

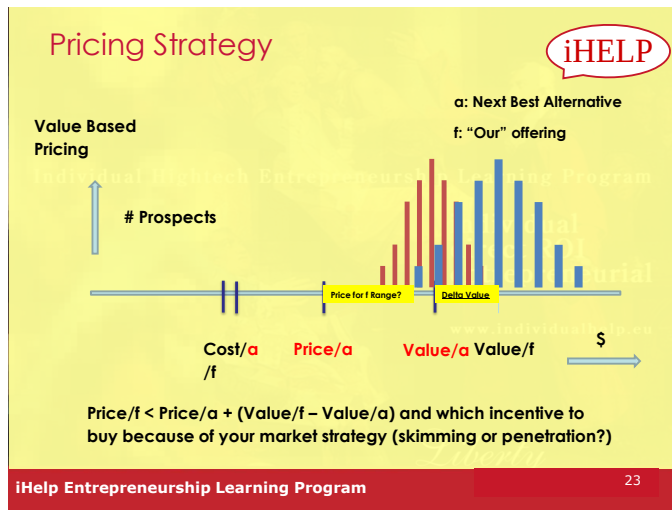
Re: Clarification of some slide in “How to create Value in the Value Chain”

Dear course participant,

From the feedback on my presentation, I learned that I did not convey the message of some of the slides in crisp and easy to understand way. Furthermore I learned that I went too fast sometimes.

In this document I will try to give you more background on some of the slides, that might have created confusion:

Slide 23



Here I wanted to make clear that the price that you ask for your offering (price/f) should obey the following formula:

$$Price/f < Price/a + (Value/f - Value/a)$$

Price/a is the price of the Next Best Alternative(NBA)

Value/f is the Value of our offering

Value/a is the Value of the NBA.

You have to do the value research for each market segment that you want to serve; read chapter 5 in “Value Merchants” and Chapter 2 in “the New Business Road Test” by John W. Mullins.

However If you do value research you will find that within a certain market segment there will be customers that will put a high value on your offering and customers that will put a low value on your offering. This is especially the case when the value proposition is “Un-proven” yet, i.e. in Business Development phase. This holds for the NBA if the NBA time wise has launched close to the launch of your product or service.

Marketers in technology Business-to-Business markets have a tendency to charge what the market will bear in the business development phase, i.e. they pursue a “skimming market” strategy because they are optimistic about the value proposition of the new offering and because product supply and demand are uncertain. They are tempted to put a price on the new offering that reflects the max value of the new offering and the minimum value of the NBA.

However the it is not very likely that a customer puts a very high value on your offering and a very low value on the NBA.

In the end your company and the company of the NBA talk to the same customers so it is more likely that a customer who puts a high value on your offerings also puts a high value on the NBA.. This means basically that, the difference in value stays the same, i.e. you can take the difference in value for the maximum of the distributions.

Making the distribution makes sense, because it tells you where the maximum of Volume*Value is in the market segment. For these customers you want to sharpen your value proposition.

you should also take into account that your competitor, who offers the NBA, has some pricing flexibility to cope with the fact that certain customers put a high value on the NBA and some put a low value on the NBA. You need to know the pricing situation in the market segment to be able to decide how to implement a “skimming” of “penetration” strategy.

So in conclusion:

- 1.Customer who put a high value on your offering, most likely will put a high value on the NBA.
- 2.Knowing the distribution of the number of customers (Y axis) their valuation (X axis) of your offering, tells you where to focus/sharpen your value proposition. This group of customers represents the highest value for your company.
- 3.You need to know the pricing situation in the targeted segment in order to decide how to implement a “Skimming” or “Penetration” strategy. Especially knowing how the company that offers the NBA, does pricing, is needed in order to implement a good pricing strategy.

Implementation Example: Value Proposition and Pricing

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- Delta Price is $< A^*$ (Delta Value)
- $0.5 < A < 1.0$ depending on "maturity" of the product; at "launch" you get 0.5 because of the risk for the customer to get the max value; value proposition is not proven yet.
- Price range of similar products is about 15 - 20%

Challenge: how to create 40 % more Value with 10 % more cost

iHelp Entrepreneurship Learning Program 24

The difference in price between your offering and your NBA should be less than the difference in Value between your offering and your NBA multiplied by a factor A which is less than 1.0.

Typically in the beginning the factor A is about 0.5 because the value proposition is unproven at the customer site and the customer runs a risk in the sense of investing without a proven return.

So sharing the "profit" i.e. "difference between Value and Price" is considered by the customer as a reasonable offer.

However you should realize that when the value proposition gets proven in the Customer Value Management process, you should be able to get a higher A factor; the upper limit is determined by what the customer sees as a reasonable profit margin.

Therefore some companies are running extensive beta programs to prove the Value Proposition at the customer site. Some companies launch an "improved" version or generation II of the product once the value proposition is proven, in order to be able to increase the price.

Customers think that products have more or less the same value proposition when the price is roughly within 15 or 20 % of the average price. Therefore if you introduce a new product with an improved value proposition in a certain category of products, you have to deliver 40 % more value in order to get a 20 % higher price. The business model in High Tech normally requires that your CoGs is less than 50% of

Revenue, in order to sustain innovation/RnD/Marketing investments levels. That's why the challenge is to create 40 % more value for 10 % more cost.

Slide 25: Pricing Strategy and initial (early) sales when skimming



Customer Value is of course very much depending on the targeted market segments; you need to have sufficient configuration flexibility in order to justify different pricing in different segments.

However even in a particular segment, the value that customers put on offering can vary quite a bit. For instance the usage of the product can vary considerably within a particular segment. So there is a distribution: # of customers/prospects versus value, they thing the product has for them. In the end you want to focus your marketing activities where the distribution has its maximum; here you can extract the maximum value.

Most marketers go for a skimming (pricing) strategy in the beginning of the product life cycle because of limited availability of "product".

So customers, who think they receive the highest value from the product will buy first and are willing to pay the "premium" price.

When product availability is ensured, you need to lower the price in order to get the maximum value out of the segment, i.e. you need to attract the customers that put an average value or even lower on

your offering. This also could mean that your cost structure needs to come down in order to make decent margins at the lowered price points. In many companies, competition is blamed for “price” pressure; I would argue that Value Research reveals that there will always be a kind of price pressure because the largest amount of customers in the segment do not put the max value on the offering.