

Pricing & revenue architecture

What is customer perceived value?

Customer perceived value is what an offering is worth to the customer in use, as the customer sees it. In B2B it is a sum of money that excludes price.

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Management summary

Customer perceived value is the customer's own judgement of what an offering does for them in use, net of every cost of obtaining and using it except the price. This concept guide defines it (Woodruff; Anderson, Thomson and Wynstra), separates it from price, satisfaction and the value of a customer to the seller, explains the customer value hierarchy from attributes to goals, reports two field studies in which purchasing managers treated a gain in value as worth less than an equal cut in price, shows what a small incentive to change did to their choices, and gives a one-page record for a value claim. The sources are one conceptual article, one set of scenario experiments with purchasing managers and one survey of purchasing managers in Germany.

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What is customer perceived value?

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It is the value of an offering seen from the customer's side. Woodruff (1997)³ separates it from the value of a customer to the seller, which is a different quantity: "Customer value, on the other hand, takes the perspective of an organization's customers, considering what they want and believe that they get from buying and using a seller's product." His definition is: "Customer value is a customer's perceived preference for and evaluation of those product attributes, attribute performances, and consequences arising from use that facilitate (or block) achieving the customer's goals and purposes in use situations."

³ Woodruff, R. B. (1997). Customer value: The next source for competitive advantage. *Journal of the Academy of Marketing Science*, 25(2), 139–153.

Woodruff reviews earlier definitions and finds three points of agreement. Customer value "is inherent in or linked through the use to some product". It "is something perceived by customers rather than objectively determined by a seller". And "these perceptions typically involve a trade-off between what the customer receives" and what the customer gives up to obtain and use the product. Zeithaml's definition, which he quotes, puts it in one line: "Value is the consumer's overall assessment of the utility of a product based on perceptions of what is received and what is given."

For business markets, Anderson et al. (2000)¹ state value in money and against the alternatives: "Value in business markets is the worth in monetary terms of the economic, technical, service, and social benefits a customer firm receives in exchange for the price it pays for a product offering, taking into consideration competing suppliers' offering and prices". The benefits are net: "These benefits are net benefits, where any costs a customer incurs in obtaining the desired benefits, except for purchase price, also are included." Price is kept out, so that "raising or lowering the price of a product offering does not change the value that the offering has in the customer's application, only the customer's incentive to purchase that offering".

¹ Anderson, J. C., Thomson, J. B. L., & Wynstra, F. (2000). Combining value and price to make purchase decisions in business markets. *International Journal of Research in Marketing*, 17(4), 307–329.

In this guide, customer perceived value means the customer's own judgement of what an offering does for them in a use situation, compared with the alternatives open to them and net of everything except price that it costs them to obtain and use it; in business markets

it can be stated as a sum of money. Price is set against it but is not part of it. It is distinct from satisfaction, from willingness to pay and from the value of the customer to the seller. Several definitions Woodruff reviews, from consumer and business research alike, count price among the things the customer gives up. The exact term in this guide's title is used in business-market research, and Eggert and Ulaga (2002)² note that "the literature contains a variety of definitions of customer perceived value". They define it for business markets as "the trade-off between the multiple benefits and sacrifices of a supplier's offering", as the customer firm's key decision-makers see it, against the offerings of alternative suppliers and in a specific use situation. Their measure puts price inside it, with items such as "Compared to the price we pay, we get reasonable quality." This guide follows Anderson et al.¹ and keeps the two numbers apart, because their experiments show that buyers treat a change in value and an equal change in price differently.

² Eggert, A., & Ulaga, W. (2002). Customer perceived value: A substitute for satisfaction in business markets? *Journal of Business & Industrial Marketing*, 17(2/3), 107–118.

Where does value sit: in the product or in its use?

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In use, on Woodruff's³ account. His customer value hierarchy has three levels: attributes and their performance at the bottom, the consequences of using the product in the middle, and the customer's goals at the top. "The customer value hierarchy suggests that customers conceive of desired value in a means-end way." Customers want attributes because of the consequences they produce, and consequences because of the goals they serve. The same product can carry different value in different settings: "If the use situation changes, the linkages between product attributes, consequences, and goals and purposes change as well." Timing matters too, since "customers may consider value at different times, such as when making a purchase decision or when experiencing product performance during or after use".

Woodruff's³ practical point is that sellers know too little about the middle level. "Organizations tend to learn most about their customers at the lowest level of the customer value hierarchy (the attribute level)." One manager in his account put it this way: "I can see now that we have a void in consumer knowledge at the middle level in the hierarchy." He adds that "Research typically shows that there are

differences in what managers think their customers value and what customers say they value”, and that the hierarchy “argues for looking beyond the so-called attribute-based key buying criteria”. To map the hierarchy he names laddering interviews, which are “effective for drawing out customers’ perceived linkages between product attributes, consequences, and goals or values” but uncover only a few linkages per interview; for the middle level he points to grand-tour interviews, in which customers take the interviewer through their use situations. The value proposition guide covers the seller’s statement of value; this is the customer’s side of it.

How is perceived value different from satisfaction?

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Satisfaction is a feeling about what happened; value is what the customer wanted from use and what they got. In Woodruff’s³ words, “Overall satisfaction is the customer’s feelings in response to evaluations of one or more use experiences with a product.” Desired value, the hierarchy the customer brings, guides which attributes and consequences are evaluated, and the value received on those same dimensions leads to the feeling, directly or through a comparison with a standard. Separately, he lists problems that firms have met with customer satisfaction measurement, among them, citing Jones and Sasser, customers “who say they are satisfied but buy elsewhere”. On this guide’s reading, a satisfaction score cannot explain that without knowing what the customer wanted from use.

Eggert and Ulaga (2002)² tested the distinction in “a cross-sectional survey among purchasing managers in Germany”, with 301 usable responses. Value as they measured it, with price included, and satisfaction were closely related (squared correlation 0.68) but distinct by the tests they applied. A model that links value to the managers’ stated intentions to buy again, to search for alternatives and to recommend the supplier only through satisfaction fitted their data better than a model with direct links, and on those data satisfaction was the better predictor of the intentions. Their conclusion is that “Customer perceived value is a complement and not a substitute for customer satisfaction”, and they add that “more research is required” before any one view of how value, satisfaction and intentions relate is accepted.

Willingness to pay is related but separate: it is the most a buyer would pay. In business markets the value of an offering against the next-best alternative caps it, and Anderson et al.¹’s results suggest that buyers

will pay less for a stated gain in value than the gain is worth. The willingness to pay guide sets out how it is defined and measured.

How do purchasing managers weigh value against price?

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Not one for one. Anderson et al. (2000)¹ tested this with purchasing managers and summarise: “The results of two field studies show that managers do not regard monetarily-equivalent changes in value and price to be the same.” Their explanation is that value is harder to trust than price: “Despite accurate assessment of value, we posit that purchasing managers perceive value as relatively more ambiguous than price”, in that “they have some doubt as to whether their firm actually will realize the stated value”. This value ambiguity is the core of their argument. They build on reference-dependent theory, in which losses loom larger than gains: “the negative deviation will be seen as more of a loss than the positive deviation will be seen as a gain”. Loss aversion alone would make a buyer turn down a price rise matched by an equal value gain, and also an equal cut in both. Their addition is a separate utility function for value and for price, with value weighted less because it is more ambiguous and buyers know prices better. Their data fit that model: a value gain did not make up for an equal price rise, while a value cut was often accepted for an equal price cut.

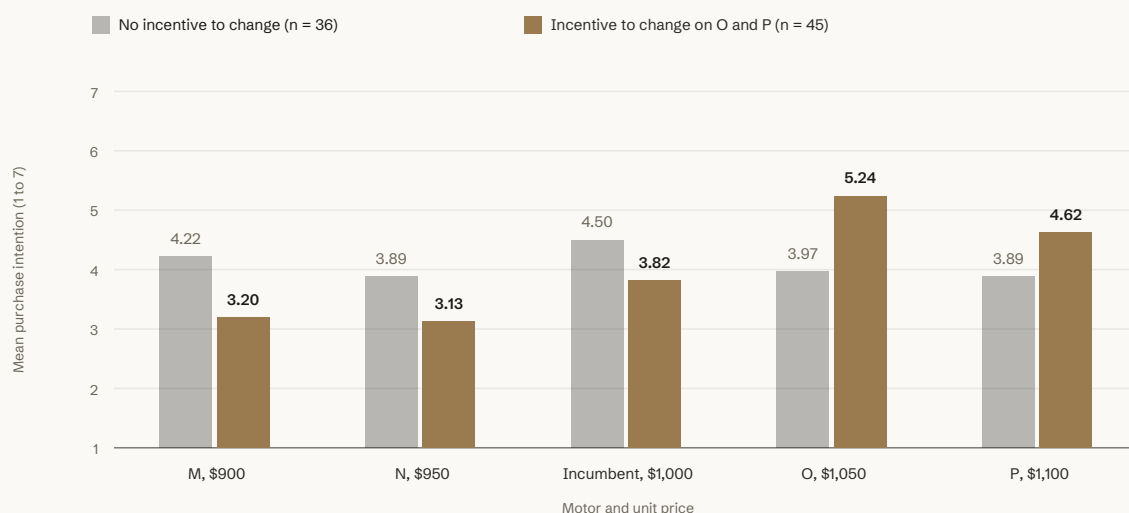
In the first study, the authors contacted 342 members of a purchasing association chapter, 288 agreed to take part, and “these research participants returned 153 complete and usable surveys, providing a response rate of 53%”. Each scenario offered alternatives to the product the manager was buying, with value and price stated in dollars, and within each experiment every alternative differed from the original by the same net amount. Offered either of two products with equal increases in value and price, 86 and 90 per cent of the managers in one experiment preferred the original; offered equal decreases in both, 52 per cent preferred the cheaper, lower-value product to the original (26 of 50, where a single utility function predicts none; p. 317). Across the gains and losses experiments, the managers significantly preferred the lower-value, lower-price offerings to the higher-value, higher-price ones, although every offering was worth the same in net terms (p. 324). The authors are careful that this is not a rule of lowest price: “Thus, the simple explanation of always choosing lowest price cannot adequately account for our pattern of results across the four experiments.”

The second study used a scenario about a product that many firms buy regularly: “We chose 10-horsepower replacement motors.” The incumbent motor cost US\$1,000; two cheaper motors offered US\$100

and US\$50 less in cost savings for US\$100 and US\$50 less in price, and two dearer ones offered US\$50 and US\$100 more for US\$50 and US\$100 more. From a random sample of 243 purchasing managers, “these research participants returned 81 complete and usable surveys, providing a response rate of 33%”. Half the scenarios added US\$75 more value to the two dearer motors, an incentive to change: “This incentive-to-change amount is 7.5% of the reference-offering price.” Figure 1 shows the mean purchase intention for each motor.

Figure 1 Purchase intention for five replacement motors, with and without an incentive to change

Without an incentive, the incumbent motor had the highest mean, by margins that were not significant. With US\$75 more value on the two dearer motors, the US\$1,050 motor was rated highest.



Between the two conditions, the difference for motor M was significant at 5 per cent and for motor O at 1 per cent; those for N and the incumbent were marginal, at 10 per cent, and for P not significant. Without the incentive, no difference between motors was significant at 5 per cent.

Source Anderson et al. (2000), p. 323, Table 4, Experiment 4: mean purchase intention on a 7-point scale (the scale is the one described for Study 1, p. 315); 36 purchasing managers without and 45 with an incentive to change of US\$75 more value on motors O and P. Without the incentive every alternative is worth the same as the incumbent in net terms.

Without the incentive, the incumbent had the highest mean and the dearer motors scored about the same as the cheaper ones; none of these differences was significant at 5 per cent. With it, motor O, which now offered US\$125 more value for US\$50 more price, was rated

highest, and the gain was smaller for motor P, where the same US\$75 sat on top of a larger price increase. Even then, “18% of purchasing managers still chose the lowest-price, lowest-value offering first”.

Why did value guarantees not change the choice?

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The authors expected a supplier value guarantee to remove the doubt about value. Neither guarantee they tested did. In the first study, where a supplier would pay back any value not realized, “So, we were unable to find any significant support for H4”, the hypothesis that a guarantee would remove the gap between value and price. In the second study they added an up-front guarantee, under which the buyer pays the extra price only once the extra value is realized, and again “we still were unable to find any significant support for H4”. Their preferred reading is that “purchasing managers’ ambiguity about value and their preference for lower price are robust phenomena against which supplier guarantees are not an effective mechanism”.

Part of the reason may sit in the buying organisation rather than in the buyer’s head. The authors describe savings that purchasing can claim and savings it finds hard to claim, where “gray money refers to cost savings that are difficult for them to claim”, and note that “Because the higher value most often is realized in other functional areas, purchasing may not get credit for procuring higher-valued products”. The authors offer their managerial implications “as simply intriguing considerations” until the findings are replicated, and the gray money distinction comes from their field research, not from the experiments. With that caveat, they write that suppliers “will have a difficult time getting purchasing managers to buy offerings that exceed minimum specifications, even when the offerings deliver superior performance, unless the higher value demonstrably exceeds the higher price”, and “suppliers providing higher-value product offerings should target customers that have superior measurement systems and capabilities”. The [value-based pricing essay](#) sets out the organisational work that sits between a value estimate and a contract price.

What does a value claim need before a buyer acts on it?

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Six things, in one record per claim: the use situation and goal it serves, the consequence that changes in use, its worth in money against the offer it would replace, net of non-price costs, the function that realizes it, how it will be shown, and how far the value gain exceeds the price gain. The fields follow Woodruff's³ hierarchy and Anderson et al.¹'s definition, their findings on doubt about value and on incentives, and their note on who gets credit. If the price is paid once, state the worth discounted to today, as the value analysis in Anderson et al.'s second study did.

Figure 2 A value claim record

Write down the use, the consequence, the worth, the owner, the proof and the margin before the claim goes to a buyer.

Use	Consequence	Worth	Owner	Proof	Margin
Which use situation and goal?	What changes for the customer in use?	Money per year, net of non-price costs?	Which function realizes it?	Measured at the customer, or claimed?	Value gain above the price gain?

If the value gain only equals the price gain, expect the buyer to keep the current offer.

One row per claim. State the worth against the offer the claim would replace. A claim that purchasing cannot credit to itself needs an owner who can.

Source Author's decision worksheet. The use and consequence fields follow Woodruff (1997), pp. 141 to 144; the worth field follows Anderson et al. (2000), pp. 308 and 309; the owner and proof fields follow Anderson et al. (2000), pp. 310 and 325 to 326; the margin field follows Anderson et al. (2000), pp. 320 to 325. The fields are reader inputs; no company data is supplied.

An illustration, with no company data: a B2B software firm offers a higher tier at renewal that automates a monthly reconciliation its

customers' finance teams now do by hand. The record names the use situation (the month-end close) and the goal (closing on time), the consequence (fewer hours of manual matching), and the worth (those hours at the finance team's cost, minus the time to set the feature up), and it says whether the saved hours lower cost or only free capacity. It names finance, not procurement, as the function that realizes the value, so the claim goes to the finance lead as well as to the buyer. It proposes measuring the hours in a pilot at the customer before the renewal, rather than quoting an average from other customers, and it prices the tier so that the stated value gain clearly exceeds the price increase instead of matching it. Anderson et al.¹ propose a pilot at the customer's site only as a test for future research, and in their experiments buyers weighed value less than price even though a team from their own firm had produced the value figures. These are the author's examples and have not been tested.

What can these studies not tell a software seller?

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How large the effects are when software is bought. Woodruff (1997)³ is a conceptual article: it presents a definition, a hierarchy and a learning process, and reports no test of them. Anderson et al. (2000)¹ ran four scenario experiments with members of a purchasing association, on a generic component and on replacement motors, and they say so plainly: "caution must be exercised in making management practice generalizations" from four scenario-based field experiments. Their effects were also weaker for gains than for losses, and the response rate in the second study was a third. Eggert and Ulaga (2002)² surveyed purchasing managers in one country at a single point in time, so their model describes how the answers hang together, not a sequence observed over time.

On this guide's reading, two things carry over to software with some confidence: value is judged in use and should be stated at the level of consequences, and a buyer weighs a stated gain in value less than an equal change in price. The cause is less certain: the authors attribute the lower weight to doubt that the value will be realized, but the guarantees meant to remove that doubt did not close the gap between value and price. Whether the 7.5 per cent incentive, the failure of guarantees or the preference for the incumbent hold for subscriptions, buying committees and renewals, the sources do not say.

 End of essay

References

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