

Value Curve – a Tool for Competitive Positioning

by *Sundar Sankaran**

Every company occupies a certain position in the market place, and in the mind of the customer. Market share and profitability of the company depend on this competitive positioning. More unique the positioning, and greater the difficulty in replicating the positioning, higher is likely to be the company's market share and profitability.

Value curve is a useful tool for companies to “see” the market and locate gaps that can be exploited to create unique competitive positioning. Drawing a value curve is a simple exercise:

1. Identify the key customer-centric parameters underlying the product / service. These would be represented on the X-axis.
2. The Y-axis would typically show ‘high’ and ‘low’. Other qualitative factors too can be shown. If some parameters are to be plotted on the ‘high-low’ scale and some other parameters are to be plotted on the ‘good-bad’ scale, then the additional Y-axis on the right can be used.
3. Mark each player's position in the industry / market for each parameter.
4. Connect the marked positions for each player in the industry / market.

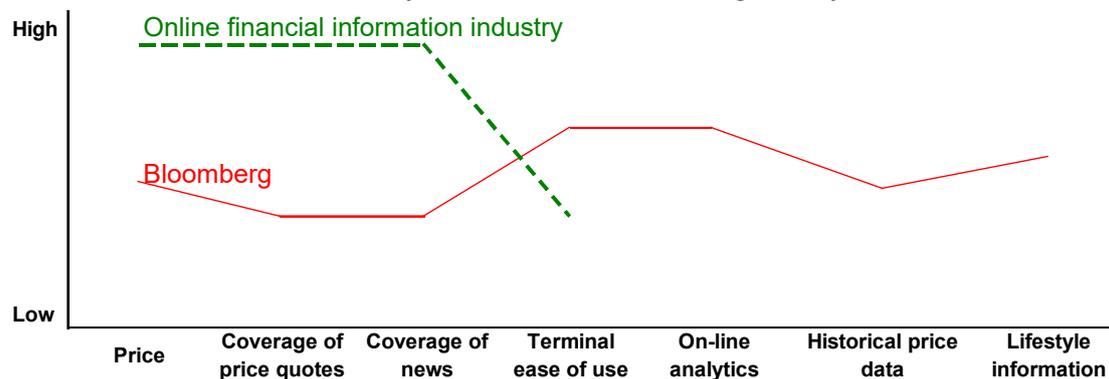
A value curve is nothing but the line that connects the “best judgment” assessment of a company's product / service offering on the various underlying parameters. By drawing one line for each competitor, the relative positioning of all the players in the market can be seen in a single graph.

The concept of value curve was first introduced by W Chan Kim and Renee Mauborgne (“Creating New Market Space”, Harvard Business Review, Jan-Feb 1999, pp 83 – 93). They provide an excellent example of Bloomberg, the business-information provider. When Bloomberg entered the market in the early 1980s, Reuters and Telerate were well established in the online financial information industry. The industry typically viewed the IT manager as the purchaser. So the thrust was on providing standardized systems that were easy to manage. Bloomberg on the other hand realized that –

1. It is the traders and analysts – not IT managers – who made or lost money for their employers each day.
2. Width of information was not as important for the traders and analysts, as the depth of information – including historical information – of the few opportunities they wanted to track.
3. Tools for analysis, specially designed key boards, two monitors etc. would facilitate the faster decisions that were required to exploit the market opportunities.
4. In their personal lives, the traders and analysts made a lot of money. But on account of long work hours, they had little time to spend the money. At the same time, there were lulls during the trading day. So information and purchasing services aimed at enhancing the personal lives – flowers, clothing, jewellery, travel, wines, real estate etc – would be valued by the traders and analysts.

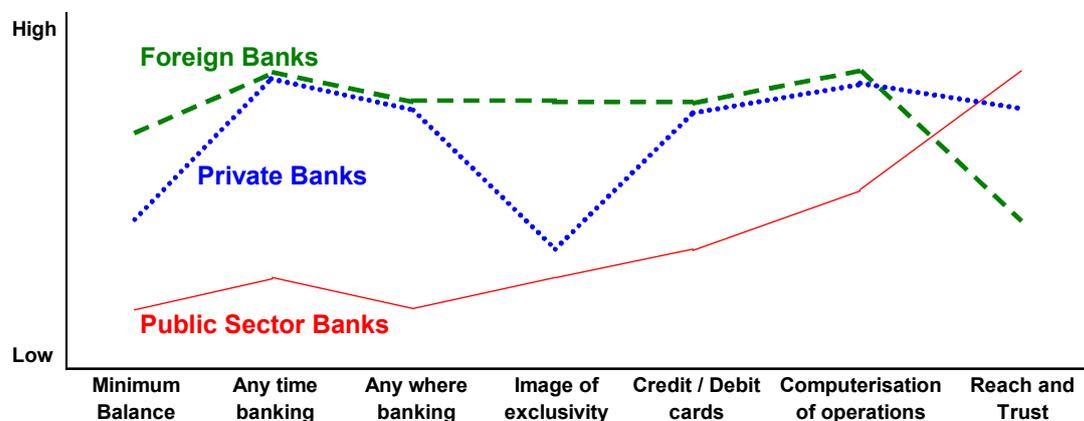
* Mr. Sundar Sankaran is Director with Advantage-India Consulting Pvt. Ltd, a strategy consulting and knowledge incubation boutique

The value curve for the industry at the time of Bloomberg's entry is as follows:



Thus, Bloomberg decided to operate on a different value curve. The company used the traders and analysts as influencers to get the IT managers to buy the Bloomberg service.

Let us consider the example of the banking industry in India. For simplicity, if we were to group the banks as public sector banks, private banks and foreign banks, their value curves would look as follows –



Thus private banks are seeking to track the foreign / private banks on most parameters. However, in order to benefit from the growing middle class, the private banks have kept minimum balance requirements moderate, and also not tried to project an image of exclusivity. (Foreign banks seem to be veering towards the private banks approach on these two parameters). Further, private banks appear to be taking a divergent path from foreign banks on reach and trust, which are areas of potential weakness for foreign banks.

Suppose we have an investor who wants to invest in the equity market. He desires a portfolio return that is in line with the returns in the market (technically called “tracking the market index”). What options does he have?

1. **Directly invest in the basket of stocks* that comprise the stock market index** – Such an investment approach would entail high initial cash outgo – apart from the inconvenience of having to hold several stocks. Further, the investor needs to change his portfolio every time the composition of the index changes.
2. **Invest in index futures† in the stock market** – Stock exchange regulations have set a high initial cash outgo for investment in futures. Further, the futures are available for a maximum of 3 months. So, a long term investor would need to

keep rolling his investment over every 3 months, with the incidental transaction costs, apart from the inconvenience of catering to the stock exchange's varying margin requirements.

3. **Invest in Units of an open end equity index fund** – This offers the benefit of low initial cash outgo. However, the Units are generally not listed in the stock market. So the investor would need to approach the issuer of the unit i.e. the mutual fund company to encash the investment. The mutual fund may charge a fee (technically called “exit load”) for the encashment.

Further, to provide for such encashment requests from investors, the fund maintains part of its portfolio in cash and other liquid assets. To the extent this liquid portion is not invested in the market, the returns on the fund’s portfolio can diverge from the returns in the stock market index (technically called “tracking error”).

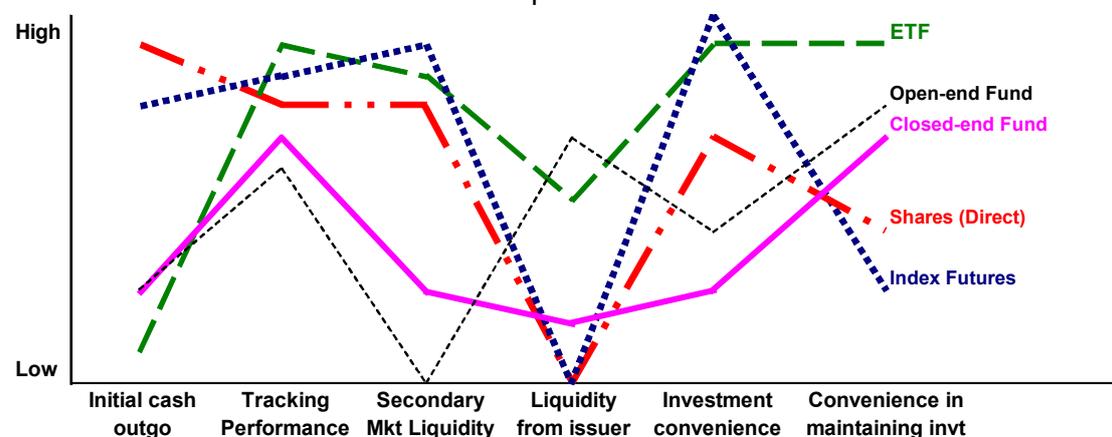
Another discomfort is that the investment and disinvestment decisions of a few “smart” investors can affect the returns of other investors in the fund.

4. **Invest in Units of a closed end equity index fund** – This too offers the benefit of low initial cash outgo. The Units are listed in the stock market. However, the experience in India is that closed end schemes are quite illiquid. Trades could happen at prices that do not reflect fully, the value of the underlying index. The option of early encashment from the mutual fund generally does not exist.

5. **Invest in Units of an Exchange Traded Fund (ETF)** - ETFs follow an interesting structure where the fund itself receives and returns securities – and not cash. This twist minimizes tracking error (viz. the scheme tracks the market index better) and ensures that the actions of any investor do not affect the returns of other investors in the fund.

The low tracking error makes it attractive for traders to explore arbitrage opportunities between the ETF and index futures, thus ensuring liquidity for the ETF. This liquidity ensures that investors can easily buy and sell the Units in the stock market – with a low initial cash outgo.

The value curve of the five investment options would be as follows –



The ETF is superior in many respects, as seen above. No wonder its importance is increasing the world over; and the global experience should be replicated in India.

Thus, the value curve “paints the competitive landscape”. It can be easily applied on groups of companies (banking), companies (Bloomberg) or products/ services (investment), to decide on competitive positioning strategy in any industry.

Notes:

* Stock exchanges offer the facility of buying or selling the “basket” of stocks that comprise an index. Thus, if an investor buys the NSE CNX NIFTY (stock market index) basket in the National Stock Exchange, the investor gets all fifty stocks that go into the calculation of the index, in the same proportion as they are used in the index.

† An index future is a product that lets you take a position on the stock market index. Suppose an investor buys today an index future that is to be settled in the end of July. He would pay the current market price of the index future. The stock exchange mandates certain margin requirements. So as the market declines or rises, the investor would pay or receive margins periodically. The investor can reverse his position any time before the settlement date in the end of July. If the investor does not reverse her position, she would need to settle the index future contract on the settlement date, receiving or paying money depending on whether the market went up or went down.

An investor who desires to maintain the investment position would need to enter into a new index future contract, once the earlier contract is settled.