

aggregated to create a firm strategy. That time has passed. There also now needs to be a firm strategy that identifies macro trends and strategy responses to these trends as a firm, allocates resources among business units, and recognizes synergy potentials. So there needs to be a strategy for the Ford company and perhaps the SUV group as well as the Ford Explorer, a major SUV brand.

### The Business Strategy

Four dimensions define an effective business strategy: the product-market investment strategy, the customer value proposition, the assets and competencies, and the functional strategies and programs. These four dimensions are depicted in Figure 1.1. To be effective, all four elements should be based on the idea of customer value. This foundation drives subsequent decisions about where and how to compete to win.

### The Foundation of Customer Value

A critical foundation of any strategy is to ensure that the company's actions offer value to customers. Without offering value, decisions about where and how to compete are unlikely to succeed. Unfortunately, "value" may be one of the most overused and misused terms in business. Thus a "value" price is often wrongly used to mean a low price or a bundled price. Low-priced products can offer customers excellent value. However, equating customer value with low price obscures the more fundamental role value plays in how markets operate and how firms must compete.

Ultimately, *customer value* is about the difference between the benefits customers perceive they are getting from an offering minus the perceived cost of obtaining these benefits—adjusted

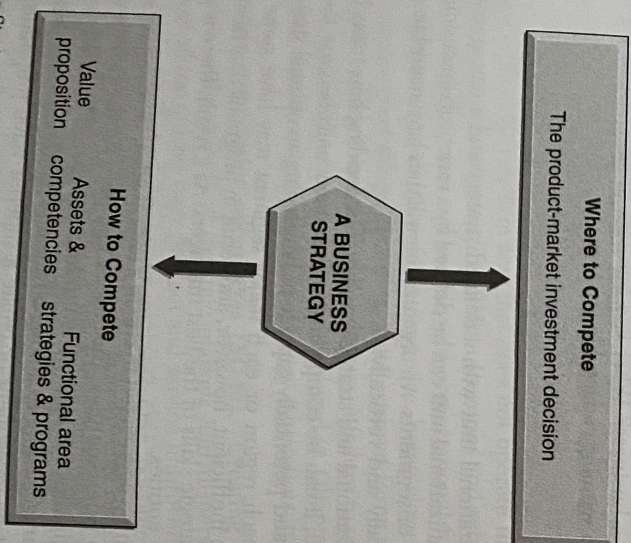


Figure 1.1 A Business Strategy

### What is a Business Strategy? 5

for the riskiness of the offering. Think about customer value using the following approach:  $\text{Customer Value} = [1 - \text{Perceived Risk}] \times [\text{Perceived Benefits} - \text{Perceived Costs}]$ . The greater the perceived benefits and/or the lower the perceived total costs and/or risks of a product, the greater the customer value and the higher the likelihood the customer will choose that product. Each component will now be examined in detail.

Theodore Levitt, famously observed, "People don't want to buy a quarter-inch drill. They want a quarter-inch hole!" *Perceived benefits* are these outcomes that customers associate with a product, service, or relationship from a company. What people want from a copier are machine up-time, speed of through-put and print quality, but customers also make choices based on the quality and speed of customer service. What people want from a video game is fun, excitement, and escape.

Customers' *perceived costs* also have many dimensions. Price paid is the most straightforward cost. However, examining the full range of costs customers incur in their search for, acquisition, and disposal of products represent total life-cycle costs. In the personal computer market, for example, the total life-cycle costs include acquisition costs (comprised of searching, ordering, price paid, processing, receiving, and installing costs), operating costs (notably energy consumption), psychological costs of learning a new system, and maintenance and disposal costs (including the cost of software upgrades, technical assistance, and repairs).

Customer choices are also swayed by differences in *perceived risks* between offerings and the companies that sell them. The degree of risk depends on the buyer's uncertainty about the answers to questions such as, "Can I trust the supplier's promises? Will the offering perform as expected? Will the vendor stay around to support the product in the future?" Small and new companies with unknown brand names, no recommendations, and limited track records are at a real disadvantage because perceived risks sharply offset the gains from any superior perceived benefits.

Leaders should be wary of these common strategy pitfalls in managing for customer value:

- First, attributes do not replace benefits. Attributes are the product or service features that the company offers to the customer—the quarter-inch drill. The benefit is what the customer gets—the quarter-inch hole—and any other needs that are met by the hole. Even though managers seem to endorse Levitt's powerful insight, most proceed to ignore the message. Instead they segment their markets by product attributes (type of drill, power, price point, etc.) or customer demographics, rather than focusing on how they are meeting customer needs.
- Second, within markets, customers vary in their emphasis on certain costs and benefits. Some segments of video game customers want high-tech performance features in a game that make it more realistic or futuristic, such as Rise of Tomb Raider, Grand Theft Auto, or Metro: Last Light; other segments want to personalize characters and the experience such as in World of Warcraft and Minecraft. The nature of the costs depends on the customer segment and the particular offering. Not all customers will recognize these costs and incorporate them into their buying decisions. Furthermore, costs that are incurred far in the future may be discounted back to their present value (consciously or not) at such a high discount rate that they virtually vanish.
- Third, customer value is dynamic. At any point in time, customers have a preference and know what they value. However, as customers become more experienced and competitors shift priorities, customer value evolves.