A Value-based Pricing Perspective on
Value Communication

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This paper studies value communication from the perspective of value appropriation, proposed by Mizik and Jacobson (2003) and others, and value-based pricing. A central tenet of value-based pricing is that the firm must communicate to customers the value of the benefits they receive. But the type of value communication may vary, depending on the buyer and nature of the buying situation. We present a framework for value communication based on the marginal cost of search and the type of benefits sought: economic or psychological. The framework suggests that different types of value communication strategies should be more effective for different types of buyer situations.
In a recent article Mizik and Jacobson (2003) distinguish between two key value-related activities firms engage in: value creation and value appropriation. Value creation includes activities your firm engages in to create value for the customer, especially new product innovation. Value appropriation includes activities that your firm engages in to capture back some of the value created — for example using price. In this perspective advertising is viewed as an extension of value appropriation that enables the firm to extend the length of time it can earn economic rents from innovation and value creation. For the past several decades value-based pricing has represented the essence of this view of creating value for customers, and then capturing back some of the value you create. Value-based pricing focuses on the worth of the savings, gains, and benefits customers realize as a result of using your product or service (Nagle and Hogan forthcoming; Forbis and Mehta 1981).

Value-based pricing will fail unless customers actually perceive the value that you create and are asking them to pay for. While most marketers recognize the truth of this statement for new, innovative products, it is often disregarded for established products. Many firms survey customers, or have sales reps ask customers what they are willing to pay, on the assumption that customers know the value of what they buy. But why should they? Unless your product represents a large expenditure for a customer and has benefits that are easily measured, the cost to them of collecting the information necessary to make an informed decision probably exceeds the gain. A common myth underlying much customer research for pricing is that customers know the value of what they buy, which they will tell you if you ask them the right way. In fact, customers are generally ill informed about the value of items they buy unless the seller proactively educates and communicates value to them.

In this paper we present a framework that suggests how to effectively communicate value to customers. We come at this topic from a pricing and value appropriation perspective, rather than from a traditional marketing communication perspective. Researchers have built an extensive base of communication theory, empirical evidence, and measures of attitudinal processes and effects – awareness, knowledge, preference, beliefs, attitudes, and behaviors (see Rossiter and Percy 1997 for a summary). But value-based pricing considers value communication from the opposite direction: By translating customer benefits into monetary value and communicating these savings and gains to customers, value-based pricing facilitates customer decision judgments of whether the price they pay is worth the value they receive.

There is good reason to approach value communication from this appropriation perspective. Buyers who are ignorant of the monetary value of a firm’s product and service differentiation generally underestimate it. The most differentiated and highest quality suppliers are vulnerable to competitors who can offer a precisely quantified price advantage in return for forgoing “qualitative” advantages that seem simply “nice to have.” The purpose of value communication—involving advertising, personal sales, programs to induce trial, endorsements, and guarantees that communicate confidence in the promises made—is to raise uninformed buyers’ willingness-to-pay to a level comparable to that of better informed and experienced buyers.

**When Value Communication Matters**

Reuter (1986) and Wind (1990) define value in terms of value in use, which is driven by product performance. Shapiro and Jackson (1978) and Forbis and Mehta (1981) conceptualize
value in relative terms, as the maximum amount a customer should be willing to pay, assuming full information about the product and competitive offerings. Anderson, Jain, and Chintagunta (1993) define value in business markets as the “perceived worth in monetary units of the set of economic, technical, service, and social benefits received by a customer firm in exchange for the price paid for a product offering, taking into consideration the available alternative suppliers offerings and prices” (p. 5). We adopt this perspective that value is perceived by buyers, and usually is not equivalent to the actual value that buyers may in fact receive. The point of value communication is to narrow this gap – between perceived and actual value.

Value communication works to the extent that your product or service creates value that is not otherwise obvious to potential buyers but is nevertheless important to them. There are many reasons why your value might not be obvious. The less experience a customer has in a market, the more innovative a product’s benefits, and the more separated the purchaser is from the actual user; the more likely it is that the value of product or service differentiation will be unrecognized or underappreciated. For example, without a planned communication from the seller, a business buyer may not have considered that your nearby distribution location and resulting short time to delivery, could reduce or eliminate the need to hold inventories. Moreover, if the buyer is unsophisticated, he may not have recognized the high cost of holding inventories for your technology product for which industry prices decline on average by 15% per year. In this case, explaining how quick delivery could reduce inventory costs by more than your price premium could motivate a purchase that would not otherwise have seemed prudent.

Still, even a well-documented case for the value of your differentiation will not have an effect unless the buyers are motivated to listen. Value communication is effective to the extent that buyers see the price as economically important. The price is economically important when the buyer is committed to getting “a good deal” or “the most for my money” as opposed simply to making a purchase that meets the need. There are five reasons why people often make purchases without a strong motivation to minimize cost of meeting their need.

- The Expenditure Effect—Some expenditures are just too small to justify serious thought or effort to find the economically best deal, rather than simply to find a brand that meets the need. In business markets, they are purchases too small to justify a purchasing agent’s time. In consumer markets, they are called “impulse” purchases.

- The Shared Cost Effect---Some expenditures involve spending other people’s money, in whole or in part. So long as travel expenses are within a business person’s expense budget, for example, there is not much incentive to look for the best deal.

- The Switching Cost Effect—Some expenditures involve making a supplier-specific investment before being able to gain maximum value. A business might have to train its employees on the use of a particular software package. A consumer might have to educate her lawyer, child-care provider, and hairdresser on her needs and expectations before they can fully meet her needs. Unless these customers get some indication that a price difference between brands exceeds this hurdle, they will repeat buy from the same supplier without evaluating other brands.
• The End-Benefit Effect—Some expenditures are simply a small part of a total package of expenditures to achieve an end-benefit. Consumers often pay little attention to the cost of accessories when buying a car, since the cost seems small in the context of a larger expenditure. The effect is not simply economic, but psychologically embedded in most people. Consider how you would feel if, after celebrating a very special occasion for you, your spouse paid the restaurant tab with a two-for-one coupon. While the economists among us would be proud, most others would feel that “getting a good deal” distracted from the occasion.

• The Price Quality Effect---Some expenditures have more perceived value because they are expensive. One would be hard-pressed to argue that Rolls Royce, with a price over $200,000, offers a value superior to that of luxury cars costing much less. Its parts are less uniform, and the cost of maintenance is very high because a Rolls is handmade. The problems with the Rolls are the ones that mass production was meant to solve: problems of consistency and cost. But Rolls buyers do not purchase the car for cost-effective transportation any more than they buy Patek Philippe watches to accurately tell time (a digital watch does a better job). They buy these items to communicate to others that they can afford them.

Still, in most product categories, “getting a good deal” is at least to some degree an important motivation. Consequently, it is usually possible and often cost-effective to influence customers’ willingness-to-pay through a systematic strategy. There are four potential goals of that strategy, one or all of which may be important to raise willingness-to-pay for your product or service. They are

1. to help customers establish an appropriate “reference value” against which to measure your product, unless there is a direct substitute for your product with a price that establishes the reference.

2. to help customers recognize your differentiation on attributes that are not readily observable, unless yours is an established brand about which the market has learned from experience.

3. to make salient potential benefits of your differentiation that translate into high value for the customer. Established brands focus the customer on the loss they could suffer (e.g., social humiliation) by relying on a cheaper substitute. Differentiated newcomers focus customers on the added benefits they could receive (e.g., prestige) over and above what they get from their current supplier.

4. to justify that the share of value captured in your price is “fair,” assuming that you are in the type of market environment (defined below) where fairness issues arise.

The first three involve value communication, the latter involves price communication. We’ll address the first three in turn.
Value Communication

Ultimately, the objective of value communication is to raise customers’ willingness to pay for the value they receive. To develop a value communication strategy, you first need to identify where in the buying process you intend to influence value perception. Perhaps you are trying to get customers to recognize that they have a need large enough to justify making a purchase. Or you may believe that there is plenty of primary demand (people intending to purchase) but that you need to increase your share of that demand. If you already have share in a repeat purchase market but are fighting off the threat of competition, you want to influence perceptions of the task of trying an unknown, unproven supplier. Imagining where in the buying process you are trying to influence customers enables you to define what alternatives a customer is likely to be considering, how knowledgeable they are already likely to be about your brand and product category, and what you offer, if anything, that differentiates you positively or negatively from those alternatives.

The differentiation that distinguishes your offering is what can drive value perceptions and price for your offering if you can influence how customers understand it. The tactics you will use to influence them depends on two things: the relative cost of search for those differentiating attributes by your target customers and the type of benefits sought: economic or psychological. These define the 2x2 matrix shown in Exhibit 5-1.

[INSERT EXHIBIT 5-1 HERE]

The relative cost of search is the cost (financial and non-financial) for a customer to determine the features and performance differences across brands relative to that customer’s expenditure in the category (Stigler 1961; Nelson 1970). Multiple factors drive the relative cost of search.

Searchability—Differences across brands of some goods are easy to determine before purchase. Such goods are called “search goods” because buyers can search thru information about the products and services to draw accurate conclusions prior to purchase about their differentiating attribute. Examples of obvious “search goods” are commodity chemicals, office furniture, internet service providers, and home equity loans. In contrast, “Experience goods” have differentiating attributes that are more difficult to evaluate across brands, requiring a substantial commitment to purchase and use before being able to evaluate their performance. Examples of “experience goods” include most services, such as management consulting, auto repair and package delivery, as well as some products, such as pharmaceuticals, batteries, and home appliances. Some products are complex hybrids with both search and experience attributes, such as automobiles.

Trialability—How easy is it to purchase and use a small amount of a brand and infer performance from that. Experience goods that one can try without making a full purchase commitment can have a cost of search as low as that of search goods. Ski shops will rent, for a reasonable daily fee, various brands of high performance skis that one can try for a day. You can purchase a small can of paint and try it before you buy enough to paint an entire house. You can buy one bottle each of different brands of spaghetti sauce before selecting a favorite for weekly purchase.
**Customer Sophistication**—What is an experience good for most customers can be a search good for others. A technophile can read the feature specifications for a personal computer and quickly make an inference regarding how it will perform in various tasks, from word processing to computer games. A more typical buyer would actually need to try different brands with the same software to make the same inferences. As a result, the less sophisticated buyer might avoid search by buying a brand name or relying on the advice of someone more expert.

**Total Expenditure**—The larger a customer’s expenditure within a category, other things equal, the lower the relative cost of search. The cost of search is high for an individual buying an automobile because so much of the car’s performance cannot be determined prior to purchase. However, for a fleet buyer planning to purchase 2,000 cars, the cost to evaluate different brands extensively, including buying one of each and trying it for a month, is not prohibitive.

In addition to the relative cost of search, the choice of an appropriate value communication tactic also depends on the type of benefits buyers seek from the purchase. Many purchases are motivated primarily by economic benefits, such as reduced cost, a better return on investment, increased productivity, or fewer breakdowns that translate readily into gains or savings of time or money. Tradespersons buy tools such as drills, power saws, planers, and nail guns primarily to enhance their productivity. The benefits are well suited to concrete performance measurements, such as nails-driven-per-minute or injuries avoided per user. Moreover, those benefits translate directly into quantifiable differential value, such as revenue gains from jobs completed faster and costs avoided from fewer injuries. Similarly, consumers often select among brands based on the economic benefit: when buying term life insurance, longer-lasting light bulbs, or purely functional items of clothing.

For other purchases, especially consumer products, buyers are less often motivated by economic benefits than by psychological benefits such as comfort, appearance, pleasure, status, health, or personal fulfillment. These benefits do not translate objectively into economic value, but depend upon each buyer’s subjective assessment of value. For example, while it is possible to describe quite objectively the features of a wedding gown, and even to observe them prior to purchase, it is impossible to say objectively what those features should be worth to an individual buyer—even if you knew all of that buyer’s relevant demographic information and the prices of the alternatives being considered. What drives that subjective valuation is the buyer’s personal end benefit of the purchase and importance placed on that benefit. Is the buyer trying to impress all his business colleagues who will be invited to the wedding, to communicate his feelings for his daughter by indulging her every desire, or trying not to appear ostentatious?

[INSERT EXHIBIT 5-2 HERE]).

Exhibit 5.2 illustrates the four different value communication challenges, based on the relative cost of search for the segment you want to influence and the types of differentiating benefits (economic or psychological) that differentiate your product or service. For each quadrant, there are different means to achieve the most favorable value perception. We will discuss and illustrate each quadrant in turn.
**Strategy 1: Economic Value Communication**

When it is relatively easy to judge differences in brands prior to purchase, and the benefits that buyers seek are primarily economic, the most effective value communication strategy is to communicate differential economic value quantitatively. Economic Value Estimation (EVE), discussed in Chapter 3, describes conceptually the process of creating such a communication. The form of the communication depends on the diversity among customers in the benefits sought and value delivered.

When customers are fairly homogeneous, at least within a few broad segments, then the value communication can be standardized and communicated in advertising and sales collateral materials. Marriott focuses its sales efforts for time share condominiums on customers who are already at a resort location and experiencing its differentiation – hence for these customers the relative cost of search is low. Its web site and sales materials (see Exhibit 5-3) compare the economics of ownership for a Marriott timeshare versus renting a hotel room at the same destination.

[INSERT EXHIBIT 5-3 ABOUT HERE.]

The nearby ad for Reliable Software (see Exhibit 5-4) provides estimates of the differences in performance for key benefits common to software developers – software quality, developer productivity, testing time, development cycles. These component differentials then lead to an overall estimate of their total impact on value – a 1,400 percent increase in return on investment. Exhibit 5-5 shows an advertisement from Kinko’s directly comparing the price of Kinko’s new DocStore service with the cost savings of not having to print and warehouse documents on your own, a web-based service that is particularly valuable to small and medium-sized businesses with small runs of catalogs, selling sheets, and marketing brochures.

[INSERT EXHIBIT 5-4 ABOUT HERE]

[INSERT EXHIBIT 5-5 ABOUT HERE]

When customers are more diverse, the quantitative value communication needs to be customized by application. International Truck, a leading manufacturer of commercial and long-haul tractor-trucks, sells trucks to buyers for multiple applications that lead them to seek different benefits. Consequently, International created “value selling sheets” for virtually every competitive comparison – resulting in a large book and computer database of value-based comparisons. Exhibit 5-6 shows a value selling sheet for a comparison of International’s versus Freightliner’s “municipal dump/plow trucks.” Specific potential savings are documented for several benefit-related “value drivers” – greater resale value, PM (procedural maintenance) savings, repairability, and less frequent engine rebuilds. These quantified value estimates are supported by additional benefit dimensions not quantified, such as greater windshield visibility, less wiring, a roomier cab, and greater maneuverability and handling.

[INSERT EXHIBIT 5-6 ABOUT HERE]

In markets where the value drivers are highly variable across customers, but sales involve direct person-to-person communication; companies can arm their sales representatives with
customizable value models. The sales rep can input basic data about the buying firm, its use of the product or service, and about the cost of their alternatives. The model uses that to estimate the cost savings and/or revenue gains that the customer could enjoy from purchasing the product.

Exhibit 5-7 shows an example of a customizable value selling tool for a computer network service company. This company sells an automated help desk system that increases the quality and efficiency of detecting, managing, and solving computer network outages. This value selling tool allows a sales representative to input customer-specific data that leads to a bottom-line estimate of incremental value that could be received by this customer from the company’s differentiation.

[INSERT EXHIBIT 5-7 HERE]

Fortunately, such models can be very valuable even when the seller has only rough guesses about the actual customer numbers, so long as the structure of the model accurately reflects the customer’s economics. Buyers frequently question the sales rep’s assumptions about their costs and revenues. That is not an undesirable result, since it initiates a discussion about the customer’s actual economics, bringing information into the discussion that otherwise would not be revealed, and focusing the discussion on the value the seller delivers. More importantly, it brings information to the attention of a purchasing department that it otherwise has little motivation to consider. Our clients have frequently reported that, after a purchasing agent has initially dismissed the sales rep’s analysis of value, someone else from operations or finance calls to request a meeting to further review it. That is the best result that a seller has a right to expect: a fair hearing from those who actually recognize and care about the value delivered.

**Strategy 2: Economic Value Assurance**

When the cost to ascertain the differences among brands exceeds the benefits for a target segment, economic value communication alone is unlikely to be sufficient and may be impractical. It is great to tell buyers that a product that could double productivity would be worth a large price premium, but that may not motivate a purchase if they cannot determine before purchase that your product or service can actually enable them to achieve such a gain. In fact, documenting a connection between features and long-term benefits, such as the effectiveness of drug therapy or the durability of a car, may be prohibitive even for the seller until the product has been on the market for years.

Studies have shown that when customers cannot directly evaluate a brand’s performance, they will respond positively to narrative, experiential, or anecdotal information. Such communications familiarize buyers with the benefits and then simply reassure them indirectly that your product or service probably delivers differential value that more than justifies its price premium. Such an economic value assurance strategy involves testimonials from credible experts, opinion leader endorsements from known and trusted sources, and claims of superior market share or repeat purchase frequency – coupled with frequent mentions and connections to your brand name.

For example, for years sellers of premium batteries have made the economic argument that their batteries last longer, thus justifying their premium prices. However, that claim is difficult for most buyers to verify; instead simple assurance strategies that the battery indeed
delivers greater differential value should be more effective. Duracell introduced an ad campaign designed to credibly communicate differential value rather than merely counter-attack its archrival’s simple repetition that Eveready “keeps going and going.” The ads (one version shown in Exhibit 5-8) report that Duracell is the battery brand chosen when human life and space missions depend on long life and reliability. Even without any direct performance data, the fact that thoughtful buyers with big benefits at stake (like hospitals) have chosen Duracell reassures buyers that it is probably a better choice.

[INSERT EXHIBIT 5-8 HERE]

Even in business markets, an endorsement can be nearly as powerful as hard data. Opinion leaders are those whose lower cost of search leads them to make what others see as more informed decisions. In medical products markets, Kaiser Permanente, an HMO on the West Coast of the United States, has a reputation for being a well-informed buyer of the most cost-effective medical products. The company often conducts its own trials of drugs and devices and will not buy a more expensive product without economic justification. Consequently, many other hospitals and HMOs who learn that Kaiser Permanente has adopted a more expensive product or service will assume that its price premium is cost justified.

Multiple testimonials from satisfied customers, even when they are not opinion leaders, can also reassure those attempting to make a purchase decision involving objective economic benefits. To counter the threat from lower cost Linux operating systems, Microsoft commissioned independent consultants to develop “Customer Case Studies,” each a video clip from a chief information officer or other systems professional. Each explained why, after considerable study, they decided to remain with the Microsoft Windows platform, despite its higher price. Microsoft reinforced these testimonials with “White Papers” showing how the total lifetime cost of an open-source operating system could exceed the costs for a comparable Windows operating system, despite saving the upfront purchase costs for Windows.

**Strategy 3: Psychological End-benefit Framing**

When customers are motivated by psychological benefits such as comfort, pleasure, safety, security, status, companionship, adventure, or fulfillment, it is not possible to define economic value objectively. Even when a low relative cost of search enables customers to recognize differences in product or service features, the psychological value they associate with those features will be subjective. The key to influencing perceived value for such products is to help buyers make connections between the differentiating features they recognize and the possible psychological benefits they could gain.

One of the most effective ways to do this is by reframing the way the customer views the product or service differentiation, not in terms of the product’s immediate attribute performance (“this razor will give you a closer shave”) but in terms of a possible end-benefit (“the shave this razor gives you will make you more attractive for an evening out with your date.”) Hart Shraffner & Marx ran a campaign showing elegantly dressed business executives with the message: “The right suit might not help you achieve success, but the wrong suit could limit your chances.”
The key to successful end-benefit framing is picking the most valuable end-benefit that you can credibly associate with your product for each target market segment. For decades, Michelin, the French tire company, had positioned its tires to appeal to men based on superior performance. Recognizing the demographic trend of baby-boomers starting families with more joint decision-making, Michelin adroitly leveraged its tire’s reputation for performance by associating it with a new end benefit: the safety of one’s family, with the tagline “There’s a lot riding on your tires.” (See Exhibit 5-9.) Moreover, Michelin’s marketing gradually included more women as tire decision-makers, culminating in its 1998 “Baby Shower” commercial in which an expectant mother receives four Michelin tires as a baby shower gift. This value repositioning proved to be one of the most successful in history, winning Michelin a consistent price premium.

End-benefit framing often involves more than just associating an important end benefit with your product’s differentiation. It may also involve influencing the value quantification of that association. Unlike economic benefits, psychological benefits have no natural value association. Consequently, what something “should” cost is often very fluid, particularly if it is an infrequent purchase where past expenditure is no guide. Thus the seller of study aids to help your child in school might point out that the cost is no more per day than what you spend for a cup of coffee (and no doubt so much more valuable to you.) Woolite successfully argued that the price of its soap is reasonable because it does the same job “for pennies” that a dry cleaner would do “for dollars.”

While most end-benefit framing is focused on raising the value associated with positive differentiation, a negatively differentiated brand can use the same techniques in reverse to minimize the discount required to win sales. “Why pay more?” challenges the customer and the competitors to justify their higher prices. Red Roof Inn, a basic, no-frills hotel chain, ran a simple advertisement that asked “What’s the value of all those amenities at the higher priced hotels? At 3 a.m. it’s hard to tell.” By framing the difference between Red Roof Inn and its competitors in terms of features that lack much benefit for those who just want a good night’s sleep, Red Roof was able to position itself as a better value, not just a lower priced, alternative.

**Strategy 4: Psychological End-Benefit Assurance**

The most difficult challenge in value communication occurs when the benefits are psychological and, therefore, subjective while the differences among brands are difficult for customers to ascertain. Personal services (e.g., hair salons), personal experience products (vacations) and personal improvement products (weight loss programs) are in this quadrant. Because comparison is difficult, the risk for customers of making what turns out to be a disappointing purchase decision is high. Consequently, buyers tend to rely heavily on even small amounts of direct experience (trial), on endorsements from people with whom the buyers can identify, and on their prior experience with a brand or brand name.
Whenever possible, the most effective way to influence value perceptions in this quadrant is to subsidize trial. Health clubs offer free trial memberships. Suppliers of baby products pay hospitals to give away samples of baby formula to new parents. New brands of food products often spend significantly to induce trial, with coupons, trial sizes, and free samples in addition to advertising. In addition, they communicate message content to raise buyer confidence that, when they do experience the product, they will find the psychological value adequate to justify the choice.

One way to communicate confidence in a value that cannot be objectively proven is via endorsements. While endorsements related to objective economic benefits rely on authorities, endorsements for psychological benefits are effective when made by people with whom the consumer can personally identify. Marketers of products in this category show real or “dramatized” users who are happy with the results, enabling potential buyers to imagine achieving the same result. Celebrity endorsers have value, not as experts, but as people with a defined image to which a target segment could relate. Many successful “self-improvement” products and services illustrate that success is possible even in this most challenging quadrant for value communication. Bowflex exercise equipment (www.bowflex.com), Weight Watchers diet programs (www.weightwatchers.com), and Hair Club hair replacement products (www.hairclub.com) all use similar marketing techniques quite effectively. They show the features of their products or services via videos and infomercials and then invite prospects to browse large numbers of testimonials. Finally, each offers a guarantee, not just that the features of their product will perform as represented, but that the customer will be satisfied with the results.

The high cost of search for customers, and therefore the challenge in value communication for sellers, gives known brands in this quadrant a large competitive advantage. Upstart brands attack them with an economic argument: the promises of all the same features and benefits at a lower price. To respond in economic terms, brand leaders would have to acknowledge their rivals, giving them more publicity, and would have to quantify the value of their superiority, which would be difficult given the uncertainty about the new competitors’ performance. A brand leader’s advantage lies in customers’ satisfactory prior experience and resulting reputation. Until experienced, a new brand offers only a promise to perform as well which cannot be tested until purchased and tried. Consequently, established brands can recast the purchase in terms of the psychological value of avoiding a mistake. For example, Federal Express ads show hapless employees that fear losing their job because they didn’t use Federal Express and were blamed when a package did not arrive.

To select from among these four generic value communication strategies, consider two additional factors: your target segments and the features that differentiate your product or service. When appealing to experienced buyers in a category who can easily make judgments about performance, or when appealing to large purchasers who will invest in trial purchases to make those judgments, strategies along the left side of Exhibit 5.2 for low relative cost of search are appropriate. Moreover, the features you would focus on would be those that differentiate your brand from others. In the same market, however, you may try to convince novice buyers, with little ability to infer brand performance, to enter the category. For them, you will use strategies in the right-hand column to provide assurances of use value. As a result, you may communicate benefits that motivate the decision to make a purchase from the category, even if
you are not differentiated in delivering them. Such a strategy definitely makes sense if there is some other reason for the buyer to pick your brand from a set of substitutes, such as an affinity group (e.g., Harley-Davidson motorcycle clubs, or recreational vehicle [RV] groups), or your large share (“it’s the leading brand so it must be good”).

To illustrate different tactics for different segments, think of ads you have seen for international air travel. Airlines appeal to experienced business travelers by describing their feature differences (fully reclining seats, showers at destination, gourmet meals) and the resulting benefits (arrive rested and ready for work). They appeal to pleasure travelers by comparing the psychological end benefits of the destination with the price.

You may need to communicate both economic and psychological benefits for the same product to the same customers. Buyers of a hybrid car may well be motivated by feeling virtuous about their responsible use of the environment, a psychological benefit that the company could communicate by reporting the car’s lower pollution levels while showing it being driven in an unspoiled vista. However, the premium buyers will pay for a hybrid car also depends on how much money they expect to save from improved gas mileage, an economic benefit that the company could communicate by reporting a table showing fuel cost savings based on someone’s annual mileage driven. Finally, customers also may be wary of the possible adverse affect of new technology on reliability (a negative economic benefit), making testimonials from existing owners or independent experts, like J.D. Powers, a valuable part of the communication.

Often, a value communication strategy involves using different tactics to deal with different types and benefits and customer constituencies. Such complexity is common in the market for medical products. In mid-2003, Johnson & Johnson had to justify a substantial price premium for its new unique drug-coated coronary stent, which is used to keep clogged arteries open. J&J priced its stent, at $3,500 – 250 percent higher than traditional uncoated stents and well in excess of the drug used to coat the stent. This aggressive pricing aroused buyers and reporters to make claims of price gouging, thus challenging J&J to reconcile the value of the new product with its price. J&J did so by feeding payers, customers, and reporters the economic facts. A stent implantation surgery costs over $30,000, including the cost of the stent. But in 20 percent of cases, an uncoated stent reclogs in less than a year, requiring a repeat of the procedure—at another $30,000 cost. With J&J’s new drug-eluting stent, whose pharmaceutical coating reduced the likelihood that an artery would reclog, the repeat rate fell to approximately 5 percent. Thus, the objective differentiation value from the lower rejection rate was $4,500 – the 15 percent rejection rate difference multiplied by the cost of a second surgical procedure. In addition, the psychological value to patients of avoiding the risk and discomfort of a repeat procedure was substantial, a fact that J&J emphasized in communications with the public press. This combination of economic and psychological justification enabled J&J not only to win a higher reimbursement from payers when surgeons used its drug-eluting stent, but also to defuse the initial hostility and resistance to its price.

**Summary**

How customers respond to your pricing is determined by more than the product you offer and the price you charge. It is also determined by how they evaluate your product and your price. If you leave that evaluation to chance, you are likely to get paid much less or to sell much
less than you could. Most customers lack the time or the incentive to fully inform themselves about their alternatives and to evaluate the information they do have. If you want them to recognize your value, you have to make the process easier for them by supplying them with information about what you offer and ideas about how to evaluate that information.
References


### Exhibit 5-1
Different Situations Require Different Value Communication Strategies

#### Relative Cost of Search

<table>
<thead>
<tr>
<th>Type of Benefits</th>
<th>Economic Benefits</th>
<th>Psychological Benefits</th>
</tr>
</thead>
<tbody>
<tr>
<td>Low</td>
<td>Commodity Chemicals, Home Equity Loans, Desktop Computers</td>
<td>SUV’s, Sports Cars, Digital Cameras, Cosmetics, Designer Clothes</td>
</tr>
</tbody>
</table>

High complexity goods require high complexity search strategies, while low complexity goods require low complexity search strategies.
## Exhibit 5-2
Framework of Value Communication Strategies

### Relative Cost of Search

<table>
<thead>
<tr>
<th>Type of Benefits</th>
<th>Economic Benefits</th>
<th>Psychological Benefits</th>
</tr>
</thead>
<tbody>
<tr>
<td>Low</td>
<td>Strategy 1&lt;br&gt;&lt;i&gt;Economic Value Communication&lt;/i&gt;&lt;br&gt;Communicate Objective Information That Differential Economic Value Justifies Pricing</td>
<td>Strategy 3&lt;br&gt;&lt;i&gt;Psychological End-Benefit Framing&lt;/i&gt;&lt;br&gt;Associate Differential Performance with Subjective Psychological Value That Justifies Pricing</td>
</tr>
<tr>
<td>High</td>
<td>Strategy 2&lt;br&gt;&lt;i&gt;Economic Value Assurance&lt;/i&gt;&lt;br&gt;Communicate Assurances That Differential Economic Value Justifies Pricing</td>
<td>Strategy 4&lt;br&gt;&lt;i&gt;Psychological End-Benefit Assurance&lt;/i&gt;&lt;br&gt;Communicate Assurances That Total Psychological Value Justifies Pricing</td>
</tr>
</tbody>
</table>

- Low Simple “Search” Goods
- High Complex “Experience” Goods
**Exhibit 5-3**

**Marriott Time Share Value Communication**


*Timeshare Ownership Is A Smart Economic Decision*

Marriott Vacation Ownership hedges against "vacation inflation". For Vacation Owners, the lion's share of vacation expenses—accommodations—will be covered. What else can you enjoy "pre-paid"...for life?

See for yourself how Timeshare Ownership makes economic sense. Compare the cost of one week a year at the current daily rate and see what you would spend over the next 10, 20, and 30 years. Enter your typical nightly hotel rental rate below.

**Enter estimated nightly room rate:**

<table>
<thead>
<tr>
<th>Rate</th>
<th>Per Night</th>
<th>Per Week (7 Days)</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>$200</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>$335.09</td>
<td></td>
<td></td>
<td>$19017.77</td>
</tr>
<tr>
<td>$2345.61</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>$545.82</td>
<td></td>
<td></td>
<td>$49995.72</td>
</tr>
<tr>
<td>$3820.75</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>$889.09</td>
<td></td>
<td></td>
<td>$100455.54</td>
</tr>
<tr>
<td>$6223.60</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Assumptions**

> Our calculations are based on a 5% inflation rate per year.**
> Premier resort areas charge an average combined room tax of 8%. Actual rates may vary.
Lies, damn lies and statistics, you say? Some of our customers used to be cynical, too. But then they started sending us these numbers. Telling us that the results of using our best practices, integrated tools and services exceeded their expectations. Cutting test time, decreasing development cycles and reducing bugs. Freeing their teams from the obstacles that hinder software development. Need more evidence? There’s plenty available at www.rational.com/customersuccess4.

be liberated
Exhibit 5-5
Kinko’s DocStore Ad

With Kinko’s DocStore, you print only what you need. You save money. And you look like a million bucks.

Without Kinko’s DocStore

<table>
<thead>
<tr>
<th>Service</th>
<th>Cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>Warehousing expense</td>
<td>$3,000</td>
</tr>
<tr>
<td>Tossing obsolete brochures</td>
<td>$5,000</td>
</tr>
<tr>
<td>Printing new brochures</td>
<td>$15,000</td>
</tr>
</tbody>
</table>

With Kinko’s DocStore

Printing new brochures $75

INTRODUCING KINKO’S DOCSTORE – THE ONLINE DOCUMENT CATALOG.
If you are a midsize to large company, there are lots of reasons to use Kinko’s DocStore. Here’s how it works: We’ll create a secure document catalog that everyone in your company can access from just about anywhere. Which makes it ideal for managing all of your sales brochures and training manuals. With Kinko’s DocStore, we’ll also print your documents for you. So you’ll get only what you need, wherever and whenever you need it. This way everyone has the most current information, giving you the competitive edge. Plus you won’t waste money warehousing or tossing obsolete documents that are associated with offset printing. For more information, call 1-888-KINKOS-1 today.

PRINT ON DEMAND • SECURE DOCUMENT CATALOG • DOCUMENT CUSTOMIZATION
COMMERCIAL BUSINESS REPRESENTATIVES • ONLINE ORDERING & PRINTING
Open 24 hours • 1-888-KINKOS-1
CEV* (Customer Economic Value) Comparison

International Model: 4400 4x2 Competitor Model: Freightliner FL 70

Application: Municipal Dump/Plow - 10 years/15,000 miles/yr, 10,000 hours
(Appplies to other applications with similar mission)

Expected Differential Savings for International Trucks and Tractors versus Competition

<table>
<thead>
<tr>
<th>VALUE CATEGORY</th>
<th>3126B</th>
<th>ISB 5.9L</th>
<th>MBE 900 6.4</th>
</tr>
</thead>
<tbody>
<tr>
<td>Resale</td>
<td>$535 - 800</td>
<td>$570 - 860</td>
<td>$570 - 860</td>
</tr>
<tr>
<td>PM Savings</td>
<td>$605 - 910</td>
<td>$250 - 375</td>
<td>$80 - 570</td>
</tr>
<tr>
<td>Repairability</td>
<td>$2,553 - 2,553</td>
<td>$2,553 - 2,553</td>
<td>$2,553 - 2,553</td>
</tr>
<tr>
<td>Engine rebuild</td>
<td>$1,990 - 2,985</td>
<td>$1,485 - 2,230</td>
<td></td>
</tr>
<tr>
<td>TOTAL (See Value Notes below for explanations)</td>
<td>$5,683 - 7,248</td>
<td>$4,858 - 6,018</td>
<td>$3,503 - 3,983</td>
</tr>
</tbody>
</table>

(Figures in table are net differences in expected dollar costs or value of International vs. competitor)

VALUE NOTES

RESALE Resale value figures are stated in today's dollars (NPV) and based on published resale values from NADA, Truck Blue Book or from International Used Truck Organization resale data. Resale values for new International or competitor models are estimated. Resale values are capped at 10 years.

PM SAVINGS PM savings are stated in today's dollars (NPV) and based on published OEM recommended service intervals and procedures for on/off highway usage (where available). 

REPAIRABILITY Repairability value is derived from expected savings associated with International's breakaway mirrors and three-piece hood based on published OEM repair procedures. The dollar value assumes a single incident for each feature during the vehicle's lifecycle for the first owner.

ENGINE REBUILD If customer's application and usage requires an engine overhaul, rebuild values are labor and parts estimates. The figures are stated in today's dollars (NPV) and derived from the OEMs service publications.
### Exhibit 5-7
**Spreadsheet Value-Based Selling Tool**

<table>
<thead>
<tr>
<th>Variable</th>
<th>ENTER AMOUNTS HERE</th>
</tr>
</thead>
<tbody>
<tr>
<td>ENTER these Inputs: <strong>Help Desk and/or Customer Service</strong></td>
<td></td>
</tr>
<tr>
<td>Total customers in impacted service area</td>
<td>4000</td>
</tr>
<tr>
<td>Average no. of trouble calls per day - normal</td>
<td>150</td>
</tr>
<tr>
<td>Avg. no. of trouble calls per day - outage incident</td>
<td>200</td>
</tr>
<tr>
<td>Duration of outage or network congestion - days</td>
<td>60</td>
</tr>
<tr>
<td>Average call duration in minutes</td>
<td>3.8</td>
</tr>
<tr>
<td>Help Desk wages &amp; benefits - hourly</td>
<td>$11.50</td>
</tr>
<tr>
<td><strong>Management Time</strong></td>
<td></td>
</tr>
<tr>
<td>No. Managers needed to resolve incident</td>
<td>1</td>
</tr>
<tr>
<td>Percent of Management time required</td>
<td>15%</td>
</tr>
<tr>
<td>Management loaded salary and benefits</td>
<td>$75,000</td>
</tr>
<tr>
<td><strong>Other Costs</strong></td>
<td></td>
</tr>
<tr>
<td>Percent calls unresolved or receive bill credits</td>
<td>50%</td>
</tr>
<tr>
<td>Average billing credit (1 month)</td>
<td>$17.95</td>
</tr>
<tr>
<td>Percent impacted calls that are long distance</td>
<td>100%</td>
</tr>
<tr>
<td>Avg. cost per minute for 800 calls to help desk</td>
<td>$0.07</td>
</tr>
<tr>
<td><strong>General</strong></td>
<td></td>
</tr>
<tr>
<td>Number of users per port</td>
<td>10</td>
</tr>
<tr>
<td><strong>Calculation:</strong></td>
<td></td>
</tr>
<tr>
<td>Total ADDITIONAL manhours cust. service</td>
<td>190</td>
</tr>
<tr>
<td>Total cost for additional help desk &amp; cust. service labor required</td>
<td>$2,185</td>
</tr>
<tr>
<td>Total cost for management time</td>
<td>$1,875</td>
</tr>
<tr>
<td>Total billing credits</td>
<td>$26,925</td>
</tr>
<tr>
<td>Total 800 call costs</td>
<td>$798</td>
</tr>
<tr>
<td><strong>Avg. cost per call (less mgt. expense)</strong></td>
<td>$9.97</td>
</tr>
<tr>
<td><strong>TOTAL COST SAVINGS TO CUSTOMER (per outage incident)</strong></td>
<td>$31,783</td>
</tr>
<tr>
<td>Estimated number PRI in impacted service area</td>
<td>17</td>
</tr>
<tr>
<td><strong>COST SAVINGS PER PRI</strong></td>
<td>$1,870</td>
</tr>
</tbody>
</table>
Exhibit 5-8
Duracell Ad

LENGTH: 30 SECONDS

ANNCRVO: Inside that Gameboy...

right next to the silicon chip...

is something familiar:

A battery.

And while it may not be the biggest decision of your day...

Consider this:

When monitoring a patient

after open heart surgery

the brand of battery hospitals

trust most... is DURACELL

So whether it’s monitoring a beating heart...

...or beating the aliens on the 8th level...

It just has to work.

DURACELL

Trusted everywhere.
Exhibit 5-9
Michelin Ad

MICHELIN. BECAUSE SO MUCH IS RIDING ON YOUR TIRES.

Michelin is guided by a single overriding concept: tires are the most important pieces of equipment you can put on your car.

Therefore, making the best tires, regardless of cost, is an obsession with us.

That is why we make our own steel for our steel-belted radials. Why we take so long to develop and test each tire model.

That is also why Michelin's performance is so well rewarded. And lasts as long as it should. And why it costs more.

Though you may find, as many Michelin buyers do, they end up costing less to own in the long run.
FOOTNOTES

1 Other elements of marketing, such as channel availability, and other issues in pricing, such as pricing policies, are still relevant even when the product is not economically important. Value communication, however, is not likely to have an impact in those cases.

