ASSIGNMENT 04

Pricing

the most important marketing message you send your customer.

The Question: What value does your customer perceive in your offering?

Pricing is an art. It is an interplay between:

1. The value of your offering to customers
2. How your customers perceive that value
3. The incentive to buy
4. The price

Pricing is the most important marketing message you send your customer.

The Assignment

01 **Read** *LP Pricing Note* by us.
Watch Harrison Metal Videos: http://www.harrisonmetal.com/
Marketing Math 1: Fixed & Variable Costs

02 **Create** a current pricing thermometer based on an interaction you've had with a **real** customer, based on how you currently perceive your own offering (use the worksheet)

03 **Conduct** a competitive landscape analysis, look at the alternatives a customer might consider. In defining the competition, consider not only the “old world” thing(s) you’re disrupting, but also the prices of other, new disruptors of the space.You also must consider ‘apathy’ as a competitor and think about why your target customer may choose to do nothing when seeing all these competitive solutions.

04 **Iterate** your pricing thermometer: do one more version. In particular, reflect more carefully about the things your customer says and does. Are there more provocative forms of objective value? What would justify a 10x or 100x increase in the objective value? (us the worksheet)

05 **Share** your Original and iterated thermometers on Slack by 5pm PST Sunday 4/9. Comment on at least two other submissions before class on Tuesday. Bring worksheets to class on Tuesday 4/11

Advice for Success

Speak to your customers. What do they value in your offering? Is it a single source of value or multiple sources of value? How much pain do their problems cause them? What are their alternatives to using your offering and how much do they value their alternatives? What do they compare you to and why?

Understand the specific sources of value for your customer and then infer the pricing thermometer yourself. You should not expect your customer to prepare a thermometer or to calculate their objective value. It may be necessary to get creative when you put a price on the objective value of deep emotional needs.

Most important: Get input only from customers (people who have bought your product or turned down an actual sales attempt). Interviews with people about what they might want to pay are useless in pricing.

A4: Pricing Thermometer

Company ___________

Version CURRENT

Customer
&
What they value

This should relate to the customer pain point/key feature

Objective Value & Justification

Objective V: Measure of the benefits the product/service delivers to the customer

Perceived Value & Justification

Perceived V: Measure of the what customer will compare you to if you did not have any marketing message

Current Price

Your current guess on price

Cost of Goods & Justification

Your current guess on cost

(decide if you time have any value :-)

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LAUNCHPAD

Concept from Robert J. Dolan
Adapted by Klebahn 2023

A4: Pricing Thermometer

Company ___________

Version **ITERATED**

Customer
&
What they
value

This should relate
to the customer
pain point/key
feature

Objective
Value
&
Justification

*Objective Value
and why?*

Perceived
Value
&
Justification

*Perceived value
and why it is
higher then the
'CURRENT' ?*

ITERATED Price

*What is new?
What is more
complex/nuanced
now?*

Cost of Goods
&
Justification

*Again - get
real about your
time…*

STANFORD UNIVERSITY d.school LAUNCHPAD 13

*Concept from Robert J. Dolan
Adapted by Klebahn 2023*

Launchpad Notes: Pricing

You must sell your offer to prove product market fit

Before We Begin

Before we begin, please visit the following link[1] and read the short article that appears after you submit your answer to the puzzle:

[A Quick Puzzle to Test Your Problem Solving - The New York Times](#) (if challenges with a p[ay wall just good New York Times number quiz)

Introduction

In Launchpad, we focus early stage founders on product/market fit. This focus means that founders will test three things over and over again:

1. Who is my target user?
2. What pain point does this user have?
3. What is the key feature of my solution that solves that pain for that user?

These three variables are critical to having focus: a segment of a user group, a particular circumstance when/where that user encounters a pain point, and a key feature (not a full product or service).

Founders who reach the point where they are getting positive feedback from target users must finally prove product/market fit by pricing their new offer and putting that offer in front of a target user and getting a sale.

Good feedback about your new offering is not enough. You need feedback ***and verification that the target user will buy***. This will give you the conviction to continue to invest resources.

In this article, we will cover three topics:

1. The importance of selling and how to sell even if you think you aren't ready
2. A value-pricing framework to use to think about the different dimensions of pricing
3. How to use the value-pricing framework to run experiments and increase prices

Why it is so important to sell

For your early-stage venture, pricing and then charging for your offering serves four important

[1] David Leonhardt, “A Quick Puzzle to Test Your Problem Solving,” The Upshot, New York Times, July 2, 2015

purposes:

1. **Validation:** there is no uncertainty when you have a paying customer; they have unambiguously demonstrated that they see value in what you offer
2. **Experimentation:** tests with prices or pricing structures can provide unexpected insights into your customer—pricing is an extremely powerful tool for sparking insightful conversations and uncovering more important needs
3. **External Validation:** having paying customers is social proof that can help convince prospective customers to try your offering, and can convince external investors that your idea is worth funding
4. **Growth:** the revenues from your sales can be reinvested to drive growth

Without validation and experimentation, you will not be making progress towards demonstrating product/market fit. Without external validation and growth your startup will languish.

Sales must be real

As far as validation is concerned, perhaps the biggest mistake that an early stage founder can make is to conduct a survey to ask, for example, "Would you buy this for $50?"

The mistake is to expect a non-hypothetical answer to a hypothetical *"would you?"* question. Your future customers don't want to lie to you but it is only human nature that your customers want to avoid disappointing you with their honest opinion. Only when you ask your customers to give up their hard earned money, will you hear directly that they don't want your offering, that they don't understand your offering, that they don't really need your offering, that they can't afford your offering or that they need to ask their boss because they don't have the authority to place an order for your offering.

To test product/market fit, you must make real sales. You need to say, "This costs $50, are you paying by cash or card?"

Case study: Simeon[2]

Asking for real sales is powerful. We recently met Simeon, who was about to invest his life's savings into software development. He had "validated" his retail receipt analytics idea by running a survey with 90 potential customers, and learned that 86 of them said that they *would pay* for his idea.

On our advice, he tried again, but asking potential customers for real payment. He discovered that not only were they unwilling to pay, he could not even pay *them* to use his service! This "rejection" saved him thousands of dollars and months of development and allowed him to discover a more lucrative but related product.

[2] Identifying names and some details in the case studies have been changed.

If you stop reading now, your take-away should be this: a paying customer is the most important validation of product/market fit; you must conduct experiments with real prices as often as you experiment with other aspects of your offering.

What if I can't accept payment?

Up-front payment is ideal, but sometimes an immediate cash transaction is impossible. However, you must still make *real* sales. Here are some strategies you could try:

- Ask your customers to place a pre-order or a deposit.
- Ask your customers to provide their credit card details, because you will charge them when your offering is ready.
- Ask your customer to sign a conditional order (e.g., conditional upon you first obtaining a mandatory safety certification from a government laboratory).
- Ask your customer to make a significant in-kind payment (e.g., your customer agreeing to provide their own time or equipment in order to help you bring your offering to market).

Don't kid yourself, though. Nothing beats the clear-cut certainty of having received cash payment. Before accepting an alternative, be sure to ask for up-front cash payment. There is no cost in asking and no harm to you in being told "no".

What if my product doesn't exist?

The temptation of founders is to price and sell **after** doing all the work to make the product real. There seems to be a thought that the customer must have the real product and after some initial work the founder must toil away and make a final version of the product to sell.

In fact, you may not have even begun development of your idea before you start to *ask* for payment. You may decide not to *accept* that payment. However, you can still *ask* for payment and watch to see how the customer responds.

Here are some strategies to try if your offering does not yet exist:

- Create a catalog with a range of products, and allow your customer to buy from the catalog.
- Use online marketing (e.g., Facebook, Google, LinkedIn) to see if your customer will click through to a "Buy Now" button.
- Create a marketing brochure and meet with your customer for a face-to-face sales meeting.

How to set a price

Many entrepreneurs (wrongly) assume they should enter a marketplace with a low price because no one knows their company or their product. Perhaps they take their unit cost (how much it costs to produce their product) and add a small markup to reach a price per unit. This pricing strategy is common in competitive markets of undifferentiated goods, where sellers compete solely on price.

However, if you are searching for product/market fit, you are certainly not competing solely on price. Your customers have unresolved pain points and they are willing to pay for it. The more pain you solve and the less competition you have the more you should charge to grab these early adopters[3].

You transmit a message with your price. Offering a low price may send an unwanted message. It signals to your customers that your customers that your offering is low quality. Price can help you get the attention of that target customer and help you transmit your message to them that your breakthrough product or service will do something great for them.

As a founder, you need to view pricing as part of your relentless experimentation. Pricing is not a spreadsheet calculation. It is a process of engaging with your customer, understanding their perceptions and pain, and testing different pricing strategies that may appeal to them.

Dimensions of Pricing

Pricing is a complex art. It serves at least three purposes:

- **Messaging:** the price signals that your offering will solve their pain point; it conveys attributes of your offering, such as its quality, your confidence in the quality, and how it compares to your competitors; it helps your customer understand your offering
- **Innovation:** the pricing structure itself may be part of the value of your offering
- **Incentive:** an attractive price, relative to the benefits you provide your customers, gives them a reason to buy

An early stage founder can't simply speculate about the full impact of a price on the minds of customers. The only way to uncover these dimensions is to put a real offer with a real price in front of real customers and then dig into their reaction.

[3] Moore, Geoffrey A. *Crossing the Chasm: Marketing and Selling Technology Projects to Mainstream Customers*. Harper Collins, 2009.

Dolan and Gourville's Pricing Framework

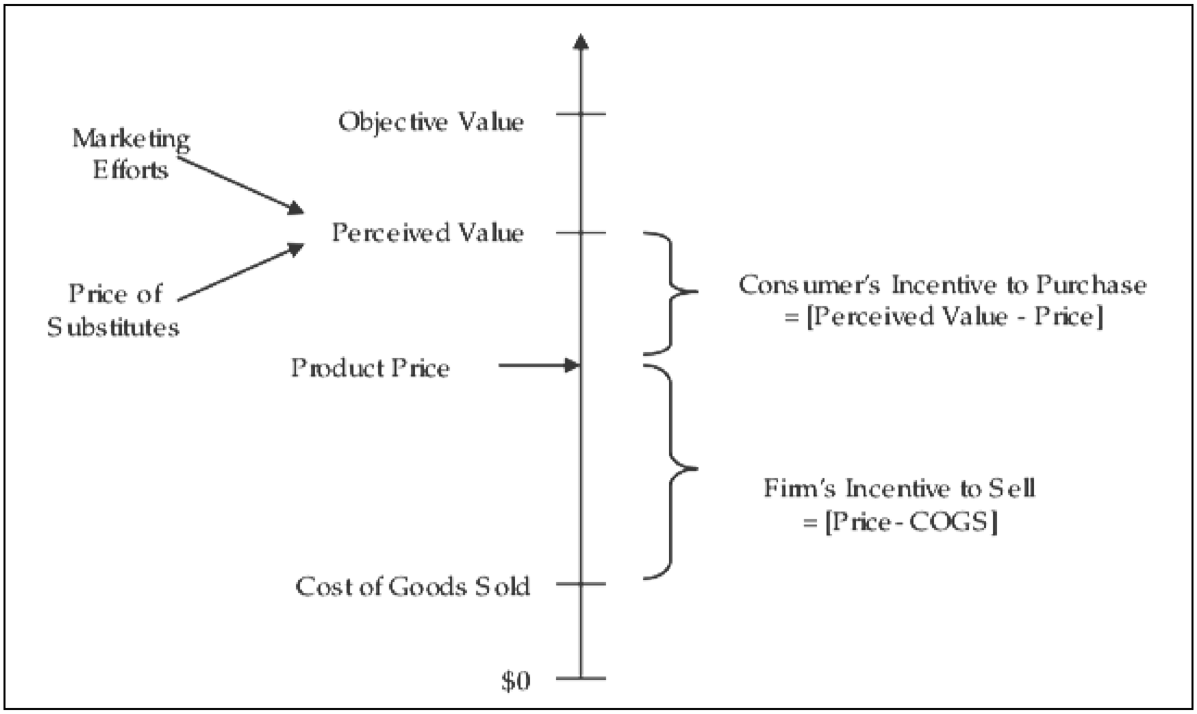

Figure 1: Dolan and Gourville's (2005) Value-Pricing Thermometer[4]

Robert Dolan and John Gourville use the *Value-Pricing Thermometer* (see Figure 1) as a framework to unpack pricing and get you thinking about how to price your offering differently and change the message you transmit to your target customer.

The thermometer has a scale with four points: Objective Value, Perceived Value, Product Price and Cost of Goods Solved.

Let's start with Objective and Perceived Value:

- **Objective Value:**

  The objective value is the sum total of all benefits that you provide to your customer.

  For example, think about the value of a telephone call. It may seem to be of little value (a few cents, perhaps), but think about the total benefits of a given call. It could include the benefits of reconnecting with loved ones, closing an important business deal, or a child's life saved by reaching a doctor. Objectively speaking, you might place an extraordinary value on a phone call. Of course, persuading you to pay that amount would be a different matter.

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[4] Dolan, Robert J., and John T. Gourville. "Principles of Pricing." *Harvard Business School Background Note 506-021*, September 2005, https://hbr.org/product/an/506021-PDF-ENG.

Objective Value is where you need to dream big as a founder. The value here is driven by thinking through what value you create for a target customer if you alleviate that pain point you found and has driven your development. What could that be potentially worth to your customer?

If you are solving an acute pain point for your customer, the Objective Value should be a high number.

- **Perceived Value:**

  The perceived value is the benefit that your customer personally perceives in your offering.

  Think again about the extraordinarily valuable phone call. No product exists in isolation. You have alternatives to a phone call: you can send emails, you can send letters or postcards, you can drive to a face-to-face meeting or rush your child directly to the hospital. When you think about these alternatives, and ask yourself what a phone call is worth, perhaps you will imagine a figure around a few dollars.

  This is where you draw from your understanding of your user and the many ways they might either solve pain points like the one you found, or what you have already seen them comparing you to. Ask yourself who your customers compare you to. Find out the price of the substitutes or alternatives available to your customer. Consider the initial impression that your customers have of your offering.

These are the two key concepts that drive the framework.

Most of the time, the objective value of a new breakthrough offering is quite high but the perceived value is considerably lower. This is normal at the start. The difference between the two highlights the work and opportunity that marketing in your startup must do to move the perceptions of your target customer closer to the objective value. Your effort is directed at changing your customers' perceptions of your offering from something that is already out there into something new with a dramatic impact.

The remaining two points involve less speculation:

- **Product Price:**

  The product price is what you want to currently charge your customers.

  For example, a cell phone plan may charge $0.02/minute for a phone call.

  The difference between the value your customers perceive and the price you charge is the incentive to buy. Suppose they perceive a $5 value but your product costs $0.02, then that $4.98 surplus gives your customer reason to use your product.

- **Cost of Goods:**

  This is the cost, to you, of delivering your offering to a customer.

  For example, it may cost your cell phone company an average of $0.005/minute for your phone call, even though they price it at $0.02.

As an early stage founder, the Cost of Goods on your first few sales may be extremely high. Making money on these sales is not the point. In the pricing thermometer, you should make an educated guess at what the costs of goods for your offering will be once you have a reasonable volume of orders.

The difference between the Product Price and the Cost of Goods is how you make money: it is your incentive to provide your offering to customers.

Experimenting with the Value-Pricing Thermometer

The Value-Pricing Thermometer offers a framework for experimentation.

To begin, use what you already know to formulate a first guess at the values on the thermometer. Think about a specific customer you have met and then estimate their Objective Value and Perceived Value. Try to put a number on the intangibles. For example, you might decide that they would value an extra hour with their family at $100. Write down your current Product Price. Estimate the Cost of Goods for when you have a reasonable volume of orders.

These four numbers (and your notes) are your first hypothesis.

Nothing on the thermometer is necessarily fixed: as a founder you have agency to influence every price on the thermometer.

Now, create many more of these thermometers to help explore ways to unlock the value you have created and message it to your customer. What could you change or do to unlock ten times or one hundred times the Objective Value? How could you change perceptions to increase the Perceived Value? How could you change your offering to reduce the cost?

Once you have created a few thermometers, you can test these hypotheses. The simple idea behind testing with the pricing thermometer is to find prospective customers and make an offer. When they decline, ask for more information.

Shifting the Thermometer

You have the agency to shift any price on your thermometer. Here are some ideas:

Objective Value:

- Targeting a more acute pain point
- Targeting a different customer who experiences the pain more acutely
- Reducing any barriers that limit the benefits your customer enjoys

Perceived Value:

- Comparing your offering to different products or services (e.g., pitching your product as a "fashion accessory", rather than a "set of earphones")
- Changing the packaging or marketing to create a different first impression
- Changing the medium or methods that you use to reach your customer
- Emphasising different aspects of your offering

- Bringing greater awareness to the Objective Value more directly

Product Price:

- Packaging non-cash benefits with your offering (e.g., satisfaction guarantees, options, insurance)
- Reducing the non-cash costs your customer experiences while using your product (e.g., the time or hassle involved in signing up, paying or using your offering)
- Offering alternative payment schemes, loyalty programs or subscriptions
- Charging based on measurable benefits experienced by the customer (e.g., commissions)

Cost of Goods:

- Changing your offering (e.g., more narrow or more broad offering)
- Using higher-cost or lower-cost materials

Case study: Joanne

Joanne developed new gloves for training in a popular martial art. It used special stitching and inserts that actively reduced a common strain injury, in addition to providing the usual armour against impact. She was about to abandon the idea because her "premium glove" was not selling.

The Value-Pricing framework helped her realize that she wasn't just selling gloves: she was selling freedom from physical pain and medical treatment, and the ability to continue enjoying the sport. With this higher Objective Value in mind, she dramatically increased the Perceived Value by increasing the price and changing the marketing message to the concept of a "physiotherapist on your hands". This *increase* in the Product Price resulted in *increased* sales.

Pricing as a Source of Value

Sometimes a breakthrough for you and your customer comes from entirely rethinking the unit of what you're selling.

Suppose you think you're selling solar-powered drainage pumps but your customer is really buying because they need water removed from their land. Your incentives might be better aligned by pricing directly for their pain point. A customer that can pay for an all-inclusive water removal service (by the gallon or by the season) may be relieved to avoid maintenance costs, up-front capital costs and the risk associated with reliability.

You should experiment with thermometers that have radically different strategies for pricing your offering.

Case study: Dave and Peter