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*Abstract.* *One of the first questions investors ask while discussing an investment opportunity is "what is a value proposition of your project/product/services, i.e. what a value you are creating for your customers?" The answer to this question is not so simple as it could seem. How to define the value, what criteria and metrics should be used to substantiate value – those issues are discussed on the article. Also: how to create and deliver the value which would be sensitive to prospective customers and markets – that was touched in the proposed paper.*

# How to Evaluate a Value Proposition?

## Value Creation for Customers is a Key

Creation and delivery of value for customers is a critically important component of any business. Ultimately, the business' viability and growth depend on that fundamental understanding. In essence, "value for customers" defines, to a large degree, the return for the company's shareholders and owners. If customers feel the benefit of a product and appreciate the value of a product or service, they are willing to pay for it, which generates revenue for a business. This is the basis of the market and doesn't need to be substantiated. The big question is, how do we determine the value that will be appreciated by customers, and how do we create and deliver it? In 1988, Michael J. Lanning and Edward G. Michaels wrote a paper aptly titled, "A Business is a Value Delivery System."[1] Nowadays, in the era of the Fourth Industrial Revolution, this determination of a business is more relevant than ever.

Many experts and scientists adhere to the following idea: "In many cases the customer—not the competition—is the key to a company's prospects."[2] In a 1988 article published in *Harvard*

[1] http://www.dpvgroup.com/wp-content/uploads/2009/11/1988-A-Business-is-a-VDS-McK-Staff-Ppr.pdf

[2] By Harvey Golub, Jane Henry, John L. Forbis, Nitin T. Mehta, Michael J. Lanning, Edward G. Michaels, and Kenichi Ohmae. Article - McKinsey Quarterly - June 2000

*Business Review*, Kenichi Ohmae, who worked for McKinsey & Company for twenty-three years, argues forcefully that strategy should be less about defeating the competition and more about creating value for your customers. That idea holds true. However, the ability to create and deliver value directly affects the competitiveness of the business. The business' position in a marketplace at a specific point in time depends on the appreciation of value of the product or service, which essentially means a widespread acceptance by happy customers.

Value creation and delivery is not solely a function of the marketing department. After communicating with customers and learning about competitors' offerings, marketers have to use their knowledge to develop a strategy that encompasses the design and development, production and promotion, and sales and customer support. Market research, gathering market intelligence, and learning major trends in customers' needs and preferences plays a very important role, as well.

Value Proposition: Essence

There are many definitions of "value proposition" to be found in textbooks, articles, and on the Internet. Investopedia defines value proposition as:

> "A business or marketing statement that a company uses to summarize why a consumer should buy a product or use a service. This statement convinces a potential consumer that one particular product or service will add more value or better solve a problem than other similar offerings."[3]

Michael J. Skok, North Bridge Venture Partner, presents the following determination of the value proposition: "In its simplest terms, a value proposition is a **positioning statement that explains what benefit you provide for who and how you do it uniquely well**. It describes your target buyer, the problem you solve, and why you're distinctly better than the alternatives."[4]

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[3] http://www.investopedia.com/terms/v/valueproposition.asp#ixzz4AxKV0InI

[4] Forbes, June 14, 2013 (http://www.forbes.com/sites/michaelskok/2013/06/14/4-steps-to-building-a-compelling-value-proposition/#72fa99e21f2c)

A compelling and well-substantiated value proposition statement plays a significant role in convincing and attracting new customers. The critically important part is to formulate a proper Unique Selling Proposition, or USP, which defines why your offering is different and better compared with those being delivered by competitors. The best framework should contain the following two elements: (1) a declaration of advantages and uniqueness; and (2) a solid proof of said advantages. A statement is not enough, especially in today's environment with streams of information and data flowing constantly from various devices and sources. It is extremely difficult to impress people. *The only thing that reinforces the value proposition statement is a proof.*

However, this general definition of the value proposition is oversimplified. Value proposition is not simply a declaration. *In fact, the statement above defines a business proposal more than a value proposition.* While considering the value proposition in the context of a business plan, entrepreneurs must have a clear strategy for the creation and delivery of products or services that ensure tangible benefits for customers. Instead, consider this different perspective on the value proposition: first, design and build; then, describe and formulate. The second step should be fully consistent with the first. The first question is how to tease out what would deliver maximum benefits and solve existing and future problems for customers; the second is how to create and deliver value; and the third is how to assess and measure the proposed value as precisely as possible. Thus, the value proposition is *a process which has to be managed as closely as any other business process.* The value proposition is a very complex process that affects all other components of business planning and operations.

*The value proposition has to be fully consistent with the target markets and the business model*. This statement can be explained through the example of Argonault Corp.,[5] a company I helped with their business strategy development. The company designed a unique power wheelchair that has an extended set of functionalities and allows disabled and aged populations to be as

[5] www.argonault.com

independent as possible. Two basic business models were proposed by the company management team:

1) To set up production facilities, partnering with an established manufacturer, and begin assembling and distributing wheelchairs
2) To license the technology and industrial design to other suitable manufacturers around the globe
In the first scenario, the company would target end-users and their families, while in the second case, they would target manufacturers of various auto and medical assistive devices. Obviously, the value proposition offered to the end-users and licensees are totally different. In the first case the company has to deliver a wheelchair that provides and ensures a higher level of independency than has not been seen on the market before. The wheelchair would need to be attractive, and Argonault had to guarantee a technical support. These points are main components of the value proposition which have to be harmonized with that type of target market and business model. In the second scenario, Argonault would propose another value, specifically to demonstrate to a customer (licensee) how this product and technology behind it, might create a new opportunity for growth and enhance the licensee's competitive edge in the marketplace. *Different target markets and business models require building, managing, and presenting different value propositions.*

One more aspect has to be taken into account in formulating the value proposition statement. In a specific period of time, a new product may be offered to early adopters who are interested in learning about a technological breakthrough. For this customer group, the most important benefits consist in gaining novel experiences and testing new things, and the price is not as important. When the product is offered to the main target customers, or the mass market, the value proposition has to present not only new features and advancements in usage and maintenance, but also advantages in price. The technology behind the new product is not necessarily of the most importance in the mass market. For this group, the most important thing is to derive as much benefits as possible for each dollar spent.

## Value Proposition: Stated and Verified

The declared value proposition has to be proven by a supplier. However, customers ultimately assess and verify what has been promised by a seller vs. what was eventually delivered. Some product or service features can be measured (which may be used for the comparative analysis of other products or services), while others are a matter of personal feeling and perception ("intangible or subjective value," as per Harvey Golub and Jane Henry).[6] For example, there are several main measurable and assessable parameters that distinguish smartphones, including size, performance, and storage capacity. However, the colour is selected by a consumer based on his/her individual preference and feeling. How do we define the value proposition in this case from the vendor's perspective? Basically, a better value is offered by the smartphone company that delivers a wider choice of colours and styles.

For another example, the main features of equipment and machinery can be easily measured. Usually, suppliers declare and buyers verify such details as the capability, energy efficiency, and sizes of the products. All these parameters demonstrate the equipment's performance. However, the value proposition includes many other components including technical support, delivery terms, required skills and training for exploitation, and equipment shipment and deployment. Thus, the value proposition is much more than the equipment and machinery specifications alone.

There are various ways a supplier can support the value proposition, including:

- demonstrating a product at trade shows and exhibitions
- presenting testimonials provided by end-users and customers
- displaying technology and market validations provided by well-known and reputable experts

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[6] "Market Strategy and the Price-Value Model," by Harvey Golub and Jane Henry

Commonly, the technology validation is performed and presented by scientists, technologists, and designers. Its general purpose is to evaluate the technology behind a product or service, and define its uniqueness and level of advancement compared with similar products and services available on the market. Unlike technology validation, market validation aims to address a market context and readiness for accepting the product. The technology validation is provided to corroborate the stated performance and advancements, while the market validation focuses on the performance/cost ratio.

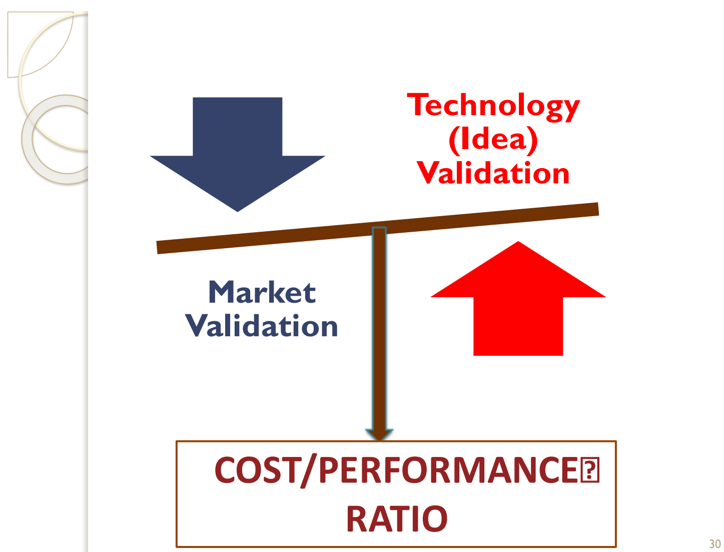


Chart 1

As Chart 1 demonstrates, the technology validation of a unique product strengthens its value proposition and supports a higher market price. However, the market validation must show that the product will be requested on the market not only because of its superior innovation and performance features, but also due to its reasonable and competitive price.

<u>Real Value</u>

According to many experts, the real value of a product is defined by customers: the deal is worthwhile if benefits exceed the costs. Essentially, this is the same as the “price-value model."[7] The price is measured by the purchase price plus associated expenses (such as shipment, installation, and maintenance). More specifically, a customer not only considers the retail price (the purchase price in B2B), but the total costs tied up with getting and using the product. In some cases, high shipment costs may change the customer's mind about purchasing a product. This could more aptly be referred to as the "value (benefits)-costs model" rather than the "value-price model."

The challenge with the value-costs model is in determining the value (benefits) of the product in dollars. When initially making a decision about purchase, a customer considers two main indicators (sometimes on a subconscious level): the performance (quality), and the price (cost). Along with these simple factors, perception also plays a significant role in the decision making process. It is common for two customers to purchase different items with equal performance and quality because of differences in perception. Several additional subjective considerations can affect a final decision:

- The importance of the brand
- Preference in colour, pattern, and appearance
- Experience with a previous version

If a customer already owns an iMac and iPad, they are likely to choose an iPhone, although the comparable Samsung phone may have a better performance and usability. Sticking with Apple allows the customer to synchronize all devices based on compatible operating systems. This is one of Apple's key marketing strategies – to build an ecosystem that motivates customers (regardless of B2C or B2B market) to buy a whole set of their products.

There are many factors that influence the perception of individual customers. For instance, trust in the management team or partnership of a company-supplier can increase the value of the proposition (especially in the B2B segment). Undoubtedly, the real value of the product or

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[7] The term "price-value model" was first was mentioned in a 1979 staff paper by John L. Forbis and Nitin T. Mehta entitled "Economic Value to the Customer."

service is a multifaceted category that embraces many objective and subjective aspects of choosing and purchasing goods and services.

Advanced computer and communication technologies, as well as ubiquitous Internet availability and use, has completely changed the way value is built, managed, and delivered. Customization is steadily being replaced by personalization. More and more businesses are reaching out not to a group of customers, but to a specific customer, given his or her individual aspirations, expectations, and perceptions. For example, Netflix employs tools that study the behavioral pattern and palate of each client to offer entertainment that fits their individual interests. In conjunction with the low $8 subscription price for unlimited viewing, which makes the service affordable to most clients, the company creates and delivers the best value. The real value of this service may be defined using the value-costs model. The average price for a cinema ticket is $20, plus $10 for transportation to and from home. With the basic assumption that a Netflix client will watch a minimum of one movie per month, the overall benefit for the client by watching a movie at home via a Netflix subscription would be $22 per a movie ($30-$8 subscription). Of course, if the viewer watches one movie per day at home versus going out to the movie theater once per month, the benefits grow exponentially; the same growth in benefits occurs if others join the Netflix subscriber to watch the movie at home. Personalized services themselves become a substantial component of the value proposition. It is important to emphasize that personalization radically changes the situation, and presents a new opportunity for businesses to define and deliver value that meets the customer’s expectations.

## Value Sensitivity of Price

As mentioned, the benefits a customer receives and the costs he or she pays are pivotal to their decision to purchase a specific product or use a certain service. The challenge any business faces is to avoid a price point that is too high for a customer to consider. An automaker may design and produce a superior vehicle that anyone would happy to have, but if the price point is one million dollars, only a few customers would consider buying this car.

Many families visit Dollar Stores that sell items at low prices, but these stores do not always offer the best value. For example, pens from the Dollar Store are not the most valuable in terms of quality and usability, as one can purchase better-quality pens at the Office Depot outlet. Nevertheless, many shoppers prefer to buy lower-quality, cheaper pens. It is hard to compare pens offered by two retailers: perhaps the more expensive pen will last longer and brings more benefits; however, the consumer in this case relies on his/her expected value, which is based on the individual perception. The expected value is not real value, but rather one that meets customers' perceptions of benefits derived from purchased products and services. The Dollar Store value proposition is a guarantee of the cheapest prices, while the Office Depot proposition is to deliver the greatest value for every dollar spent.

What is the driving force that determines the maximum price a consumer is willing to pay for a specific value? That is a key problem that many businesses face. A clear understanding of customers' expectations and motivations distinguishes successful ventures. The best marketer is a professional who thinks like a prospective customer. This is a difficult strategy to enact.

To explore value-price sensitivity with expected value, consider Chart 2. The two lines showing the correlation between the value and price behave differently before and after the $6 threshold. The correlation between the value and price is very tight when the price is under $2. This doesn't mean that customers would get the best real value; however, in their mind the price is commensurate with the benefits, so they hope to get the expected value for lower prices. Thus, their perception of the expected value may force them to visit the Dollar Store and buy the cheapest pen.

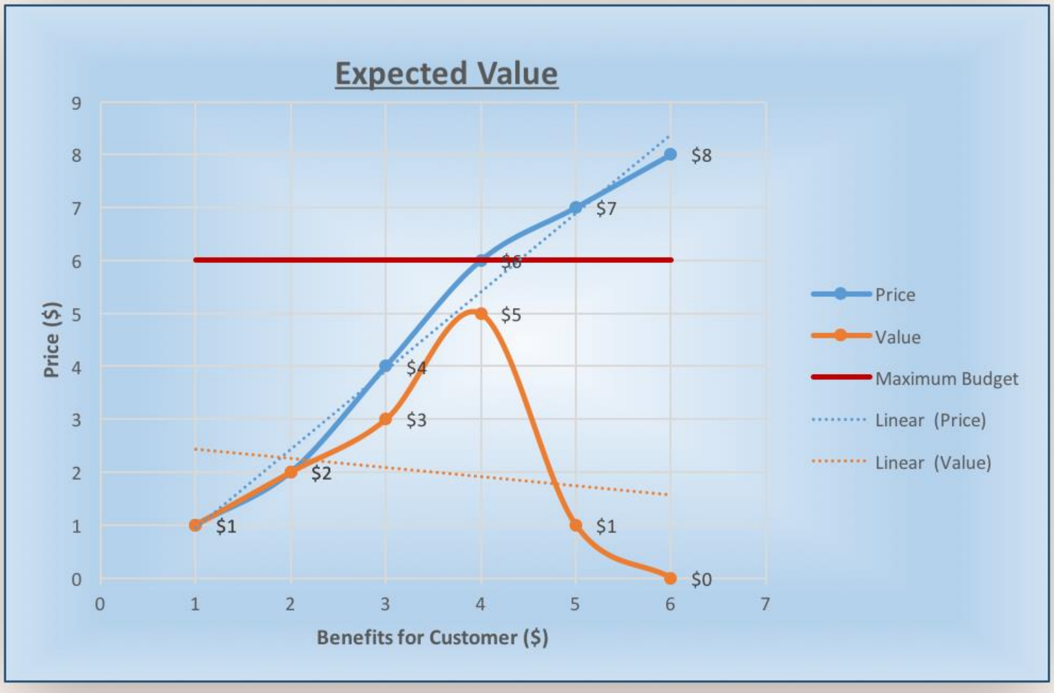


Chart 2

However, the situation changes at the $2 price mark: as the price grows the value of the product in the customers' eyes gets lower. When the price climbs above $6 the expected value drops sharply. That means that $6 is the maximum amount of money the customer allocated for purchasing this item, and only an exception may provoke him to pay more. In summary, the supplier needs to be aware that $6 is the maximum price point before it manufactures and delivers the product and formulates the value proposition.

Market research, close communication with prospective customers, market testing, and big data mining can help determine the maximum price point for prospective customers. In some cases, the maximum price point and expected value can be defined based on a direct conversation with a customer. Personalization is based on a clear understanding of the customer expectations in terms of value and maximum price point. A smart salesman can identify the financial resources a prospective customer has allocated in their budget through a conversation with him or her.

The value proposition is not only a statement. It is a multifaceted process that deeply incorporates into all aspects of business, from market research, to product design, to sales and customer support. It is extremely important to have a clear idea of what a customer expects for each dollar spent – or what the expected value is that motivates target customers to buy a specific product or service. Identifying the correlation between benefits and costs for a customer allows you to develop and successfully execute an efficient marketing and sales strategy.