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Pricing the Innovation for Market Introduction

The factors that influence pricing strategy change over the life of a product concept. The market defined by a product concept passes through four phases: development, growth, maturity, and decline. Briefly, the changes in the strategic environment over those phases are as follows: Market development. Buyers are price insensitive because they knowledge of the product's benefits. Both production and not a threat since the potential gains from market development exceed those from competitive rivalry. Pricing strategy signals the product's value to potential buyers, but buyer education remains the key to sales growth.

1. Introduction

An innovation is a product so new and unique that buyers find the concept somewhat foreign. It does not yet have a place in buyers' lifestyles or business practices. Consequently, the market requires substantial education before buyers recognize a product's benefits and accept it as a legitimate way to satisfy their needs. The first automobiles, vacuum cleaners, and prepackaged convenience foods initially had to overcome considerable buyer apathy. The first business computers had to overcome skepticism bordering on hostility. Today, innovations from home banking to video conferencing have encountered similar consumer reluctance, despite their legitimate promise of substantial value. An innovation requires buyers to alter the way they evaluate satisfying their needs. Consequently, before a product can become a success, its market must be developed through the difficult process of buyer education.

Not all new products are innovations, at least from a marketing perspective.

Sometimes a new product results from a technological breakthrough that simply lowers the cost of a product concept already well accepted among buyers. In 1909 Ford's Model T was a new product born in the technology of mass production, but its forerunners had already paved the way for its acceptance by consumers. Sometimes a new product simply improves on an already well-established concept, as was the case with the 3.5 inch computer diskette, the plain paper fax and the digital watch, all of which required little or no market development [1]. Even when a product provides a completely new benefit, it may not be an innovation from the standpoint of buyers. For example, drugs are so readily accepted as cures in our culture that new ones are generally adopted whit little hesitation by both doctors and patients.

A new product that embodies a new concept for fulfilling buyers' needs is an innovation whose success requires buyer education. An important aspect of that educational process is called information diffusion. Most of what individuals learn about innovative products comes from seeing and hearing about the experiences of other [2]. The diffusion of that information from person to person has proved especially influential for large expenditure items, such as consumer durables, where buyers take a significant risk the first time they buy an innovative product. For example, an early study on the diffusion of innovations found that the most important factor influencing a family's first purchase of a window air conditioner was neither an economic factor such as income nor a need factor such as exposure of bedrooms to the sun. The most important factor was social interaction whit another family that already had a window air conditioner [3].

Recognition of the diffusion process is extremely important in formulating a marketing plan for two reasons: First, when information must diffuse through a population of potential buyers, the long run demand for an innovation product at any time in the future depends on the number of initial buyers. Empirical studies indicate that a demand does not begin to accelerate until the first 2 to 5 percent of potential buyers adopt the product [4]. The attainment of those initial sales is often the hardest part of marketing an innovation. Obviously, the sooner the seller can close those first sales, the sooner he or she will secure long-run sales and profit potential.

Second, the "innovator", people who try new product early, are not generally a random sample of buyers. They are people particularly suited to evaluate the product before purchase. They are also people to whom the later adopters, or "imitators", look for guidance and advice. However, even innovators know little about how attributes or major attribute combinations should be valued. Marketing effects can, therefore, readily influence which attributes drive purchase decisions and how those attributes are valued. Identifying the innovators and making every effort to ensure that their experience is positive is an essential part of marketing an innovation [5].

What is the appropriate strategy for pricing an innovative new product? To answer that question, it is important to recognize that consumers' price sensitivity when they first encounter an innovation because they tend to use price as a proxy for quality and because there are usually no alternative brands with which to compare. Moreover, until they learn about the product's benefits, they may not even recognize a need for it. They lack a reference for determining value and to evaluate what would constitute a fair or bargain price. Consequently, most potential buyers are understandably unimpressed by a low price relative to the product's value, while the innovators are often undeterred by a high one.

It is ironic, therefore, that the greatest innovation of the past decade, the internet, was promoted as a channel for discounting. In fact, researchers discovered that, as in other cases, most users did not switch to internet shopping to save money, but to save time and to get access to a broader array of goods and services. Not surprisingly, then. Most internet venture failed. The few that have succeeded offer unique products or a business model that vastly enhances the value or convenience of the shopping experience. Although grocery delivery companies in the United States took the discount road and failed, Tesco in Great Britain has succeeded with a high-service, full-price model. Similarly, Indulge.com and DRessmart.com cater profitably to customers looking for unique clothing for which they are willing to pay top dollar. Consequently, although those sites have remained small, they became profitable quickly.

Given the problem of buyer ignorance, the firm's primary goal in the market development stage is to educate potential buyers concerning the product's worth. Consequently, the regular or list price for a new innovation should be set to communicate the product's value to the marketplace. It is the price that a seller believes satisfied buyers would pay for a repeat purchase. It given buyers a reference from which to estimate the product's worth and assess the value of price discounts and future price reductions. If the seller plans a skim-pricing strategy, the list price should be near the relative value that price-insensitive buyers will place on the product. If the seller plans a neutral strategy, the list price should be near the relative value for the more typical potential user. The seller of an innovation should not set a list price for market penetration, how-ever, since the low price sensitivity of uninformed buyers will make that strategy ineffective and may, due to the price-quality effect, damage the product's reputation.

2. Why Pricing Is Often Ineffective

The difference between price setting and strategic pricing is the difference between reacting to market conditions and proactively managing them.[1] It is the reason why companies with similar market shares and technologies of ten earn such different rewards for their efforts. Strategic pricing is the coordination of interrelated marketing, competitive, and financial decisions to set prices profitably. For most companies, strategic pricing requires more than a change in attitude; it requires a change in when, how, and who makes pricing decisions. For example, strategic pricing requires anticipating price levels before beginning product development. The only way to ensure profitable pricing is to reject early those ideas for which adequate value cannot be captured to justify the cost. Strategic pricing also requires that management take responsibility for establishing a coherent set of pricing policies and procedures, consistent with its strategic goals for the company. Abdicating responsibility for pricing to the sales force or to the distribution channel is abdicating responsibility for the strategic direction of the business.

Perhaps most important, strategic pricing requires a new relationship between marketing and finance. Strategic pricing is actually the interface between marketing and finance. It involves finding a balance between the customer's desire to obtain good value and the firm's need to cover costs and earn profits.

Unfortunately, pricing at most companies is characterized more by conflict than by balance between these objectives. If pricing is to reflect value to the customer, specific prices must be set by those best able to anticipate that value—presumably marketing and sales managers. But their efforts will not generate sustainable profits unless constrained by appropriate financial objectives. Katfrer tftan attempting to "cover costs,''fimance must learn how costs change with changes in sales and must use that knowledge to develop appropriate incentives and constraints for marketing and sales to achieve their objectives profit ably.

With their respective roles appropriately defined, marketing and finance can work together toward a common goal—to achieve profitability through strategic pricing. Before marketing and finance can attain this goal, however, they must discard the flawed thinking about pricing that leads them into conflict and that drives them to make unprofitable decisions. Let's look at these flawed paradigms and destroy them once and for all.

3. Marketing Innovations Through Price-Induced Sampling

Whether the list price is the actual price firs-time buyers are asked to pay is another question entirely. The answer should depend on the relative cost of different methods for education buyers about the product’s benefits. If the product is frequently purchased, has a low incremental production cost, and its benefits are obvious after just one use, the cheapest and most effective way to educate buyers may be to let them sample the product. For example, America Online built its commanding market share by sending every family in America a mailing, including a diskette, for a thirty-day, free, trial membership.

Not all innovative products can be economically promoted by price-induced sampling, however. Many innovations are durable gods for which price cutting to induce trial is rarely cost-effective. A seller can hardly afford to give the product away and then wait years for a repeat purchase. Moreover, many innovative products, both durables and nondurables, will not immediately reveal their value when sample once. Few people who sampled smoke alarms, for example, would find them so satisfying that they would yearn to buy more and encourage their friends to do the same. And many innovations (for example, personal computers) require that buyers learn skills before they can realize the product’s benefits. Without a marketing program to convince buyers that learning those skills is worth the effort and strong support to ensure that they learn properly, few buyers will sample at any price, and fewer still will find the product worthwhile when they do. In such cases, price-induced sampling does not effectively establish the product’s worth in buyers' minds. Instead, market development requires more direct education of buyers they make their first purchases'.

4. Marketing Innovations through Direct Sales

For innovations that involve large dollar expenditure per purchase, education usually involves a direct sales force trained to evaluate buyers' needs and to explain how the product will satisfy them. The first refrigerators, for example, were sold door to door to reluctant buyers. The first salesperson's job was to help buyers imagine the benefits that a refrigerator offered, beyond those that an ice chest was already capable of providing. Only then would those first buyers abandon tradition to make a large capital expenditure on new, risky technology. Business buyers are equally skeptical of the value of new innovations. In the 1950s, most potential users of air freight service thought they had no need for such rapid delivery. American Airlines built the market for this new innovation by offering free logistics consultation. American's sales consultants showed potential buyers how this high-priced innovation in transportation could replace local warehouses, thereby actually saving money [6]. They taught the shippers how to see their distribution problems differently, from a perspective that revealed the previously unrecognized value of rapid delivery by American's planes.

When the innovation is more complicated than refrigeration or air freight, even a convincing evaluation of buyers' need may leave them too uncertain about the product's benefits to adopt it. For example, a business computer in the 1950s was quite a risky purchase. Even if a buyer was certain about the quality of the computer hardware, he or she had no assurance that computer system could actually do the billing, payroll, and production scheduling that the salesperson claimed it could do. IBM increases the business adoption rate of computers, quickly overcoming. Sperry Rand's three-year lead as a mainframe manufacturer, by mitigating this source of uncertainty. IBM did so by marketing as a single package the hardware, software, systems analysis, and employee training required to guarantee the benefits its salespeople promised.

Neither American nor IBM priced their products cheaply despite their desire for rapid sales growth. Instead, they educated their markets, showing why their products were worth the price, and they aided buyers' adoption to minimize the risk of failure, they funded these high levels value of the products. Du Pont has employed this same high-price, high-promotion strategy in introducing numerous synthetic fabrics and specialty plastics. Apple employed it in developing the market for personal computers. And the most successful marketers of industrial robots are using it today [7].

5. Marketing Innovations Thought Distribution Channels

Not all products have sufficiently large sales per customer to make direct selling practical. This is particularly true of innovative products that are sold indirectly through channels of distribution. However, the problem of educating buyers and minimizing their risk does nor go away when the product is handed over to a distributor. It simply makes the need to rely on an independent distribution network problematic. The innovator must somehow convince the distributors who carry the product to promote it vigorously. Once way to do this is with low wholesale pricing to distributors. The purpose of the low wholesale prices is not for distributors and retailers with high margins, giving them an incentive to promote the product with buyer education and service. While that works whenever distribution is relatively exclusive, there is the risk whenever distribution is less restricted that competition will simply cause the extra margin to be passed on in price discounts, thus losing the promotional incentive. To over come that challenge, innovators may keep the margins at normal levels but pay incentive fees for stocking new products, for on-site service and demonstration. They may also offer incentives directly to the middleman's salespeople for taking the time to understand and promote the product. For example, Cuisinart, Inc., successfully introduced its food processors to the United States by giving retailers substantial incentives for promotion. Department and cookware stores responded enthusiastically, spurring sales with in-store demonstration and classes in Cuisinart cooking. Millions of consumers then willingly paid the Cuisinart's high retail price once they learned it was justified by the product's benefits.

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