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James ANDERSON

Nirmalya KUMAR
Singapore Management University, nirmalyak@smu.edu.sg

James A. NARUS

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Business market value merchants

By ANDERSON, James; KUMAR, Nirmalya; NARUS, James A.

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To get a fair return on the superior value that their offerings deliver to customers, progressive B-to-B companies transform their sales forces from value spendthrifts into value merchants. These companies foster value merchants in more ways than simply compensating salespeople on profitability. As a result, their salespeople become value merchants, making business with customers more profitable by finding value drains and value leaks--rather than by seeking price cuts to retain or gain business.

Giving value away takes no particular skill. However, it is the responsibility of marketing and particularly sales to get a fair return on the value delivered to customers. For many firms serving business markets, though, salespeople become the customer's advocate for price cuts—rather than the supplier's advocate for the value provided.

A "value merchant" recognizes the supplier's own costs and the value to the customer for each market offering, and works to obtain a fair return for both the supplier firm and customer firm. He stands in stark contrast to the all-too-common "value spendthrift," who squanders the superior value of the supplier's market offerings, getting little in return. In the "Value Merchants or Value Spendthrifts?" sidebar, we provide a series of paired statements that contrast value spendthrifts with value merchants. By candidly picking the statement in each pair that best describes their salespeople, readers can construct a profile of their salespeople that indicates the extent to which they are value merchants or value spendthrifts.

Hoping for Value Merchants

A classic management practice article by S. Kerr is titled, "On the Folly of Rewarding A, While Hoping for B" (Academy of Management Executive, February 1995). In our context, this refers to the folly of rewarding revenue or volume, while hoping for profitability. To transform the sales force into value merchants, suppliers must have sales compensation plans that seamlessly reward value-selling behaviors and profitable outcomes.

Many firms have a profitability component as part of their sales compensation plan. Unfortunately, the weighting of this component relative to the revenue or volume component is often insufficient for swaying salesperson preference away from pursuing revenue or volume. This relative weighting might reflect management's own mixed feelings about what the business should pursue, particularly in businesses that have costly capacity that management wants to fully utilize. Yet when management is able to resolve its conflicting feelings to make profitability count significantly more than volume or revenue, the effect on salesperson behavior can be profound. One manager at a chemical company told us that when his firm made a change to having gross margin weighted 60% in its incentive compensation, it instantly revitalized the sales force.

Undeniably, though, some businesses pursue a strategy that depends on substantial volume. The challenge is to make that profitable volume. Consider the noteworthy example of Composites One, an Arlington Heights, Ill.-based reseller of composites materials such as fiberglass, catalysts, and plastic resins. Composite One's sales compensation plan consists of a good base salary plus substantial incentive compensation, which can range from 50% to more than 100% of the salesperson's base salary. The incentive compensation is based on the total gross margin dollars that each salesperson earns in his or her territory. Expenses that the salesperson can directly control and an allocation for any bad debt occurring from the salesperson's customers then are subtracted from the total gross margin dollars to yield adjusted total gross margin dollars. The percentage of these adjusted total gross

margin dollars that become the salesperson's incentive compensation varies from 8% to 10%, depending on the size of territory and number of customer accounts. This sales compensation plan makes it clear to Composite One's salepeople that although volume is important, total gross margin dollars are paramount.

To ensure that salespeople practice value-selling skills, suppliers' sales compensation plans might have a behavioral component, as well as a profitable outcome component. Even well-learned skills, if not practiced regularly, begin to decline. Thus, it is critical to have salespeople demonstrate that they regularly use their value-based sales tools with customers and continue to build their proficiency and comfort with them.

Salespeople at The SKF Group (a Swedish bearings company) have 50% of their incentive compensation based on individual targets, such as completed documented solutions program (DSP) activities (a tool to demonstrate and document value created for customers), sales growth in their territories, and introduction of specific products. The remaining 50% is based on total value added, which is defined as net profitability after subtracting the cost of capital—and is calculated based on the geographic area, business unit, and division performance. Interestingly, SKF uses the number of activities a salesperson quantifies in monetary terms using the DSP tool as its measure for the sales force compensation plan. It believes that the number is more important than the actual monetary amounts because it wants salespeople to make use of the DSP tool as part of their daily activities.

Equipping Value Merchants

How have we equipped our salespeople to be able to sell value? Some managers mistakenly believe that the right sales compensation plan is all that is needed, perhaps revved up periodically with a sales promotion or contest. Although the right compensation scheme significantly contributes to salespeople wanting to be value merchants, wanting to without ability will not succeed. And properly equipping salespeople to be able to sell value can lead to their comfort and success with customers, which then also significantly contributes to their wanting to be value merchants.

Management must equip salespeople with tools that enable them to persuasively demonstrate and document the superior value of the offerings to target customers—and in doing so, enable the salesperson to favorably influence customer manager perceptions of what a fair return is. (See J.C. Anderson, J.A. Narus, and W. van Rossum, "Customer Value Propositions in Business Markets," Harvard Business Review, March 2006.) We have emphasized value calculators, value case histories, and value documenters as value-based sales tools. Yet whatever form these tools take, they must provide evidence to customers about the superior value of the supplier's offering that those customers find persuasive. This evidence should be fact- or data-based and accurately reflect the customer's business. Wherever and whenever possible, this evidence should be expressed in monetary terms.

For sales force training on value-based sales tools to be meaningful, begin by providing a compelling answer to the question: "Why sell on value?" SKF has found that providing its salespeople, who are accustomed to technical selling, with success stories of value selling and case examples of failure with technical selling gets their attention. For example, the manager leading the training will share a case where the SKF salesperson did a great job of technical selling, yet lost the business on price. He then asks the training participants why this happened and how SKF can overcome it. Success stories share actual SKF cases that reinforce outcomes of using the DSP tool that salespeople find compelling: (1) Salespeople are able to sell more products; (2) it dramatically increases the close rate—up to 50%-60%; and (3) it gets the salesperson away from price discussion, with customer managers often using the DSP reports internally to justify their capital requests.

Value Merchants or Value Spendthrifts?

From each of the following pairs of descriptive statements, decide which one best describes your sales force. Then put together the profile of your sales force from the descriptive statements you have selected.

Our salespeople:

1. routinely trade more business for lower prices, or routinely gain more business at the same price.
2. make unsupported claims about superior value to customers, or demonstrate and document claims about superior value in monetary terms to customers.
3. focus on the revenue/volume component, or the gross margin/profitability component of their compensation plan.
4. give price concessions without changes in the market offering, or only give price concessions in exchange for cost-saving reductions in the market offering.
5. complain that our prices are too high, or complain our proof of superior value is lacking.
6. give services away for free to close a deal, or strategically employ services to generate additional business.
7. prefer to give quick price concessions to close deals and go on to other business, or are willing to "hang tough" in the negotiations to gain better profitability out of each deal.
8. believe management pursues a capacity-driven strategy, or believe management pursues a value-driven strategy.
9. sell primarily on price comparisons with competitors, or sell primarily on customer cost of ownership comparisons with competitors.
10. tell us customers are only interested in price, or tell us customer insights to improve the value of our offerings.

Suppliers that are serious about transforming their salesforces into value merchants make certain that they follow up sales training with in-the-field practice, with the salesperson receiving "hands on" coaching and support. SKF has area value champions work one on one with its salespeople, spending a week driving around with them and conducting joint sales calls. The two use the DSP tool in customer visits, with the salesperson increasingly taking the lead during the calls. In doing so, the salesperson gains confidence and comfort in his or her ability to use the DSP tool. There is also ample chance that driving around and having social time in the evenings can build a relationship between the area value champion and salesperson, allowing the salesperson to feel comfortable calling the area value champion with any DSP questions or concerns that might occur.

Suppliers that make use of value-based sales tools an integral part of their salespeoples' everyday selling activities not only keep their value merchants from slipping into value spendthrifts, but continue to strengthen their value-selling capability. Applied Industrial Technologies, a Cleveland, Ohio-based reseller of bearings and other industrial supplies, furnishes an illustrative example. The foundation of Applied's selling efforts is its documented value added (DVA) program, which requires every salesperson to record all of their efforts to provide value for individual customers in DVA reports. Importantly, customer managers must sign off on these reports, acknowledging that the value Applied claims to have provided has actually been provided. Since its inception, the DVA program has documented the provision of more than $1 billion in savings for Applied customers. Applied's salespeople use DVA as an integral part of their everyday selling activities in a number of ways. They use DVA reports to build customer loyalty and gain future sales. DVA enables the salesperson to make statements to a customer, such as: "Last year you purchased $200,000 worth of MRO [maintenance, repair, and operations] items from us. By doing so, you gained more than $85,000 in documented cost savings from Applied." Applied's salespeople report that this not only takes the sting out of a 3%-4% price increase, it also enables them to gain the

sale even though a competitor has undercut Applied on a price quote. Applied's salespeople also know that their customers' purchasing managers have to meet incentive goals. By providing documentation to them, these purchasing managers can effectively show their managers that they have met their firm's cost reduction goals. Applied's salespeople help them earn their incentives.

Instilling the Culture

Businesses that want their salespeople to act as value merchants instill and invigorate a value merchant culture throughout the business. Just as salespeople can be thought of as value merchants, so too can the businesses for which they work. The businesses adopt a philosophy of doing business based on demonstrating and documenting superior value to target customers.

Emphasize a value merchant culture in salesperson titles.

A salesperson's title has a subtle, yet profound, effect on how the individual thinks about himself or herself. It also communicates to customers the way a business thinks about itself and its salespeople. Some progressive suppliers have recognized this, and use it to instill and invigorate a value merchant culture.

After researching a number of potential value drivers for its customers, Lake Forest, Ill.-based Grainger Industrial Supply concluded that it was uniquely positioned to assist its customers in better managing unplanned and infrequent purchases of MRO supplies—which can account for an outsized proportion of the typical customer's purchasing budget. It built a value proposition, the Grainger value advantage (GVA), which assists its customers in aggregating and consolidating infrequent and unplanned MRO orders—thus significantly reducing total costs for MRO supplies. It then designed a value-selling process and value-based sales tools to enable salespeople to deliver and substantiate this value proposition with customers. As part of this, it created the designation "certified value seller," to provide distinctive status and prestige to salespeople who demonstrate competence.

To become a certified value seller, a salesperson first attends a four-day "GVA boot camp," in which they learn and practice value-selling skills. Two weeks after the course, each salesperson must return with a polished value proposition for one of his or her customers, which the salesperson presents to a panel of sales managers. The salesperson must demonstrate that he or she is knowledgeable about the GVA material, is able to relate it to a customer's business issues and construct a compelling value proposition, and put together evidence to support the value proposition. The sales managers throw out objections and challenge aspects of the value proposition, which the salesperson must handle. If the sales managers judge that the salesperson passes, he or she is certified as a value seller. If not, the salesperson must repeat the process. By making this process rigorous, Grainger management signals both its intention of becoming a value merchant and that it means something to become a certified value seller.

Recognize and celebrate extraordinary value merchants.

Contests are a means of emphasizing and celebrating a value merchant culture. Setting the rules for the contest; determining who in the business is eligible to compete; and deciding how to celebrate, recognize, and reward top performers give management the chance to build and invigorate a value merchant culture throughout the business. In designing these contests, management should build on past success, but strive each time to add something creative that adds a spark to the proceedings—as well as further advances the business's value merchant culture.

Coinciding with the implementation of its GVA market strategy, Grainger sponsored the first Grainger value advantage contest among all members of its salesforce in 2005. At each district level, around 10 local salespeople competed against one another to present the best value proposition. Winners at the district level then competed at the regional level. In turn, the regional winner competed at the national level.

Four national winners were then invited to present their value propositions at Grainger's national sales and service meeting in Orlando in March 2006. There they had to get up on stage in front of more than 3,000 sales and service personnel, and present their value propositions to a panel of sales and marketing managers. The panelists challenged each salesperson on his or her value proposition. As the presentations began, Grainger's president, James Ryan, appeared unexpectedly and joined the panel. The crowd went wild. Ryan assumed the role of customer, and challenged each presenter's value proposition. He grilled each one, asking tough questions. The contest served to provide recognition and reward to Grainger's extraordinarily skilled salespersons. Three of the four presenters subsequently were promoted.

Value Drains and Leaks

Rather than trying to find ways to cut price, value merchants try to make the business with customers more profitable by finding value drains and value leaks. Value drains are services, programs, and systems that cost the supplier more to provide than they are worth to customers and have no strategic significance. Value leaks are customer activities and practices that increase the cost of doing business for the customer and/or the supplier, and yield no offsetting greater cost savings or value to either.

Identifying and eliminating value drains and value leaks represent a promising means for businesses acting as value merchants to improve their own as well as their customers' profitability. These changes in how the supplier and customer do business can provide cost savings to each, or one might incur incremental cost while the other gains greater offsetting cost savings. In this latter case, most suppliers and customers are willing to share the net cost savings as an incentive to change so that each firm is better off. Success at identifying and eliminating value drains and leaks promotes greater cooperation between a supplier and customer, with the intent of doing still better. Customer value assessment, along with activity-based costing analysis, provide the "Aha!" tools to detect value drains and leaks. (See R.S. Kaplan and S.R. Anderson, "Time-Driven Activity-Based Costing," Harvard Business Review, November 2004.)

Tata Steel identifies and eliminates value drains and leaks. Tata Steel is a leading supplier in India. Through its customer value management (CVM) process, it strives to find and eliminate value drains and leaks in doing business with its strategic customers. The relationship between these customers and Tata Steel has undergone a notable change, from being adversarial to mutually reinforcing. Often, once the relationship is cemented through the CVM process, the customer also begins to contribute ideas on potential value drains and leaks. This is a magical moment in Tata's relationship with the customer.

In a value drain example from the tubes business, Tata Steel supplies steel tubes to a boiler manufacturer located 1,000 miles away. The tubes, after manufacturing, were specially oiled to avoid rusting en route to the customer's plant. Bizarre as it might seem, the customer first cleaned the oiled surface and then treated the surface of the tubes to allow them to pick up rust in its plant. As the CVM assessment revealed, a little bit of rust on the tubes was desirable to create enough friction between the tube and the bobbin drum while making coil-type boilers. Eliminating the oiling process at Tata Steel and the subsequent cleaning process at the customers' end was a win-win solution for both firms. That resulted in $30-$40 per metric ton savings for the customer, and it also lowered Tata's costs by eliminating the oiling step in its process.

In a value leak example, Tata Steel shipped large tonnages of steel bars in straight and fixed lengths of 12 meters to construction firms purchasing steel reinforcing bars. The customer wanted differential lengths of 10 meters or 11 meters, and a fixed length offering from Tata Steel would imply 12%-16% loss for the customer. The relationship was an "arms-length" transactional relationship. The CVM process revealed the value leaks to the Tata Steel sales manager and the customer representative. The two firms decided that it was more appropriate to roll and cut customized lengths at the Tata Steel factory, and then ship the bars in ready-to-use lengths to the customer. Tata and its customer conducted an assessment of the extra costs that Tata Steel would incur to make

customized lengths at its mill, and the cost savings in conversion and wastage that the customer would receive from customized lengths. The two firms then were able to arrive at a price premium for customized lengths that more than covered Tata's incremental costs, while providing the greater portion of the cost savings to the customer. Tata finds that giving the customer the greater proportion of the identified cost savings leaves the customer delighted, while still giving Tata a "good enough" incremental margin over its additional costs.

In 2002, before the start of the CVM, the top 16 customers accounted for just 15% of Tata Steel's revenue (in one of its business lines). In 2005, the revenue share from these 16 customers had increased to 35%. The marked improvement in share was due to business diverted from other suppliers by engaging Tata Steel in developing new products. It was also due to increases in overall requirements of customers as a result of growing in India. The end result is that Tata is more often supplying these customers higher-end and more-customized products that differentiate it from competitors, while also providing a higher level of profitability.

Becoming Value Merchants

Which do your salespeople tend to be, value spendthrifts or value merchants? Do they really want to sell value and are they really able to? Transforming the sales force into value merchants is not easy, yet it is increasingly essential for prospering in business markets. As the anecdotes cited previously convey, far from squandering value as value spendthrifts tend to do, value merchants actually become a part of the value of their firms' offerings to customers. That's an outcome that won't take much selling to senior management.

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About the Authors

James C. Anderson is the William L. Ford Distinguished Professor of Marketing and Wholesale Distribution, Kellogg School of Management, Northwestern University; the Irwin Gross Distinguished ISBM Research Fellow at the Institute for the Study of Business Markets (ISBM), Penn State University; and a visiting research professor at the School of Business, Public Administration & Technology, University of Twente, The Netherlands. He may be reached at jc-anderson@kellogg.northwestern.edu. Nirmalya Kumar is professor of marketing, faculty director for executive education, and co-director of the Aditya Birla India Centre at the London Business School. He may be reached at nkumar@london.edu. James A. Narus is professor of business marketing, Babcock Graduate School of Management, Wake Forest University. He may be reached at jim.narus@ mba. wfu. edu.