

THE IMPORTANCE OF “VALUE” FOR BUSINESS STRATEGIC MANAGEMENT

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Abstract

The Alignments and Paradoxes Model (MAP) comprises six matrices: the Market; the Value; the Effort; the Product Margin; the Potential Profit; and, the Strategy. The intra-relation between all of them provides an integrated view to any business. The model allows managers to understand the potential market growth, the potential product value for consumers, the needed effort to produce the product or service, the potential product margin and the potential profit for the business. It also allows managers to create scenarios and evaluate different potential solutions for any business proposition.

One of the three starting inputting points of the model is a conceptual value analysis of the product, which analysis the functionalities of the product (intrinsic and extrinsic) against the accepted or paid price for the product. This classifies products in four different categories: Premium, Best Value, Commodities and Lesser Value. As a result of this, the model calculates the potential margin of the product and integrates it in the potential profit of the business.

The “value” of the product is a determinant factor for the business profit and success and different product strategies can be defined in order to have impact in the final business result. Understanding how the “value” perceived by consumers can change and how a product can take advantage of it allows managers to define product changes, in which innovation plays a great deal. One of the windows to look into the potential areas of innovation is the “value curve”.

Using the “value curve”, which analysis and evaluates the different attributes (functions) of a product against competition, managers can identify similarities and differences between all, and, therefore, define strategies for differentiation. These must focus on the product attributes most valued by consumers and must provide the market with some unique and desired product.

The model provides a comprehensive and extensive understanding of a business, covering a wide range of strategic management areas and directs managers to the innovation on the product side, on the working processes and on the organizational structure, in order to maximize profit (returned value for all stakeholders).

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The strategic approach

It is commonly understood that the mission of any business proposition is to achieve profit to the shareholders; otherwise they would not invest their resources in any business, in the first instance. It is in accordance with this simple concept that the MAP - Model of Alignments and Paradoxes has been developed. It has been constructed with the specific objective of understanding the potential profit of any business proposition and its consequent strategy. With that purpose, the model comprises six matrices which relate to one another in a logical way. The starting points must be the analysis of the potential “value”, followed by the needed effort to produce the “value” and market dimension and growth.

The “Value” as a factor for strategy definition

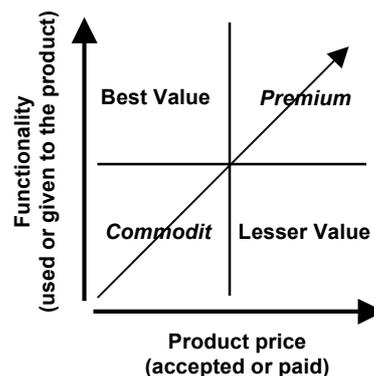
The basic concept

There are several factors that contribute to the margin of a product. Innovation and differentiation and perceived “value” by consumers can influence, among other factors, the contributing margin that a product brings to the business. The perceived “value” by consumers, however, must be the primary factor to be understood in order to create a profitable business.

Accordingly to the “EN 11325-1:1996 Value Management, Value Analysis, Functional Analysis vocabulary – Part 1: Value Analysis and Functional Analysis” standard the definition of “value” is “*the relation between the contribution of the function to the satisfaction of the need and the cost of the function*”. The standard also indicates that value is not absolute but relative, being perceived differently by the different stakeholders.

Choosing from two equivalent products, it is assumed that the consumer values higher the one that provides better satisfaction of the existing needs, even if he or she has to spend some extra resources, that being some extra cost. It is based on this assumption that the model is constructed, as in figure 1. The matrix evaluates two variables, the functionalities used or given to the product by the consumer and the price accepted or paid (imposed to) by the same consumer.

Figure 1 – “Value” Archetypes



The functionality variable is divided into two different kinds: intrinsic and extrinsic. The intrinsic functionalities that a product can provide are the basic ones any consumer can expect of the same product, that being, the reason for which the product has been conceived and produced. A watch (clock) is made to provide the consumer with the indication of the accurate time at any moment, and that is what any consumer can expect from it when buys any watch. Providing the exact time and other related expected information, like the date and others, makes a watch fit in the bottom haft of the functionality axis. The extrinsic functionalities that a product can provide are related to the emotional values, that being the prestige that a brand can give to any consumer who uses the product. The same watch do not only provide the exact time and some other information with extreme precision and accuracy, but also provides importance to its user, making of him, or her, a person with more prestige (at least, that is what is expected). These functionalities are located in the top haft of the matrix “y” axis.

The price variable is divided into two levels: the accepted price and the paid price. The accepted price is what any consumer accepts to pay in order to acquire a given product, rejecting anything above a certain level, from which the price is considered not justifiable by the return (functionalities) that it provides. Most products prices are based at the level of acceptance by the consumers, matching the offer/demand curves concept that serves the founding of the capitalism economy. This price category seats on the left half of the "product price" dimension, which is measured by the "x" axis of the matrix. The paid price is what the producer or supplier of a given product demands to sell it, despite what the consumer thinks about it, forcing the last to pay. Some products consumption is regulated and the price paid for them is much higher than what the consumers would consider as acceptable. Other products have a seat price at a very high level, becoming not acceptable, and affordable, by most consumers, being, however, still acquired by a very small number of consumers who can afford to pay their high prices, based on the special appeal that comes from the extrinsic functionalities. These products are classified on the right half of the "x" axis of the matrix.

Therefore, we have four "value" archetypes: Premium; Best Value; Commodity; and, Lesser Value.

The four "value" archetypes

Products in the "premium" archetype are perceived by consumers as providing all needed intrinsic functionalities and also extrinsic functionalities, which add prestige to the usage, justifying the higher price paid, what can also be seen as a factor that contributes to the desired exclusivity. Not many products fit in this archetype, and they are the ones that need a strong effort in the branding support field. Some well known luxury products, like cars and watches, and services, like hotels and health facilities, illustrate these kind the "premium" products. However, some more common products and services can fall into this category, like "premium" beers and well recognizes brand cloths or consulting advice and beauty treatments.

Products in the "best value" archetype are also seen by consumers as providing all needed intrinsic functionalities and some extra extrinsic functionalities but, however, at a much more affordable price, which makes consumers to buy it in larger quantities. Normally considered as "good value for money", consumers prefer this kind of products due to the perception of the real low price. Many products that are considered in their first stage of life as "premium", fall later into the "best value" category when, due to a strong price reduction, are offered to consumers at an affordable price and that makes consumption rise tremendously, which also pushes the price even to lower levels, forcing the product to become a "commodity". The mobile phones generalization went through a process of this kind.

The "commodity" archetype comports the generality of most products and services. They only respond to the intrinsic functionalities, providing satisfaction to the operational needs of consumers. No prestige is given to the usage of these products. Consumer understand very well what they can expects from the product or service and they are only willing to pay a certain amount of money for it, rejecting to buy the product if the price is above the level which is considered as acceptable. This pressure forces producers to reduce production costs and going many times to the "disposable product" concept. Almost all every day to day product buy is in this category.

Last, the "lesser value" archetype contains products that only respond to the intrinsic functionalities but which are acquired at a price which is considered, by the generality of consumers, very high and not equivalent to the low level of the satisfied needs. Consumers only buy this category of products when they do not have any other alternative or substitute product or are forced to buy them by any external force (regulations or others). Many compulsory insurance coverage or legal services fall into this archetype. Some companies also make their products fall into this category by applying "skimming" strategies when launching them, like some mobile phones and IT equipments, or when the demand reaches very high levels, like toys during the Christmas season. Normally, these strategies are short term and try to explore the appeal that the products can have on consumers at a specific point in time.

Forward

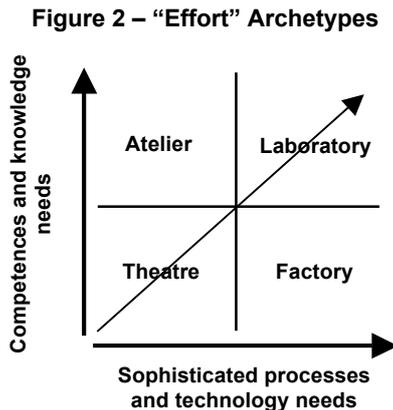
The kind of value in which the market classifies a given product is determinant for the construction of the same product margin, which makes the understanding of the product "value" an important issue for the success of any business.

The "value" increases from the left bottom corner to the right top corner of the matrix, in a diagonal onto which is projected any point representing a product position in the same matrix.

The “Effort” as a factor for strategy definition

The basic concept

There are several factors that contribute to the margin of a product. Innovation, differentiation and perceived value by the consumer, among other factors, can influence the margin that a product can generate and contribute to the business success. The basic idea that defines margin is the difference between the price obtained by the sale of a product and the cost spent to produce the same product, or in a simple way, the difference between revenue and cost. The price of the product is determined by the “value” matrix, as seen before. The cost can be determined by the “effort” matrix, as in figure 2.



The sophisticated processes and technology needs are related to what the supplier of any product needs to put into its work in order to deliver the same product. If these needs are similar to what any competitor needs to produce the same product, then the effort on this dimension is considered on the left half of the “x” axis. If the needs for sophisticated processes and technology, in order to produce an innovative or differentiated product, are different and more expensive than any other competitor needs to achieve the same result, then the product fits on the right half of the “x” axis.

The “y” axis measures the needs of competences and knowledge that any supplier has to put into its work to obtain the desired value for a product. If these needs are similar to any competitor’s needs, then the product is classified on the bottom half of the axis. If the producer needs higher competences and more advanced knowledge than its competitors to produce an innovative and differentiated product, then this is classified on the top half of the “y” axis.

The “effort” matrix provides information related to the innovation and differentiation obtained by the use of more advanced competences and knowledge and more sophisticated working processes and technology. Therefore, the “effort” can be classified in four archetypes: theatre; atelier; factory; and, laboratory.

The four “effort” archetypes

The “theatre” archetype is characterized by using the same common working processes and technology and competences and knowledge than any other competitor. Any investment made by firms in this archetype won’t be changing the product in terms of innovation or differentiation, but will try to level up their performance to the best practices in the industry. The large majority of products fall into this category.

The “atelier” archetype comprises products that use extra knowledge and new competences in order to be innovative or differentiated. The additional or extra investments related to knowledge and new competences can be used in the concept and development of the product or in the marketing and commercialization of the same product. Solutions are founded in existing and known processes and technologies but using new knowledge and information and developing new competences. The fashion industry fits in this category, as well “mass market” products with simple processes like bank services, where the technology resides in the information management.

In the “factory” archetype the usage of new technology and more sophisticated processes is a way to innovate and differentiate the way the product is produced. The focus is mostly on the production processes and not on the product. Normally, the technology is acquired from leading developing firms but the processes are developed internally. The car industry fits mostly in this category.

The “laboratory” archetype comprises those products that are the result of a strong investment in innovation and differentiation on product development and production processes. The I&D is the focus of companies that produce these kind of products, and they create and develop new knowledge and competences as well as new technology and working processes, which are “breakthroughs” in industries. The IT and the biotechnology industries are good examples of this category.

Forward

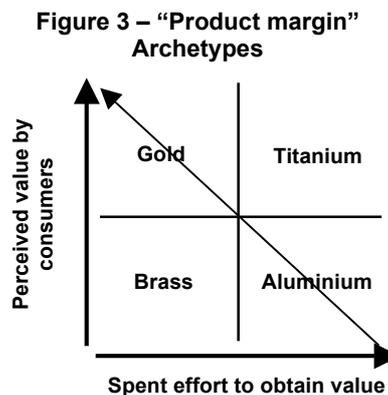
Companies need to understand what kind of effort they make in order to achieve the “value” of their products and how that is equivalent to a reasonable profit margin. The costs of investment, which are measured by the “effort” matrix, are dependent of the business strategy and must be a part of the last.

The “effort” increases from the left bottom corner to the right top corner of the matrix, in a diagonal onto which is projected the point representing any product position in the same matrix.

The “Profit margin” as a factor for strategy definition

The basic concept

In normal circumstances, products with similar “value” must have similar costs. However, to innovate or differentiate, products need extra investment in knowledge and competences and in technology and sophisticated processes, as explained before. That affects the potential product margin. To understand what the product margin can potentially be we need to combine both factors as shown on figure 3.



The quantification of each axis comes from the previous matrices. Transporting the diagonals and the points projected on them from the “value” and “effort” matrices, we can calculate in which category of margin a product can fall. These are: brass; gold; titanium; and, aluminium. They represent the potential product margin that a business can expect.

The four “product margin” archetypes

The “brass” archetype is characterized by low effort and low perceived value, which makes any product fall into the most average “product margin potential”. This category of product is perceived as low innovative and not differentiated from the others, being, many times, just replication or copies of others. Margins can be sustainable if the production costs are kept low. Most of the commodities that fill our day to day fall into this category. Strong investments in these products have to be well evaluated, and most of times are not advised.

The “gold” archetype is the best of all, as it is the one that can potentially provide the highest profit margin. Normally these are low production cost products but with a strong brand name, with low need for innovation or differentiation. They can be luxury products or well known and famous services. The investment needed is mostly in the promotional field. Due to the low effort needed, these products are normally subjected to the entry of new competitors, which gives them a short term margin perspective.

The “titanium” archetype comprises products that are considered generally by the market as state of the art products, as they normally are very innovative and differentiated when comparing with others. These products have potentially high profit margins, but they also need very high investments in technology and competences, being considered very often of high risk. The biotechnology is clearly in this category. The high effort needs imposed to new entrants gives a longer term margin perspective to these products.

The “aluminium” archetype may be perceived by the market of low value but it needs a strong effort to produce the desired “value”. These are the lowest profit margin makers, and they do not survive in the long term. Some unknown or less accepted technologies have products that fall into this category.

Forward

Companies need to understand the potential profit margin of their products in order to evaluate the potential net profit of the business.

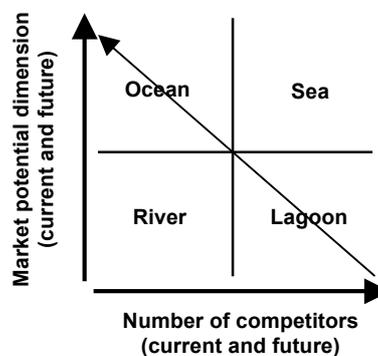
The “profit margin” increases from the right bottom corner to the left top corner of the matrix, in a diagonal onto which is projected the point representing any product position in the same matrix.

The “Market Potential” as a factor for strategy definition

The basic concept

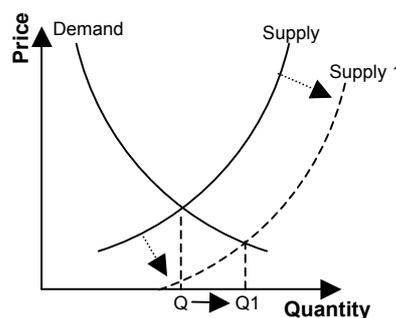
The potential market analysis is critical to project the future profits of any business. This depends of two very important factors: the market potential dimension and the number of competitors. To understand what the market can potentially be we need to combine both factors as shown on figure 4.

Figure 4 – “Potential Market” Archetypes



The market potential dimension depends upon the potential growth that a specific market segment can have if, by any reason, the price of the product can be reduced, provoking an increase in demand. This can be demonstrated the right shift of the supply curve, which provokes an increasing of quantity on the demand curve, as shown on figure 5.

Figure 5 – “Supply and Demand” Curves



The demand can also increase due to a right shift of the demand curve, provoked by economical changes that increased the purchasing power of consumers.

In any case, if the demand increases, it means that there is a growth potential for suppliers, then the market is positioned on the top half of the “y” axis, that is, the market has potential to grow in dimension (number of consumers or sales per consumer). If, even with price reduction or any other mean, the demand doesn’t increase, then the market is positioned on the bottom half of the “y” axis.

The number of competitors is positioned on the left half of the “x” axis if the entry or withdraw of a new or of an existing competitor, respectively, has some kind of visible or felt effect on the market share of the other competitors. On other hand, if that is not felt by the others, then the position is on the right half of the “x” axis.

This creates four quadrants for the “potential market”: river; ocean; sea; and, lagoon.

The four “potential market” archetypes

The “river” archetype is characterized by a low number or no competitors in a non potential growth market. Normally these markets are specific niches that do not attract new entries due to different kind of barriers related to the dimension of the niche, the specificity and product knowledge, or even restrictions of some kind.

The “ocean” archetype has a strong potential growth but with only a few or no competitors. These are markets that can be monopolies or oligopolies, where it is very difficult to enter. Markets fall into this category when they are much regulated, have very scarce natural resources or, still, they have a product which “brand” name has a strong power and effect over the other competitors.

The “sea” archetype is characterized by a strong growth but also a large number of competitors. These are markets of products in the early stage of their life cycle or of large demand, where the barriers of entry are quite soft. Large demand products or large demographic markets fall into this category.

The “lagoon” archetype is the most common type, where a large number of competitors fill a non growing market. These markets have mature products and are much filled with different options. This is the archetype with less potential to support any business proposition.

Forward

Companies need to understand the potential of the markets where they operate in order to evaluate the potential net profit of the business.

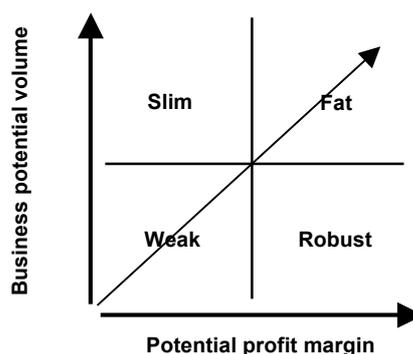
The “market potential” increases from the right bottom corner to the left top corner of the matrix as a diagonal onto which is projected the point representing any product position in the same matrix.

The “Potential Profit” as a factor for strategy definition

The basic concept

Businesses are made to generate profits. The potential profit that any business proposition is capable of delivering is related to two factors that impact the “net profit”: the quantity of product sold and the profit margin provided by the product. The equation (Profit = Q x M) can be represented in a matrix and generates four categories of potential profit: fat; slim; weak; and, robust, as in figure 6.

Figure 6 – “Potential Profit” Archetypes



The quantification of each axis comes from the previous “potential market” and “product margin” matrices. Transporting the diagonals and the points projected on them, we can calculate in which category of potential profit a product can fall.

The four “potential profit” archetypes

The “fat” archetype is the one that provides more potential profit to a business. The product margin and the potential volume of sales are above average. Normally, products in this category are market leaders, monopolies or oligopolies, large natural resources owners and some even protected by regulations. They use their profits to invest strongly in the innovation of new products.

The “slim” archetype is characterized by large volumes of sales but low unit product margin, suffering a strong pressure on the last factor. Fluctuations on sales volumes or unpredictable added costs can create serious problems to these businesses. Many mass production and sales products fall into this category.

The “weak” category comprises products that are normally going over their life cycle, with low profit margins and low or even negative potential volume growth. Any fluctuation on the demand side can suffocate the business. These products are not sustainable in the long run.

The “robust” archetype is still very much attractive. It has strong product profit margins despite de fact that has low potential volume growth. Normally these products are leaders in small niches, and they answer very specific market needs, having a strong customer loyalty, potentially based on differentiation and innovation.

Forward

Companies can become profitable and sustainable if they follow aligned strategies of profit incrementation, either based on the increment of sales and markets (expansionistic strategy) or on the increment of profit margin (lucrative strategy).

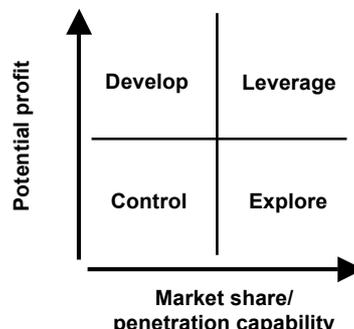
The “potential profit” increases from the left bottom corner to the right top corner of the matrix as a diagonal onto which is projected the point representing any product position in the same matrix.

The “Strategy”

The basic concept

To define the strategy that a business must follow, one has to know the potential profit that it can obtain and also how deep the product and the organization can penetrate into the market. To understand this, we need to combine both factors, as shown on figure 7.

Figure 7 – “Strategy” Archetypes



The potential profit value comes from the “Potential Profit” matrix.

The market penetration capability comes from the current market share that the product has and from the capacity the organization has to increase production in order to answer market demand growth. If this is small, or below the competitors’ level, the product will be positioned on the left side of the “x” axis. If this is strong, or above the competitors’ level, the product will be positioned on the right side of the “x” axis.

Then, we will have four different generic strategies: develop; leverage; control; and, explore.

The four “strategy” archetypes

The “develop” strategy configures a strong investment in product and market development. There is a very strong need for product innovation and for market penetration. The effort in market penetration means making the consumer try the product and adopt it, communicating the product attributes clearly and finding reliable distribution channels. The effort in product innovation is related to understanding the needs of consumers, developing of new needs and finding disruptive solutions that can project the innovation far ahead of competitors.

The “leverage” strategy comprises a strong investment in marketing, production, distribution and innovation capability, taking advantage of a strong potential leading position that the organization may has. It is fundamental that the organization defends the product position against attacks from smaller

and weaker competitors and imposes its rules on the market place. The existing product improvement must be based on a sustainable kind of innovation, to keep its performance ahead of any existing or potential competitor.

The “control” strategy focuses all efforts on controlling the market and competitors, looking for any market advance, consumer changes and competitors developments. The low market penetration capability and the low potential profit force many business to disappear, forced by a large number of competitors and by a very strong pressure on margins. It is essential that the organization controls costs, mainly within investments, and forces sales in order to acquire more market share.

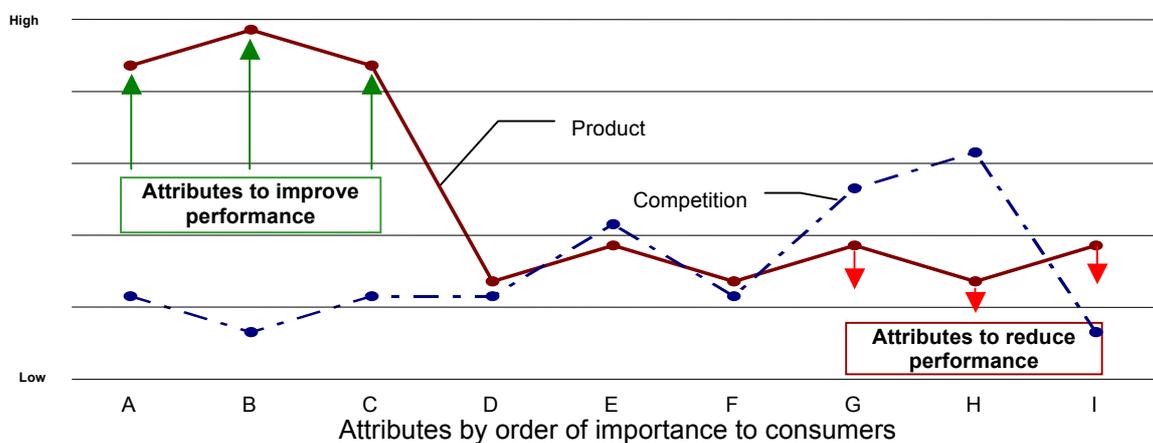
The “explore” strategy comprises products that have a large market share, perhaps leading products that are achieving or have already achieved maturity. The effort is focused on controlling business development costs and acquiring distribution capabilities, together with a strong image and “brand” name. The sales and marketing functions must be very strong and play an important role in the business strategy. The objective is gaining market share from other competitors.

Conclusion

From the analysis of any business through the model, we can easily find that the only elements management can impact or change are the “value” of the product and the “effort” spent to produce the product. The “market” has its own course, which organizations, even if very large, can not change. The most that any organization can do is moving from one market to other. The “margin” and the “profit” are consequences of the other elements of the model. Finally, the “strategy” is more of a course of action that is defined by the previous elements and by the capability organizations have to penetrate into the market place.

The value can be changed if the attributes of a product are redefined in order to differentiate the performance of the same product, on the “value curve”, from the competition, as shown on figure 8.

Figure 8 – “Value Curve”



This can increase the “value” of the product, if it is done accordingly with the consumer needs and preferences, impacting on the product margin, and consequently on the potential profit and adequate strategy. The “effort” changes and adjustments must follow the “value”, keeping them in alignment with each other in order to maintain the desirable product margin. Changes in the “value” side can also uncover or create new markets, provoking movements on the market place, which will impact the potential profit and strategy, as well.

The changes in the effort side must be performed at the organizational structure level, intervening in the areas of the authority and responsibility, learning and competences, processes and technologies.

The model must be used as an integrated tool, providing an overall and integrated view of any potential business proposition.

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