Value-Based Pricing

- Don’t need to price by identity
- Offer product line, and watch choices
- Design menu of different versions
  - Target different market segments
  - Price accordingly (self selection)

Quicken Example Revisited

- Quicken for Windows at $20
- Quicken Deluxe at $60

Traditional Information Goods

- Hardback/paperback
- Movie/video

Dimensions to Use

- Delay (Fed Ex, Stock Quotes)
- User Interface (DialogWeb, DataStar)
- Image Resolution
- Speed of operation (Mathematica)
- Format (Lexis/Nexis)
- Capability (Kurzweil)
- Features (Quicken, tech support)
- Comprehensiveness (DialogWeb, DataStar)

Example

- How to Price?
  - 40 Type A’s
    - SLOW: $40
    - FAST: $100
  - 60 Type B’s
    - SLOW: $30
    - FAST: $50
Example

- Fast only? Revenue = $5000

Example

- Slow only? Price = 30, Revenue = $3000

Example

- Fast 100, Slow 30? Type A’s buy the slow!
- Revenue = $3000

Example

- Fast 89.99, Slow 30? Revenue = $5400

Making Self-Selection Work

- May need to cut price of high end
- May need to cut quality at low end
- Value-subtracted versions
  - May cost more to produce the low-quality version.
- In design, make sure you can turn features off!

Pitfalls

- Arbitrage
  - Windows NT workstation/server
Online and Offline Versions

- The Whole Internet
- Netscape Navigator
- National Academy of Science Press
  - Format for browsing, not printing

How Many Versions?

- One is too few
- Ten is (probably) too many
- Two things to do
  - Analyze market
  - Analyze product

Analyze Your Market

- Does it naturally subdivide into different categories? AND
- Are their behaviors sufficiently different?
- Example: Airlines
  - Tourists v. Business travelers

Analyze Your Product

- Dimensions to version
- High and low end for each dimension
- Design for high end, reduce quality for low end
- Low end advertises for high end

Goldilocks Pricing

- Mass market software (word, spreadsheets)
  - Network effects
  - User confusion
- Default choice: 3 versions
- Extremeness aversion
- Small/large v. small/large/jumbo

Microwave Oven Example

- Bargain basement at $109, midrange at $179
  - Midrange chosen 45% of time
- High-end at $199 added
  - Mid-range chosen 60% of time
- Wines
  - Second-lowest price
Bundling

- Offer a package
- Microsoft Office
  - 90% market share
- Work together
- Discount one of the products
- Option value: zero incremental price
- Microsoft's per-processor license

Reduce Dispersion

- Example: price separate or together
- Mark: $120 for WP, $100 for spreadsheet
- Noah: $100 for WP, $120 for spreadsheet
- Profits
  - Without bundling: $400
  - With bundling: $440

Reduce Dispersion:
Price separate or together?

<table>
<thead>
<tr>
<th></th>
<th>Word Processor</th>
<th>Spreadsheet</th>
</tr>
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<tbody>
<tr>
<td>Mark Ketting</td>
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<td>$100</td>
</tr>
<tr>
<td>Noah Count</td>
<td>$100</td>
<td>$120</td>
</tr>
</tbody>
</table>

Profits: With Bundling: $440  Without: $400

Information Bundles

- Magazines and newspapers
- Law of large numbers
- Customized bundles
- Nonlinear pricing
  - In previous example sell first item for $120
  - Sell second item for $100
  - Example: MusicMaker

Promotional Pricing

- Sales, coupons, rebates
- Only worthwhile if segment market
- Credible signal of price sensitivity
- Problem with software agents
  - Bargain Finder
  - Price Scan

Lessons

- Version your product
- Delay, interface, resolution, speed, etc.
- Add value to online information
- Use natural segments
- Otherwise use 3
- Control the browser
- Bundling may reduce dispersion