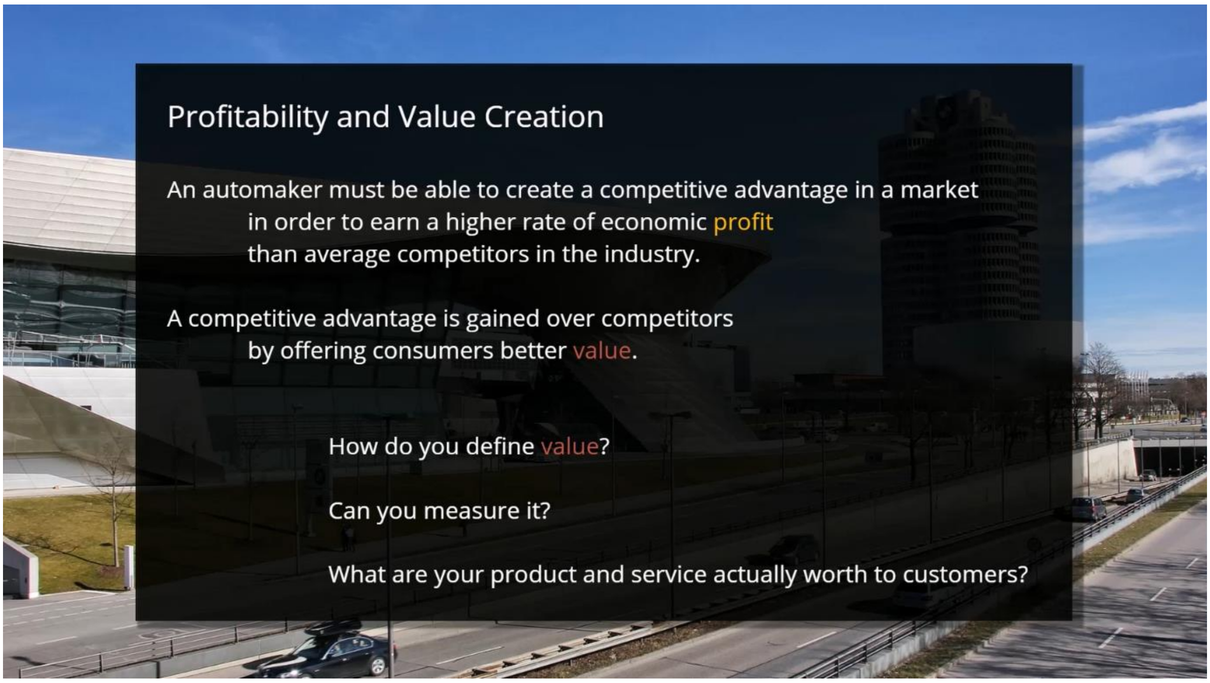
M5L9. Value Creation

Slide #1

In this topic, the professor discusses value creation with reference to the automobile industry.

Slide #2



An automaker must be able to create a competitive advantage in the market in order to earn a higher rate of economic profit than average competitors in the industry.

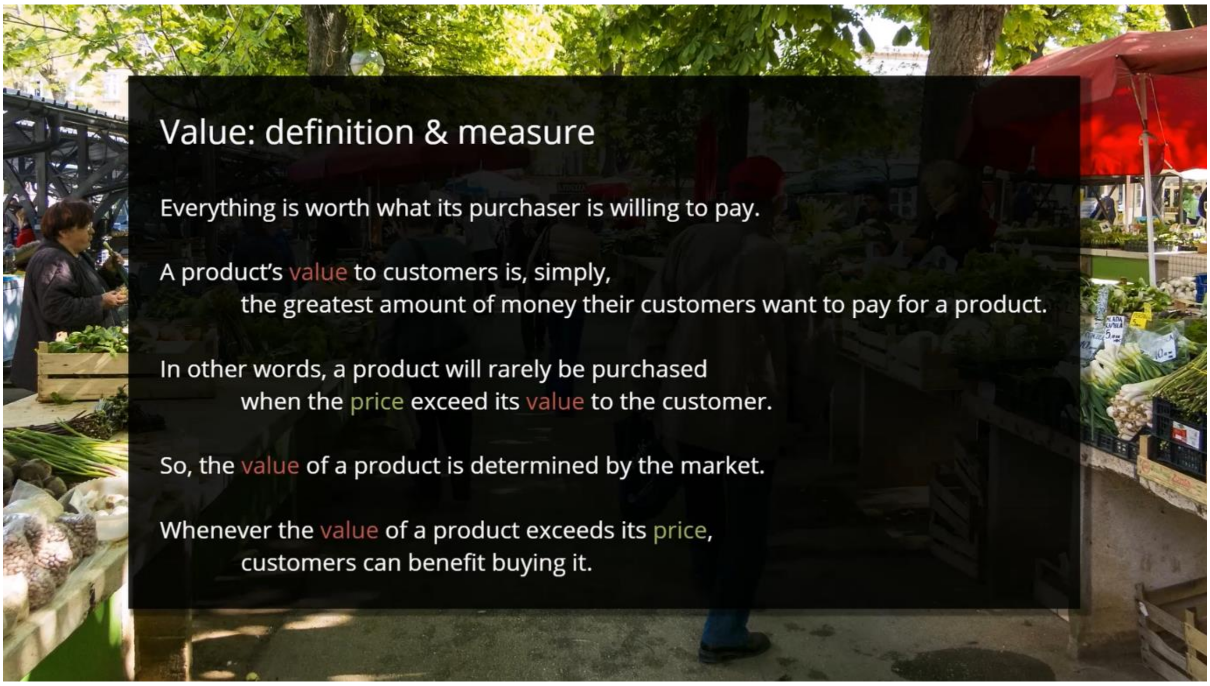
A competitive advantage is gained over competitors.

By offering consumers better value, how do you define value?

Can you measure it?

What are your products and services actually worth to customers?

Slide #3



Everything is worth what is purchased is willing to pay for.

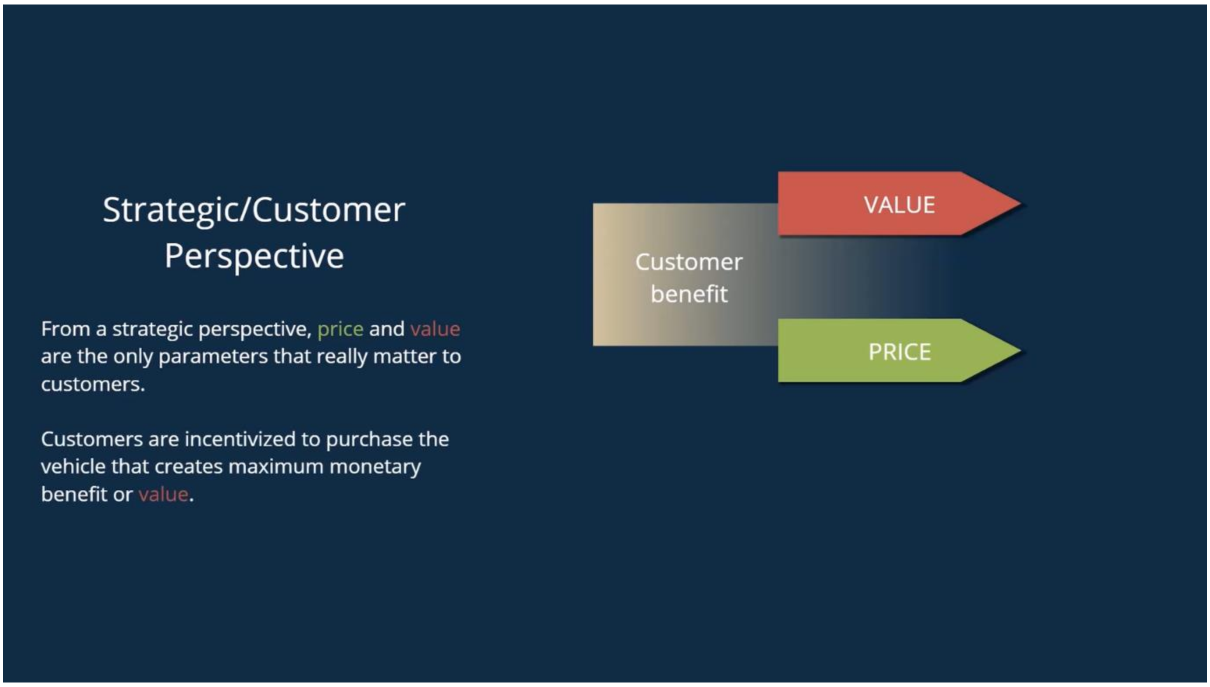
A product's value to customers is simply the greatest amount of money their customers want to pay for the product.

In other words, a product will rarely be purchased when the price exceeds its value to the customer.

So the value of a product is determined by the market.

Whenever the value of a product exceeds its price, customers can benefit buying it.

Slide #4



From a strategic perspective, price and value are the only parameters that really matter to customers.

The difference between the value and the price is the benefit that a product brings to its customers.

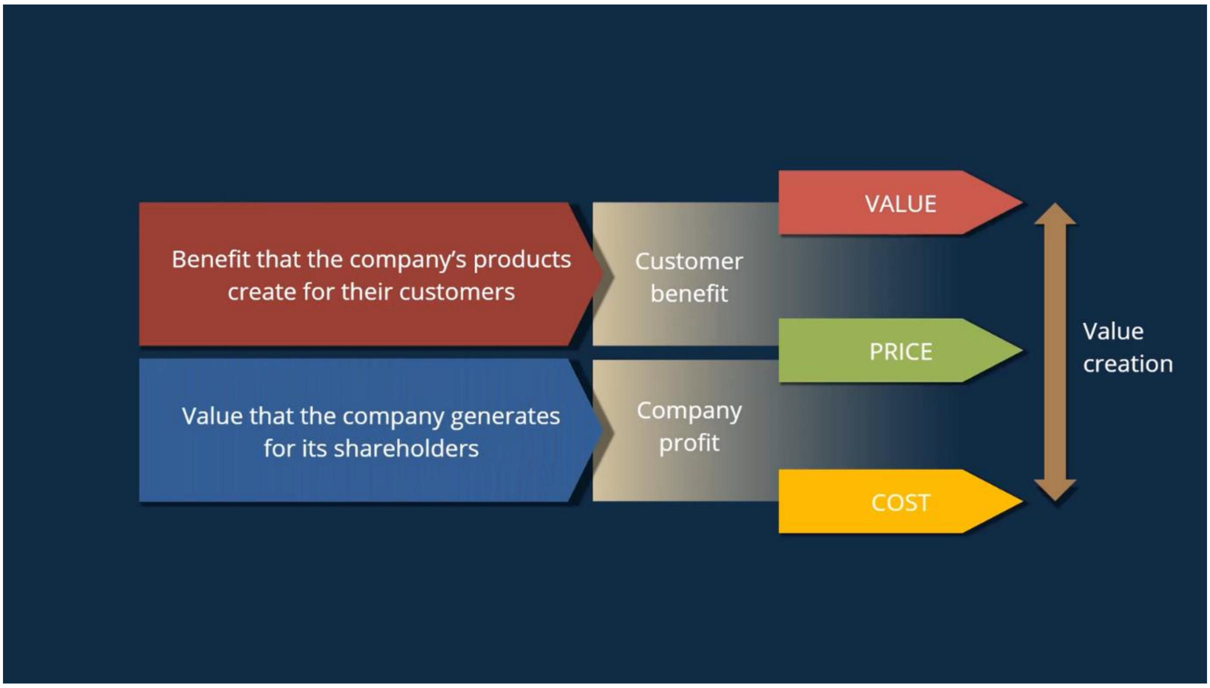
Customers are incentivized to purchase a vehicle that creates maximum monetary benefit or value.

Slide #5

From a company's perspective, the profit of a product is the margin between the selling price and the cost.

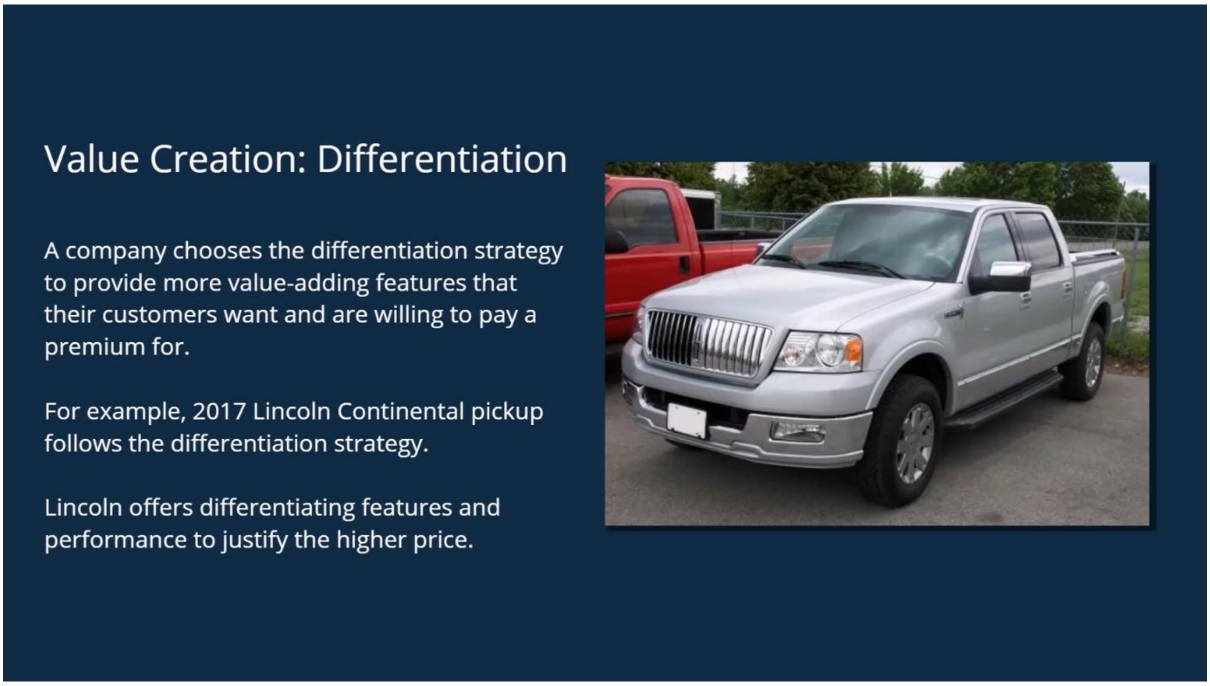
The overall value that a company creates includes customer value and company profit.

Slide #6



The customer value represents the benefit that the company's products create for their customers and the profit is the value that company generates for its shareholders.

Slide #7



A company chooses differentiation strategy to provide more value adding features that their customers want and are willing to pay a premium for.

For example, 2017 Lincoln Continental Pickup follows the differentiation strategy.

Lincoln offers differentiating features and performance to justify the higher price.

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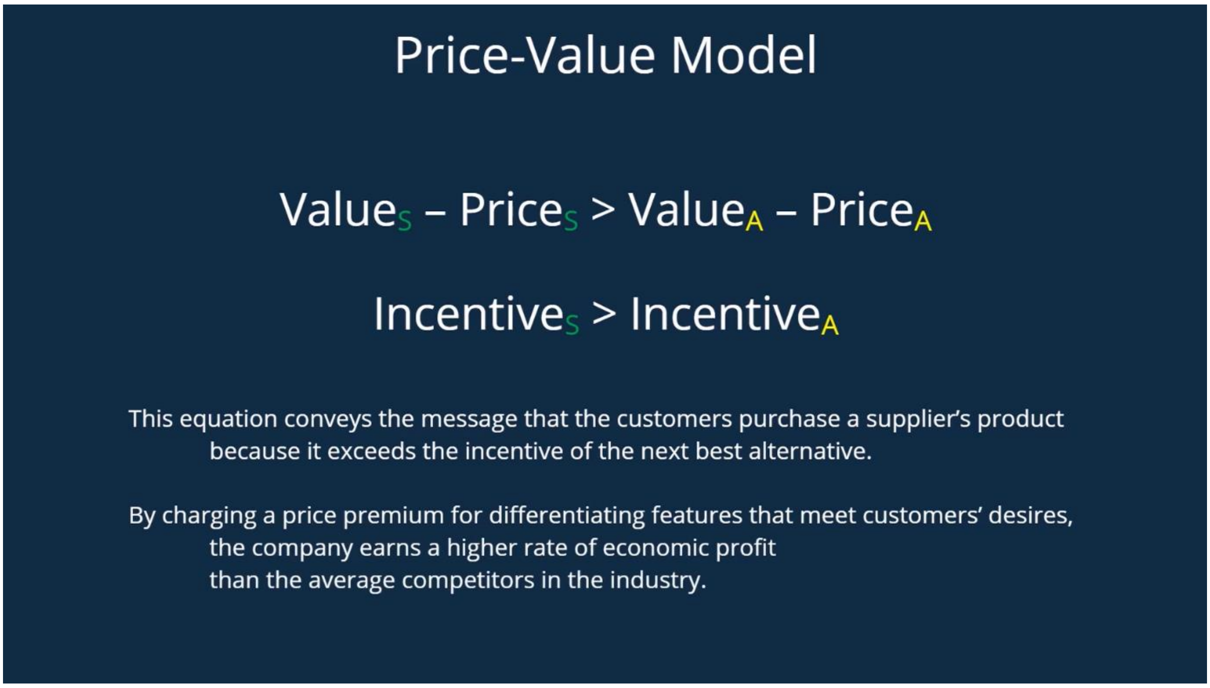
For instance, a customer is willing to pay $58,000 for the Lincoln Continental. and the automaker priced the vehicle at $52,000.

The product creates about $6,000 net value to their customers.

When choosing a differentiation strategy, the company pursues competitive advantage by generating greater customer value over competing product.

Slide #9



The relationship can be described with this price value model.

Price S and value S are value and price of the supplier's market offer, and value A and price A are value and price of the next best alternative.

The difference between the value and price equals the customer's incentive to purchase a product.

This equation conveys the message that the customers purchase a supplier's product because it exceeds the incentive of the next best alternative.

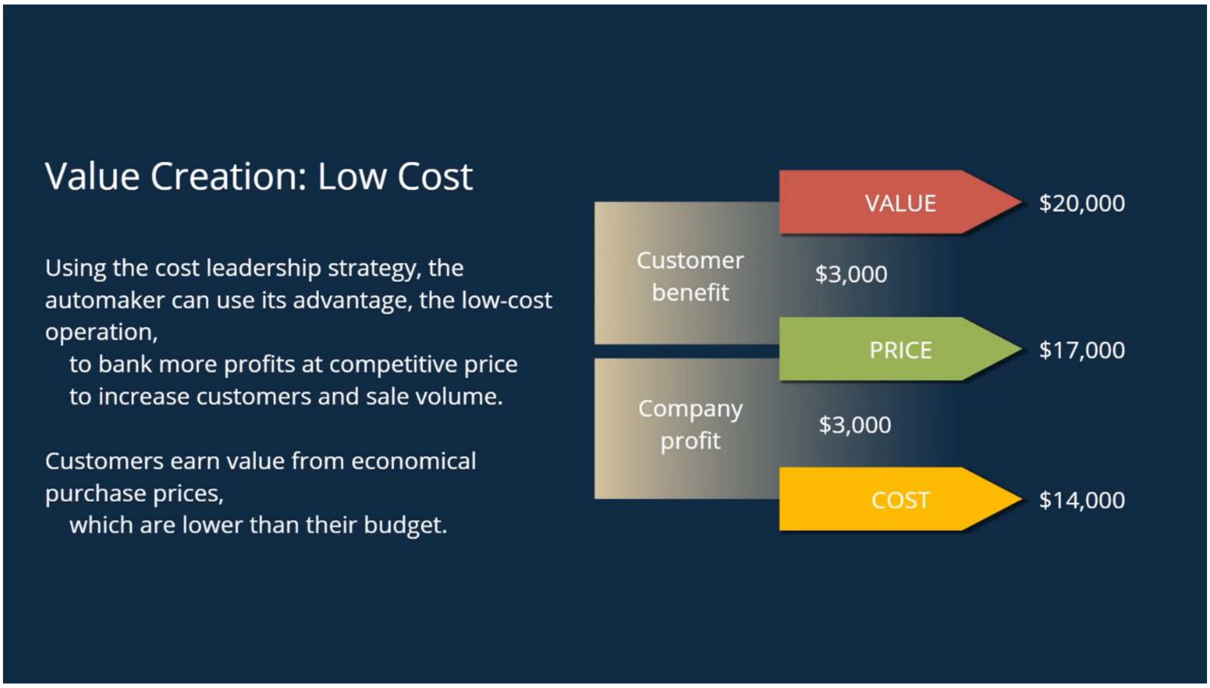
By charging a price premium for differentiating features that meet customers desires, the company earns a higher rate of economic profit than average competitors in the industry.

Slide #10

A company can also choose a cost leadership strategy to reduce the cost of their products and share the value with their customer to gain competitive advantage.

For instance, the strategy of Ford Focus is cost leadership.

Slide #11



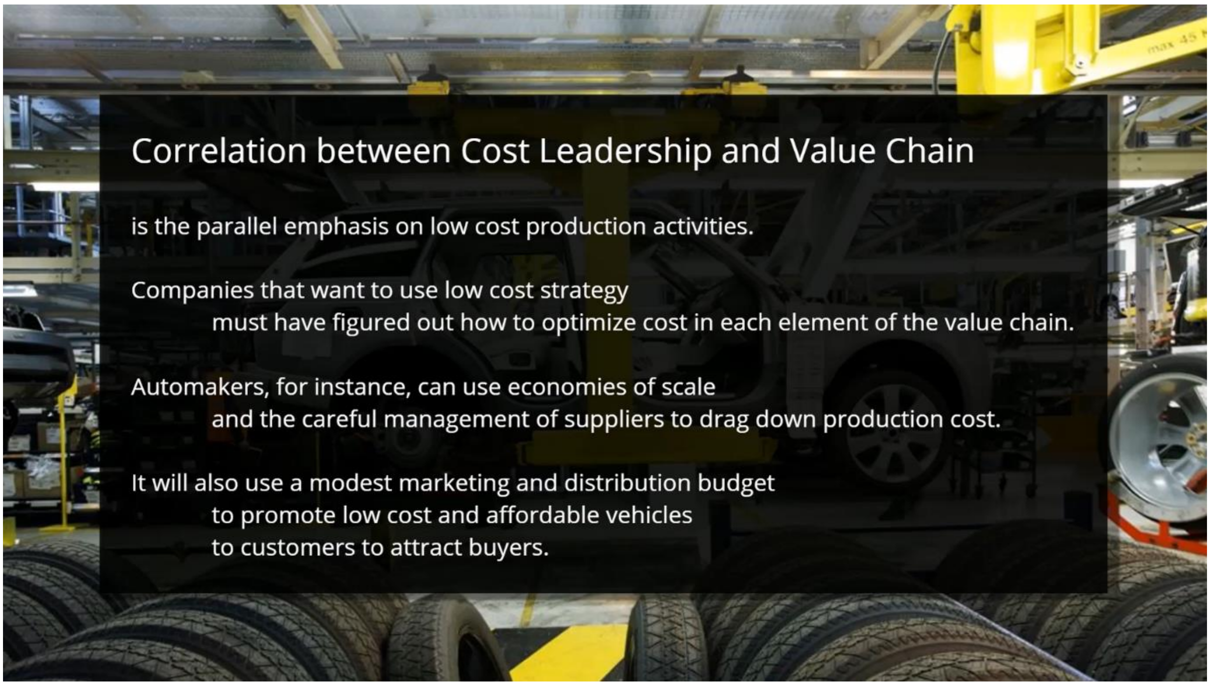
Ford managed to lower the production cost of Focus vehicle at $14,000 bulk of customers are willing to pay $20,000 for a model.

By offering a sales price of $17,000, the company creates $3,000 value to its customers and also keeps $3,000 profit.

Using the cost leadership strategy, the automaker can use its advantage in low-cost operation to bank more profits at competitive price to increase customers and sale volume.

Customers earn value from economical purchase prices, which are lower than their budget.

Slide #12



The correlation between the cost leadership strategy and value chain is the parallel emphasis on low-cost production activities.

Companies that want to use low cost strategy must figure out how to optimize cost in each element of the value chain.

Automakers, for instance, can use economies of scale and careful management of suppliers to drive down production cost.

It would also use a modest marketing and distribution budget to promote low cost and affordable vehicles to customers to attract buyers.