
Strategic Pricing for Start-Ups, New Products and Innovations

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MIT Sloan School
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Agenda

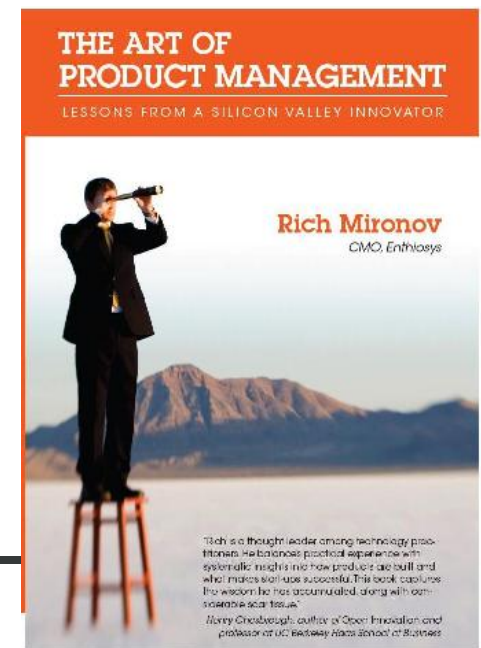


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- Introductions
 - Basics and theory
 - Thought experiments
 - Quick case study

An Unapologetic Product Guy



- CMO at Enthiosys, agile product mgmt consultancy
 - Business models/pricing, roadmaps
 - Innovation Games[®] and customer needs
 - Agile transformation, interim PM executive
- Haas executive education faculty
- Repeat offender at software prod mgmt
 - Tandem, Sybase, four start-ups
- *“The Art of Product Management”*



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*“Pricing is almost never
about the number.
It’s about the model.”*

Where Does Pricing Fit?



- Price is rarely the headline
- Part of the business model
 - How do we make money? How much?
 - Revenue/profit/shipment forecasts
- Supports core value proposition
 - “Our product/service saves you \$\$\$\$...
 - ...and we want 15% of the savings.”
- Often an obstacle to buying
 - Too complex
 - Much too high (sticker shock) or too low (desperate)
 - Free (no reason to trade up)

Company Models



- Big companies that do serious pricing analysis
 - General Mills, Goldman Sachs, United Airlines, Toyota
- Small companies built on a pricing strategy
 - Salesforce.com, NetFlix, ZipCar
- Companies that don't handle pricing strategically
 - Nearly everyone else

Avoid Creating Pricing Problems



- **DON'T...**
 - Make price the primary issue (usually)
 - Over-complicate the sale
 - Require customers to be smart
 - Change prices too often

- **DO...**
 - Support the business model/plan
 - Reinforce (charge for) key benefits
 - Pick natural units
 - Make correct ordering easier

New and Mature Markets



Mature markets	<i>Outside threats, late-comers</i>	<i>Compete on price</i>
New markets	<i>Let 1000 Flowers Bloom</i>	
	New pricing models	Dominant pricing model

Start with Customer View

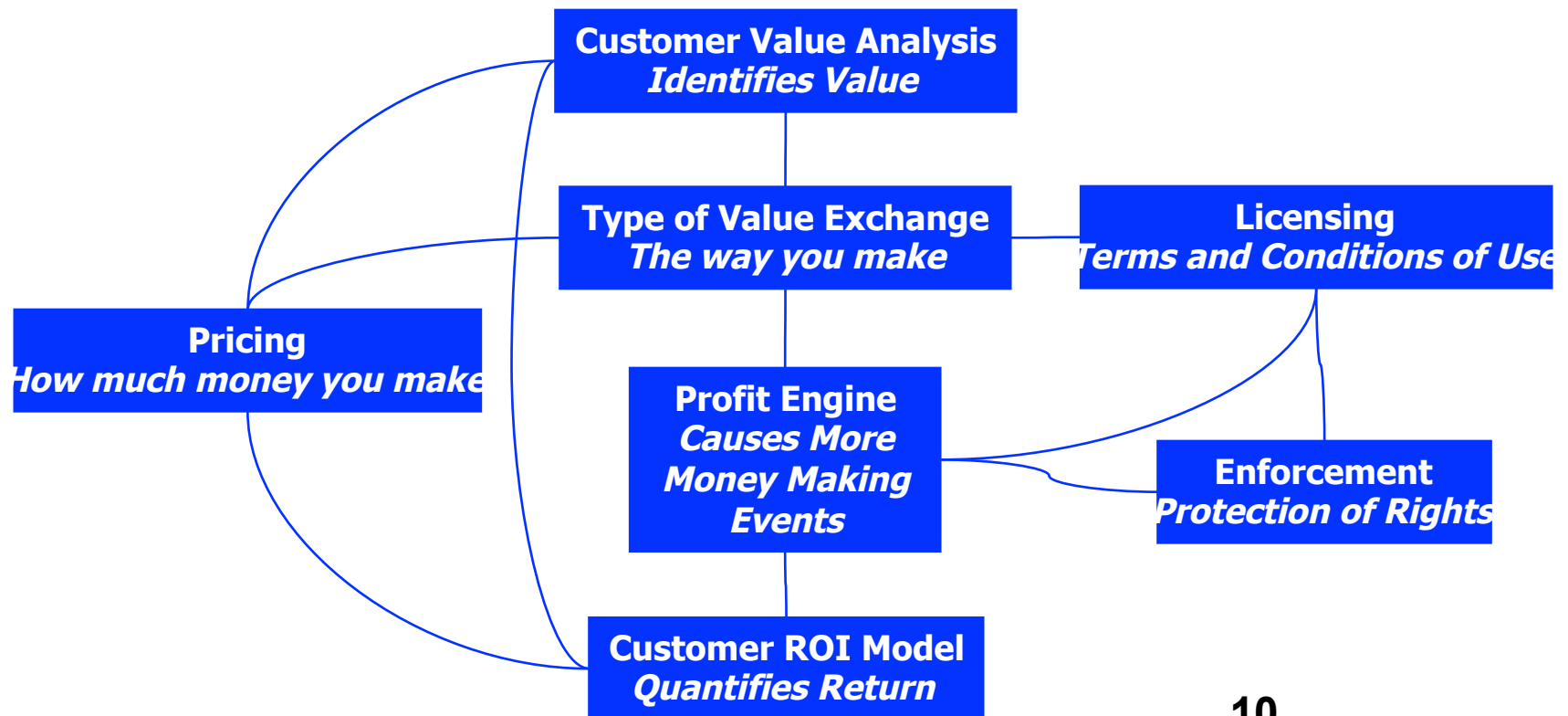


- Customers buy products to make money or save money
 - How do they describe value?
- Quantify it for them
 - They won't spend the time to do it right
- Assume you can capture a fraction of value
 - B2B: often 5% to 15%
 - Consumers often driven by fashion, not analytics

Business Model Framework



A framework of interrelated choices that help you create offerings that provide maximum value.



Customer Commitments



"by the drink"



"by the month"



No commitment
High variable costs

Lower volume
Uncertain usage
Optional
Actively manage costs

NEED CONTINUOUS MARKETING

Big commitment
Low/no variable costs

Higher volume
Predictable usage
Required (cost of business)
Low cost control effort

HARD INITIAL SELL

Software Value Exchange Models



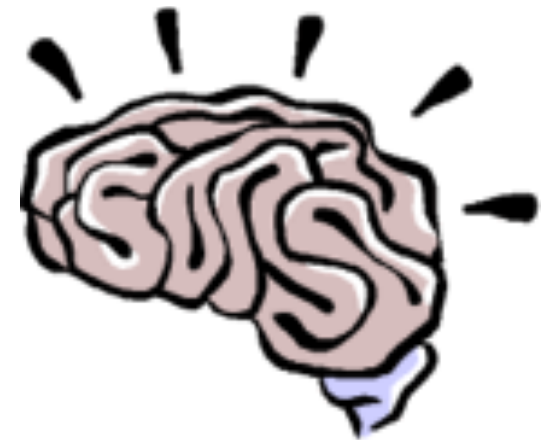
- Time-based access (e.g. unlimited/month)
- Transaction (stock trade)
- Metered (seats, CPUs, named users)
- Hardware (appliances, dongles)
- Service (virus updates, support)
- Percentage of incremental revenue/savings
- Data-driven insights



Exercise: Consulting Services



- Your last start-up just closed, so you are suddenly a consultant. A prospective client needs market analysis, MRD, a pricing model.
- What are your pricing objectives?
- How to structure a project?
- Risks for you? For client?



Possible Objectives



- **Work at any price**
 - Food on the table
- **Loss leader**
 - Underprice first assignment, get follow-on work
 - Good reference for other clients
- **Become indispensable**
 - Push for a full-time position later
- **Gain market experience**
 - What will the market bear? OK to lose assignment

Some Consulting Pricing Models



- Per hour, no limits
- Per project
- Per hour with project ceiling
- Fixed price for initial sizing (“pay me to estimate”)
- Milestones (progress payments)
- Equity (pre-IPO stock)
- Customer sets value at end
- Shared savings (portion of ROI)
- Free (experience, reference, try & buy)

Risks in Consulting Models



	Client's Risk	Consultant's Risk
Straight Hourly	Unlimited cost, quality, completion	None
Fixed project price (pay on completion)	Timely completion	Unlimited effort, defining "done"
Fixed price milestones	Partial work not valuable, how to inspect work?	Upfront analysis
Equity, portion of ROI	May overpay later	No immediate cash value

Pricing Your Start-Up



- **Why** will customers buy?
 - Customers make more money or save money
- **What's** the natural unit of exchange?
 - How do they derive value? What does the competition do?
 - Can you split off a profitable segment?
- **How much** of customer value can you take?
 - 5% to 15%?
- **Test, trial-close, get your hands dirty**

Workshop Exercise: Teleportation



- Founders: MIT quantum physicists
- Lots of VC money available
- Software plus custom hardware
- Imagine some product limitations
 - Inanimate objects only (no people)
 - Under 40 pounds, under 18" diameter
 - 2000 mile limit, arrival +/- 6 inches
 - High power requirement (15 kW)
 - 45 second recharge time
- Initial segment? How does that shape pricing?



Case study: iPass

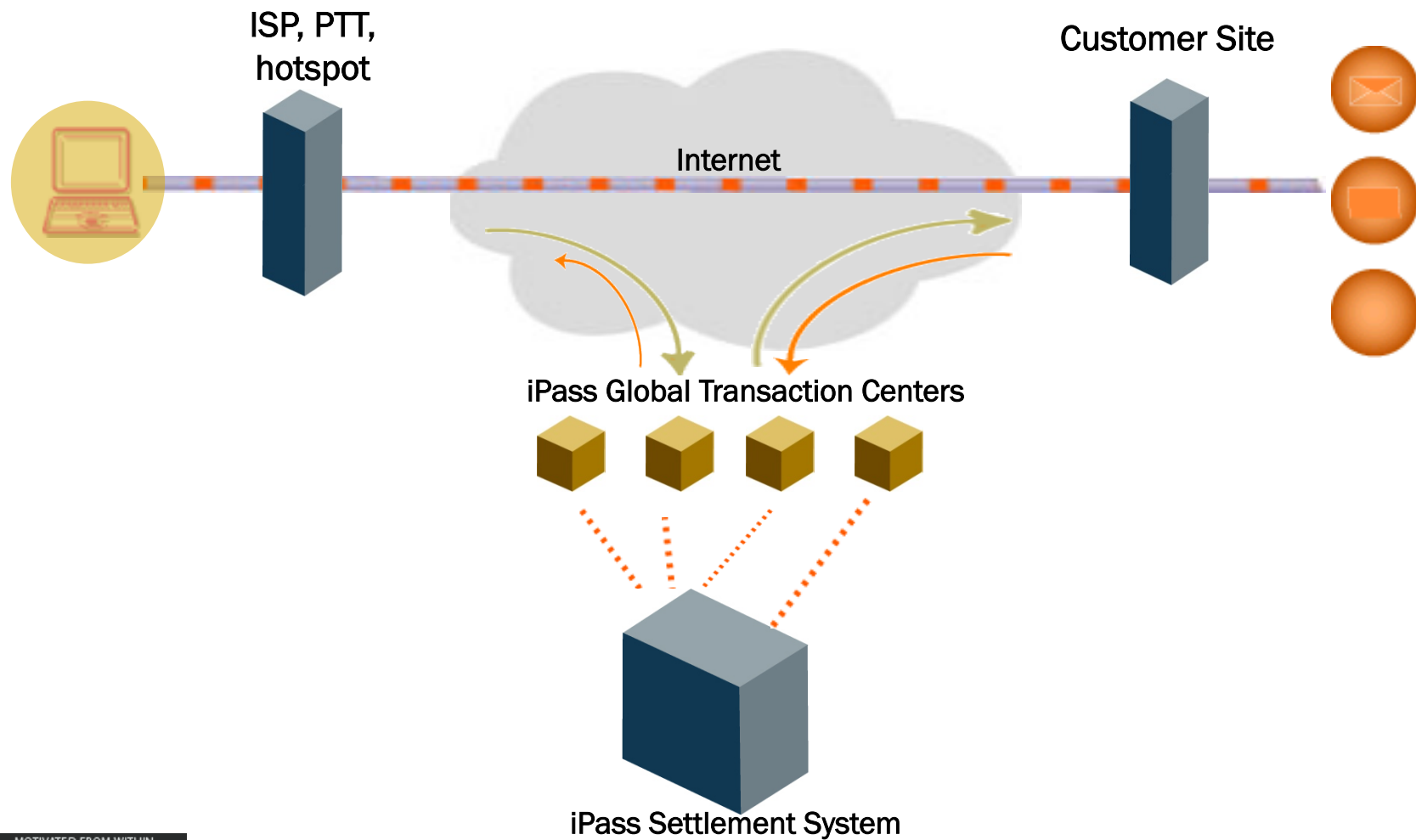


- Founded 1996: new market, new application
 - Falling asleep in Tokyo hotel
- Early clearinghouse for Internet “roaming”
 - How do I dial into the ‘net when far from home?
- Target: corporate travelers, “road warriors”
- By 2004, covered 170 countries
 - 20,000 dial-up numbers, 5000 hot spots...

- IPO July '03, \$1B market cap



iPass Transaction Model



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Evolution of iPass Pricing Model

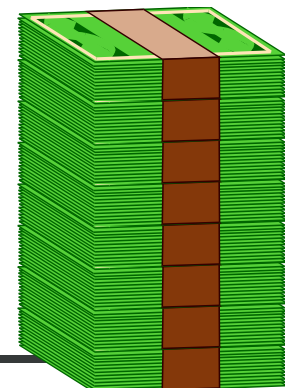
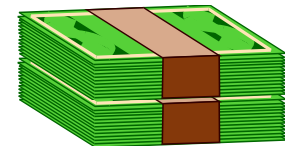
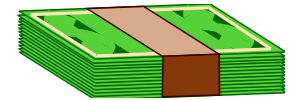


1. Cost-plus pricing (mark up each POP 40%)
 - Buy-side prices are visible
2. Flattened by country (then continent)
 - Simpler
 - Customers indifferent to suppliers
3. Overlay Home/Roam model
 - Charge less at “home” but more to “roam”
 - Lots of “home” substitutes but few “roam” alternatives

Network Effect: Strategic Leverage



- Early: low volumes, high supplier prices, difficult purchasing
 - Grow user base, add more networks...
- Mid-cycle: can substitute suppliers, improve quality, simplify end user experience
 - Companies want biggest network
 - Networks want most roaming users
- Maturing: dominant player
 - All major dial-up networks (BT, FT, DT, AT&T...)
 - All major hotspots (T-Mobile...)
 - Who wants to join the second-largest ATM network?



Pricing Take-Aways



- Complex pricing plans impede sales process
- Must support business model
- Think hard about target audience's pain
- Pricing model aligned with pain
 - KISS
 - Savings >> price
 - Units make sense
- Invest in research if you can
 - Competition, interviews, historical databases

