VALUE ABOVE COST

Driving Superior Financial Performance with CVA®, the Most Important Metric You've Never Used

Donald E. Sexton
Praise for *Value Above Cost*

“*Value Above Cost* reminds us that superior financial performance must be at the heart of every decision and every action we take as business professionals. And in addition to bringing fresh insight and accompanying techniques, the Customer Value Added™ metric provides a formula with which to measure results and the tools to deliver on that responsibility.”

—Mark Yolton, Senior Vice President, SAP

“Marketers can always spend money to hide a flawed business strategy. When money is tougher to come by, we need to be much smarter about how we spend it. *Value Above Cost* shows us how to be smarter. It underscores the potential contribution marketers can deliver if they diligently pay attention to this ratio.”

—Chris Gaebler, Vice President, Corporate Marketing, Sony Electronics

“CVA® is such a simple yet ingenious concept. Every businessperson from marketing to operations to finance should put this concept into everyday practice. All organizations need to get back to the basics of measuring, monitoring, and increasing customer value. After all, customer value is the net value created for society. Don’s book gives a great framework on how to achieve that nirvana.”

—Alfred Lin, Chairman and COO/CFO, Zappos.com

“In challenging economic times, it is essential to have a clear path for extracting the maximum value from your investments in product design and development. This book offers the tools to plan and evaluate your marketing program.”

—Ed Reilly, Chief Executive Officer, American Management Association

“Finally, a straightforward and practical way to show the value of marketing efforts in terms of revenue and profits. Don Sexton clearly explains why marketing works and how to determine whether or not your marketing efforts are effective.”

—Bernd Schmitt, Robert D. Calkins Professor of International Business, Faculty Director, Center on Global Brand Leadership; author, *Big Think Strategy*

“The book is really a substantial step in bringing marketing and finance together. Corporations have been grappling with the problem of overlapping effects of these decisions, and Don’s book provides a simple paradigm that can be measured and implemented in most industries in most countries.”

—Kamal Sen, Regional Director, Business Research and Corporate Planning, Hindustan Lever Ltd.
“CVA® is an important topic in today’s world of budgetary control. It makes a no-nonsense case for marketing and finance working closely together in assessing appropriate and necessary spend through the perspective of customers. The future of business is directly tied to the concepts which Don has crafted through his outstanding work.”

—Mark C. Kershisnik, Executive Director, Eli Lilly and Company

“Securing long-term preference by managing customer perceived value should have as much strategic focus as managing costs. There are great insights in Value Above Cost: to strategically manage both sides of the equation to ensure customer loyalty and drive superior financial performance.”

—Steven Haro, Brand Manager, Boeing Commercial Airplanes

“Don Sexton renders a simple yet profound truth visible when he defines marketing as ‘managing perceived value.’ Customer Value Added (CVA®) is breakthrough thinking about the way customers understand value and how organizations can deliver and measure value. His 40 years of award-winning teaching, writing, and research in the field of marketing at Columbia University are now concise and actionable insights for the mere price of a book.”

—Kevin Clark, President and Founder, Content Evolution LLC Worldwide; Program Director emeritus, IBM Brand & Values Experience

“If marketing is about creating value, some marketers struggle with staying focused on the objective. Others struggle with proving they’ve achieved it. Dr. Sexton’s book is a must-read for both.”

—Steve Smith, CMO, Enterprise Rent-A-Car

“CVA® will be a powerful addition to the business lexicon, helping to bridge the gap between the CMO’s budget request and the CFO’s perceived value of marketing spend. Value Above Cost should be required reading for both.”

—Shailendra Ghorpade, Group Managing Director, Europe, Middle East, and India, MetLife

“Effective brand management requires a solid understanding of the value being delivered by the brand and how the business strategies link together in delivering the value of the brand. The concepts that Don Sexton has summarized in Value Above Cost provides practical tools and many examples on how to understand the value components. With these tools, marketers and business managers should be able to improve the performance of their businesses while delivering the best value to their customers.”

—Dean Adams, Principal Brand Strategist, LEVEL
“Marketing commitments can be viewed as an expense or as an investment. Don Sexton’s *Value Above Cost* establishes the framework for differentiating between investment with payback that should be optimized and an expense that should be minimized.”

—Tom Finneran, EVP, Agency Management Services, American Association of Advertising Agencies

“In describing how Customer Value Added™ can be used by organizations to improve their financial performance, Professor Sexton has bridged the gap between theory and application...between marketing and finance. Using his techniques, CEOs and marketing executives can evaluate alternatives and make decisions to maximize market share and profitability.”

—Daniel C. Petri, Group President—International (retired), Verizon Communications

“Don Sexton writes like he lectures: clearly, succinctly, relevantly, and always sprinkled with a good sense of humor.”

—James R. Gregory, CEO, CoreBrand

“Don Sexton has managed to weld key ideas from marketing, economics, finance, and statistics to explain clearly how marketing drives the financial performance of a company. Furthermore, he has given us forward control through his Customer Value Added™ metric that allows us to predict a company’s future performance.”

—JC Larreche, INSEAD Alfred H. Heineken Professor of Marketing; author of *The Momentum Effect*

“In synthesizing basic economic, financial, and brand marketing concepts under the banner of ‘Customer Value Added™,’ Don Sexton has designed a powerful tool that creates a foundation for a company-wide shared view of how to think about and how to measure the financial impact of its brand marketing efforts. In this time of heightened scrutiny of expenditures and strict accountability, we should all keep *Value Above Cost* close at all times.”

—Frank Cooper III, Chief Marketing Officer, Sparkling Beverages, Pepsi-Cola North American Beverages

“Price, marginal cost, gross profit, product attribute cost/benefit analysis, advertising effectiveness, and marketing ROI all have value in the senior manager’s toolkit, but CVA® is the one metric I have found that brings these together, creating a common reference for operations, marketing, sales, and finance. This is a powerful tool every manager needs to understand and use.”

—Mark Osterhaus, Vice President and Assistant General Manager, Harrah’s Council Bluffs
“A book that blends the disciplines of finance, economics, marketing, and branding in a logical and thought-provoking way is one that provides real ‘Customer Value Added™.’”

—John Dodds, Global Branding and Marketing Communications Director, Air Products

“A probing discussion and rewarding read. Don’s premise on the valuation of brands contains the analytics, relevant business examples, and commentary of what to do and how to do it. Take advantage of his insights.”

—Gary Elliott, Vice President, Brand Marketing, Hewlett-Packard

“Don Sexton’s book clearly lays out best practices for gaining maximum value for your marketing investment. This is a must-read in these tough economic times when every marketing dollar is being seriously questioned. This book will help you to charter unchartered waters!”

—Ed Faruolo, Principal, VitaLincs, LLC

“Too many business people take a conventional view of pricing as a simple cost plus exercise. This doesn’t take into consideration the value of a brand, nor consumers’ willingness to buy a brand versus a mere product—as a sum of its raw material plus margin. In Value Above Cost, Don Sexton gives us ideas as well as methods to more accurately understand the value of our brands to consumers and to maximize profit and grow brand equity. I will recommend his book to anyone who has influence over ‘brand pricing’ as a way to better manage brands and their businesses.”

—Marshall Dawson, cofounder, Deviate Marketing; former Global Brand Director, Bombay Sapphire Gin

“Customer Value Added™ combines a discipline with an insightful approach to assessing and capturing the intrinsic value of business opportunities.”

—Scott Fuson, Vice President, Specialty Chemicals and Global Executive Director Life Sciences, Dow Corning

“Marketing no longer has a seat at the boardroom table in many companies because they can’t discuss CVA® and link it to the financial performance of their company. Read on.”

—Grahame Dowling, Professor of Marketing, Australian School of Business, The University of New South Wales

“CVA® serves to normalize data for multinationals like Lenovo that seek to attract both up-market and emerging market audiences. This is no easy feat, but Don Sexton’s book demonstrates that it can be done. As marketers increasingly are held accountable for return on their in-market investments, this kind of sensible construct can only help provide them with the ammunition they so desperately need!”

—Glen Gilbert, VP, Brand Management & Marketing Strategy, Lenovo
Value Above Cost
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Value Above Cost

Driving Superior Financial Performance with CVA®, the Most Important Metric You’ve Never Used

Donald E. Sexton, Ph.D.
To all the members of my wonderful family: Laura, Mitra, Daniel, Jonathan, Ian, Matt, and Nan, who are always in my thoughts.
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Customer Value Added is the most critical concept for the business community to understand, embrace, and practice. The greater the value added, the greater the opportunity to drive profitability and, therefore, increase shareholder value—which is the primary objective of the CEO.

As business people, our primary responsibilities are to drive shareholder value by selling sufficient quantities of preferred and profitable products and services to consumers and customers. The key word in that sentence for marketers is *preferred*. Preference by consumers and customers may be *real* or it may be *perceived*—but it is a preference nonetheless.

Our job as marketers is to create *preference* via distinctive and differentiated communications. Not only must marketers create preference, but we must also try and grow it over time to ensure that the product or service can contribute positive cash flow to the business enterprise over the longer term. Preference equals perceived value. The more preference that marketers can drive, the more perceived value can be delivered to customers—thereby driving increasing levels of cash flow and shareholder value.

Professor Sexton can certainly explain these business dynamics far better than I—and he does—in this eloquent masterpiece of business marketing and economics. What is magnificent in Professor Sexton’s work is that he provides the fundamentals of how this business model effectively operates. By paying attention to these core fundamentals, marketers will improve their odds for delivering upon the CEO’s ultimate objective—driving shareholder value.

Many successful marketers have paid attention to the fundamentals—and have succeeded as a result. Let’s take a look at a few recent examples:

- Apple’s iPod was brilliant—not in its technology—but in its marketing. Apple didn’t invent MP3 players or flash technology or recorded music. But what it did so well was it marketed the
perceived benefits of portable and customized music. Apple’s technology was easily replicated—but not its leadership position. Consumers perceived that Apple was the preferred device for personal, customized music management. Customer value added could not have been higher as it reflected substantial marketplace preference.

- Procter & Gamble’s Pampers brand is reinventing how parents choose diapers. Pampers created enormous equity and customer value by changing the conversation with consumers. While parents care about keeping their babies dry, Pampers went one step further and expanded the focus on total baby care. By doing so, Pampers tapped into the reservoir of parental goodwill, which was rapidly transferred to Pampers in terms of trust and preference. That meant marketplace leadership and growing profits. Was Pampers necessarily a better diaper? Probably not, but in the minds of parents it certainly was.

Does a lot of this sound familiar? Well it should—because this is the essence of building a successful brand. There is no greater responsibility for a marketer than to preserve, if not build, brand value. Building strong brands creates the core customer loyalty and long-term demand that gives marketers great latitude for creating price premiums among a sea of commodity-like products. What kind of price premium can marketers charge? Quite simply, it’s the perceived value that consumers ascribe to the product and service. The greater the perceived value, the greater opportunity to build margins via price, thereby increasing positive cash flows and brand profitability.

Professor Sexton’s book wonderfully and easily navigates the marketplace strategies and theories that serve as beacons for successful brand management. As you leap into the contours of this outstanding brand management perspective, know that there are many pitfalls lurking that can undercut a marketer’s ability to deliver the goods. Good marketers must follow core brand management practices that can often escape even the most savvy of marketers, for example:

- **Strong marketing accountability practices.** Insufficient metrics and measurements can derail any good brand building management. In fact, it’s an old axiom, “You can’t manage what
you can’t measure.” Marketers must continue to work to link marketing, finance, and a solid analytics to create targeted metrics that provide quick and compelling feedback on the impact of brand management programs.

• **Effective integrated marketing communications.** As marketers have an expanding array of media to pursue their customer and consumer targets, they need to have a good foothold as to how they select the most effective media and decide on the levels of financial resources to devote to the use of various marketing approaches.

• **Outstanding marketing and media talent.** The field of marketing has received increasing criticism for failing to keep the marketing management pipeline full of holistic business thinkers that can blend great creativity with dynamic leadership potential and superb business savvy. Those needs are critical, not only at the brand management level, but also in terms of the support resources at advertising and media agencies.

It’s certainly not easy being a marketer. But Professor Sexton makes it a lot easier by providing guidance on how to think about managing the significant challenges marketers face each and every day. And, now, it’s time for you to move from my take on Professor Sexton’s work and to create your own perspective. Enjoy the good reading. You probably won’t come across this wonderful path again.

Many thanks Professor Sexton—not many could have said it as well as you.

Bob Liodice
President & CEO
ANA—The Association of National Advertisers
Acknowledgments

Many thanks to many people: Peter Farquhar, Jim Gregory, and Don Lehmann, professional colleagues and friends, whose ideas are always fresh, always stimulating. Bob Liodice, CEO of the Association of National Advertisers, for his breadth of vision, thoughtful marketing insights, and long-time encouragement. Barbara Bacci Mirque for her much-appreciated support. All the executives who generously shared their experience and insights in their sidebars: Dean Adams, Susan Avarde, Serdar Avsar, Michael Bentivegna, Jeff Berman, Robert Bordley, Kevin Clark, Eduardo Conrado, Marshall Dawson, Jamie DePeau, John Dodds, Gary Elliott, Carlos Falchi, Ed Faruolo, Tom Finneran, Lauren Flaherty, Amy Fuller, Scott Fuson, Chris Gaebler, Shailendra Ghorpade, Andrew Giangola, Steven Haro, Tony Hsieh, Peter Neiman, Mark Osterhaus, Evan Oster, Dan Petri, Ed Riley, Cheryl Sawyer, Becky Saeger, Kamal Sen, Steve Smith, and Jon Spector, all singularly effective managers whose paths I have had the good fortune to cross. Rajinder Balaraman and Venu Gorti for our vigorous discussions. Ashleigh Brilliant, whom I met in Santa Barbara many years ago and whose wit provides perspective on everything. Tim Moore, Gina Kanouse, Anne Goebel, and Megan Colvin of Pearson for the many ways they have helped. Thanks to all.
About the Author

Donald E. Sexton is Professor of Marketing and Decisions, Risk, and Operations, and Director of the Jerome A. Chazen Institute of International Business, Columbia University. Don received his B.A. in mathematics and economics from Wesleyan University and his Ph.D. and M.B.A. in business economics and mathematical methods and statistics from the University of Chicago. He has been teaching at Columbia for more than 40 years in the areas of marketing, international business, and quantitative methods, and is a recipient of the Business School’s Distinguished Teaching Award. Don is a visiting professor at the China Europe International Business School in Shanghai and has also taught at the University of California-Berkeley, INSEAD, the Indian School of Business, the Australian Graduate School of Management, Skolkovo (The Moscow School of Management), the University of Tehran, the US Business School in Prague, and the Hong Kong University of Science and Technology. He has more than 100 publications and has published articles in numerous journals such as the Harvard Business Review, Journal of Marketing, Journal of Marketing Research, Journal of Advertising Research, and Management Science. He is frequently quoted in media such as the New York Times, BusinessWeek, Ad Age, Brandweek, and Beijing’s China Economic Daily. Don is the Program Director of the Conference Board’s Marketing Effectiveness Conference and Marketing Research Councils and is a frequent speaker at Association of National Advertisers events. His research concerns marketing return on investment and marketing and branding strategy. His best-selling book on marketing management, Marketing 101 (Wiley), has been translated into several languages including Chinese, Turkish, Polish, and Indonesian. His book on building and managing brands, Branding 101 (Wiley), was published in 2008. Don is the principal of The Arrow Group, Ltd.®, which has provided consulting and training services to companies such as GE, IBM, Pfizer, Unilever, Citigroup, DuPont, and Verizon. You can reach Don at donsexton@mindspring.com or log onto www.cva.us.com.
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Today’s competitive environment creates enormous pressures on all managers to be more effective (Exhibit 1.1). Managers at every level from Chief Executive Officer, Chief Marketing Officer, and Chief Financial Officer to the assistant to the Assistant Brand Manager feel these pressures.¹
Marketing managers feel not only the external pressures of the competitive environment but also internal pressures from fellow managers who ask reasonable questions within their organizations, such as:

- What is the return on our marketing efforts?
- What would our sales or profits be if we cut back on the marketing budget?
- Why should we increase efforts in marketing?

In their surveys of marketing managers, the Association of National Advertisers (ANA) has found that relatively few managers are satisfied with their ability to estimate the return on their marketing efforts, and relatively few believe that they can forecast the impact of a 10 percent cut in the marketing budget (Exhibit 1.2).²

**Exhibit 1.2  Marketing manager’s views on their ability to evaluate marketing**

<table>
<thead>
<tr>
<th>How would you evaluate your ability to determine marketing ROI?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Very Satisfied or Satisfied</td>
</tr>
<tr>
<td>2005 (ANA)</td>
</tr>
<tr>
<td>2006 (ANA)</td>
</tr>
<tr>
<td>2007 (ANA)</td>
</tr>
<tr>
<td>2008 (ANA)</td>
</tr>
</tbody>
</table>

“I can forecast the impact of a 10% cut in the marketing budget.”

<table>
<thead>
<tr>
<th>2005 (ANA)</th>
<th>16%</th>
</tr>
</thead>
<tbody>
<tr>
<td>2006 (ANA)</td>
<td>28%</td>
</tr>
<tr>
<td>2007 (ANA)</td>
<td>18%</td>
</tr>
<tr>
<td>2008 (ANA)</td>
<td>10%</td>
</tr>
</tbody>
</table>

It is, therefore, not at all surprising that about 60 percent of finance managers surveyed by *Financial Executive Magazine* have doubts about marketing forecasts (Exhibit 1.3).³ In fact, given the discouraging opinions of marketing managers regarding their own forecasts, it is surprising that about 35 percent of the finance executives were found to be willing to believe the marketing numbers!
Exhibit 1.3  Financial managers’ views on marketing’s ability to evaluate marketing return

<table>
<thead>
<tr>
<th>Question</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Given that marketing forecasts are often input to financial guidance, do you believe these forecasts are audit-ready?</td>
<td>60%</td>
</tr>
<tr>
<td>Do you believe that marketing has adequate understanding of financial controls?</td>
<td>63.1%</td>
</tr>
</tbody>
</table>


Few managers are satisfied with their ability to estimate the return on their marketing efforts.

These findings are remarkably consistent—not only over studies conducted by a wide range of organizations including the ANA, the Conference Board, the American Productivity and Quality Center, the CMO Council, and various consultancies—but also over time. In fact, in all these various studies, the percentage of managers very satisfied or satisfied with their ability to evaluate marketing ROI is generally between 10 percent and 20 percent, with no upward trend. At the same time, 80 percent of senior marketing managers surveyed in late 2008 believed that the demands of board members and C-level executives for proof of the effectiveness of marketing and branding initiatives were increasing.

Today’s intensely competitive environment makes it increasingly difficult to determine marketing accountability. Marketing returns are affected by numerous, powerful marketplace forces such as knowledgeable customers, aggressive competitors, shifting macro trends, and technological changes—evolutionary changes that produce new industry leaders and revolutionary changes that produce new industries.

This book provides marketing managers and other managers, including finance managers, with tools to answer questions about the impact of marketing efforts on an organization’s financial performance. The heart of the book is the concept of Customer Value Added (CVA®). CVA® is the difference between the value an organization provides customers and the cost of providing that value—Value Above Cost (Exhibit 1.4).
CVA® is the net value to society created by an organization. The higher the CVA®, the more economically successful the organization. The lower the CVA®, the less successful the organization. It is that simple.

CVA® is the net value to society created by an organization.

This chapter explains how you can use CVA® to improve marketing decision-making.

Unum: Marketing and Shareholder Value

Scroll half way down the Fortune 500 list and you’ll find a company called Unum. Rooted in a 150-year heritage, it was known primarily to Human Resource and Benefits professionals as the leading disability insurance company in the country. It was also known for having stumbled early this decade due to litigation issues and some strategic missteps. In fact, the stock price had fallen from a high of $33 in May, 2001, to just $6 in March, 2003. Because Unum products are sold through brokers and offered through the workplace, the company’s previous promotional campaigns had been trade-focused. But in the summer of 2007, to help give more visibility to Unum’s brand—and to reposition the company from a disability insurance company to a leading employee benefits company, Unum launched a multi-million dollar advertising and branding campaign. The work centered on the company’s new tagline “better benefits at work” and included a new logo, visual identity system, sales literature, television advertising, trade print, consumer print and a sponsorship of ESPN’s Injury Report.
Determining Marketing Accountability

Interest in how marketing affects financial performance has a long history. Nearly 40 years ago, the author’s first published journal articles concerned marketing accountability (Exhibit 1.5). Over the years, many qualified researchers have spent considerable time and effort attempting to estimate the return from marketing activities. Yet the answers have remained elusive, and today marketing accountability remains one of the most important issues facing marketers.5

Exhibit 1.5  Personal involvement in marketing accountability research

Marketing managers seem to believe that the evaluation of the return on the marketing investment is important. In 2006, members of the CMO Council placed issues involving marketing ROI as three of their top five concerns.6 A 2007 Conference Board survey found nearly 80 percent of the respondents considered marketing ROI and marketing metrics among their most important challenges.7
Given the amount of interest and efforts over many years, one would expect some success. Yet, a 2008 study by the Conference Board found that only 19 percent of the organizations surveyed felt that they had made good progress in measuring marketing ROI, and more than 50 percent had not started or had just started their efforts to measure marketing ROI.  

A 2007 Marketing NPV study found fewer than 10 percent of respondents felt their ability to measure marketing ROI to be “as good as it needs to be.” While a 2008 study by the Lenskold Group found that 26 percent of the firms surveyed calculated some profitability measure for at least some marketing investments, that is still far from a majority.

This lack of progress is reflected in the budgeting process. Nearly two-thirds of marketing budgets are set based on history—last year’s budget, according to the ANA surveys and corroborated by other studies.

In Chapter 11, “Organizing to Manage CVA®,” the reasons for this lack of progress are examined in detail. In brief, numerous studies suggest that the main factors slowing progress in determining marketing accountability are:

1. **Lack of clarity as to what marketing return is.** Many managers report that there is no definition of marketing ROI within their organization.

2. **Lack of time devoted to marketing return.** Time spent on marketing return is one of the most useful predictors of progress, but many organizations have not even started to develop systems to examine marketing return.

3. **Lack of motivation for people to work on marketing return.** Relatively few compensation or recognition systems seem to encourage work on marketing return.

4. **Lack of skills and resources.** Many organizations feel they do not have the appropriate data or the appropriate analytical skills to evaluate marketing return.

5. **Lack of cooperation between marketing and finance.** Marketing and finance silos still seem to be the reality in many organizations.

6. **Inertia.** Many managers seem comfortable with what they are currently doing and neither feel the pressure to change nor have the time to change their approaches.
This book focuses on how to think about the return on marketing activities. It shows how a company's marketing and branding efforts play a major role in determining the financial performance of any organization, including revenue, profits, cash flow, and shareholder value and how those efforts can be monitored and evaluated for maximum impact.

Will this book solve all the problems in determining marketing accountability? No, of course not. But it provides methodologies and approaches that are broadly rooted in many disciplines—marketing, economics, finance, and accounting—and which are supported by multiple studies. The book explains how to evaluate marketing efforts with a straightforward concept—CVA®—that has a direct relationship to contribution. Its use has been proven in practice by the author's corporate clients.

The Value of a Business

The value of a business depends on its future, not its past.

Managers, investors, and others concerned about the well-being of an organization need to look at where it is going, not where it has
been. A company’s future financial performance depends on its long-term abilities to manage both the value it provides customers and its costs. Expected future financial performance, in turn, determines shareholder value. The company value meltdowns in the Fall of 2008, such as that of AIG, were due to lack of confidence in the future financial performance of those organizations.\textsuperscript{14}

There is a huge body of thought and writing devoted to the determinants of the value of a corporation.\textsuperscript{15} Many factors have been suggested, including managerial talent, resources, innovation ability, and core competencies. While all of these factors surely affect the financial performance of an organization, none of them provide a direct link to financial performance. Managerial talent and resources are very broad categories. Innovation may be managed but is difficult, by its nature, to predict. Core competencies are specific but look inward (at the organization) rather than outward (toward the customers and competitors). Intangible assets, such as brands, have appeared to pose especially difficult valuation problems for many companies.\textsuperscript{16}

In lieu of factors that are linked directly to financial performance, many managers attempt to predict performance by relying on various financial ratios such as return on sales and turnover.\textsuperscript{17} The problem with many of those measures is that they look backward rather than forward.\textsuperscript{18} A manager should always prefer leading indicators to lagging indicators because forward control is preferable to backward control. One wants to steer by looking through the windshield, not through the rear-view mirror.

CVA\textsuperscript{®} is both outward looking—toward customers and competitors—and forward looking, in that it indicates the future performance of an organization.

<table>
<thead>
<tr>
<th>3M: Relation of Loyalty to Growth and Profit</th>
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<tbody>
<tr>
<td>3M has more than 50,000 products, 36 divisions spanning almost all major markets and subsidiary companies in 65 countries. With that complexity, building powerful brands is a difficult task. A key element of powerful brands is delivering relevance and differentiation. Maintaining relevance and differentiation over a long period</td>
</tr>
</tbody>
</table>
Customer Value and Costs

In the long-run, an organization’s financial success depends on how well they manage two things: value to customers and costs. Both determine margin and demand, and both need to be managed in concert.

Over the years, some management gurus have suggested that being the customer value leader or the cost leader produces winning
strategies. That is not the case. Focusing solely on customer value or cost can lead to implementation of lopsided strategies.

Having the highest customer value does not guarantee success, just as having the lowest costs does not guarantee success. High customer value can lead to high costs. Low costs can lead to low customer value. Customer value and costs must be in balance.

What determines financial success is how well an organization maximizes the difference between the value to customers and the costs of providing that value. That difference is known as Customer Value Added (CVA®), the focus of this book.

CVA® has two important components: perceived value and cost. Perceived value is discussed at length in Chapter 4, “Perceived Value,” and costs are explored in Chapter 5, “Costs.”

**Perceived Value**

In CVA®, customer value is defined as the value *perceived* by the customer.

*Perceived value is the maximum that the customer will pay for your product or service.*

Perceived customer value is not price—it is the ceiling on price. It can be both measured and managed.

Perceived customer value may well be different from actual value. In fact, most of the time perceived value is less than the actual value a customer receives because a customer rarely knows all the value a product or service provides.

Perceived value alone has been found to be an important leading indicator of financial performance in a variety of studies conducted by different researchers with different sets of data (Exhibit 1.6). In a process the author facilitated for members of the Conference Board's Council on Corporate Brand Management (described in Chapter 10, “Building the Marketing Accountability Scorecard”), perceived value was selected as the most important single measure of brand health by a nearly 2:1 margin over the next most frequently mentioned measure.
“The relationship between brand equity and stock return was…strong.”
—Jacobson and Aaker, EquiTrend data

“Brand differentiation and relevance are leading indicators of brand success.”
—Agres, BrandAsset Valuator data

“There is no doubt that relative perceived quality and profitability are strongly related.”
—Buzzell & Gale, PIMS data

“…brand equity is found to have nearly as strong an influence as ROI [on stock return].”
—Jacobson and Aaker, Techtel data

“…Corporate brand image actually has some degree of influence on a significant 75 percent of the key factors that explain stock price.”
—Gregory, Fortune 500 data

Exhibit 1.6 Research findings regarding perceived value and financial performance

A New Definition of Marketing

Many people routinely define marketing as the “4 P’s”: product, pricing, place, and promotion. The author never uses the 4 P’s definition of marketing. Except perhaps for product, the 4 P’s definition of marketing concentrates on the tactical aspects of marketing such as pricing, distribution, and advertising and promotion. While tactics are certainly important, the marketing strategy, including in particular target marketing and positioning, must be appropriate in order for the tactics to have effect.

Marketing is managing perceived value.

The author’s definition of marketing is managing perceived value. Managing perceived value incorporates both the strategic and tactical
areas of marketing. Frances Farrow, executive member of the board of Virgin Atlantic, described how their marketing focuses on managing value to the customer “...the customer viewpoint remains the heart of our companies’ origins...[We evaluate opportunities by asking:] Are we meeting a gap where there is a need? Does it offer consumers a better deal? Can we offer both substance and a unique Virgin flair across many consumer touchpoints?”

To attain high value perceived by target customers, it is necessary to think strategically and design or position the product or service for a target group. It is also necessary to think tactically, for example, by communicating the product or service position effectively to the target customers.

Products with on-target design that no one knows about do not sell. Products that are communicated widely but that have poor design may sell once, but not again. There is a saying in advertising, “Great advertising makes poor products fail even faster”—since people are persuaded to try them and find they do not like them.

Perceived value per unit can be increased with managerial attention, and it can also be decreased through managerial inattention. However, for any level of costs, the higher the perceived value, the stronger the company’s position in the market, both now and in the future.

While CVA® depends on both perceived customer value and costs, much of this book concerns perceived value because managing the value perceived by the customer should be the primary purpose of all marketing and branding efforts.

CVA®

CVA® is the difference between perceived value per unit and the variable cost per unit for a product or service (Exhibit 1.7). CVA® is the net value—as perceived by customers—that an organization provides society.
Exhibit 1.7  Customer Value Added

If CVA® is high, an organization is perceived as providing value to society and will be rewarded with strong financial results. However, if CVA® is low, the financial results will be weak. At the extreme, if CVA® is negative, in a free market the organization will likely go out of business because the inputs it is using cost more than the value of the products or services it is producing. In open markets, such organizations fail.

Keep in mind, as mentioned earlier, that perceived value per unit is typically below actual value, as shown in Exhibit 1.7, because customers usually do not know all the benefits that they receive from a product or service.

Cost Orientation

Unfortunately, all too often managers become preoccupied with costs to the detriment of value to customers. With a cost orientation, managers pay minimal attention to customer value (Exhibit 1.8).
According to Boyd Beasley, the senior director of customer support at Electronic Arts, the successful producer of video games, “In years past, we [EA] were very much a cost center operation and our vision was to come in on budget...We are turning the ship to be significantly more customer centric” by providing more services to customers and bringing them into the product development process earlier.22


Exhibit 1.8 Orientations

There are at least two problems with a single-minded cost orientation:

1. Cost reduction programs may lower value to the customer more than they lower costs.
2. Cost preoccupation is often, but not necessarily, associated with low pricing strategies.

Hollowing-Out

If lowering costs leads to an even greater lowering of perceived value, CVA® is being decreased, and the organization is contributing less to society and will, therefore, have a lower level of financial
performance. Decreasing CVA® when lowering costs represents the *hollowing out* of a brand.23

During a hollowing-out process, because CVA® depends on the perceptions of customers, there may be a time lag between the lowering of costs and the lowering of perceived value. There is inertia in perceptions—customers may be forgiving at the first signs of lowered product or service value.

An example of how easy it is for managers to begin the hollowing out of a brand: Typically the author travels to China two or three times a year with a major US airline. In the past, they provided sandwiches in the middle of the trip—the time in the air is 14 to 15 hours so the sandwiches were welcome. Recently, the airline decided to eliminate the sandwiches, cutting back on their value to customers. Notice the price of a round-trip business class ticket is in the vicinity of $10,000; the cost of providing a sandwich perhaps a dollar or two. By cutting back on costs, they risk losing the entire fare because there are other carriers flying the same route that are not cutting back on the small comforts that make a trip bearable. Truly, the airline is following a policy of “penny wise, pound foolish.”

When the author mentioned the loss of sandwiches to a flight attendant, she said, “Yes, they are just getting very chintzy—and I am tired of reporting the negative passenger reactions. The managers don’t understand.” Perhaps it would be helpful if the cost-cutters were asked to experience a 15-hour flight sometime and learn how the world looks from a passenger’s point of view.

Incidentally, whenever the author sees one of this airline’s expensive print ads, he immediately thinks, “How many sandwiches is that ad worth?” Glossy advertising does not offset perceived product or service deficiencies—as eventually the top managers of this airline might learn. In fact, glossy advertising makes customers more sensitive to perceived value deficiencies.

One can see hollowing out actions all the time and everywhere. When a local bank promises wonderful service and a customer does not receive that level of service, perceived value falls even faster than any cost savings. When a chemical produces lags in their delivery, perceived value may decrease more than any shipping costs saved.
The time lag between when a cost is cut and when customer value falls can tempt a senior manager to cut costs because they can appear to be successful with a cost-cutting program as long as customers have not yet noticed the decline in customer value. Their successor will discover later that the cost decreases have eroded the customer value and brand reputation of the organization, compromising the brand’s power to generate revenue, profits, and cash flow, sometimes irretrievably.24

All cost reduction programs should be calibrated against the impact on customer value as perceived by the customer—value engineering from the customer’s point of view. Unfortunately, many organizations are cost-oriented because they do not know the perceived value associated with their product or service and, therefore, are unable to discover the impact of cost changes on value as perceived by their customers.

An infamous example of failing to consider CVA® is the Schlitz beer story. In the 1970’s, Schlitz was the number two brewer in the US. Concerned with their stock price, top management cut costs by using less expensive hops and reducing the time to age the beer. In the short run, profits increased and so did the stock price, but then customers started to realize that the Schlitz taste had deteriorated and they stopped buying the beer. Schlitz was never able to climb back to their number two position. It was a classic case of deliberately decreasing CVA® for short-term gain and consequently hollowing out a once strong brand.25

**Price-Cutting**

Organizations focused on costs often seem to focus on price-cutting strategies. As a result, they risk training their customers to be concerned about price to the exclusion of value and often incite price wars. The airline, telecommunications, and automotive industries include competitors that seem to have adopted this approach.26

There is usually only one winner of a price war: the customer. Of the companies involved in the price war, the lowest-cost producer may do the best; but their financial results may or may not be attractive. As demonstrated in Chapter 5, as prices are lowered, unit volume must increase substantially simply to maintain contribution.
Meanwhile, in such an industry, many customers become price-shoppers instead of value-shoppers. That simply intensifies the pressure to lower prices and accelerates the vicious spiral of price cuts. Price wars not only erode profits, but also train customers to expect the same prices and to assume that all products and services perform the same—even if that is not true.

**Appropriate Costs**

A preoccupation chiefly with costs can keep one from achieving an optimal strategy for all the reasons above. But the situation is even worse. As discussed in Chapter 5, many organizations do not even know their appropriate costs and, instead, use some form of average full-costing, which compounds the errors associated with a cost orientation.

**Value Orientation**

Some time ago the author listened to an economist, a colleague, discuss his research concerning luxury products. At one point, he said, “You will not believe this, but in the luxury product industry, prices do not follow costs.” In that one sentence, he captured the key difference between economics and marketing—one of point of view, not theory.

Economics and marketing are both consistent in concept. However, an implicit assumption in economics is the movement of markets toward equilibrium as prices decline and profit margins across industries approach some equivalent levels. That equilibrium, in fact, would be achieved in open markets with free flows of information, resources, and products and services.

However, marketers try to interrupt the forces driving markets to equilibrium through innovation, continual redesign, and communications—a focus on customer value. While economists might declare that prices should follow costs if a market reaches equilibrium, marketers would say that their job is to keep a market from reaching that equilibrium by continually adding value and communicating those value increases to the customer.
All marketers try to keep prices from following costs. The marketing task is to break away from the pack of commodity products and services and distinguish their product or service for their target customers. The CVA® for differentiated products or services will generally be high, while the CVA® for commodity products and services will generally be low (Exhibit 1.9).

However, a value orientation that translates as value at any cost should not be the objective. Many books on customer satisfaction and customer loyalty often employ the phrase, “Delight your customers.” Yes, one wants to delight customers, but one needs to make a profit while doing so. One should not try to increase continually perceived value without regard to the increases in costs associated with those value changes. At some point the costs of delighting customers may become greater than the value that they are willing to pay for.

There was an industrial supply distributor that held a much higher percentage of parts in their catalog in inventory than did their competitors. Their customers were delighted with the higher chance of finding the parts they needed at this distributor. They were less delighted when the distributor went out of business due to its high inventory costs.


**Exhibit 1.9 Differentiated products and services versus commodity products and services**
Costs and perceived customer value must be monitored, measured, and managed together.

**CVA® Orientation**

A CVA® orientation is about *balancing* perceived customer value and costs. Because CVA® is the difference between perceived value per unit and cost per unit, it rewards those organizations that can measure, monitor, and manage *both* customer value and costs.

How many people in the typical organization measure, monitor, and manage costs? Usually a lot of people. How many people in the typical organization measure, monitor, and manage customer value? All too frequently, very few.

*How many people in the typical organization measure, monitor, and manage customer value?*

There are some organizations that are proficient at evaluating customer value, and managers from many of those organizations have provided sidebars for this book. Often, however, when the author addresses audiences on the topic of marketing accountability and asks how many people know the perceived value for their products or services, very few raise their hands. A follow-up question concerns how many of the attendees know about some of the techniques for measuring perceived value—and again very few raise their hands. The CVA® orientation forces managers to look at customer value and costs and then rewards them for their efforts with strategies that are more effective in achieving desired financial goals. Gordon Bethune dramatically raised the performance of Continental Airlines by examining the implications of all decisions on both customer value and cost. For example, before the Bethune takeover, pilots were given bonuses for using less fuel—which they accomplished by going more slowly resulting in missed connections for Continental passengers. The pilot incentives constituted a classic example of single-minded thinking, lowering costs without regard to the impact on CVA®—an attitude that Bethune completely changed with dramatic results.27
Marketing is a dynamic and foundational component of all commerce. Marketing resides at the intersection of the seller’s economic interests and the buyer’s behavioral values. When done well, marketing can and will inform, inspire, and motivate consumers into action.

Over the course of the past thirty years, there are countless examples of marketing strategies and advertising tactics that have dramatically changed the fortunes of companies, product categories, and individual brands:

- Graphics and design elements define many categories and brands—think Chanel (perfume category), Method (cleaning products), or Absolut (vodka).

- Pricing strategy has become a communications vehicle that establishes an audience profile and value framework that can range from prestige and luxury (Hermès, Rolls-Royce, Gucci, Haagen-Dazs) to everyday affordable (Wal-Mart, Costco, Ikea, Southwest Airlines).

- Business model innovations are almost always predicated on insightful marketing (eBay, Nintendo, TiVo, Google)

- Advertising initiatives have introduced revolutionary products (Swiffer, Palm’s PDA), changed pop culture (Apple’s iPod), altered societal norms (Viagra—Bob Dole, Friends Don’t Let Friends Drive Drunk—Nat’l Highway Traffic Safety), rejuvenated tired categories (Got Milk—California Milk Processors Board), and won presidential elections (George H.W. Bush’s Willie Horton release from prison ad in 1988).

- Iconic Ad campaigns now define a significant number of Fortune 500 company brands. To name just a few: Just Do It (Nike), Priceless (MasterCard), You’re in Good Hands (Allstate), or When it Absolutely, Positively has to be there overnight (FedEx).
Marketing is the seller’s investment in their brand, which defines the distinctive public face of a product or service. For sellers the question is not if they should market their brands. The operative questions are how, where, when and how much should be invested in order to optimize a brand through marketing.

Don Sexton’s seminal work in the areas of marketing accountability, pricing, metrics scorecards and now “Customer Value Added” has advanced the dialogue that sellers need to consider in order to optimize their commercial interests.

—Tom Finneran, EVP, American Association of Advertising Agencies
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### Strategic Themes

The power of the CVA® concept can be seen in a comprehensive industry study conducted by William Hall. He studied 64 companies in eight industries, four business-to-business industries and four consumer industries. The industries Hall studied included steel, tire and rubber, heavy-duty trucks, construction and materials handling equipment, automotive, major home appliances, beer, and cigarettes. All were characterized by single-digit annual growth and intense competition.

In each industry, Hall identified two companies that were leaders in regard to annual revenue growth rate and return on equity, not only in their respective industries, but among all US companies. In his seminal article, he described the strategies of these winning companies with what the author calls the *Strategic Themes Matrix* (see Exhibit 1.10).

In Hall’s formulation of the matrix, the horizontal axis is “relative delivered cost.” *Relative delivered costs* are all costs involved in placing the product or service in the hands of the customer: operations costs, but also costs such as distribution costs and marketing costs. The vertical axis of Hall’s matrix is “relative product/service differentiation” and refers to product or service performance relative to competitors.
In the reformulation of Hall’s matrix for this book, the definitions of the horizontal and vertical axes have been refined.

The horizontal axis is defined here as “variable delivered cost per unit”—all the incremental costs involved in bringing a unit of the product or service to the customer. That definition is fairly close to that of Hall.

The vertical axis is defined here as “perceived value per unit.” Recall that the perceived value per unit is the maximum that a customer is willing to pay for a unit of a product or service. That definition varies from Hall’s definition with the addition of the word perceived. Even if a product or service is differentiated from its competitor’s product or service, that differentiation must be perceived by the customer to have an impact on their purchases.

The most powerful strategic position on the Strategic Themes Matrix is the upper right position—lowest cost per unit and highest perceived value per unit. However, among the 16 leading companies that Hall identified, only 2 companies occupied that position at the time of his study: Caterpillar in earthmoving equipment and Philip Morris in cigarettes. Today, companies in the upper right position arguably include companies such as Southwest Airlines and Trader.
There are two other winning positions on the matrix—the highest perceived value per unit combined with the medium (or acceptable) cost per unit and the medium (or acceptable) perceived value per unit combined with the lowest cost per unit. In Hall’s study, in heavy-duty trucks those positions were occupied, respectively, by Paccar and Ford.

A company would not want to be in the four cells on the lower left-hand side of the matrix—low or medium perceived value coupled with high or medium costs, which Michael Porter of Harvard Business School has memorably termed *stuck in the middle*. Stuck-in-the-middle companies lose their performance-minded customers to their higher perceived value competitors and their economy-minded customers to their lower cost competitors.

The upper left position is filled by elite companies with high value products such as Hermès, Chanel, or Carlos Falchi. The lower right position is filled by companies producing cheap but shoddy products or services. A company can succeed in either of those two positions, but they require very special types of managerial thinking. Elite companies typically focus on market niches, while shoddy product companies do not expect much repeat business.

The Strategic Themes Matrix clearly shows the two main factors driving business success: perceived customer value and cost. These same themes have been identified and discussed by numerous highly regarded management thinkers such as Michael Porter, Peter Drucker, Al Reiss, and Frederick Reicheld. When such diverse thinkers agree, that is a signal that the idea is significant.

The importance of perceived customer value and cost in determining financial performance has also been validated by several diverse empirical studies over many years. (See Exhibit 1.6.) Different researchers such as Jim Gregory of CoreBrand, Stuart Agres of Young and Rubicam, and Robert Buzzell and Brad Gale of the PIMS Project, and professors including David Aaker, Robert Jacobson, Dominique Hanssens, and Natalie Mizik have all arrived at similar conclusions using different data bases—*perceived value is clearly linked to measures of financial return*.
When an idea is supported both by well-known management gurus and by highly respected researchers, the idea is not only significant, but one that works and has been proved in practice.

Carlos Falchi: The Real Meaning of Luxury

LUXURY—EXPENSIVE...DOES NOT SYSTEMATICALLY MEAN QUALITY.

INEXPENSIVE DOES NOT AUTOMATICALLY MEAN CHEAP.

A PRODUCT CARRIED BY A CELEBRITY DOES NOT MAKE IT LUXURY.

Real luxury and value are beyond celebrities photographed wearing them and all the brand advertising.

The value and luxury that a customer receives when making her purchase is in the caring, thoughtfulness, time spent, and top quality materials assembled to achieve a product of distinction. A product that I can offer with pride.

When I see a customer who is still carrying one of my handbags after 30 years and wearing it with the same pleasure she had the day she bought it, I am deeply touched she has had so many years of pleasure from something made with care. Thirty years of wear and still worn with pride. That is satisfying.

Quality is a lasting value.

Some countries show their appreciation of this principle by making people who excel in their trade a “National treasure.” Be it the best rice grower, best scientist, best artist, best photographer or best tailor. The title is given for constant Zen dedication in achieving the best.

When all these ingredients come together everyone is satisfied.

Thank you,

—Carlos Falchi, Designer, Design and Development Lab, LLC

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Design and Communication

To succeed, an organization needs to provide customer value at acceptable costs and communicate that value to target customers. Design and communications must both be focused on the customer. As Tony Davidson, president of the D&AD Global Awards, pointed out, “In the end, it’s not just about whether something [an advertisement] is a good idea. It’s about whether it’s a good idea and relevant.”32

Customer value comes from innovations in design—the new products and services or improvements in products, services, and processes that a company generates over time. At the heart of communications is branding—the reputation of the company in the minds of its target customers. Without innovation, branding withers. But without branding, the company is not rewarded for its innovations.

For example, many years ago Xerox developed many innovations in computing—but never truly received credit for their achievements in terms of their brand. On the other hand, Levi’s has been a very powerful brand, but failures to keep pace with innovations in styling eroded the brand’s value.33

In the long run, both innovation and branding are required for success, as shown in the sidebar, a 30-year tale of two companies: Harley-Davidson and Norton Villiers Triumph.34

<table>
<thead>
<tr>
<th>Winners and Losers: The US Motorcycle Industry</th>
</tr>
</thead>
</table>

**The 1970s**

In the 1970s, the motorcycle market in the United States was under fierce attack from the Japanese motorcycle manufacturers. At one time, Harley-Davidson held nearly 100 percent of the US motorcycle market, but by 1981, the Japanese companies had secured 94 percent of that market (Table 1.1).
Table 1.1 United States Motorcycle Shares

<table>
<thead>
<tr>
<th>Year</th>
<th>Harley Davidson</th>
<th>Honda</th>
<th>Yamaha</th>
<th>Kawasaki</th>
<th>Suzuki</th>
<th>BMW</th>
<th>NVT</th>
</tr>
</thead>
<tbody>
<tr>
<td>1974 TOTAL</td>
<td>6.0%</td>
<td>.9%</td>
<td>1.4%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1981 TOTAL</td>
<td>5.0</td>
<td>.4</td>
<td>.2</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>&lt;750 CC</td>
<td>0</td>
<td>.2</td>
<td>N/A</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>&gt;750 CC</td>
<td>17.0</td>
<td>.8</td>
<td>N/A</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1991 TOTAL</td>
<td>31.0</td>
<td>2.0</td>
<td>0</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2001 TOTAL</td>
<td>24.0</td>
<td>1.8</td>
<td>0</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2005 TOTAL</td>
<td>25.6</td>
<td>1.3</td>
<td>.8</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>


The Japanese motorcycle manufacturers used a classic international strategy to defeat Harley: They obtained a beachhead in the market with innovative products—small motorcycles—then built their brand and introduced larger and larger bikes.

Compared to Harley, the Japanese manufacturers Honda, Kawasaki, Yamaha, and Suzuki were more efficient producers, built more reliable motorcycles, and spent more on customer advertising. When AMF merged with Harley, they increased output three-fold. The speed of the expansion had its consequences. More than half the Harley’s produced were missing parts, and the others leaked oil. Bikers said you needed to buy two Harley’s, one to provide spare parts to keep the other on the road.

The 1980s

Harley-Davidson and Norton Villiers Triumph (NVT) both lost share to the Japanese companies during the 1970s. In the 1980s, NVT eventually went out of business, but Harley-Davidson used innovation and branding to not only survive, but also regain its position as a force in the motorcycle industry.

At the beginning of the 1980s, both Harley-Davidson and NVT, arguably, were stuck in the middle in the Strategic Themes Matrix.
In the middle of the top row was BMW, which was widely regarded as a high-performance, reliable motorcycle and, seemingly, content to stay in that position. In the right-most column were the four Japanese producers, led by Honda, all driving toward the upper-right hand high value/low cost position.

Meanwhile, the situation was getting worse for both Harley and NVT. Their bikes had poor reputations for reliability, and they were behind in product design. Both Harley-Davidson and NVT had to take action if they were to survive. In 1981, 13 Harley managers purchased the company from AMF and proceeded to decrease their costs by cutting their workforce by 40 percent, decreasing salaries by 9 percent, and then freezing hiring and salaries. They adopted cost-lowering methods such as just-in-time inventory, which they learned from visits to the production lines of their Japanese competitors. They also improved their quality control.

These changes in operations required time. Their chief designer, William “Willie G.” Davidson, provided that time. He designed new Harley bikes such as the Super Glide that did not require substantial time for retooling. Davidson’s designs permitted Harley to increase their perceived value per unit in the short-run, while they waited for their longer-term efforts to pay off. In 1984, for example, they introduced a new engine, the Evolution, which was very well-received.

The Harley brand was in danger of being hollowed out by the prior actions of AMF. While Harley had improved their product, their brand had to be revived by communicating the product improvements to their customers.

Once they had restored the performance of their product, Harley used print ads to communicate with their target customers, including a memorable print ad showing a group of tough-looking bikers with the headline, “Would you sell an unreliable motorcycle to these guys?”

Another key part of the revival of their brand was the Harley Owners Group (HOG). Started by Harley in 1983, today it is the
largest motorcycle club in the world—and an excellent example of how to build relationships with your customers.

Increasing CVA® by simultaneously increasing perceived customer value per unit and decreasing cost per unit worked for Harley. In 1991, they had more than a 30 percent share of the total US market for motorcycles and nearly 50 percent of the cruiser (large) motorcycle market.

Meanwhile, during the 1980s, NVT was struggling and continuing their retreat strategy of the 1970s, dropping models from their line. They had labor problems. Their motorcycles continued to have product defects. Their policy with regard to warranty claims could be described as grudging. Spare parts were difficult to find. They lost orders destined for police departments in the UK.

Their brand was spiraling down the failure route, and their cash flow problems made it difficult for them to innovate. In efforts to lower costs, they cut models from their line until, finally, they could no longer cover their overhead. In 1983, NVT closed their Meriden factory and the company was liquidated.

**The 1990s and Beyond**

Honda eventually reached the upper right-hand corner—the high value/low cost position on the Strategic Themes Matrix—and remains a formidable competitor to Harley-Davidson. Harley occupies a position on the high perceived value top row. They continuously reinvigorate their brand with a stream of new engines, new transmissions, and new bikes (10 new models launched in 2005-6). They have also focused their efforts on lucrative new segments among older bikers. In 1987, the median age of a Harley buyer was 35; in 2006, it was 47. More than 20 percent of their sales are outside the US, in markets such as China and Japan, where Harley has the leading share in heavyweight motorcycles.

Going forward, Harley still faces challenging decisions concerned with younger riders. The competitive environment does not get quieter.
Lessons

In the 1970s, both Harley-Davidson and Norton Villiers Triumph were multi-domestic companies, succeeding in their home markets and selected export markets. They did not seek competitors, but the competitors—the Japanese motorcycle companies—came to them. Both Harley and NVT were slow to react, and both lost share in the US market in the 1970s. However Harley-Davidson was able to use innovation and branding to recover. NVT was unable to innovate and reverse their brand failure route.

Harley-Davidson’s recovery is even more dramatic if one recalls the backdrop. In the 1970s and 1980s, many managers of US companies were complaining about the “unfair” practices of Japanese companies. One Harley executive commented, “First, we thought it was the Japanese pricing, then we thought it was the Japanese culture…. Finally, we realized the problem was us, not them.”

Although NVT disappeared, Triumph motorcycles live on. A new, privately-owned company—Triumph Motorcycles Limited—was started in the mid-1980s. Six brand new Triumph motorcycles were launched in 1990, followed by more innovations and more models. One might say that innovation and branding Triumph once again.35

CVA® and Economic Development

This book is about how CVA® can be used by organizations to improve their financial performance. CVA® also has implications for how economies are managed to increase Gross Domestic Product (GDP).

There continues to be substantial discussion regarding the economic futures of China and India. To the extent managers in either country are successful with their marketing and branding efforts to develop specialty products and services, the GDP of their country will increase far beyond what might be expected were they producing commodity-like products or services.36
In the most recent Business Week listing of the 100 most valuable brands in the world as estimated by Interbrand, there are 52 brands from the United States; 10 from Germany; 8 from France; 7 from Japan; 5 from Switzerland, 2 from Sweden, 2 from South Korea; 1 each from Finland and Spain; but none from China and none from India. Lenovo is thought by some to be the strongest Chinese global brand; with strong global potential, but, in 2007, their global brand awareness was estimated by Interbrand to be 59 percent—far below that of Sony (98 percent) and Samsung (96 percent).

Both China and India have demonstrated substantial economic growth. However, their growth rates are especially astounding given that they have not included substantial branding success in world markets, although Indian companies seem to be more successful than Chinese companies in certain product categories (Table 1.2)

<table>
<thead>
<tr>
<th>Product</th>
<th>Preferred Country</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>China</td>
</tr>
<tr>
<td>Pet Food</td>
<td>22%</td>
</tr>
<tr>
<td>Prescription Drugs</td>
<td>26%</td>
</tr>
<tr>
<td>Toys</td>
<td>27%</td>
</tr>
<tr>
<td>Makeup</td>
<td>30%</td>
</tr>
<tr>
<td>Skincare Products</td>
<td>26%</td>
</tr>
</tbody>
</table>


A study by a colleague shows that the efficiency of capital in China and India is similar to that of the US in heavy industries, but well below that of the US in consumer packaged industries. Most likely this comparison reflects the relative strengths of US marketing and branding efforts—especially in consumer packaged goods.

Many Chinese and Indian companies have exceptionally low costs. For example, Pearl River in China, the world’s leading producer of pianos, is known for very low costs. The challenge of companies that rely on low costs is to increase CVA® by building perceived value in the minds of their target customers.
Because of their low cost positions, price has often been a major weapon of many Chinese and Indian companies for acquiring customers. For example, from 2000 to 2003, local Chinese cell phone manufacturers such as Bird, Amoi, and Panda moved from a 0 percent market share to nearly 50 percent by cutting prices against Nokia, Motorola, and other international brands. Tata has produced an extraordinarily low-priced automobile. Unfortunately, low price strategies often foment price wars. Preoccupation with low prices can be a major distraction to building customer perceived value.

While they are in position to build their brands, Chinese and Indian companies especially need to be wary of the temptation to enter foreign markets by offering low prices. While such an approach may provide a quick market entry, there are long-term consequences—both to their own brands and to their country’s brands. If a company starts at a low price point, then it can take much longer to build a brand that connotes value to customers. Today Samsung and Hyundai are valuable brands; but when each entered the United States, they exploited low prices. It took many years of brand-building for Samsung to raise their customer perceived values to their deserved position and Hyundai, one of the top three on J.D. Powers and Associates’ automobile overall product quality list, continues their efforts to raise their perceived value to their actual value.

Akio Morita, the founder of Sony, used to tell this story: One of the first very successful products of Sony was the transistor radio. Supposedly a department store in New York City told Mr. Morita that they wanted to order thousands for the holiday sales season. His reply was, “No.”

Akio Morita knew that at that point in time the reputation of the “Japan Brand” was low. If something broke, at that time people in the United States often said that, “It must have been made in Japan.” Morita knew that if he tried to produce the thousands of units the store wanted, the Sony quality control would falter—and the products would not represent the brand he was trying to build. So he said no to the large order the department store wanted, but agreed to furnish them the number of transistor radios he felt he could produce at a quality level of which he could be proud. How important was his decision? It was the foundation for the Sony brand in the US. Actions today determine the brand tomorrow.
If Chinese and Indian companies succeed with their marketing efforts to increase their perceived value, then the GDPs of both China and India will increase substantially—perhaps by 30 percent—even without increases in production capacity! The same observation can be made of most fast-developing economies.

**Conclusions**

Marketing is managing customer perceived value. In turn, customer perceived value is a key component of CVA®. Perceived value per unit and cost per unit—CVA®—determine the net value an organization provides society according to the perceptions of customers. CVA® has a direct relationship to the contribution earned by an organization, which in turn affects profit, cash flow, shareholder value, and share price.

Managing CVA® provides forward control over the financial performance of an organization as well as the financial performance of an economy.

The next chapter explains exactly how CVA® determines financial performance.

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