Pricing in the Digital Age

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Strategy & Marketing Consultants

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Prof. Dr. Dr. h.c. mult. Hermann Simon

Bonn office
Willy-Brandt-Allee 13
53113 Bonn, Germany

Stockholm office
Kungsgatan 10
11143 Stockholm, Sweden

hermann.simon@simon-kucher.com

@HermannSimon

www.simon-kucher.com

What Does Change in the Digital Age?

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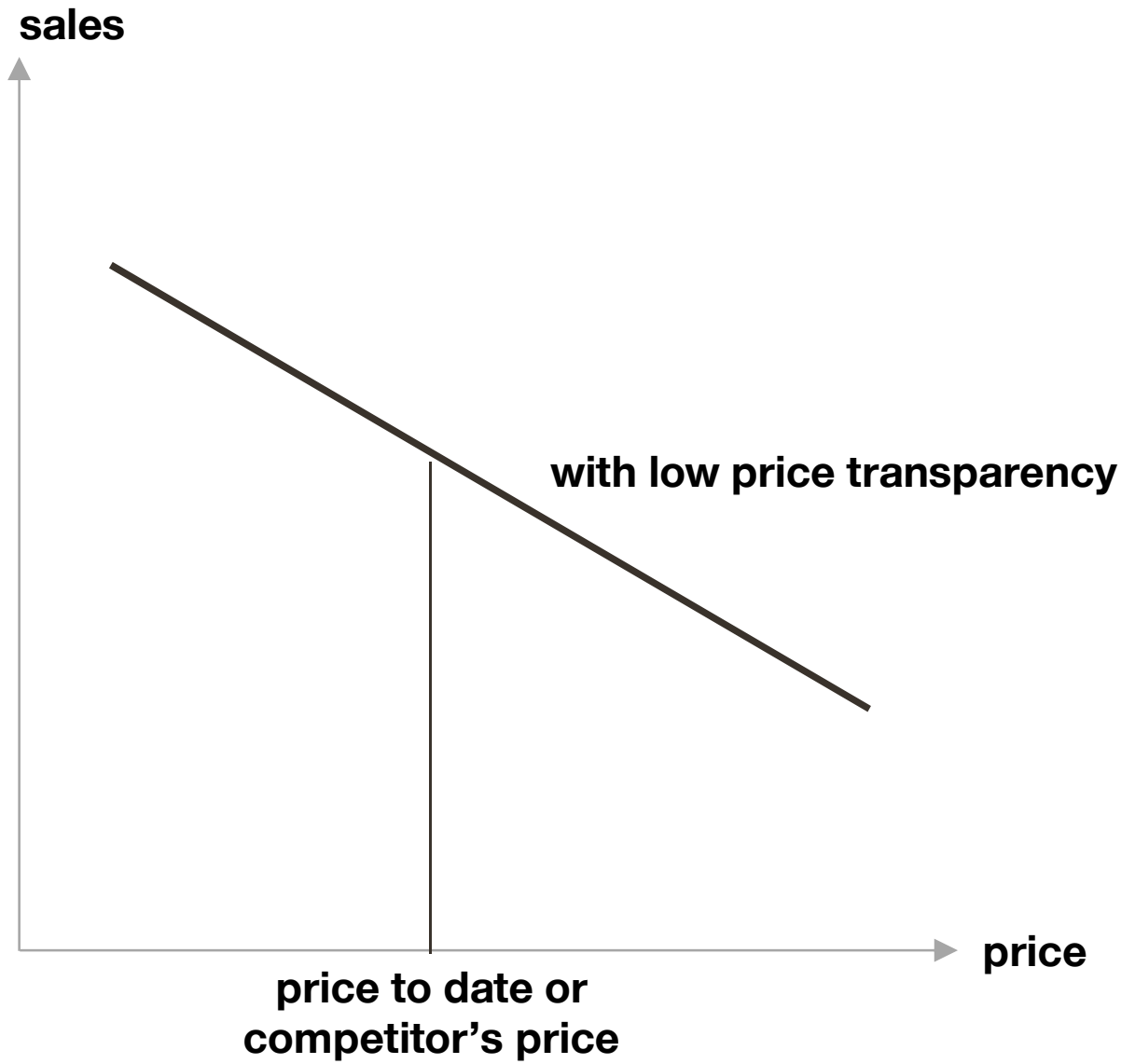
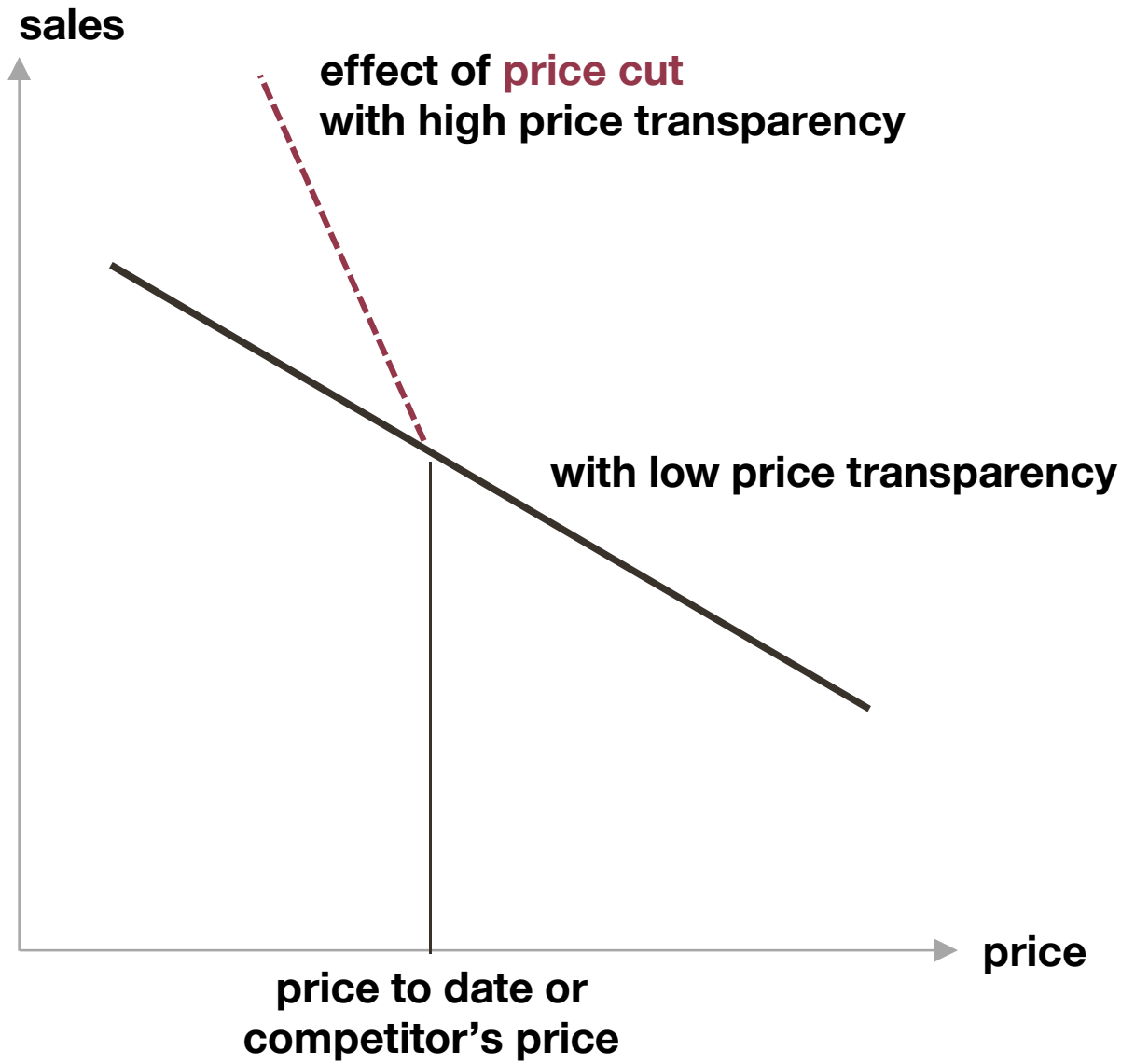
- Price perception: Price transparency
- Value perception: Customer feedback
- New business/pricing models
- Marginal costs: "Zero marginal cost society"
- Competition against "monopolists"

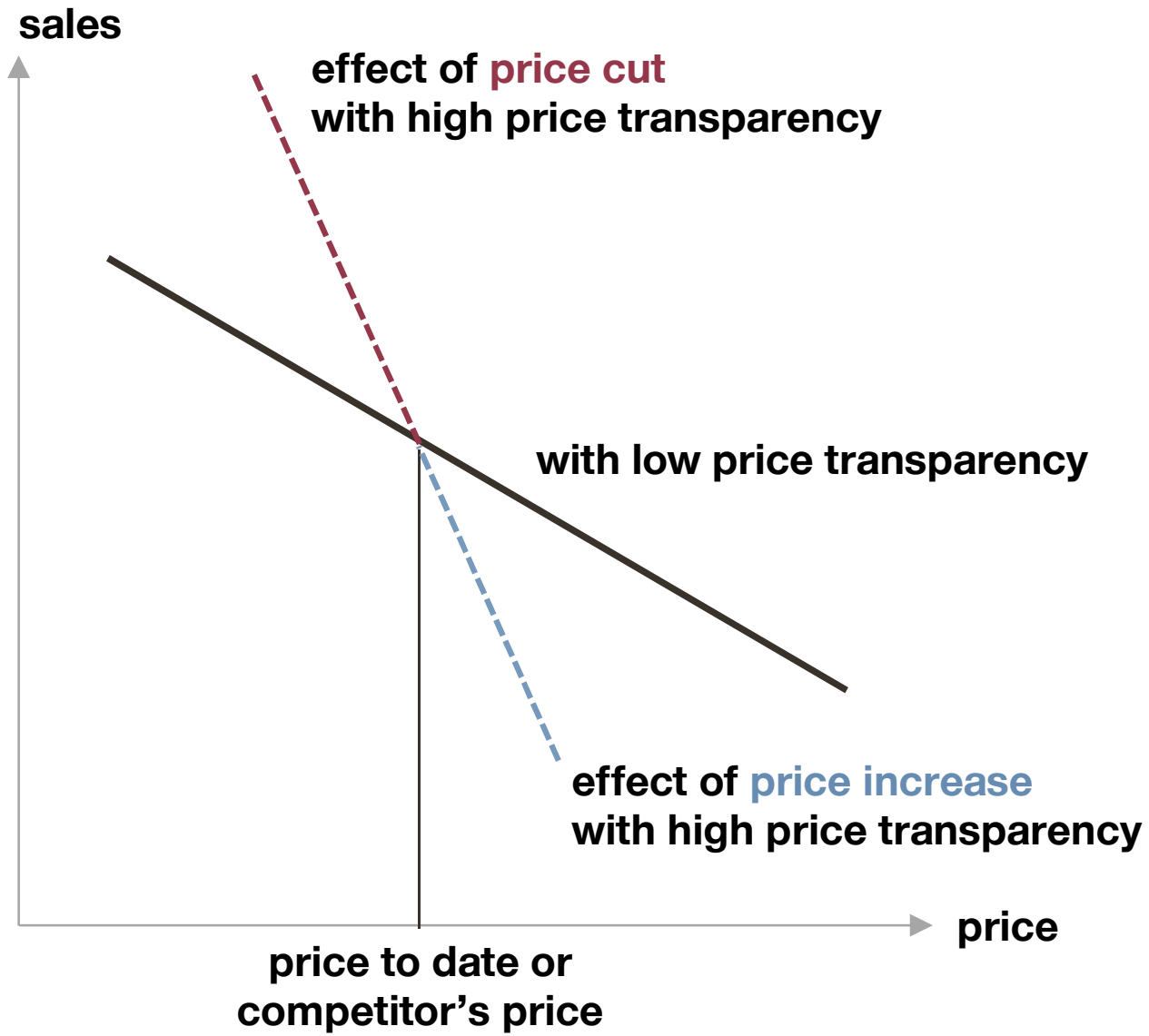
What is the (currently) strongest effect of digitization on pricing?

RADICALLY INCREASED

PRICE TRANSPARENCY


sales
with low price transparency
price
price to date or
competitor's price


sales
effect of price cut
with high price transparency
with low price transparency
price
price to date or
competitor's price


sales
effect of price cut
with high price transparency
with low price transparency
effect of price increase
with high price transparency
price
price to date or
competitor's price

Consequences for Pricing

Static:

- Advantages for aggressive pricers (yes, increased price elasticity can have advantages)
- Disadvantages for more expensive providers

Dynamic:

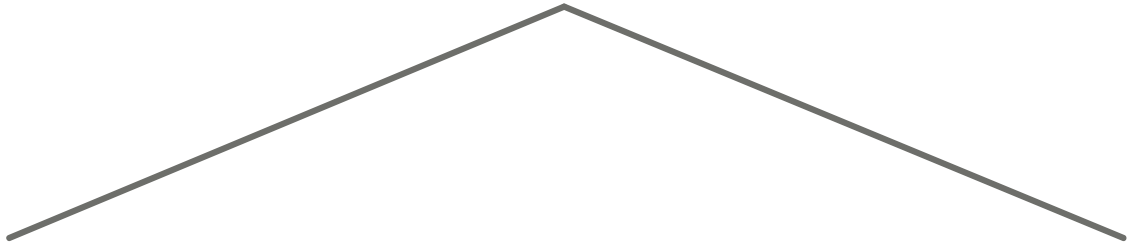
- Price reductions have a stronger **positive** effect
- Price increases have a stronger **negative** effect
- There will be more price changes
- Price wars are more likely

Lesson 1

The currently strongest effect of digitization is the radically increased price transparency. It leads to massively higher price elasticities. This makes it more attractive for price-aggressive sellers to reduce prices. It makes it much harder for high-price sellers to successfully increase prices. The danger of price wars increases.

What is the most important aspect of pricing?

Value-to customer and building trust



"Traveling dealer"

"Local dealer"

Source: Domizlaff 1937

Provocative Thesis

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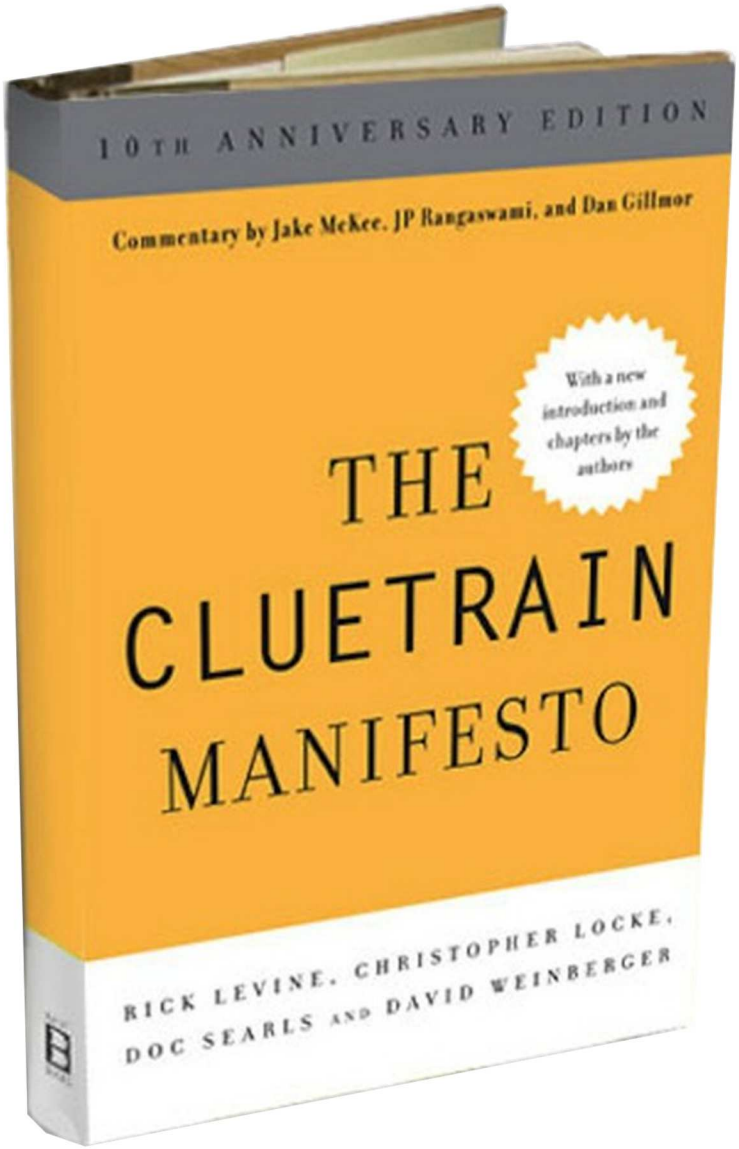
In the digital age, "traveling" and cheating dealers will not survive.


10TH ANNIVERSARY EDITION
Commentary by Jake McKee, JP Rangaswami, and Dan Gillmor
With a new introduction and chapters by the authors
THE CLUETRAIN MANIFESTO
RICK LEVINE, CHRISTOPHER LOCKE, DOC SEARLS AND DAVID WEINBERGER

There is a new conversation...

... between customers, like in a village

(McLuhan's global village)

What may become the more important long-term effect of digitization on pricing?

RADICALLY INCREASED

VALUE TRANSPARENCY!

Pre-Internet: Low Value Transparency

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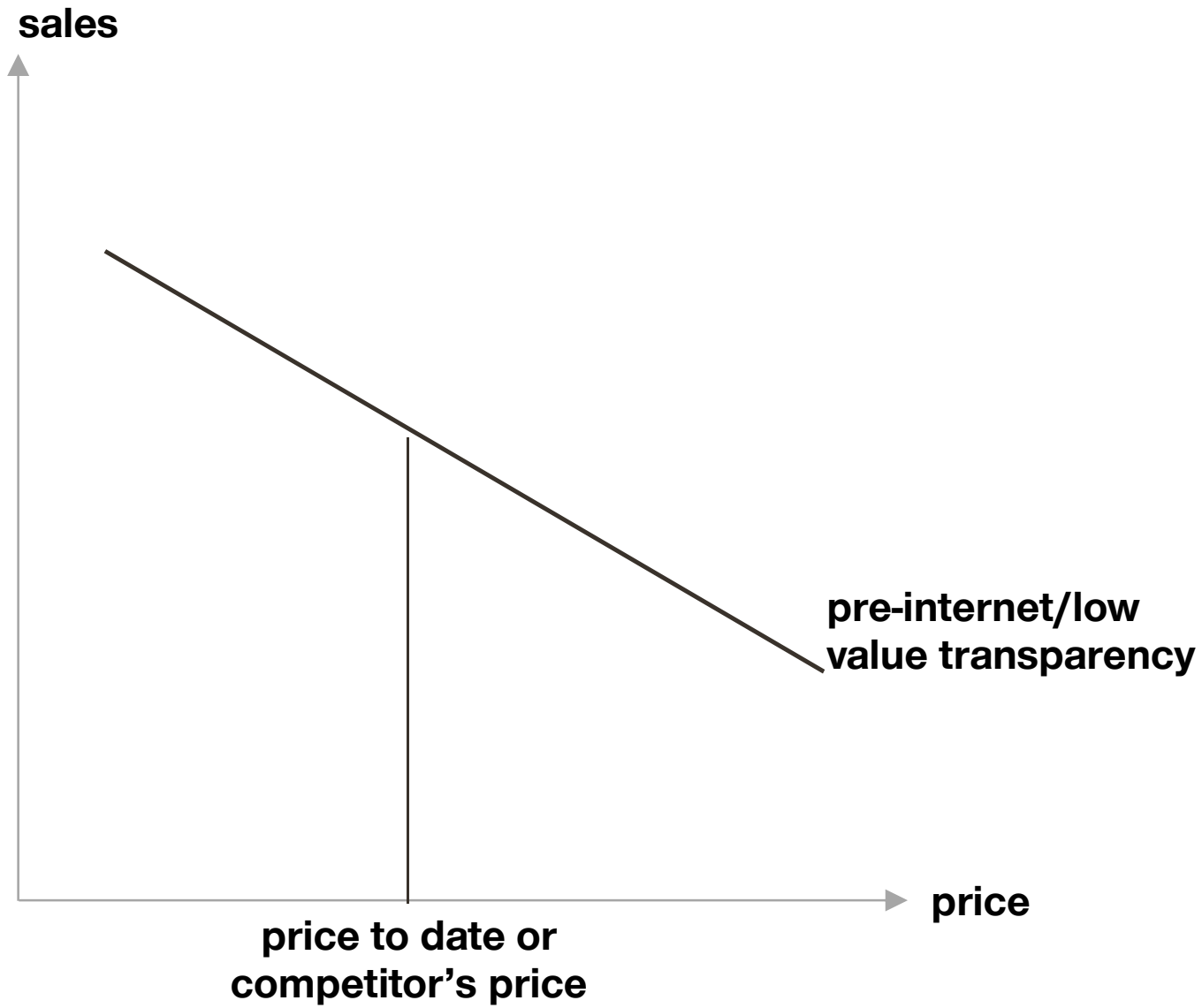
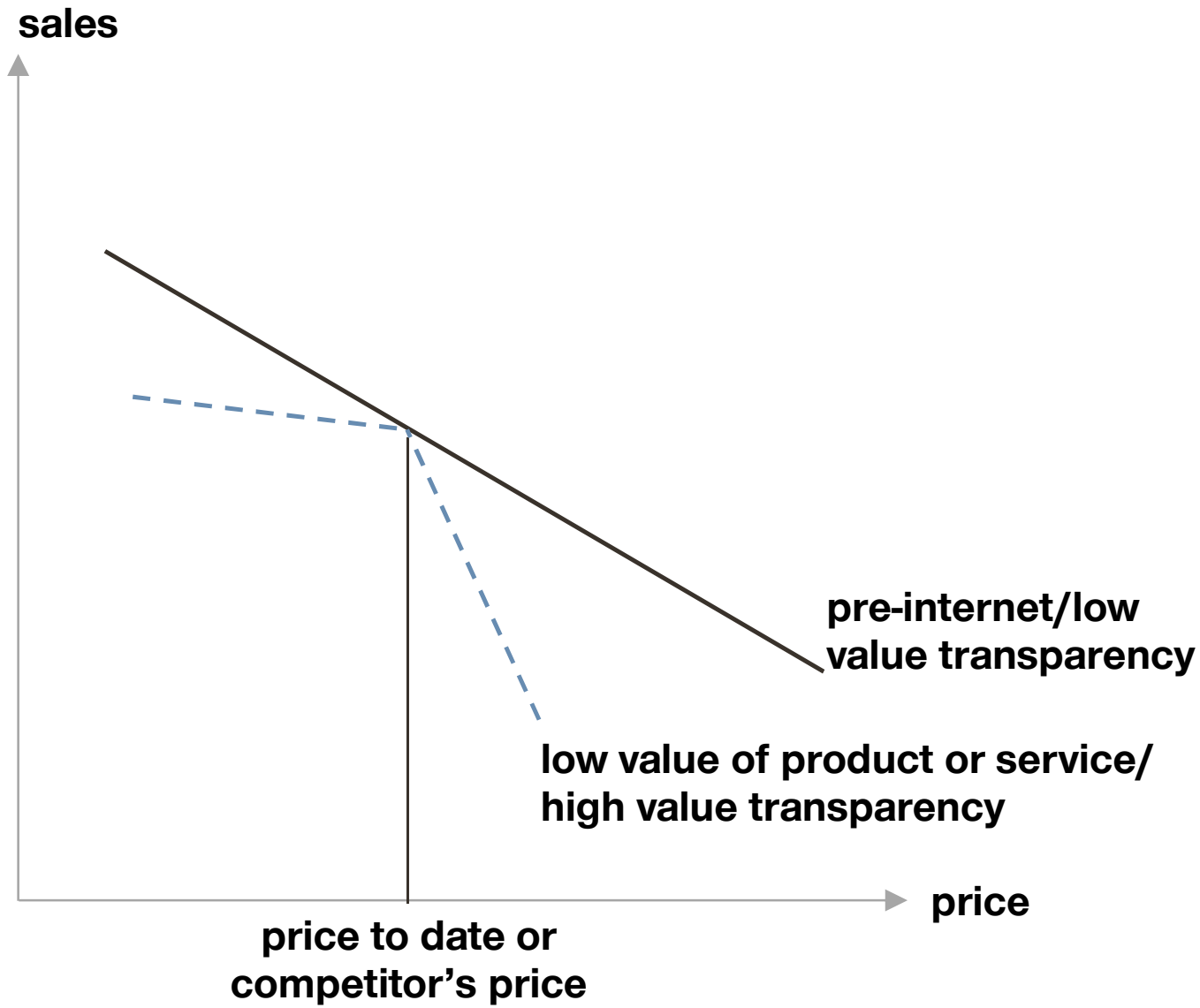


Radically Increased Value Transparency



Radically Increased Value Transparency

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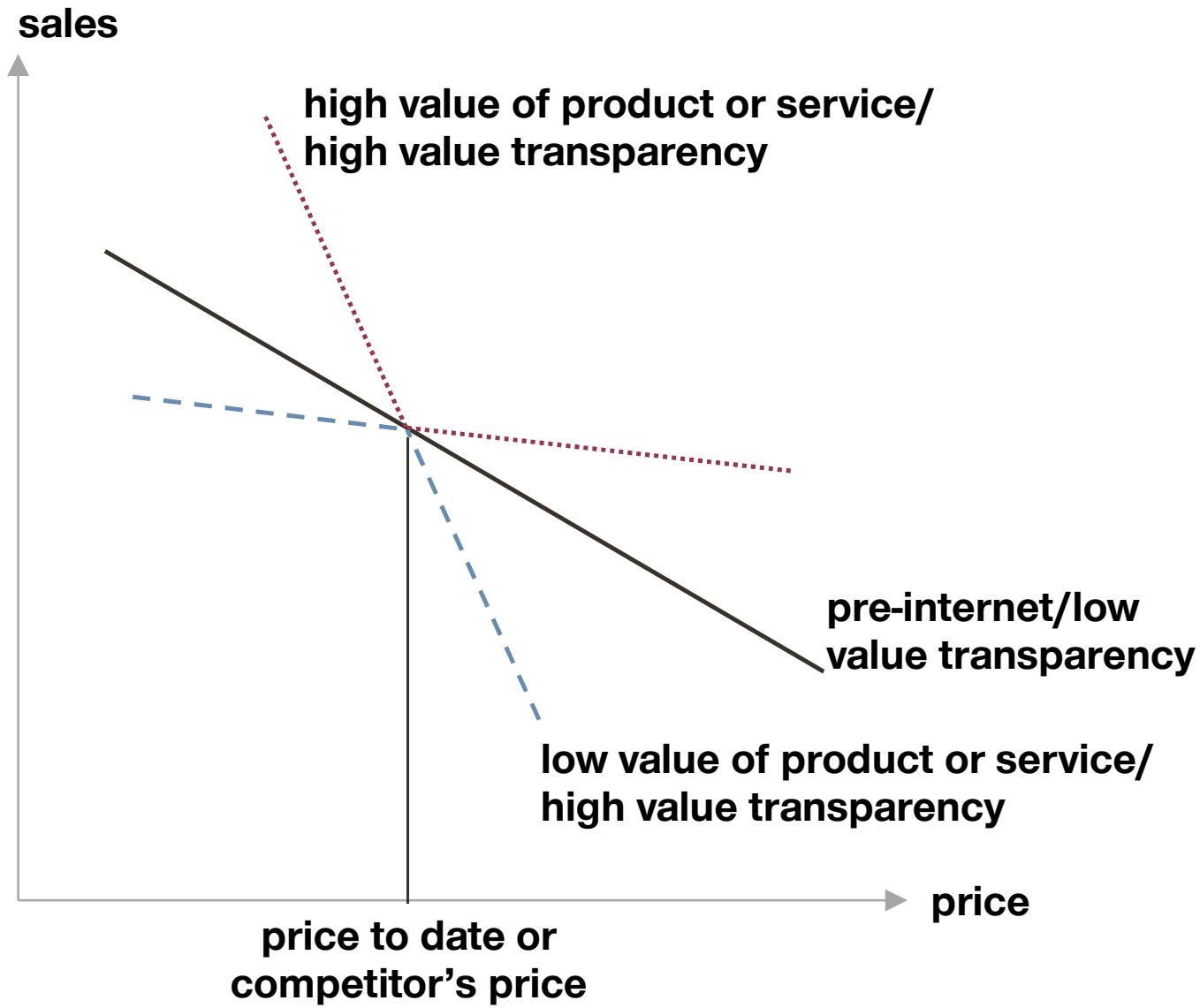

The Effects Are Asymmetric : "Fatal Silence"

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"Happy customers keep quiet, whereas unhappy customers voice their anger loudly – and quickly. Bad product or service ratings spread through the internet rapidly and are widely perceived. At the same time, consumers look at positive ratings only briefly and click away at the slightest atmospheric disturbance."

Source: Sybille Wilhelm in Der Handel, September 2015, p. 8

Sellers with bad ratings do not stand a chance even with aggressive prices

With negative ratings

- price ceases to be an effective competitive weapon
  (price elasticity goes down)
- price increases end in disaster
  (price elasticity goes up)
- Optimal price sticks

Sellers with positive ratings

- sell more with constant prices
- can raise price and lose less volume
  (price elasticity goes down)
- price cuts have stronger effects
  (price elasticity goes up)
- Optimal price can be lower or higher

Lesson 2

The internet will radically increase value transparency. This process has only just begun. The "cheating dealer" will disappear; only the "honest dealer" will survive and flourish.

Value transparency has asymmetrical effects on price elasticity. Companies need to **understand** and **pay attention** to these asymmetries. Striving for positive feedback becomes crucial for pricing.

A wave of new business/pricing models

Pricing Innovations in the Digital Age

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- **Flatrates**
- **Freemium**
- **Dynamic pricing** (improved revenue management)
- **Pay-per-use**
- **Individualized pricing/ personalization**
- **Two-dimensional pricing** (Amazon Prime)
- **New price metrics**
- **Interactive pricing** (auctions, name your own price)
- **Negative prices**
- **Sharing economy**
- **New payment systems**

5

A Critical Component: Sensors

The full potential of digital pricing can only be exploited if the whole process is digitalized, including the measurement of value delivery.

Examples

Water on the old farm
Michelin tyres
Enercon service concept
Teatreneu, Barcelona
Invers: car sharing systems

Areas with huge potential for value-based pricing:

- medicine/health,
- agriculture,
- logistics,
- potentially culture/leisure

Not "Sortware-as-a-Service" (SaaS)**, but "Results-as-a-Service"** (RaaS)

5

Lesson 3

Throughout history pricing innovations have been rare and spread very slowly. In the digital age, we are experiencing an explosion of new pricing and payment systems. Numerous new techniques and tricks work extremely well in e-commerce. But the complexity and the information requirements increase massively. Big data still needs very intelligent interpretation. Sensors play a critical role for fully digitalized business and pricing models.

What are the consequences of zero marginal costs?

Consequences of Zero Marginal Costs

- Short-term lower price limit: marginal cost
- Thus, a price of just above zero yields a positive contribution margin
- We will see negative prices more often (even today marginal cost is often undercut)*
- But long-term one cannot live from a positive contribution margin, one has to recover full cost
- We will see many suicidal pricing actions

*see Hermann Simon, Negative Prices – A New Phenomenon, The Journal of Professional Pricing, Fourth Quarter 2016, pp 18-21.

Lesson 4

Marginal costs of zero are a new phenomenon. They open the road for many pricing opportunities. But they also involve serious dangers, like dominance of volume or market share orientation, and negligence of profit orientation. Again, a deep understanding is indispensable.

How can an e-commerce dealer survive against Amazon?

Possible Approaches

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- **Higher value**
  - personal service
  - Hidden Champion strategy/specialization
- **Convenience: fairly hopeless**
- **Price: fairly hopeless**
- **Brand**
- **Customer retention**
- **Combination internet – stationary (multi channel)**

Where do I buy (besides Amazon)?

teacampaign

Drugstore.com,

Zalando (sometimes),

Bestsilver.de,

Moebelguenstiger.de,

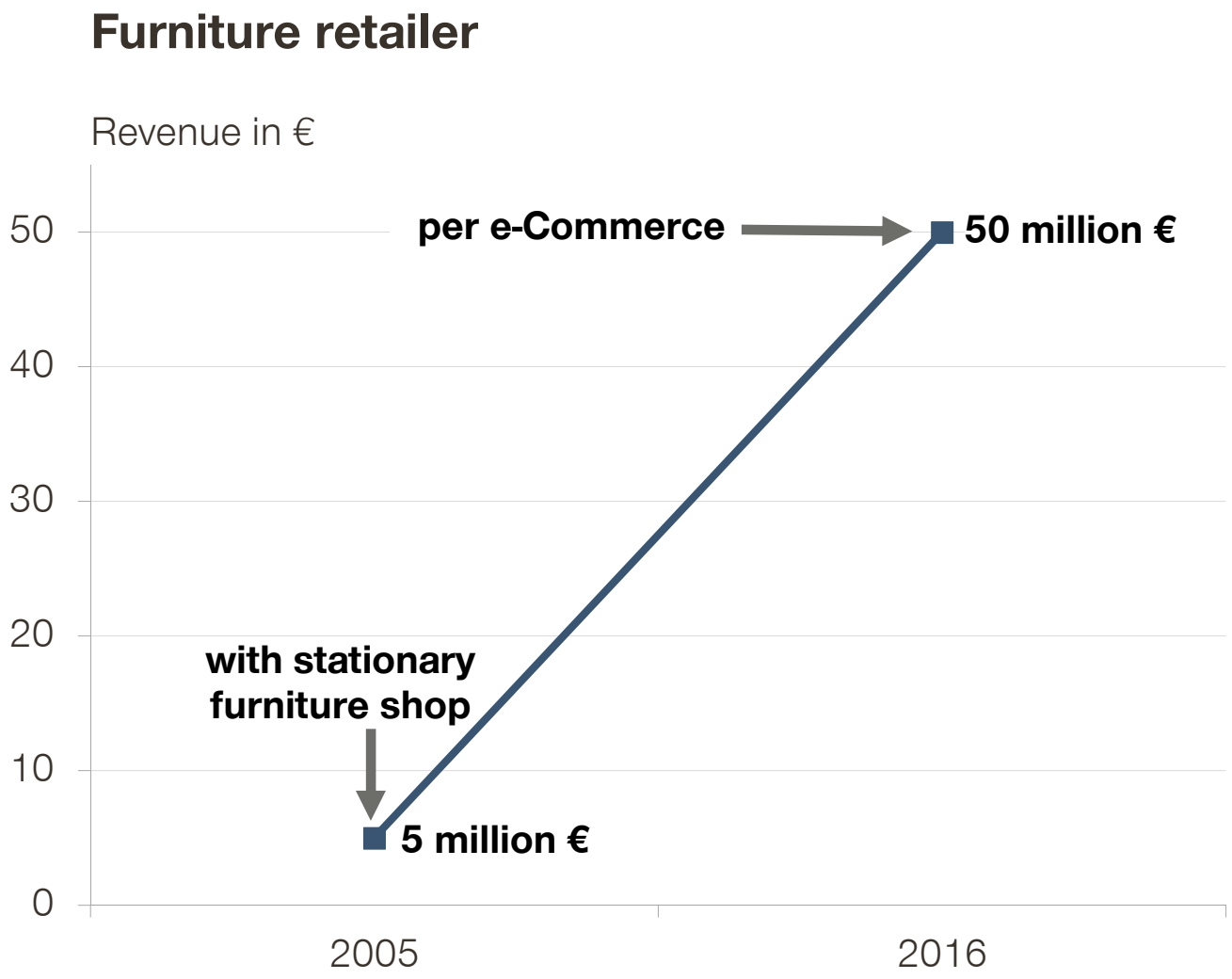
dietary supplements (Zonediet.com)

5

Case: Butlers

Digital + personalized Service

Case: moebelguenstiger.net



Case: Casper.com

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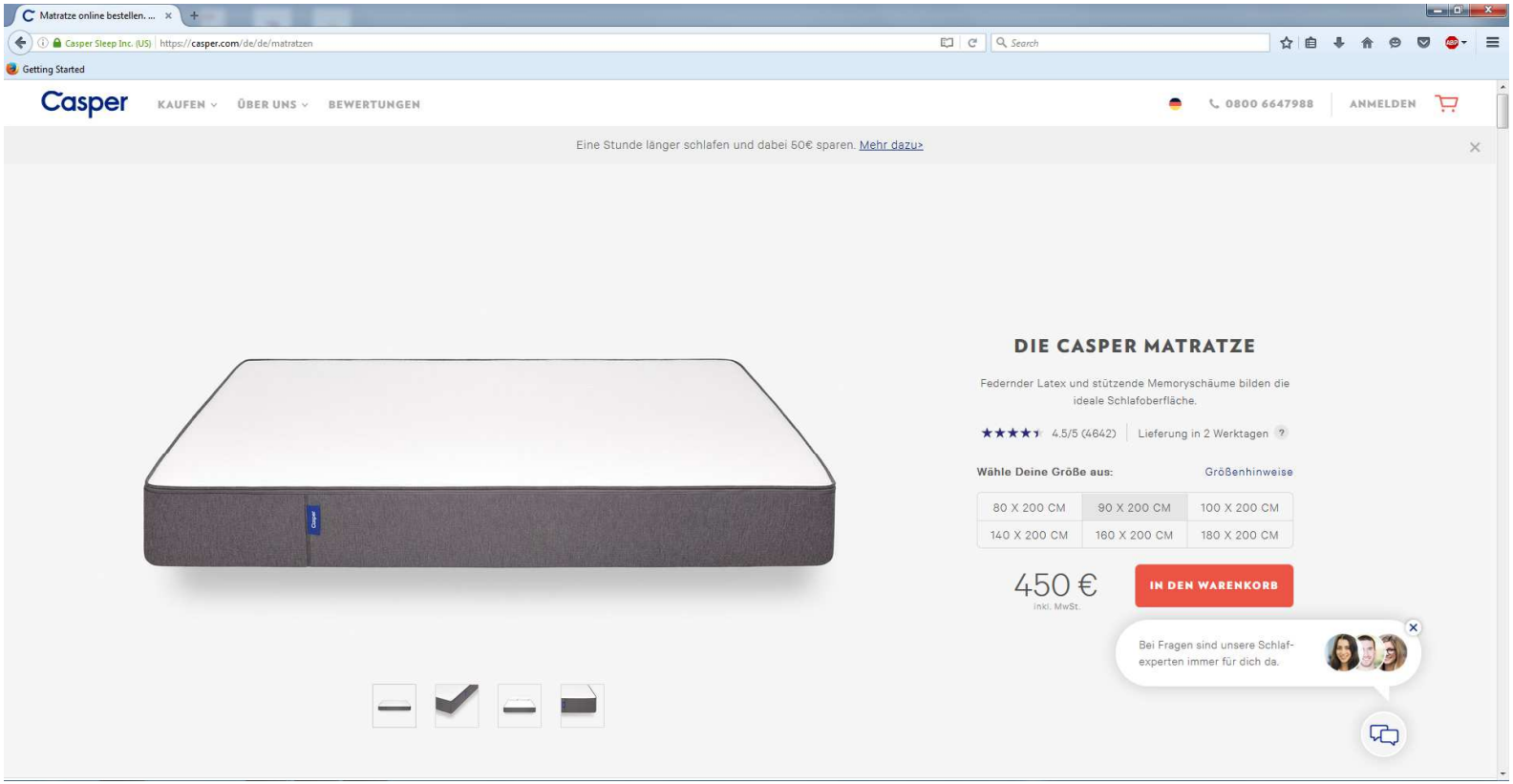
Idea:	**2013**
Product Introduction:	**2014**
Revenue 2015:	**200 Mio. $**
Valuation 2017:	**$1 billion (investment by Target)**



Lesson 5

Life in e-commerce is not easy if you are up against a giant like Amazon. However, a number of promising approaches have shown that it is possible to survive and to be successful. Even in the digital age, we will not exclusively see monopolies. Without massive cost advantages or superb financial resources price wars should be avoided. This is as true in the digital age as it was in the old world.

Summary

- In the digital age (as in the old economy)
  - price remains the most effective profit driver.
  - value-to-customer remains the most important aspect of pricing: Understand, create, and communicate value!
- Increased price transparency is currently the strongest effect on pricing. This effect favors price-aggressive providers.
- In the long run, the more important effect may be higher value transparency – with complex implications. The "cheating dealer" will not survive in the digital age.
- New business/pricing models imply big opportunities and big risks.
- Zero marginal cost offers more pricing latitude.
- Sensors are a critical component.
- There are ways to survive against the powerful e-commerce competition. Success examples show that it can be done.

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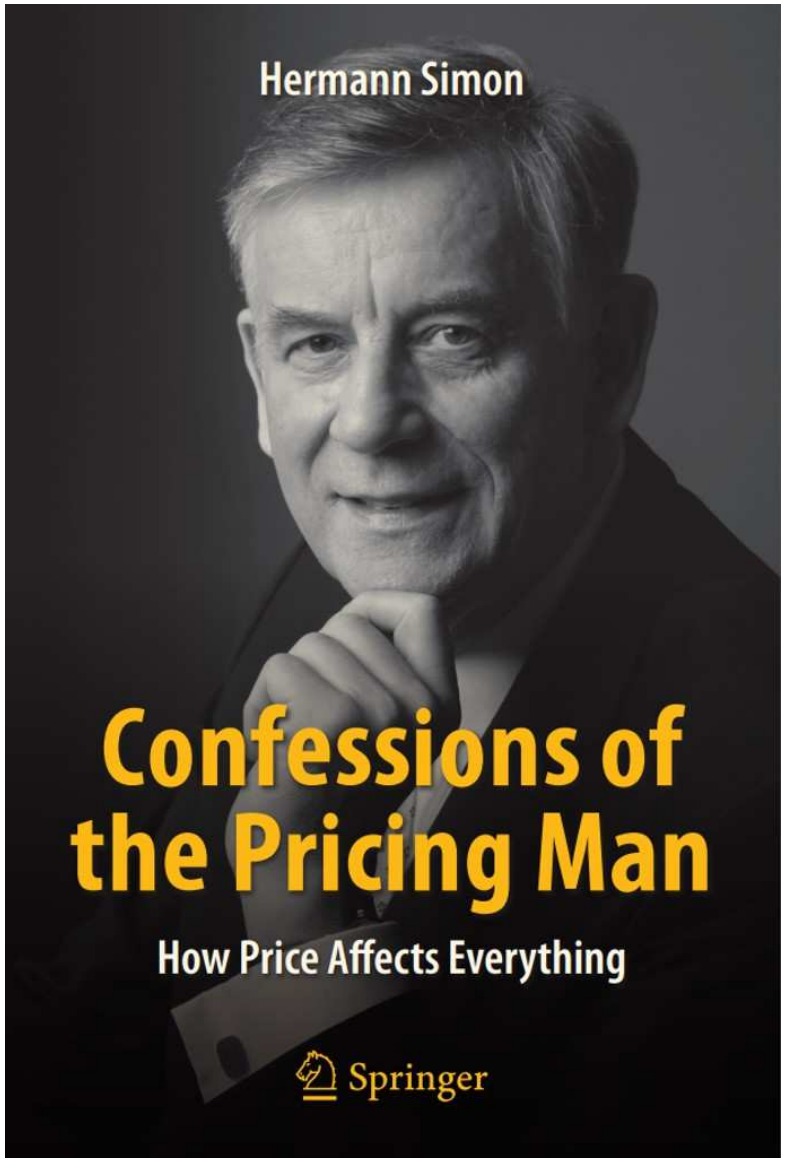

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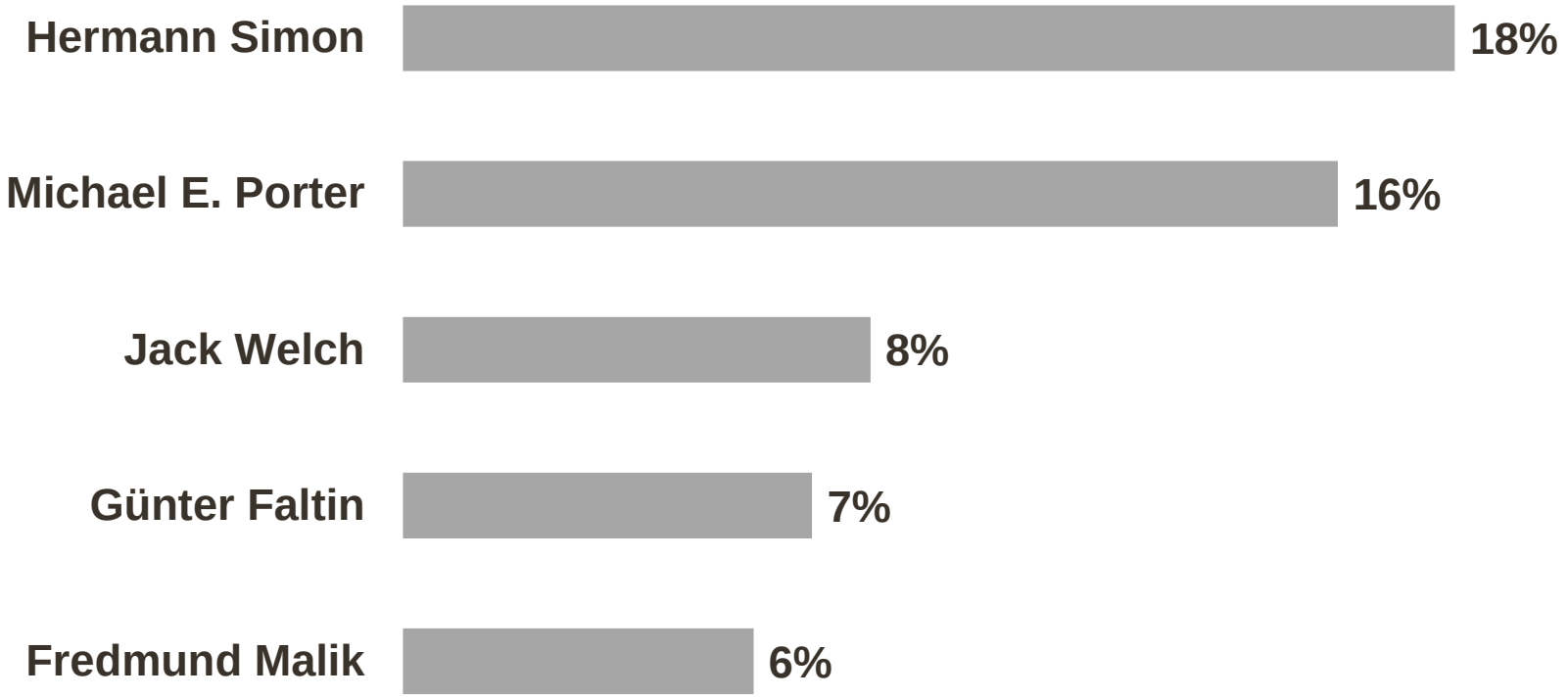

www.managementdenker.de, Internet Survey, n=661

Hermann Simon

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Hermann Simon is Honorary Chairman of Simon-Kucher & Partners. He is an expert in strategy, marketing and pricing. He has an extensive global range of clients. In the German language area he has been voted the most influential living management thinker.

Before committing himself entirely to management consulting, Simon was a professor of business administration and marketing at the Universities of Mainz (1989-1995) and Bielefeld (1979-1989). He was also a visiting professor at Harvard Business School, Stanford, London Business School, INSEAD, Keio University in Tokyo and the Massachusetts Institute of Technology. From 1995 to 2009 he was CEO of Simon-Kucher & Partners. His Hirsch-Index is 51.

Professor Simon has published over 35 books in 26 languages, including the worldwide bestsellers *Hidden Champions* (Boston 1996, cover story of *BusinessWeek* in 2004) and *Power Pricing* (New York 1997), as well as *Manage for Profit, Not for Market Share* (Boston 2006). His book *Hidden Champions of the 21st Century, Success Strategies of Unknown World Market Leaders* (New York 2009) investigates the strategies of little known market leaders. His book *Confessions of the Pricing Man* was published by Springer, New York in October 2015. *Price Management*, the US version of his leading textbook, will be published in 2017.

Simon was and is a member of the editorial boards of numerous business journals, including the International Journal of Research in Marketing, Management Science, Recherche et Applications en Marketing, Décisions Marketing, European Management Journal as well as several German journals. For several decades he regularly wrote columns for the German business monthly Manager Magazin. As a board member of numerous foundations and corporations, Professor Simon has gained substantial experience in corporate governance. From 1984 to 1986 he was the president of the European Marketing Academy (EMAC). Simon is co-founder of the first Special Purpose Acquisition Company (SPAC) listed on the German Stock Exchange in Frankfurt, which acquired Exceet Group S.E. in July 2011.

A native of Germany, he studied economics and business administration at the universities of Bonn and Cologne. He received his diploma (1973) and his doctorate (1976) from the University of Bonn. Simon has received numerous international awards and holds honorary doctorates from IEDC Business School of Bled (Slovenia), from the University of Siegen (Germany) and from Kozminski University Warsaw (Poland). He is a honorary professor at the University of International Business and Economics in Beijing.