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3535 Roswell Road, Suite 59
Marietta, GA 30062
770-509-9933
www.pricingsociety.com

The Pricing of Big Bang Disruptive Innovation

Big bang disruptive innovation challenges conventional pricing science and how differentiated offerings should be introduced to market. Instead of using value-based pricing science, their pricing is based on aggressive penetration pricing models aimed at proliferating their offering as fast as possible, as the authors explain. Stephan Liozu (www.stephanliozu.com) is the Founder of Value Innoruption Advisors and specializes in disruptive approaches in innovation and value management. He earned a PhD in Management from Case Western Reserve University and can be reached at sliozu@case.edu. Katie Richardson is a Game Changing Coach at Ennova Inc. (www.ennovainc.com) and specializes in game changing behaviors using The Shared Clarity System. She can be reached at krichardson@ennovainc.com.

A recent paper published in Harvard Business Review discussed the concept of big bang disruption and how "a new kind of innovator can wipe out incumbents in a flash." The big bang disruption concept challenges the traditional disruptive innovation process in a way that breaks conventional wisdom and the science of innovation management. **The main goal of big bang disruptions is to enter the market super-fast and to wipe out an existing solution whether it is a new or mature one.** The introduction process of such radical innovation does not follow the Roger's traditional diffusion of innovation model as shown in figure 1 on the next page.

Big bang disruptors come from outside the industry and are hard to stop. They proliferate very fast because they have a simple offering which is easy to understand by users and simple to adopt. **Most of the time they are also priced very aggressively to generate an adoption tsunami which is so powerful that competitors are totally disoriented.** Big bang disruptive innovations are game changers for an industry because of their newness, simplicity and affordability.

No need to search a lot for them, to read a lot about them, or to spend a fortune to be an early adopter. Their success comes from a combination of smart marketing, robust technology and simple pricing models. Here are three examples of big bang disruption and how they used pricing strategies to penetrate their respective markets:

Netflix: Netflix's disruptive innovation was driven entirely by the newness and uniqueness of their business model. They identified unmet and underserved market needs and created a new business model to serve them simply and without any headaches! By sending DVDs mail order from a central location, Netflix eliminated the huge cost of stores, and having inventory where it wasn't needed, and in the process offered limitless catalog with the convenience of not having to drive.

In addition, Netflix removed the late-fee inconvenience and offered a very simple and affordable pricing structure. Today with over 30 million streaming users and a basic flat fee of $8.99 per month, Netflix continues to gain traction and is moving into adjacent markets. The simplicity, affordability and user-friendliness of their business model created a big bang disruption in the entertainment industry.

Free Mobile: In 2011, Free Mobile in France introduced a mobile phone plan with unlimited talk, unlimited SMS and MMS messages, tethering and, even more important, unlimited data with a speed reduction after 3 GB.

Usually for that plan in the U.S., you would pay more than $100 for limited data with a two-year contract. In France, it costs $25 per month with no contract.

This introduction was a big bang disruption for two reasons: the introduction of the generous plan with no contract; the price level at $25 compared with traditional plans priced at between $57 and $82 per month for a smartphone plan with only a couple of hours of talk time. After the introduction of this simple offering and during its first quarter, Free reported 2.6 million activations or a 5.4% market share.

Today, they passed the bar of 5 million users and have forced competitors to redesign their strategies, footprint and pricing models. It is expected that this particular big bang disruption has led to 10,000 job eliminations at traditional phone carriers and has seriously shrunk their profitability.

Square: Because of Square, small businesses no longer need multiple banks charging them inexplicable and exorbitant fees to accept credit card payments. Square's approach is disrupting the credit card processing industry. With over 3 million users and 250,000 merchants taking Square Wallet, they've built a product that creates dynamic user value through the marriage of hardware and software to accomplish an incredibly common payment task.

Millions of small businesses that accept credit cards each day are forced to purchase point of sale equipment and sign long-term contracts with traditional merchant service providers. These systems are built for large companies with many locations, not for local businesses — but since there was no viable alterna-

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tive, these small businesses used to have no choice. Square's big bang disruption gives anyone and everyone the ability to accept credit cards simply, elegantly, and cheaply (2.75% per swipe, no additional fees and money the next day!).

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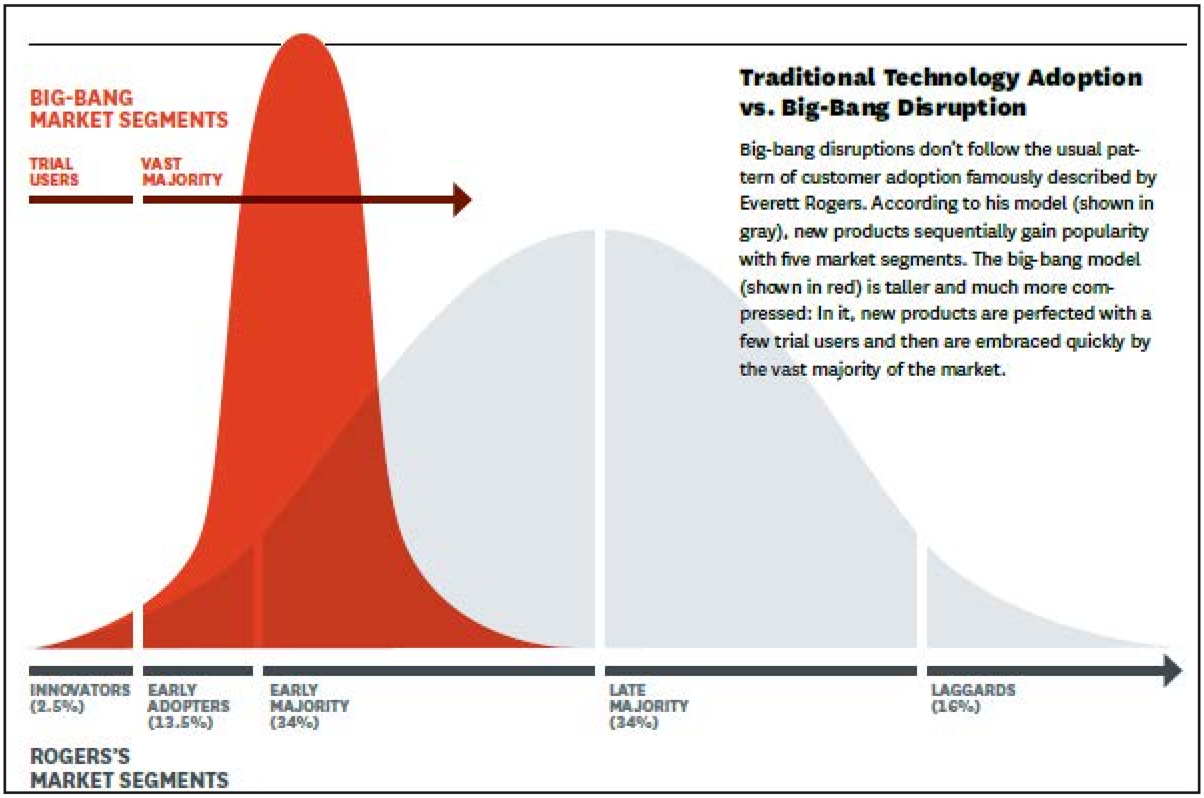
Figure 1: Big-Bang Market Segments; Source - Harvard Business Review, March 2013



Is it possible that they are leaving money on the table? You bet. One could argue that their prices are too low compared to their reference value and when compared to the potential customer willingness-to-pay. There is no doubt that they could have captured more value in the market by sharing some of it with the market and keeping a bit more for themselves. This is a problem today for Netflix, for example, as they are posting depressed profitability numbers. Could Netflix raise their prices by $1 per user per month? Yes they could but I doubt they will do it as price perceptions are already set and the perceived simplicity of their offering might not justify it now.

Making price changes might be really dangerous as Netflix experienced in 2012. Others have been more successful. For example, it was a risky move for iTunes when they increased their prices in 2009, but in the end it was successful.

The question we would like to raise is about the sustainability of their business and revenue models with such aggressive pricing to market once the disruption is behind them. One approach is to get as much revenue out of the disruption as possible with the acceptance that it will not live as historical business models did. The name of the game becomes serial disruption, otherwise they are focusing on "what-if scenarios" when they should be focusing on how and what to disrupt next.

The foundation of big bang disruption is to take the market by storm. Speed and simplicity is of the essence. But we conjecture that pre-launch pricing decisions should be carefully and scientifically justified to start on the right foot. Once the price is out, it is associated with the excitement of the big bang disruption and cannot be changed.

Affordability does not mean super low prices. It means sharing more value with the market and pricing responsibly versus the reference value. Square, Netflix and Free Mobile have been extremely successful. Only time will tell if they might get disrupted as well in the future.