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Brief Managerial Overview of Conjoint (Trade-Off) Analysis

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A great deal of market research commissioned today is descriptive in nature rather than predictive. Descriptive information is useful to characterize demographics, usage patterns and attitudes of individuals. Beyond descriptive information, managers need survey research tools that can predict what consumers will buy when faced with the variety of brands available and myriad product characteristics. It is precisely due to this focus that conjoint (trade-off) analysis has become so popular over the last three decades.

Humans employ a variety of heuristics when evaluating product alternatives and choosing in the marketplace. Many products are made up of a dizzying array of features (computers, cell phone calling programs, insurance policies, manufacturing equipment), whereas some are more straightforward (yogurt, beverages, light bulbs) and are mainly differentiated by brand, packaging and price. How does the manager decide what product characteristics, packaging, and branding to use or what price to charge to maximize profits? And how does the consumer evaluate the offering vis-à-vis other alternatives in the marketplace?

To decide what product to sell, some managers use their own intuition, the recommendations of design engineers, or they look to competitors for indications of what already “works.” These strategies are myopic and reactive. In consumer-oriented organizations, potential products are often evaluated through concept (market) tests. Buyers are shown a product concept and asked their purchase interest, or new products are actually placed in test markets. These tests can be quite expensive and time consuming, and generally investigate just one or a few variations of a product concept. Sometimes survey research has been used, where respondents are asked to check or rate which brands and product features they prefer. None of these approaches by itself has been consistently successful and cost efficient. Conjoint analysis uses the best elements of these techniques in a cost-effective survey research approach.

Back in the early 1970s, marketing academics applied the notion of conjoint measurement (which had been proposed by mathematical psychologists) to solve these complex problems. The general idea was that humans evaluate the overall desirability of a complex product alternative based on a function of the value of its separate (yet conjoined) parts. In the simplest form, one might assume an additive model. Consider a PC purchase. A consumer browsing the internet might see the following alternative:

Dell
3 GHz processor
512 MB RAM
21-inch monitor
\$1,399

Again, assuming that this consumer uses some internal, subconscious additive point system to evaluate the overall attractiveness of the offer, the unobserved scores (called part worths) for each of the attributes of this product for a given buyer might be:

	Part <u>Worths</u>
Dell	20
3 GHz processor	50
512 MB RAM	5
21-inch monitor	15
\$1,399	30

Total Utility:	120

The estimated overall utility (desirability) of this product alternative is equal to the sum of its parts, or 120 utiles. The trick is to somehow reliably obtain these scores from individuals, for the variety of attributes we might include in the product, or that our competitors might include. To do this, one first develops a list of attributes and multiple levels (degrees) within each.

Brand:	Processor:	RAM:	Monitor:	Price:
Dell	2 GHz	256 MB	15-inch	\$1,099
IBM	3 GHz	512 MB	17-inch	\$1,199
HP	4 GHz	1 GB	21-inch	\$1,399
Micron				\$1,699

It is easy to see that there are many possible combinations of these attribute levels. In the 1970s, it became popular to print each of many product profiles on separate cards and ask respondents to evaluate them (by either ranking or rating). For example:

<p>How likely are you to purchase this computer? (Use a scale from 0 to 100, where 0 = "not at all likely" and 100 means "definitely would purchase.")</p>
<p>IBM 2 GHz processor 512 MB RAM 17-inch monitor \$1,199</p> <p>Your Score: _____</p>

By systematically varying the features of the product and observing how respondents react to the resulting product profiles, one can statistically deduce (typically using linear regression) the scores (part worths) for the separate features respondents must have been subconsciously using. In contrast to simpler direct questioning approaches, conjoint survey respondents cannot simply say that all features are important—they must trade off different aspects of the product (as in real life), weighing products featuring both highly desirable and less desirable qualities.

Using the attribute list we earlier developed, there are 432 possible product profiles ($4 \times 3 \times 3 \times 3 \times 4$) that could be considered. But what makes conjoint analysis work so nicely is that each respondent doesn't have to evaluate all possible product profiles. If we are willing to assume a simple additive model (which tends to work well in practice), each respondent needs to evaluate only a fraction of the total combinations. With our example, only about 20 to 26 carefully chosen product concepts (using experimental design principles of independence and balance) would need to be evaluated to lead to a full set of part worth scores for each respondent for all 17 attribute levels. The part worth scores are useful for determining which levels are preferred, and the relative importance of each attribute. Once we know these scores, we can simply sum them to predict how each respondent would react to any of the 432 possible product profiles.

Although the scores on the attribute levels provide significant value in and of themselves, the real value from conjoint analysis comes from the “what-if” market simulators that can easily be developed, often within spreadsheets. It follows that if for each respondent we can predict the overall desirability for all possible product profile combinations (given the set of attribute levels we measured), we can also predict how each respondent might choose if faced with a choice among two or more competing profiles. For example, we can simulate what percent of the market would prefer each of four PCs (described using the different brands and performance characteristics we measured) if available for purchase. These predictions across a sample of respondents are referred to as shares of choice or preference.

Holding competitive offerings constant, managers can systematically vary the features of their own product profile (such as pricing changes, or performance attributes) and observe what percent of the market would prefer their product under each condition. With conjoint simulators, one can estimate demand curves, substitution effects (e.g. from which competitors do we take the most share if we increase the processor speed?), or cannibalization effects (e.g. what happens to our overall share if we come out with another product with lesser performance at a lower price?). In essence, the manager has the ability to estimate the results of millions of possible concept/market tests based on a data collected in a single survey research project among typically 300 to 600 respondents. If additional information is included such as feature costs, computer search algorithms can find optimal product configurations (holding a set of competitors constant) to maximize share, revenue or profit.

Since the 1970s, as one might expect, additional improvements and refinements have been made to conjoint analysis. In the 1980s, a computerized version of conjoint analysis called Adaptive Conjoint Analysis (ACA) was developed which could customize the conjoint interview for each respondent, focusing on the attributes, levels, and tradeoffs that were most relevant to each respondent. As a result, even more attributes and levels could be studied effectively than before. In the 1990s, researchers began to ask respondents to simply choose among product profiles rather than rate each profile individually on a numeric scale. The feeling was that buyers in the real world don't actually score each alternative on a rating scale prior to choosing—they simply choose. With Choice-Based Conjoint (CBC), respondents answer perhaps 12 to 24 choice questions such as:

If you were in the market to purchase a PC today, and these were your only alternatives, which would you choose?			
Dell 3 GHz Processor 512 MB RAM 21-inch Monitor \$1,399 <input type="radio"/>	HP 2 GHz Processor 1 GB RAM 17-inch Monitor \$1,199 <input type="radio"/>	Micron 2 GHz Processor 512 MB RAM 15-inch Monitor \$1,099 <input type="radio"/>	None: If these were my only choices, I'd defer my purchase. <input type="radio"/>

Although each question takes longer to read (because there are multiple alternatives to consider), Choice-Based Conjoint questions seem more realistic, and can include a “None” choice that can be selected if none of the products would appeal to the survey respondent. New developments in computationally intensive statistical methods (hierarchical Bayes estimation) still make it possible to estimate a full set of part worth scores on each attribute level for each respondent. The results are typically even better than with ratings-based conjoint, and the “what-if” market simulators even more accurate in predicting actual market choices.

Today, thousands of conjoint studies are conducted each year, over the internet, by fax, using person-to-person interviews, or mailed paper surveys. Leading organizations are saving a great deal of money on research and development costs, successfully using the results to design new products or line extensions, reposition existing products, and make more profitable pricing decisions.