

By John R. Brandt and George Taninecz

>> Compliments of

**Microsoft**  
Business  
Solutions

# Manufacturing Beyond the Margin: Changing the Customer Conversation from Price to Value



© 2004 Manufacturing Performance Institute

The most fundamental strategic questions facing manufacturers today aren't about technology or talent or stock price. They're about customers — and the fundamental ways in which customer expectations have changed. Market dynamics have reduced most customer interactions to discussions of “price” without reference to value.

Yet even though customers focus on price in negotiations, they increasingly select vendors on non-price value attributes — a fact that few leaders and even fewer companies understand. Even worse, most leaders have failed to recognize how deeply advances in information technology, logistics, and management techniques have affected their customers' expectations. In market after market, real prices — those adjusted for inflation — have declined steadily over the last 20 years. In high-tech markets the trend is even more impressive: Calculators that sold for hundreds of dollars in the 1970s are now giveaways at trade shows, and computing power that cost millions of dollars then is now available for under \$500.

Manufacturers' focus on price has driven extensive commoditization of products and prices, even in markets where complexity and customization should differentiate. With margins in freefall, manufacturers cut corners to survive, instead of increasing real and perceived value (which customers really want). Increasingly dissatisfied customers demand even lower prices, driving even more commoditization. In many manufacturing industries, CEOs despair of ever being able to raise prices again — or of investing in the future.

Can manufacturers change the customer conversation from price to value?

Yes — but doing so requires a fundamental reorganization of the customer relationship, by providing a customer-value package *wrapped around* the core product or service, and negotiating what the package offers:

- > **Improved quality/reliability/timeliness of delivery and service;**
- > **Reduced total cost of ownership/procurement/business relationship;**
- > **Reconfigured solution bundles, of which the core product or service may be a small part;**
- > **Transparent access to information, serving the end-customer and supporting the product; and**
- > **Provision of valuable business expertise, even if unrelated to the core product or service.**

Changing the discussion from price to value increases margins dramatically — because adding more customer value does not mean proportionally more investment. It also enables manufacturers to grow customer loyalty as customers increasingly value the relationship, not merely the product or service.

## >> Five Facets of Value Delivery

In order to make the price-to-value argument stick, a manufacturer must reorganize all processes and customer interactions around a value-added strategy. This requires five key initiatives:

### >> (1) Develop a systematic, continuous methodology to understand what customers *really* value.

End customers now have fundamentally different perceptions of themselves (consumers) and their organizations (business-to-business), and they expect the products they purchase to reflect a deep understanding of those perceptions, frustrations, and aspirations.

How are consumers different?

- *Demographics and ethnicity:* In just one example, the Hispanic population in the U.S. represents the largest non-Caucasian group (37.4 million people) in the U.S. and a full 13% of the population. More significantly, while less than one-fourth of the non-Hispanic white population in the U.S. was under 18 years old, 37% of Hispanics were less than 18 years old<sup>1</sup>. This and other demographic shifts have tremendous implications for product development, packaging, and advertising as customers expect these demographic differences to be respected. Organizations need to ask: *What is the customer's cultural background, and do our products reflect that?*
- *Gender and work roles:* Customers have moved beyond stereotypical gender roles (Career-track vs. Mommy track, etc.) to embrace multitrack, multitasking roles. With more than 60% of women participating in the workforce in March 2004, compared to just 37% in 1959<sup>2</sup>, marketers can no longer ignore the psychographic changes in their customer base. Nor can they ignore the fact that work itself is changing: In 2004 there will be 54 million remote and mobile workers in the U.S. alone, with more than three times that

<sup>1</sup> “U.S. Hispanic Population: 2002,” U.S. Census Bureau, 2003.

<sup>2</sup> Seasonally unadjusted civilian labor force participation rate, 20 years and over, women, Bureau of Labor Statistics, March 2004.

number worldwide. Customers now demand that marketers understand that within a given week the same customer can be a senior executive, a father, a volunteer at a shelter, a sports coach, and a caregiver to an elderly parent. *What are the customer's various roles at work and beyond, and how do our products support them?*

- *Prioritization:* The increasing automation of calendars and task lists through paper, computer, and digital-assistant systems has created a customer base that is harried, stressed, and focused on To-Do Lists. In just one example, half of U.S. heads of households are too tired to prepare an evening meal, and 63% are constantly looking for ways to get household chores (shopping, cleaning, cooking) done faster<sup>3</sup>. This means that products and services are now evaluated by customers in simple terms: *Does the product offer a solution that adds to – or subtracts from – the To-Do list?*

Business-to-business customers have also changed profoundly in recent years:

- *Leaner and meaner:* Corporations have significantly increased productivity while decreasing headcount since the turn of the century, with business output per hour for all persons climbing from an index of 115.7 in 2000 to 133.4 for the first quarter of 2004.<sup>4</sup> Even with an economic tailwind, it's unlikely that organizations will allow themselves to bulk up to the sizes reached during the Internet boom; they are far more likely to seek further productivity gains. Companies must ask themselves: *Do our products help customers sustain or increase employee productivity?*
- *More globally dispersed:* Either through corporate expansion or outsourcing, companies are more geographically dispersed than ever. China's entry into WTO has lured thousands of enterprises to the PRC. Other low-cost markets, such as Eastern Europe, also are intent on capturing their share of offshoring business. *Can our organization connect with customers, all the time and any time, anywhere around the globe?*
- *More outsourcing:* Companies now outsource a much wider and deeper variety of functions than ever before. *Do our products help customers improve competencies (and margins) and maintain control of outsourced activities, thus encouraging more outsourcing opportunities?*

These issues beg for business solutions geared to value, as sellers/suppliers literally replace the office down the hall or plant across the street. Gaining a deep understanding of customers – with particular focus on self-perceptions, attitudes, and changing needs – and satisfying those needs allows companies to prevent a “downward migration” in spending habits that can lead to products becoming perceived as commodities – and to customer defections.

## >> (2) Focus intently on building relationships instead of products, broadening your value proposition from merely having preferred products to becoming a preferred partner.

Just because customers can get detailed technical help about a jet engine from GE in a few seconds – via phone or web – that doesn't mean that they can expect turn-on-a-dime service from their other suppliers, does it? According to customers, the answer is “Yes.” Customer expectations are leaping industry bounds as never before because:

- > **Increased media coverage of business and consumer issues have made customers more aware of service issues and comparisons;**
- > **In today's leaner organizations, managers typically have a wider span of control and exposure to service from more vendors and industries, making them better “consumers”;** and
- > **On the Internet, every firm looks like every other firm. Customers now benchmark service levels against best-in-class levels – regardless of industry.**

Even when an entire industry is behind in providing a particular customer service, if a customer has a positive experience in any remotely related industry, that customer will instantly wonder why all industries are not the same. Consider the standard set by FedEx, which ranked highest in J.D. Power & Associates 2002 Small Package Delivery Service Business Customer Satisfaction surveys for air, ground, and international delivery: It's on-time, or your money back. If your company can't – or won't – provide service that matches customer expectations developed across a wide range of industries, he or she will find someone who will. In Europe in 2001, consumers frustrated by bad service transferred 70 billion euros of business between manufacturers and 26 billion euros of business between retailers. At the same time, consumers switched some 21 billion euros to “good service” retailers and 80 billion euros to “good service” manufacturers<sup>5</sup>.

<sup>3</sup> “A.C. Nielsen Consumer Pre\*View Study,” A. C. Nielsen U.S., January 6, 2003

<sup>4</sup> Productivity and costs first quarter 2004, Bureau of Labor Statistics, May 2004; index base year 1992=100

<sup>5</sup> “Customer Service,” November 2002, Terrapin B2B Media in association with Datamonitor.



Many companies already understand the potential positive and negative effects of cross-industry expectations, and have nascent plans to address customer concerns. According to a study of 110 senior executives from Fortune 1000 companies by Booz Allen Hamilton and the Kellogg School at Northwestern University, almost four out of five respondents plan to shift from selling products and services to developing value-added solutions in partnership with customers: “Companies that focus on ‘relationship-centric’ activities while emphasizing growth opportunities and adapting to a changing marketplace are more likely to be top performers than those companies that focus on decreasing working capital, supply chain efficiency, and spinning off non-core businesses.”<sup>6</sup>

The effects of cross-industry benchmarking by customers can be surprising. Consider, for example, a consumer who orders a computer from Marlow, New Hampshire-based PC Connection. If the customer calls before midnight, PC Connection will fully configure a new computer — including the addition of accessories and loading software — and then deliver the computer to the customer’s home the next day. What happens the next time the customer calls a catalog retailer and orders an in-stock shirt — only to be told that since he has called after 1:00 p.m., the order cannot be processed until tomorrow? Does the customer say, “OK?” Or does he say, “What’s wrong with this company?” More ominously, does the customer begin looking for another vendor?

### >> (3) Reexamine your product and customer value proposition, and bundle it with other products/services.

Customers want manufacturers to invest the time to learn enough about them and their businesses so that they can receive a total solution package — of which a product or service may be just a small part. Sales pitches about a product and its attributes are no longer relevant. What matters is how those attributes contribute to the value bundle, which in total solves a unique customer problem or offers a unique consumer experience. For example, the grocery industry realized this long ago, and it began placing enormous emphasis on consumer demand for bundled goods, defined by the Grocery Manufacturers of America as “the bundling of products, services, and information to deliver answers to consumers.”<sup>7</sup> Shoppers increasingly are buying complete “mealtime experiences” rather than individual recipe ingredients.

A more radical example of this evolution is occurring in the automotive industry, which is fundamentally challenged by emerging trends, particularly in sales and distribution. Automakers can expect margins to decline as more and more consumers seek information online and eventually buy via the Internet or through non-traditional dealers. Increasingly, the answer will be for automakers to bundle services with their vehicles. Do car buyers, for instance, really want automobiles, or do they want safe and secure transportation? If the latter, then subscription roadside assistance — such as the OnStar service, with about 2 million subscribers — will provide substantial ongoing revenues and profits for automakers. Other automakers are incorporating a range of information and entertainment options, from DVD players to real-time traffic reports to Internet access. Why? Because the automotive industry’s ultimate product may no longer be a car or even safe and secure transportation, but instead a one- or two-hour daily experience in the automobile. In-vehicle information and entertainment systems enhance that experience and offer additional revenue opportunities for services. It’s not too far-fetched to imagine that the automobile companies could eventually become Internet and entertainment portals, with cars as content delivery vehicles. Leaders everywhere need to ask themselves how their own industries might manage and invest differently if they took such broad views of their opportunities.

Bundling also means pulling together products and services from upstream and downstream suppliers to create a supply-chain value solution. AMR Research estimates a \$400 billion industry opportunity exists for partners that can fully integrate their supply-chain operations. Those dollars will come via streamlined inventory levels, improved supplier and product lifecycle management, and broader sales and operations planning.<sup>8</sup>

### >> (4) Put information management — about product/services/value and customers — at the core of your customer value proposition, delivering data, information, products, and services whenever, however, and wherever customers want it.

Customers now value well-managed information — about product, about *themselves* — as highly as the product or service. For example, in a just-in-time environment, information about a shipment or service delivery date is often more valuable than the shipment or service itself — because a missed delivery may shut down a customer’s operation. Information about shipments or service deliveries gives customers the power to schedule, to plan, and to deliver outstanding service to *their* customers. Without information, customers don’t know if a supplier will deliver on time or not — which makes them nervous. Competitors have a word for your nervous customers: “Prospects.”

<sup>6</sup> “Organizing for Success in the 21st Century,” Booz Allen Hamilton, 2002.

<sup>7</sup> “Full service solution selling,” Grocery Manufacturers of America, Food Marketing Institute, and Arthur Andersen LLP, June 1999.

<sup>8</sup> “\$400 Billion Supply Chain Opportunity Identified by AMR Research,” AMR Research, Feb. 23, 2004.

Even more important is information about the customers themselves — managed for their benefit and customer value. Many companies already recognize this, and are investing heavily to put customer information at the heart of their value proposition. For instance, IDC predicts worldwide revenue from customer relationship management (CRM) applications will reach \$14 billion by 2005. But CRM alone will not create customer loyalty or increased profits. Companies must have a comprehensive business strategy that provides “a global, holistic view of their customers to all customer-facing employees.”<sup>9</sup>

At Frontier Electronic Systems (FES), a supplier of electronic systems and technical services to the U.S. government, the replacement of monthly contract reviews with an electronic Contract Management System Database allowed 24/7, real-time access for FES employees and customers alike. With all parties focused on current, up-to-date contract deliverables, FES achieved a consistent 98% delivery rate and received numerous customer awards<sup>10</sup>.

Just as customers want information, they increasingly want it wherever they might be. Customers are now mobile, and expect product, service, and information wherever they are. Manufacturers must incorporate mobility into their customer value propositions.

Customers increasingly don't want to sit in front of a PC at work or at home any more than you do. They want to be out on the floor of their facility, out with their customers, or out on the golf course. How manufacturers deliver information to customers beyond the PC — via the wireless Internet and mobile commerce — will be one of the most important competitive differentiators of the next five years. PDA shipments are forecasted to have a 6.5% compound annual growth rate (CAGR) over the 2003-2008 period, with shipments forecasted to reach 10.8 million units in 2004.<sup>11</sup> Via mobile technology customers will:

- Buy, placing purchase orders wirelessly. Amazon and numerous other consumer firms already offer mobile commerce.
- Check prices, get bids, and verify order status. Fidelity and a host of other financial companies already offer mobile account management.
- Receive geographically sensitive information, such as the location of a nearby facility or truck. A number of companies offer online dispatch of their trucks.
- Receive location-specific services, including mobile access to maintenance records and references, as well as remote monitoring systems for shipments, machinery, and storage facilities. Caterpillar operates an application called “Pocket Technician System” which interfaces with engines in Caterpillar trucks. Fleet managers are able to remotely monitor engine performance and to diagnose/improve potential problems.
- Get help in selling to their own customers. Microsoft and a host of other software firms are enabling their ERP and supply-chain software packages to utilize the mobile Internet — enabling true anytime, *anywhere* commerce among partners.

Leaders focused on tomorrow's customer value are re-integrating the concepts of distance, geography, and location into their business models to include mobility and the wireless Internet.

## >> (5) Develop a systematic, continuous, methodology to evaluate products and customer-value propositions as well as the value packages offered by competitors, and invent and implement new concepts in customer-value creation.

It wasn't too long ago that a long-term contract meant that customers could expect a cap on price increases in exchange for their loyalty. But now customers demand declining prices and/or increasing value in return for their continued patronage. And customers expect value to increase continuously — at least 5% per year — through a combination of declining prices and increased features and benefits.

The predicament for leaders is clear: Create at least 5% more value in products or services each year, or focus on producing current levels of value more efficiently. Most savvy business leaders will choose the first option over the latter, if only because a primary focus on cost-cutting and reengineering often reduces their product's or service's reputation among customers to that of a commodity — something to be purchased quickly, from a variety of vendors, on the basis of price alone.

<sup>9</sup> Lisa Picarille, “The ABCs of Global CRM,” *destinationCRM*, Feb. 2003.

<sup>10</sup> “Best Practice: Contract Management System Database,” Best Manufacturing Practices database, November 2001.

<sup>11</sup> “PDA Market Still Evolving in Hopes that Usability will be Key to Growth,” *In-stat/MDR*, Feb. 24, 2004.

Successful companies recognize that value can be added by wielding new business models that use technology to align all processes and workflow around specific customers or customer niches. These firms start their organizational design from the outside in – identifying the processes that go into satisfying customer needs, and then designing their departments and job titles to fit. These customer-led, customer-organized companies offer powerful advantages in speed-to-market and customers responsiveness – driving significant profits.

Consider GE's relationship with a large healthcare customer, Cincinnati Children's Hospital Medical Center. GE hoped to expand its relationship beyond imaging equipment sales by also providing bedside monitoring equipment and operating-room equipment. When the hospital balked at doing more business with what it perceived as a bloated sales bureaucracy, GE appointed a single, primary salesperson for all calls within Cincinnati Children's, regardless of product. This reorganization of its sales model allowed GE to counter a perception that too many sales people handle too many pieces of Cincinnati Children's business<sup>12</sup>.

Most importantly, delivering improved customer value doesn't necessarily mean providing more product features or lower prices; it means offering greater value than customers knew they wanted or needed. At Starbucks, for example, quality coffee is only the first level of customer value. By adding grocery store availability of high-end coffees and coffee drinks, Starbucks debit cards, and Internet access with pay-as-you-go or unlimited-usage charges at retail locations, the company managed to grow from a coffee stand in 1971 to a global corporate power with more than \$4 billion in revenue in fiscal year 2003.

Companies can continue to offer the same product next year for 5% less, and reinforce customer perceptions' that, like any commodity, the price will continue to decline. Or they'll join the savvy manufacturers that understand their customers, build relationships with them, use information technology to solidify their links with customers, bundle products to increase value, and keep the customer – and customer value – always front and center. These companies will satisfy the demand for 5% more value by innovating – and in the process create more value for themselves than ever before.

---

<sup>12</sup> Matt Murray, "GE's Immelt starts renovations on the house that Jack built," Wall Street Journal, Feb. 6, 2003



WINNING STRATEGIES FOR **MANUFACTURING**

**Manufacturing Performance Institute**

2835 Sedgewick Road  
Shaker Heights, OH 44120  
TEL: 216/991-8390  
FAX: 216/991-8205