



8 REASONS COMPANIES DON'T CAPTURE MORE VALUE

WHY COMPANIES CAN ACCEPT LESS THAN THE FULL VALUE OF THEIR
OFFERINGS

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In general, companies don't devote enough time to thinking about [value capture](#). Their innovation efforts tend to be focused wholly on the *creation* of new value; meanwhile, the question of how exactly they will be compensated for it usually goes unexamined. Why is it that? One typical reason is that top executives haven't managed to clarify something even more fundamental: how much priority they place on increasing profit margins.

That might sound strange. Doesn't every business want to maximize its profits? Pricing textbooks certainly all assume they do, or at least that they want to achieve a certain profit level under given constraints. But in truth businesses rarely focus on only profitability; most strive to satisfy various stakeholders and meet the goals of [balanced scorecards](#). And even when a company is focused tightly on financial performance, there are at least eight reasons it might have for deliberately accepting something less than the full value it could capture from an offering. They are listed below, each with an example:

1] Profit maximization (long-term): A bank offers accounts to students at a special interest rate to attract a segment of customers whose incomes will later increase.

2] Profit maximization (short-term): A shipping company increases freight rates by 50% to benefit from a capacity shortage in the market, even though doing so will strike customers as exploitative and damage loyalty.

3] Growth: A TV cable company offers special subscription plans for new customers, aiming to achieve a strong market position within 24 months.

4] Market share: An international beer company strives for at least 10% of market share in any national market, treating that as a strategic threshold level.

5] Market stability: A steel distributor does not follow a price reduction by a competitor, assuming that it will be temporary and that customers hate readjusting their inventory valuations frequently.

6] Price leadership: A no-frills airline constantly advertises the lowest fares on any route served.

7] Deterring new providers: A professional event technology firm offers rock-bottom quotes to special events to signal its pricing power to any potential new entrants.

8] Positioning: A watch company prices different brands along a predefined, brand-led price corridor.

The challenge for executives is, of course, to manage their conflicting goals, or so-called trade-offs. The most prevalent tension to resolve is between market share (or sales revenue) and margin. If the product manager in a consumer packaged goods company is focused on gaining market share within her category (perhaps because her bonus is predicated on that), a low-price attack by a competitor is likely to trigger a price decrease for her own product, even if the profit suffers more from the price decrease than from the market-share loss. Similarly, if the salesforce of an industrial equipment producer is offered incentives to hit revenue targets ("You get \$10,000 extra bonus if sales exceed \$5 million"), it is quite likely that salespeople will try to sell the products at any price.

Another typical trade-off is between resource allocation and profit. A manufacturer, for example, might maintain production levels to keep the workers and the machines busy, even knowing that the products are likely to be sold at a loss and the price dynamics could cause a price war.

With such trade-offs to manage constantly, it can be hard for companies to make unambiguous decisions about priorities. But the confusion runs deeper than that. In the real world, the decision-makers are not companies but rather people within those companies. Individual objectives often are not aligned. For example, the sales manager is interested in top-line revenues, whereas the factory manager is interested in capacity utilization and predictable ordering patterns.

All this makes it clear why it can be so hard to devise and stick to strategies for pricing – let alone to pursue the many options for capturing more value that go above and beyond mere pricing decisions. Indeed, it is sometimes shocking to see how much money and resources company spend on better pricing data, research, and tools, and how little is achieved, simply because executives are not aligned in their priorities.

In my experience of working with companies in various industries around the globe, two types of misalignment are most common. The first type occurs when different stakeholders make decisions that favor their preferences at the expense of other objectives, and everyone is aware of it. The more dangerous situation, which I call Type Two misalignment, happens when the different stakeholders are not even fully aware of conflicting goals and objectives.

The advice to address both types is to take on the task as a management team to set and broadly communicate the strategic priorities that should inform decision-making and innovation in value capture. Again, profit maximization is rarely the sole objective for a firm but just one of many dimensions to be considered, so a good starting point is to consider the company's balanced scorecard and draw its [strategy map](#).

Then, as the focus shifts specifically to value capture, everyone should be reminded of some basic truths. First: Market share is a dangerous key performance indicator (KPI). It is a backward-looking measure and likely to lead to price wars as soon as one competitor challenges the status quo with a low-price strategy. Second: Revenues and sales metrics should never be used in isolation to determine rewards or decisions of any kind, but only in conjunction with the contribution margin and profit figures. Practitioners sometimes justify their top-line focus by arguing that revenue is much easier to measure than profit (which is sometimes even confidential). In such a situation, the company has to define proxy variables that prevent fighting for nonprofitable deals. Third: When value capture objectives are not aligned within a company, the result is inconsistent behavior and frustration. Conversely, a shared sense of what must be achieved creates the climate for productive cross-functional collaboration.

There are all kinds of reasons, of course, for management teams to try to achieve more strategic clarity. But one of them is the fact that poor alignment on priorities is a serious obstacle to capturing value. Most companies have developed quite sophisticated processes and heuristics to balance competing objectives when it comes to *creating* value for customers. However, they are not as strategic in their thinking about how to *capture* value. As a rule of thumb, it might sound unhelpful, but yet it is true: *Managers should always try to maximize profits, except when they should not.* The occasions when they should *not* are when other strategic priorities must be considered, and are explicitly taken into account.

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