The Dollarization Discipline

HOW SMART COMPANIES CREATE CUSTOMER VALUE . . . AND PROFIT FROM IT

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Rick Gregory dedicates this book
to the team at MKM Group, especially the CEO.

Jeffrey Fox dedicates this book to Marlene.

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Preface

This book is about a concept that, on its surface, is simple to comprehend. It is about understanding the *financial* impacts a product or service has on its buyer. Readers may conclude this means the book is about "total cost of ownership." In fact, it is . . . in part. But it is also about something bigger. Traditionally, as the phrase suggests, "total cost of ownership" focuses only on *cost*. Cost reduction and cost avoidance are important aspects of dollarization, but they are often only half the story. Dollarization also requires measuring the financial impact of noncost benefits. Benefits such as increased market share, increased sales volume, and increased pricing power also must be dollarized.

Further, companies often use "total cost of ownership" and similar concepts in limited circumstances. An important goal of this book is to demonstrate how dollarization should be a *discipline* that organizations apply across a broad set of sales, marketing, and management activities. Most marketers would agree that a business should be customer-focused or customer-driven. Dollarization forces companies to behave this way. It does so by helping companies maintain steadfast focus on the *financial* performance that is the ultimate arbiter of their customers' success.

So while dollarization may be an easily understood concept, it can be difficult to put into practice. But our experience in helping great companies make dollarization work has convinced us that it is well worth the effort.

Introductory Notes

A NOTE ON TERMINOLOGY

Throughout this book, we use terminology such as "supplier," "vendor," "customer," and "product" to describe the buyer/seller business relationship. These words may suggest a focus on tangible products, exclusive of intangible or intellectual services. This is not the case. Nearly every point we make in this book can be applied to either a product *or* a service, without distinction. We find that tangible product examples allow us to more clearly articulate the observations we seek to share, and we use them solely for this purpose. Several chapters and specific service examples should clarify this.

A NOTE ON CASE HISTORIES

Every case example we use in this book is based on an actual business situation. In many cases, the companies involved have chosen to remain anonymous, preferring to keep their competitive strategies nonattributed. For these cases, we have substituted fictitious company names. The use of such invented names is indicated at the start of each of these cases.

We thank all the many excellent companies, managers, marketers, and salespeople who have made these events happen and have shared them with us.

SECTION 1

INTRODUCTION TO DOLLARIZATION

There is hardly anything in the world that some man cannot make a little worse and sell a little cheaper, and the people who consider price only are this man's lawful prey.

—John Ruskin

It's unwise to pay too much, but it is more unwise to pay too little. When you pay too much you lose a little money—that is all; When you pay too little, you sometimes lose everything, because the thing you bought was incapable of doing the thing it was bought to do.

—John Ruskin

Chapter 1

Getting Started with Dollarization

The weekend arrives and you're shopping for paint to freshen up the outside of your home. You arrive at the local paint store to find many choices. You narrow the possibilities down to two: Product X costs $12 a gallon; product Y costs $20 a gallon. Which paint should you buy?

The salesperson greets you with a warm smile. She watches you deliberate, then says, "I strongly recommend product Y. Its price may be higher, but it will last eight years, while the other paint will last four at best. That means that over eight years, you'd have to buy product X twice, for a total of $24 a gallon, versus just $20 a gallon for product Y. In reality, product Y costs less!"

You reply, "That's very interesting, but I'm preparing to sell my home, so I don't care about how long this paint will last. I think I'll go with product X for $12."

The salesperson listens and responds, "I understand, but I think product Y is still your best choice. You see, product Y contains 50 percent more pigment, which results in better coverage than product X. This means you will need to apply only one coat to your house. Product X will require at least two coats. This will also cut your labor costs in half. Plus, you are guaranteed that your house will look freshly painted, which will improve your success in selling your home. Wouldn't you agree that an extra $8 per gallon is a great investment to sell your house at the price you want?"

Finally, you decide. The $20 paint is actually less expensive than the $12 paint.

The logic in this example seems obvious, yet every day, sellers and marketers lose sales because they unintentionally allow customers to believe that their higher-priced products truly cost more than their competitors'. And every day, customers choose low-priced products despite the higher total cost that will actually result.

Consider another familiar scenario: When buying a car, there are many costs and considerations to weigh. There is, of course, the *price*, which typically gets 99 percent of the buyer's attention. But there are also fuel costs, maintenance costs, finance costs, insurance costs, personal property taxes, resale value, and on and on. In reality, price is but one of many costs to consider when weighing the decision to buy a car.

When businesses make purchases, too often they are myopic and overemphasize the importance of price. They overlook (sometimes inadvertently, sometimes intentionally) the many other financial consequences of choosing one offering over another. This is a failure on the buyer's part, because it may very well result in financial harm to the organization. But more importantly, it is a failure on the seller's part because the seller has missed the chance to demonstrate the true financial impact that could be provided to the customer.

As with house paint and cars, the meaningful way to compare the cost of two offerings is by evaluating the *total cost* of using each. In order to help customers to understand the true net cost of your product, you must *dollarize the product's true value*.

WHAT IS DOLLARIZATION?

This book is about a concept we coined called *dollarization*. Dollarization can be defined many ways depending on its usage, but the essential concept is:

> **Dollarization** The translation of the benefits a product or service delivers to a customer into the dollars-and-cents financial impact to that customer.

In other words, dollarization is a method for converting the ubiquitous buzzword "value-added" into real money. It is *figuring out what your offering is really worth—in dollars and cents—to your customer*.

Dollarization is a management discipline that is missing in many sales and marketing organizations. Its impact can be great, and its applications are many.

Dollarization is not an entirely new concept. For years, good companies have understood the need to express their value in financial terms. But even the best firms tend to utilize a dollarized approach to sales and marketing only in selected situations. Or they apply it too narrowly. For example, some companies use the concept called "lowest cost of ownership." This is a good concept—if the seller really does the math—but it is often half the dollarized story. The other half of the dollarization story is calculating the top-line revenues (and consequent margin dollars) that *a seller's product can generate* for the buyer. If the seller's product enables the customer's company to get its product to market faster, or to outperform the customer's competition, or to raise prices, then the customer's return on the seller's product can be enormous.

Sellers of big-ticket items are often forced (by customer capital appropriation policies) to demonstrate the return on investment (ROI) for their wares. Other industries dollarize because the need is self-evident: For example, jet engine makers compete on fuel efficiency because small changes in miles per gallon can have enormous impact on the operating costs of their airline customers. But more often than not, dollarization is not even considered by the seller.

Nor is dollarization demanded by enough customers. The foremost mission of a business is to create value for its owners. Managers of a business have a fiduciary responsibility to the owners to manage in a fashion that can be reasonably expected to create value. And when shareholders discuss "value," they are talking about the *financial* value of the share price, the cash flow, the dividend paid.

When a business operates, its managers must align the available resources to create value. It follows, then, that every expenditure made by a company should be made with an eye toward value creation.

When a company needs to make a major infrastructure investment—a new piece of capital equipment or a new software platform, for example—it is common for managers to conduct some level of due diligence and economic analysis to assure themselves that their investment will provide the best return. But somewhere down the purchasing chain, after the capital goods but long before the paper clips and toilet paper, many managers abandon this financial discipline. They see those remaining products as inconsequential and focus not on value but on price. Worse yet, the *marketers and sellers* of these products succumb to this negative belief and complain that their so-called commodity products are judged only on price. But even seemingly inconsequential products can be dollarized. Whether through subtle product design or performance differences, or through packaging, delivery, or service elements, any product a business buys *can* be dollarized.

With this book, we will explain how dollarization can help your company better understand, articulate, and profit from the value you create for your customers and clients. Dollarization should become a standing discipline that guides your thinking

Note: Our discussion of dollarization is intended to help companies understand and demonstrate the true value delivered by their offerings. This knowledge can be used for direct advantage in the marketplace, and can be used for a variety of strategic purposes. Occasionally, we are approached by firms that hope dollarization can in some way help obfuscate the true market situation, and thereby provide an opportunity for an offering to shine brighter to potential customers than reality might warrant. While there are certainly many legitimate sales and marketing uses of dollarization that we believe can improve a seller's chances of success, we do not intend it to serve as an illegitimate smoke screen.

> *If you tell lies about a product, you will be found out by the Government, which will prosecute you, or by the consumer, who will punish you by not buying your product a second time.*[1]
>
> —David Ogilvy

about pricing, selling, positioning, new product development, and nearly every other area of your sales and marketing.

Companies that truly create economic value for their customers *deserve to share in that value*. The price premium a value-creating firm can command enables the company to invest in continued innovation and to commit resources to generate even further value. Dollarization enables companies to afford the necessary investments required to perpetuate the creation of customer value.

Too many companies create value but don't keep their rightful share. We hope after reading this book you will do otherwise . . . and dollarize.

Chapter 2

Value Is a Number

Just as languages have leaped across borders and diseases have jumped from one species to another, somewhere in the history of business, the word *value* escaped the finance department and migrated into the lexicon of sales and marketing.

But finance people live in a world of numbers. Accordingly, their notion of value is true. They talk of book value, discounted value, asset value. When finance and accounting people talk value, they talk about financial value. They talk about dollars, cents, euros, yuan, and yen. If value can't be calculated on an accountant's HP-12C calculator, it does not exist. But when the term *value* leaves the realm of finance and accounting and heads to sales and marketing, a loosening of definitions occurs.

In sales and marketing, *value* takes the form of value-added (or more succinctly, value-add), value chain, value proposition, or value engineering. In concept alone, these are all legitimate business ideas. However, in execution, they seldom meet the breathless promise to which they aspire. When sales and marketing people talk value, they use words and rarely use numbers. The words they use lack precision.

When explaining this concept to managers, we often use the analogy of a recruiting dialogue between a football coach and his scout.

> *Scout*: Coach, you really ought to draft this kid. He's fast.
> *Coach*: How fast?
> *Scout*: Really fast! And also, he's huge.
> *Coach*: How huge?
> *Scout*: Really, really huge. He's as big as a mountain! And guess what—he's really strong, too.

And on it goes.

If instead the scout had come from the finance side of the organization, he might report as follows:

> *Scout*: This prospect runs the 40 in 4.3 seconds, he's 6 foot 3 and weighs 240, and he bench-presses 400 pounds.

Subjectivity and uncertainty are now eliminated from the coach's assessment. The recruit is a tenth of a second faster and 10 pounds heavier than the next kid. He's the one.

But in business, fine companies fall short in defining their value. In just the past few months, we've observed the following vague statements of value by top firms:

"Valeo adds technology. Valeo adds value."

"Value our Value-Added Valves."

"The Value-Added Specialist."

"When Value Matters."

In fact, a recent Google search for the phrase "How We Add Value" produced more than 1,500 hits! (The phrase "add value" by itself generated 1.3 million hits!) It would seem that some enterprising web design guru has persuaded an army of website designers that all sites must have a "How We Add Value" section.

We don't point out these uses of *value* in sales and marketing to ridicule. In fact, the mere presence of one of the many value

What Exactly Is Value?

The word *value* gets lots of play in business, but what does it mean, and how does it apply to businesses? Several definitions are listed in the dictionary. One set of definitions addresses personal, moral, and ethical value. These refer to value as a "principle, standard, or quality considered worthwhile or desirable." This aspect of value is important in the overall governance and conduct of companies, but it is not the definition of value that truly drives businesses.

Another set of definitions describes value as economic value. In this realm, value is defined as:

- The worth of a thing.
- An assigned or computed numerical value.
- Monetary or material worth.

This definition is more in line with legendary value investor Benjamin Graham's approach to value, where through careful analysis, investors seek to identify companies with intrinsic economic value that is greater than the current share price.

The value described by the first set of definitions is required to keep the world of business civilized. Shareholder activism and a huge and growing body of legislation and regulation are in place to sustain these values. The value described by the economic definitions is required to keep companies *profitable*.

phrases at least indicates that someone at each of these firms understands—at some level—that they are in fact in business to create value for their customers. Instead, our intention is to help companies convert that understanding into a meaningful way of executing business strategy.

Unfortunately, the word *value* has become yet another

Value As in Cheap

While the term *value* may be used too casually in describing the economic impact companies generate for their customers, another egregious area of misuse can be seen in the growing category of low-priced products now known as the "value" category. As Ralf Leszinski and Michael Marn of McKinsey & Company accurately observe: " 'Value pricing' is too often misused as a synonym for low price or bundled price."[1]

Certain carmakers, retailers, and other purveyors of low-priced products scream "value" in an attempt to avoid the derogative "cheap." In some cases, so-called value-priced products do in fact create value. This is because value can cut both ways. The delivery of significant dollarized value in exchange for a premium price may leave the customer with excess "net value." Meanwhile, a so-called value-priced product may deliver much less dollarized value, but if the price is low enough, it may in fact create the same net value for the customer (total dollarized value minus price).

However, more often than not, the value-priced product is a low-price/low-value offering meant to appeal to human frugality and limited purchasing power. Customers must guard against *cheap* products masquerading in "value" clothing.

Accurate comparisons of "cheap" and "value" cannot be made without first understanding the dollarized value of each offering.

meaningless sound in the cluttered language of business. Like "quality," "reengineering," "paradigm shift," and countless other buzzwords before it, the word *value* receives much management energy, but little sound execution. Business plans, marketing plans, and sales plans promote how companies will "leverage the value" they create for customers, but rarely do they state what that value is worth. It strikes us that some managers believe that if they *say* they create value enough times, it might actually become true or the customer will bite and buy.

The solution is an approach to sales and marketing that goes beyond articulating features and benefits, but in fact calculates the economic value a customer receives from a product or service, and therefore enables the seller to price the product or service as a true reflection of that value. This approach is called dollarization.

BUSINESSES DON'T BUY, THEY INVEST

Let's back up a bit. We're talking about turning value into a number. But first, let's take a conceptual look at why this works in the business of sales and marketing. In their 1996 book *Power Pricing*, Robert Dolan and Hermann Simon concisely describe the dynamics of price and value:

> Price is the economic sacrifice a customer makes to acquire a product or a service. The customer always compares this sacrifice with his perception of the product's value. Price and value are the cornerstones of every economic transaction. In essence, a customer buys a product or service only if its perceived value—measured in money terms—is greater than the price. If selecting from several alternatives,

> the customer prefers the one offering the highest net value, i.e., the greatest differential of perceived value over price.[2]

Dolan and Simon hit the nail on the head, but in our view, their description stops a few steps short. They do not address the challenge of *how* to quantify and articulate "perceived value—measured in money terms." (In fairness, the purpose of Dolan and Simon's discussion is to set up a presentation of their excellent microeconomic pricing analysis, not to explain how value is communicated.)

"Perceived value—measured in money terms" is what dollarization is all about. In other words, this book is about a very simple idea: Every time a company sells something, it must at some point present its price to the customer. In many cases, the customer also looks at alternative companies, all of which must also present prices for their offerings.

But there is a critical disconnect in most business-to-business sales and marketing. When it comes to discussing price, the facts are clear. The seller offers a price in dollars and cents, sometimes even fractions of cents, with great precision. There is no ambiguity about the price.

But when it comes to presenting what the customer gets in return for that price, the same seller hurls a list of features, benefits, and promises. (See Figure 2.1.) The seller claims superlatives such as best, fastest, strongest, most robust, most reliable, most effective, most experienced, most dependable, and so on. The marketer hopes the presentation of these claims sufficiently persuades the prospective customer to part with more money in return. In the end, the customer is left to make a financial decision: "What price is worth paying?" Customers are forced to make this financial decision by assessing *nonfinancial* arguments.

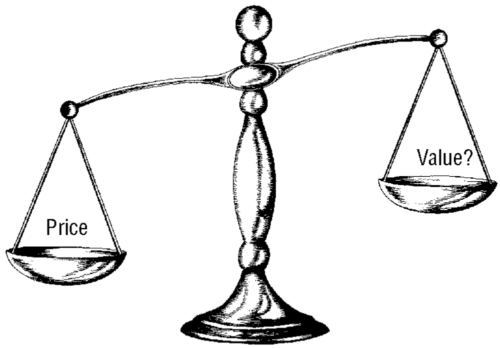

FIGURE 2.1 Without Dollarization, Comparison of Price and Value Is Impossible

Most marketers and salespeople stop short of translating their story into numbers. Instead of helping a customer understand that the $4 price will produce $7 in net savings, or that the $1 million investment will yield a total return of $4 million, they use words that are simply inadequate. To use a baseball analogy, this is akin to a sports page reporting that "the Red Sox scored four runs and the Yankees played really well" (without telling the reader if the Yankees scored two runs or eight)!

Today, most customers are left to apply a strange calculus of experience, analysis, and guesswork to determine the value side of the pricing equation: *What is the value of the benefits received, and therefore how much should be invested in the product or service?* Many companies have become skilled at doing this analysis themselves, but most, in our experience, have not. In the absence of such knowledge, many customers set minimum performance criteria and then refuse to pay extra for any so-called value-added. For example, a public school building committee could decide that a single criterion would qualify a brand of door hardware for consideration: the ability to meet minimum durability standards as defined by government rating agencies. All brands meeting this criterion would compete on the basis of lowest price only. In framing their decisions this way, the committee forgoes the opportunity to consider higher-priced hardware that might far exceed the minimum performance required. This exposes the school committee to saving on the purchase price while risking higher long-term costs of maintenance, security, and overall ownership.

Other, more conservative organizations may overinvest in the hope of scoring greater value, only to throw good money away. This is like the driver who assumes that buying 92 octane gasoline is worth the extra 30 cents a gallon without truly understanding the performance difference between regular and premium fuel.

If you take nothing else away from this book, we hope you take this: Businesses do not buy; they invest. Companies do not wake up in the morning and exclaim, "Let's go buy $10,000 worth of fasteners today" (or $15,000 worth of software, or 10 hours of their lawyers' time). On the contrary, companies don't want to spend one penny on any fasteners. But if they need fasteners, they must invest in fasteners. And the customer's need reflects a problem. The fastener solution can always be dollarized.

Every time a company makes a purchase decision, it is committing company capital. In theory, that capital is constantly being allocated and reallocated to achieve the best available return. But in our experience, too few companies exercise this discipline for all purchases. And far fewer companies market and sell in a way that permits customers to understand the economic value provided in return for the investment.

Whether you sell industrial products, legal services, high-tech components, or enterprise software solutions, you must understand why your customers should invest in you. Do you