
Profiting From Innovation

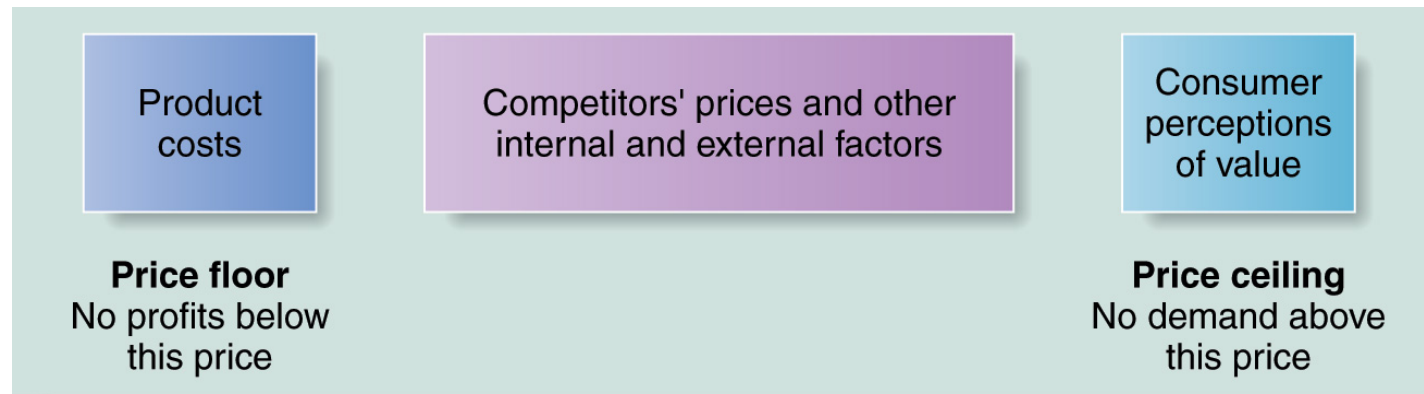
1. Pricing 2. Licensing, partnerships, alliances

BET 320



“If anyone says they are a pricing expert, they are a liar.”

Costs, competitors, value



Two approaches to pricing

Cost-based pricing



Value-based pricing



Relative Perceived Value of Two Product Offerings

$$\begin{aligned}
 &\text{Relative Perceived Value of Offering "A" vs. Offering "B"} = \text{Price Premium for Indifference} = \left[\begin{array}{c} \text{First} \\ \text{Attribute} \\ \text{Value} \end{array} \right] \left[\begin{array}{c} \text{Perceived} \\ \text{Performance of} \\ \text{Offering "A" on} \\ \text{First Attribute} \end{array} \right] - \left[\begin{array}{c} \text{Perceived} \\ \text{Performance of} \\ \text{Offering "B" on} \\ \text{First Attribute} \end{array} \right] + \left[\begin{array}{c} \text{Second} \\ \text{Attribute} \\ \text{Value} \end{array} \right] \left[\begin{array}{c} \text{Perceived} \\ \text{Performance of} \\ \text{Offering "A" on} \\ \text{Second Attribute} \end{array} \right] - \left[\begin{array}{c} \text{Perceived} \\ \text{Performance of} \\ \text{Offering "B" on} \\ \text{Second Attribute} \end{array} \right]
 \end{aligned}$$

SOURCE: Irwin Gross, "Insights from Pricing Research," in *Pricing Practices and Strategies*, ed. Earl L. Bailey (New York: The Conference Board, 1978), p. 38. Reprinted by permission.

Price Elasticity of Demand

- The rate of percentage change in quantity demanded attributable to the percentage change in price.
- Factors of price elasticity,
 - The ease with which customers can compare alternatives.
 - The importance of the product in the cost structure.
 - The value that the product represents to a customer.

Reference Prices

- Pricing standard used by customer
 - Prior experience or current competitor's prices
 - Current purchase environment
- Possible reference prices
 - Fair price
 - Typical price
 - Last price paid
 - Upper-bound price
 - Lower-bound price
 - Competitor prices
 - Expected future price
 - Usual discounted price

Prospect Theory

- Consumers evaluate 'gains' or 'losses' from a reference price, not expected outcomes or goals
 - Gains = paying less than reference price
 - Losses = paying more than reference price
- Customers are more sensitive to losses than gains
 - Respond more negatively to price increases than they do positively to decreases
- Diminishing incremental sensitivity to larger losses or gains
 - The incremental impact of a loss of \$20 may not be double the impact of a loss of \$10

Implications

- Frequent promotions affect consumer's reference price
- Offering temporary price reductions and then retracting them affects consumer's willingness to buy
- Given two equal choices, one expressed in terms of possible gains and the other in possible losses, people would choose the former
- Price changes impact consumer satisfaction with prices already paid

Implications

- Segregate gains
 - Several smaller gains favoured over one large gain
- Segregate silver linings
 - Automobile rebates segregate savings from cost of vehicle
- Integrate losses
 - Additional options added to large purchases have less impact
- Integrate losses with larger gains
 - E.g., payroll deductions are the reduction of a large gain

Examples

- Gasoline
 - Frequent small decreases, infrequent large increases
- Infomercials
 - Multiple uses for products, bonus products
- Dollar stores
 - Always a gain? Influence on reference price?
- Coupons versus price reductions
- Small retailers versus (a new) Walmart
 - Price difference framed as gain or loss?
 - How can retailers influence reference price?

Pricing New Products

Skimming

- Appropriate for a distinctly new product, provides the firm with an opportunity to profitably reach market segments that are not sensitive to the high initial price.
- Enables the marketer to capture early profits.
- Enables the innovator to recover high developmental costs more quickly.

Penetration is appropriate when there is

1. High price elasticity of demand,
2. Strong threat of imminent competition,
3. Opportunity for a substantial reduction in production costs as volume expands.

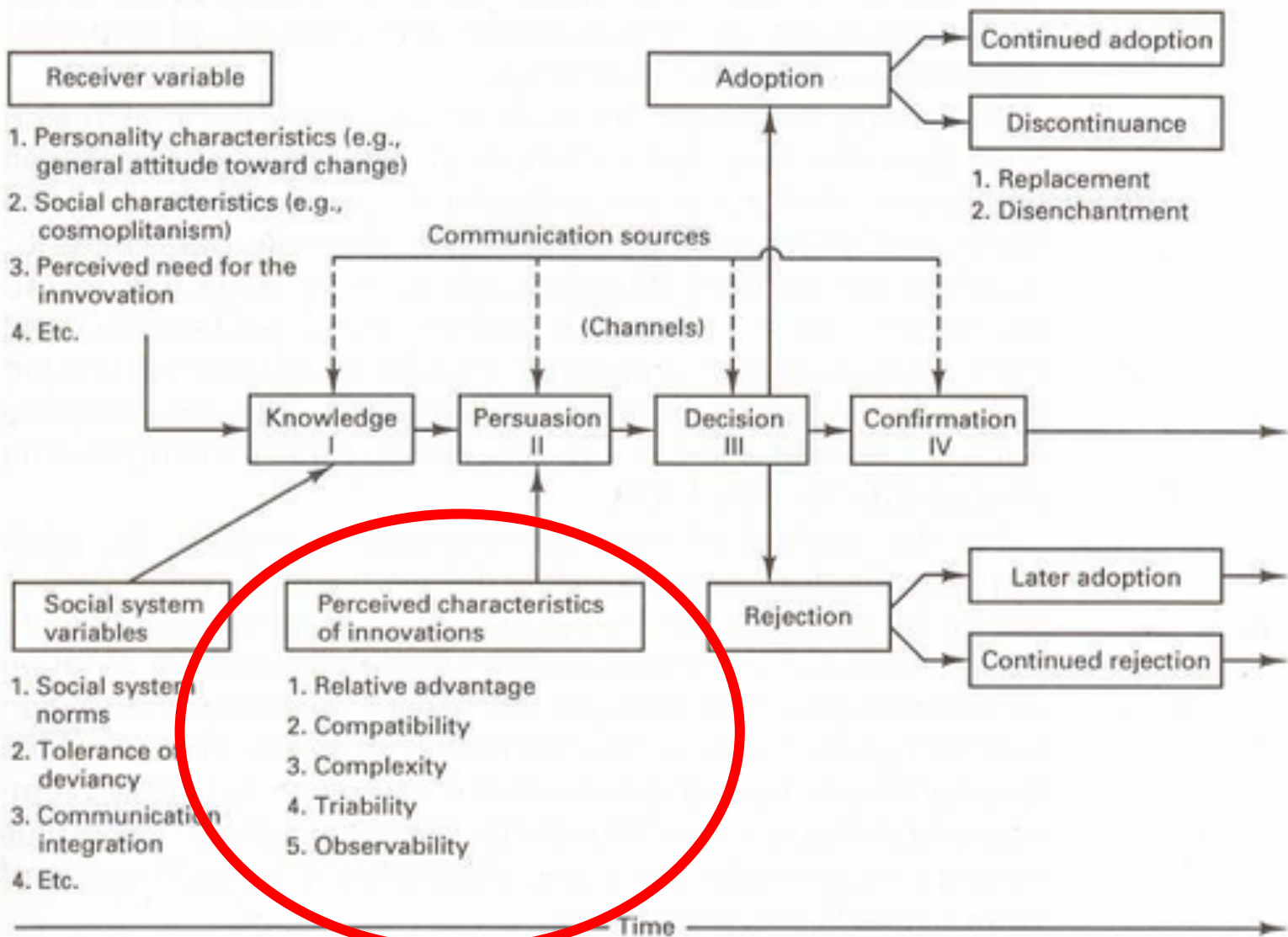
Product Adoption Lifecycle



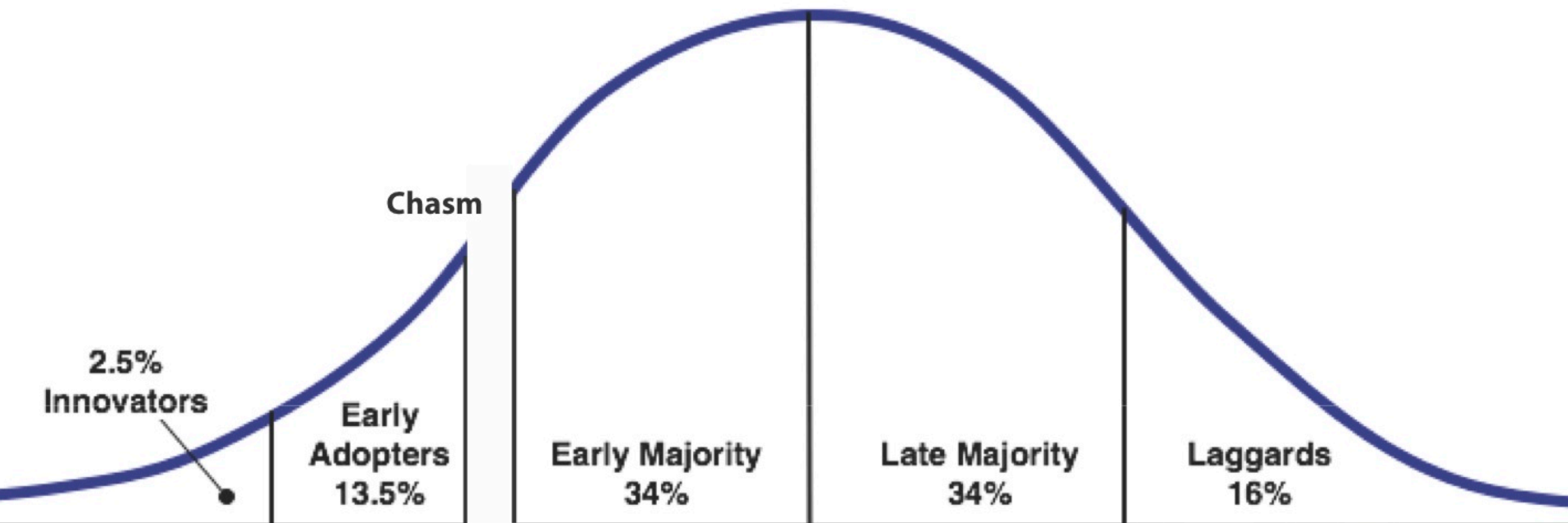
Antecedents

Process

Consequences



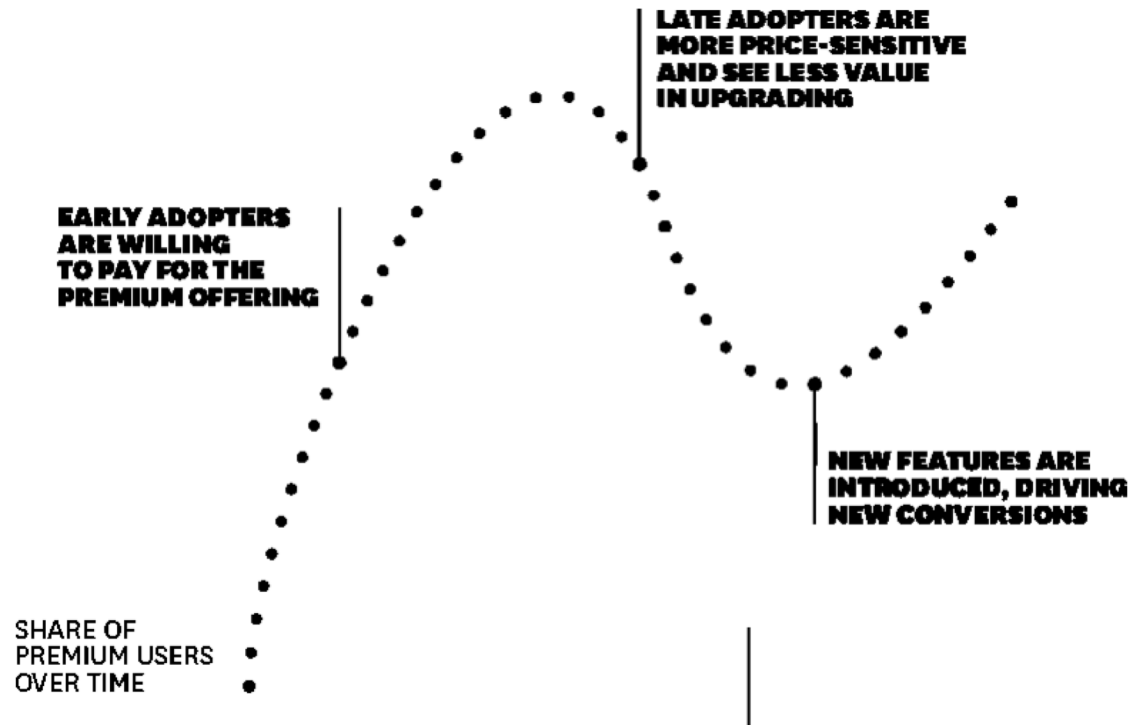
Technology Adoption Life Cycle



How Four Companies Use the Model

Among the biggest decisions facing “freemium” businesses are which features to make free and how much to charge for the rest. Here’s a look at several approaches:

	Dropbox	LinkedIn	NYTimes.com	Spotify
WHAT IT IS	A cloud storage and file-sharing service	A social media site for professional networking	A digital, enhanced version of the print newspaper	A music streaming and downloading service
WHAT'S FREE	2 GB of storage, with up to 16 GB more for referring friends	Creating a profile, making connections, basic communication	10 articles a month	Unlimited music, interspersed with ads
WHAT'S PREMIUM	100 GB of storage for \$9.99 a month	Advanced searches and communication, starting at \$19.95 a month	Full access, starting at \$3.75 a week	Downloads and ad-free streaming for \$9.99 a month
HOW MANY USE IT	More than 200 million users (free and premium)	277 million users (free and premium) at the end of 2013	53.8 million visitors in December 2013; 760,000 subscribers	24 million users, of whom 6 million are subscribers



INNOVATION CATEGORY	INNOVATION STRATEGY	EXAMPLES
CHANGING THE PRICE-SETTING MECHANISM	VALUE-BASED PRICING	<ul style="list-style-type: none"> • BOSSARD'S ECOSYN-LUBRIC FASTENERS
	AUCTIONING	<ul style="list-style-type: none"> • GOOGLE ADWORDS • GOVERNMENT AUCTIONS OF VANITY LICENSE PLATES
	DEMAND-DRIVEN PRICING	<ul style="list-style-type: none"> • AIRLINES' YIELD-MANAGEMENT SYSTEMS • THE BERLINER REPUBLIK RESTAURANT'S BEER EXCHANGE
	NAME YOUR OWN PRICE	<ul style="list-style-type: none"> • PRICELINE
	PAY WHAT YOU WANT	<ul style="list-style-type: none"> • PANERA BREAD'S COMMUNITY CAFÉS
CHANGING THE PAYER	TWO-SIDED MARKET MODEL	<ul style="list-style-type: none"> • 20 MINUTEN • CARDEA
	CHANGING THE PAYER IN THE VALUE CONSTELLATION	<ul style="list-style-type: none"> • CARBON FOR WATER • SUBSIDIZED TUTORING SERVICES
	INTERNAL BUDGETING	<ul style="list-style-type: none"> • IMD'S EXECUTIVE EDUCATION PROGRAMS
CHANGING THE PRICE CARRIER	CHANGING THE CARRIER	<ul style="list-style-type: none"> • NETFLIX • NESPRESSO
	BUNDLING AND UNBUNDLING	<ul style="list-style-type: none"> • TELECOMMUNICATIONS • AIRLINE INDUSTRY
	ALL-INCLUSIVE OFFERING	<ul style="list-style-type: none"> • CRUISES • CHÂTEAUFORM'
CHANGING THE TIMING	INSTALLED BASE PRICING	<ul style="list-style-type: none"> • GILLETTE • SCHINDLER
	FUTURES CONTRACTING	<ul style="list-style-type: none"> • COMMODITIES PRICING • PRESOLD HOTEL ROOMS
CHANGING THE SEGMENT	TARGET COSTING	<ul style="list-style-type: none"> • XIAMETER
	SELF-SEGMENTED FENCING	<ul style="list-style-type: none"> • GROCERY COUPONS

Your own startup
Or
Collaborate with others?

How do you decide?

Types of collaborative arrangements

1. Strategic alliances
2. Joint ventures
3. Licensing
4. Outsourcing
5. Collective research organization

Reasons for going solo

1. Availability of Capabilities
2. Protecting Proprietary Technologies
3. Controlling technology development and use
4. Building and renewing capabilities

Advantages of collaboration

1. Obtaining necessary skills and resources more quickly
2. Reducing asset commitment and enhancing flexibility
3. Transferring knowledge and creating new knowledge
4. Sharing costs and risks
5. Creating a shared standard

Alternative endgames

- Growing a company to maturity
- Growing a company to a target point
 - Acquisition by others
 - IPO
 - Professional management
 - Liquidated partnership
 - Spin-off
- Selling a patent or trade secret
- Licensing a patent or trade secret
 - Exclusive and non-exclusive licenses
- Developing a technology, then selling the patent or license