5-Part Series on Value, Pricing and New Product Development

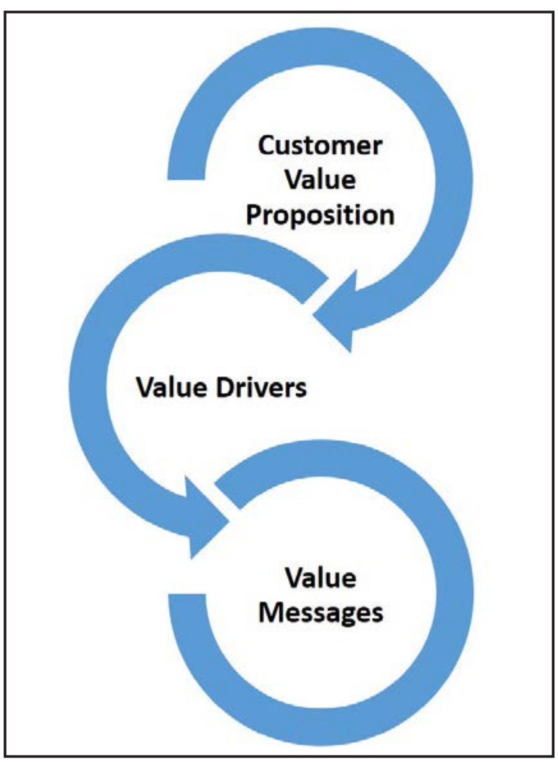
In this article, the author provides an in-depth analysis on value management in innovation and new product development. Stephan M. Liozu is Chief Value Officer of the Thales Group (www.thalesgroup.com). He is also an Adjunct Professor & Research Fellow at the Case Western Research University Weatherhead School of Management. Stephan holds a Ph.D. in Management from Case Western Reserve University (2013), is a Certified Pricing Professional (CPP), a Prosci certified Change Manager, and a Strategyzer Business Model Innovation Coach. He authored three books, *Dollarizing Differentiation Value* (2016), *The Pricing Journey* (2015) and *Pricing and Human Capital* (2015). Stephan sits on the Advisory Board of LeveragePoint Innovation and of the Professional Pricing Society. He is a Strategic Advisor to 360pi, The Kini Group, and PriceSenz. He can be reached at sliozu@gmail.com.

Part 1: Managing Value in the New Product Development Process

Are you capturing the value of your innovation? This is a question that I ask innovators over and over. Chances are that the answer is “not at all” or at least “not fully.” In my experience in innovation management, I have seen great levels of sophistication and process orientation in the new product/service development process. Everything is in place: the deliverables are being worked on; multi-functional teams are in place; priorities are being managed; and the process works like clockwork. All is good in innovation land!

There is a however a huge piece of the innovation puzzle which is missing: value management. Value is being discussed for the most part but not reviewed and measured in detail. Why is that happening? My research has shown that value is a very subjective term that means different things for different people.

Figure 1: New product development (NPD) process



Innovators and marketers have a tendency to confuse value-based innovations with value added services or added-value product features. This issue of equivocality leads to a difficulty in the operationalization of the value construct in the new product and service development process.

There are three things that are critical to consider and integrate in the New Product Development (NPD) process.

1. Customer Value Proposition: Every innovation should include the description of a compelling and distinctive value proposition (DVP). It needs to clearly state what specific pains the new product and service will address and solve. This is what business model innovation experts call the “job” that the innovation is supposed to do for customers. I encourage innovators to research the concept of customer value proposition and to study the various value proposition canvasses that are readily available to innovators.

2. Value Drivers: Once the value proposition is defined and crystallized, it should focus on one or two critical drivers of customer value that are clearly articulated and measured. Value drivers have to be crisp, clear, concise, credible, and relevant to customers. Being relevant means that they have to adopt the language the customer uses, i.e. focus on the outcome of what the benefits will be when the customer selects your new product or service.

3. Value Messages: The work is not done yet. Each value driver should be linked to one or two value messages that can be used to support the commercial launch of the new product or service. Value messages have to be written as a short value story that uses the customer’s vocabulary. These messages are used in marketing communication campaigns, technical training manuals, and the selling sheets that are given to the salesforce to promote the innovation.

If you are using a Stage-Gate process, the DVP should be included in the business case early on the process. Value drivers are quantified in the middle of the process and will be used to set value-based prices. Value messages will be used later in the process to support the innovation launch. I recommend you

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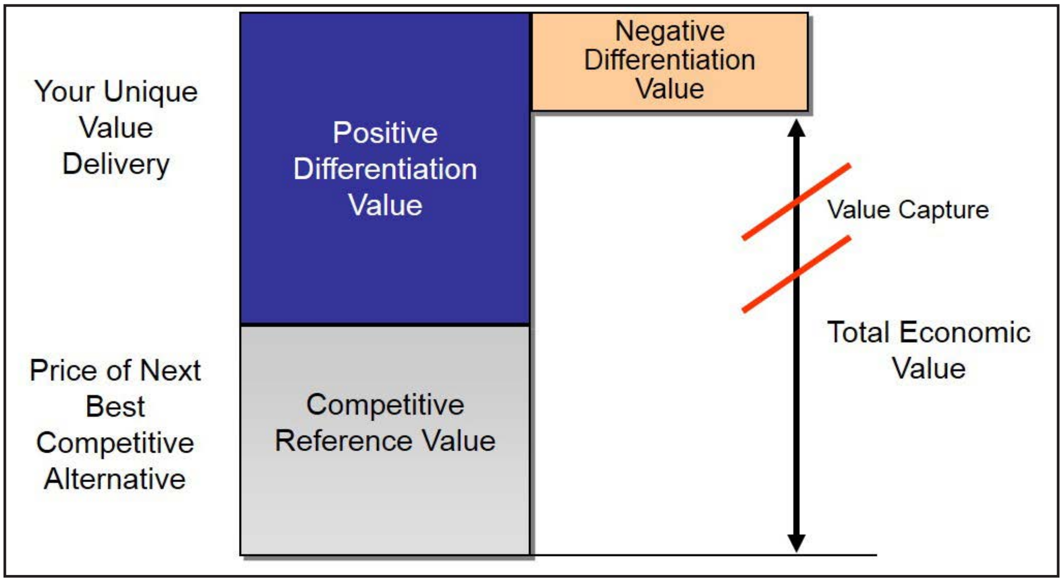
add these three elements in your NPD deliverables and start experimenting with them.

Figure 2



Part 2: Modeling Value for New Product or Service Opportunities

Value modeling is a science that cannot be improvised. Because pricing decisions are based on value models and their relevant value drivers, marketers and innovators need be using the proper techniques, steps and value assessment methods to support these important pricing decisions. There is no other way around this! The key question thus becomes where to find the precise and most relevant methodological information to build a value model and to perform Economic Value Estimation (EVE) as shown below.

The information available about value modeling is highly fragmented. There are books touching on the process of dollarization, monetization and other methodologies. They are, however, incomplete, too theoretical and for some obsolete. This is why Steven Forth and I decided to create an exhaustive eBook listing all relevant and modern information about value modeling (Value Modeling eBook). This eBook is a theoretical but also practical user's guide providing anyone who is interested with practical examples, dos and don'ts of value modeling, relevant vocabulary and a list of resources. It also provides 15 examples of value models across several industries and business contexts. Each model shows a step-by-step approach to defining the value drivers, calculating the economic value and building the overall model.

The value quantification process is a unique way to connect the innovation team with the salesforce and the pricing team. Working in a tactical team, their goals become:

- Validating the voice of customer in the overall process: terms, vocabulary, expressions, perceptions, preferences, behaviors.
- Validating the quantified savings or incremental revenues in the value driver quantification process.
- Validating the selection of the reference product in the mind of the customer.
- Getting access to the customer sites and to the relevant gate keepers at the customer locations.
- Conducting value-in-use analysis with the help of marketing, engineering and innovation.
- Validating that the right value drivers are selected in the value models out of a large potential pool of drivers.
- Validating that the value messages are powerful and relevant to the customers.
- Piloting value concepts, value models and value stories in the field.

Value modeling is a challenging process that requires skills and sweat equity. The role of innovation professionals is critical in the identification, measurement and modeling of value drivers working hand-in-hand with the salesforce and the pricing team. There is no doubt that value modeling is a team-based process. So, are you getting enough training in the value modeling process? Do you really know how to conduct value-in-use analysis? If not, ask for the proper tools and training to become an expert in the

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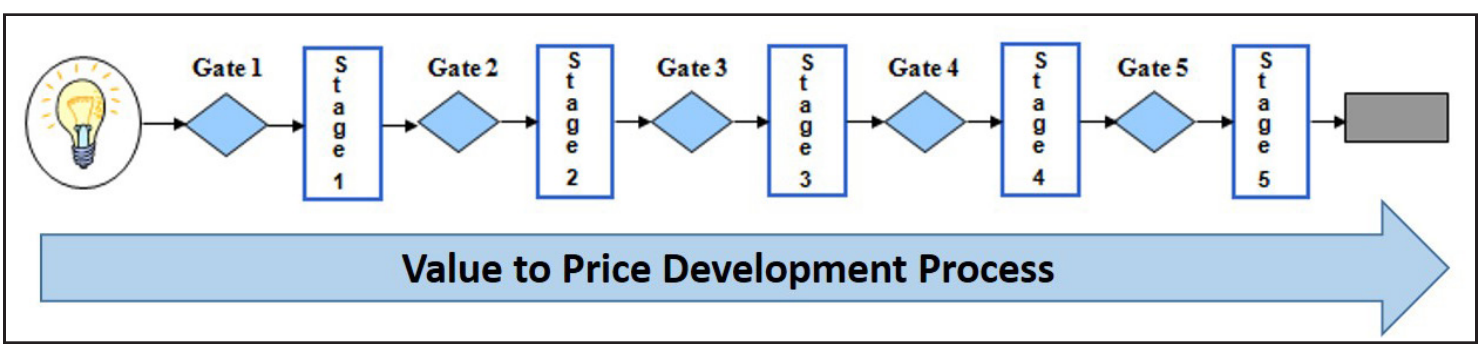
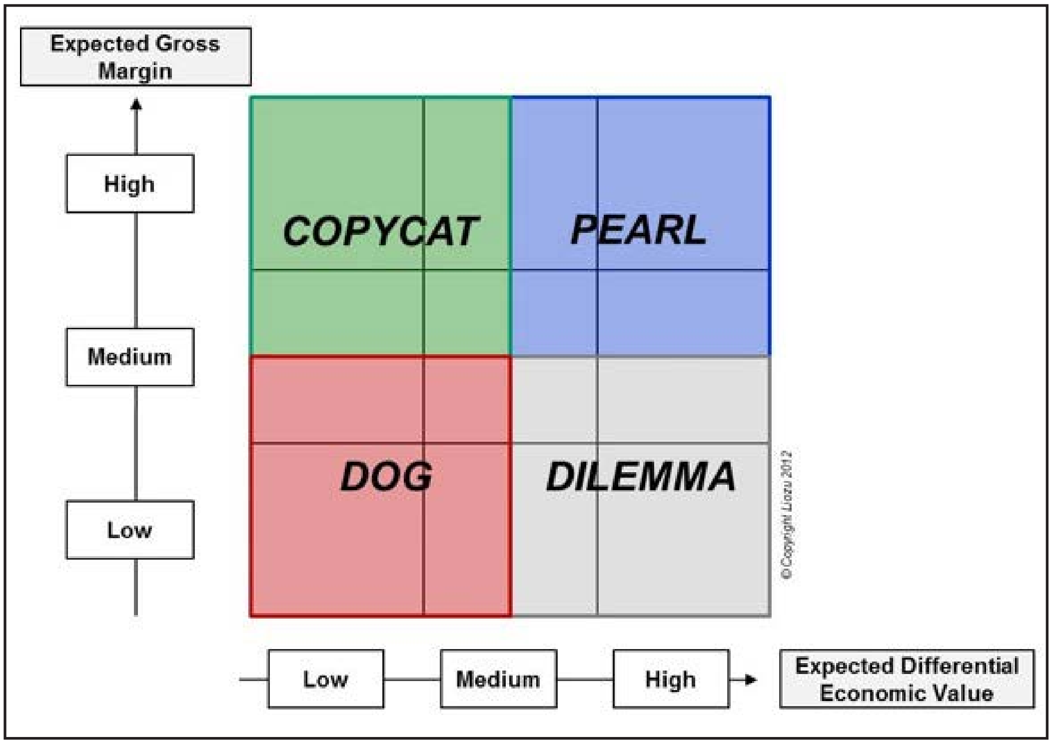
Figure 3



subject. These are powerful skills to acquire.

Figure 4



Part 3: Value and Pricing in Stage Gate Process

In past writings, I conjectured that the Stage-Gate process does not pay enough attention to value and pricing management. I also proposed that requiring the identification of an estimated price level for the new product or service in Gate 2 is a strategic flaw in the process. It prevents innovators from conducting a thorough value investigation process and forces pricing decisions that innovators are not ready to make yet. In 2010, I conducted a benchmark of twelve of the most innovative companies in the world. Most of them were Fortune 500 global companies. Most of them did not have clear deliverables related to the value and pricing in their Stage-Gate process. One of them had one dedicated pricing form appearing at Gate 3 of their ten-gate process. So clearly, there is opportunity for improvement.

So how do you manage value and pricing in a traditional Stage-Gate process?

Here are some recommendations:

1. **Start with value:** the work in Gates 1, 2 and 3 should primarily focus on the customer value proposition and on the identification and measurement of value drivers. If the process requires initial price estimations in Gate 2, then make sure you propose a price range and you call it preliminary in nature. Make sure that prices can be changed after all the value investigation work is performed. One recommendation is to propose price level options in Gate 2 if price estimations are required by the process.

2. **... And finish with price:** Once your value work is done and in Gate 4, you can start designing your value-based pricing strategies. You will have to incorporate results from your segmentation analysis and the economic value estimation (EVE) process. Then in Gate 5, you focus on your pricing execution strategy i.e. your tactics. This is also when you equip your salesforce with value messages and train them on value selling for your new product or service.

3. **After product or service launch:** It is also critical to conduct a post-launch review of all the value and pricing work that was done in the process. Value models can be evaluated for accuracy and dynamically modified. The responsibility of pricing then moves to the pricing team but innovation professionals need to learn from pricing successes and failures.

So I cannot repeat this enough. Start with value and finish with pricing. Make sure your process includes 5 deliverables/documents related to value and pricing: Distinctive Value Proposition (DVP), formal value model, value messaging sheet, documented value-based pricing strategy, and pricing dashboard to be used post launch. These documents should be added to the project plan and should not be optional. Some value experts also recommend running a parallel Stage-Gate process fully dedicated to value management. The gates are called "value gates" and the list of deliverables is very advanced. A few best-in-class companies are known to use value gates and are screening their innovation opportunities based on the accuracy and completeness of customer value assessments.

Part 4: Screening NPD with Differential Economic Value

Traditional methods for screening innovation opportunities include effort/benefit analysis, cost/margin analysis, or risk/attractiveness matrices. Innovation teams work closely with finance teams to create these screening mechanisms that sometimes can include a complex screening formula based on a series of critical attributes. I have used these tools in both family-owned businesses and Fortune 100 companies. They work well and allow you to work on the right opportunity. A different method to screen these opportunities is to pay close attention to the expected differential economic value they generate versus respective competitors. Mapping new products and services based on both expected gross margins and expected differential value is a novel approach and a much more balanced approach especially when considering the pricing power firms all aim at generating.

In order to be able to plot your innovations in this matrix, you have to be able to deploy the Economic Value Estimation (EVE) methodology and embed it in your innovation process. EVE is a challenging but highly rewarding technique that allows innova-

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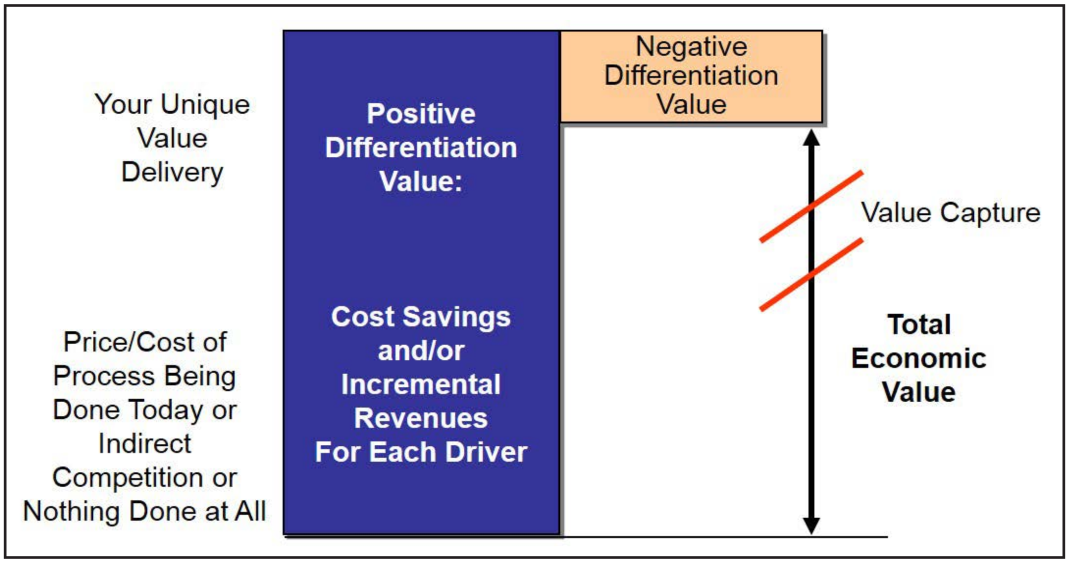
tors to focus on the differentiation they create in the market place and to measure that differentiation versus competitors. Measuring product advantage and thus differentiation is one of the steps of the value management chain. That chain starts with value creation in the innovation process. Then value gets measured and quantified using EVE. Finally value gets captured through value-based pricing.

Figure 5



So you might wonder why you should focus so much on differentiation and differential value. Research has shown a positive relationship between product advantage and the ability to deploy value-based pricing. That means that if you create innovation solutions with greater differential value, chances are you can capture greater pricing power in the market place and thus superior profit level. While there is a need for more research in the field, it is common sense to think that differentiation is a must-have in today's environment. Thinking about differentiation in terms of unique selling propositions (USPs) and unique value propositions (UVPs) makes sense. The next step is then to measure that differentiation power and to develop a balanced portfolio of innovation opportunities with enough "pearls" to compensate for the "copycat" opportunities. Add this matrix in the arsenal of screening tools you use to screen your opportunities. Add Estimated Differential Value (EDV) as a key metric for your innovation success.

Part 5: Pricing Breakthrough Ideas and Concepts

Economic Value Estimation EVE is a reference-based methodology. That means that you are integrating in the calculation of total economic value of your innovation the price of your next best competitive alternative (NBCA). This is what is called the reference value that is being used by buyers to compare your value-based offering. Through a series of questions, you will have to identify which product or service is your NBCA (i.e. in the mind of your customer). If you have an incumbent product or service you are trying to displace, it is fairly easy to do. If you are the incumbent and trying to gauge your level of differential value, you might have to produce several value models based on several NBCAs. But what happens when there is no NBCA and you are trying to introduce a radical innovation that is truly disruptive and that is changing the game? How to calculate economic value when there is no NBCA?

If your innovation is not truly disruptive and/or radical, you will have to identify the indirect competitive process in place at the customer location. Your product or service might replace several processes or sub processes. You will have to draw a blueprint of what you are replacing and precisely narrow down the scope to be able to have an apple-to-apple comparison. Value-in-use analysis will help you design that blue print of the indirect process and nail your NBCA.

If you do have a truly disruptive or radical innovation, you have to bring out the big guns to identify your NBCA and to conduct some advanced research.

1. **Kano Methodology:** The Kano methodology is great to identify the true differentiators of your offering. Through customer interview techniques, you can separate the must-have's from the need-to-have's and the true differentiators. This is not going to help you in defining your next best competitive alternative but it will help conceptualize your differentiated offering that can then be used to conduct your value modeling exercise.

2. **Concept Testing:** Once you have your concept or several concepts defined, you can conduct qualitative concept testing with groups of customers in different segments to evaluate various concept designs for your offering. Concept testing is qualitative in nature and can only be used to inform a more quantitative research process.

3. **Pricing Research:** Only 15% of firms conduct formal pricing research as reported by McKinsey. The reason for this is that pricing research techniques are advanced, fairly difficult to interpret and require good customer data. Some of the research techniques you can use are conjoint analysis and willingness-to-pay research. Both techniques can help you identify the necessary value and pricing information to inform your new product development process.

If you have a game-changing innovation and are struggling to estimate differential value, do not improvise or do not simply give up. It is a good problem to have! You can use a combination of qualitative and quantitative research methods to estimate your NBCA or to derive the differentiation economic value. It is more challenging and certainly more costly but the reward of getting it done right is priceless. Conducting pricing research early on in the new product development process is a worthy investment. Ask for help from your pricing team.

Be bold. Join the value-based revolution!