vocatus:

Product as a service

A new business paradigm calls for a revolution in pricing strategy

From the car as a product to mobility as a service

Offering products made companies big – offering services will be the future

Until now, car manufacturers have typically focused on selling their physical products in a one-off transaction. This means they've been very busy finding ways to constantly reduce costs, benchmark product line-ups, and manage dealer discounts. Most pricing strategies in the 'car as a product' world are thus based on costs and competition.

As part of their journey towards the 'connected world' and the 'internet of things', many car manufacturers are no longer selling a physical product only. Instead, cars are becoming a 'product as a service', and this yields new opportunities:

Steady cash flow:
A subscription model creates a continuous revenue stream.

Integrated bundles:
'Product as a service' enables the natural integration of third party services (e.g. car insurance) and thus increases the share of wallet.

Long-term relationships:
By definition, 'product as a service' creates long-term relationships with customers.

Differentiation:
'Product as a service' increases product and customer differentiation and thus reduces price wars.

Reduced sales costs:
Sales become easier and less stressful when the business model changes from acquisition to retention.

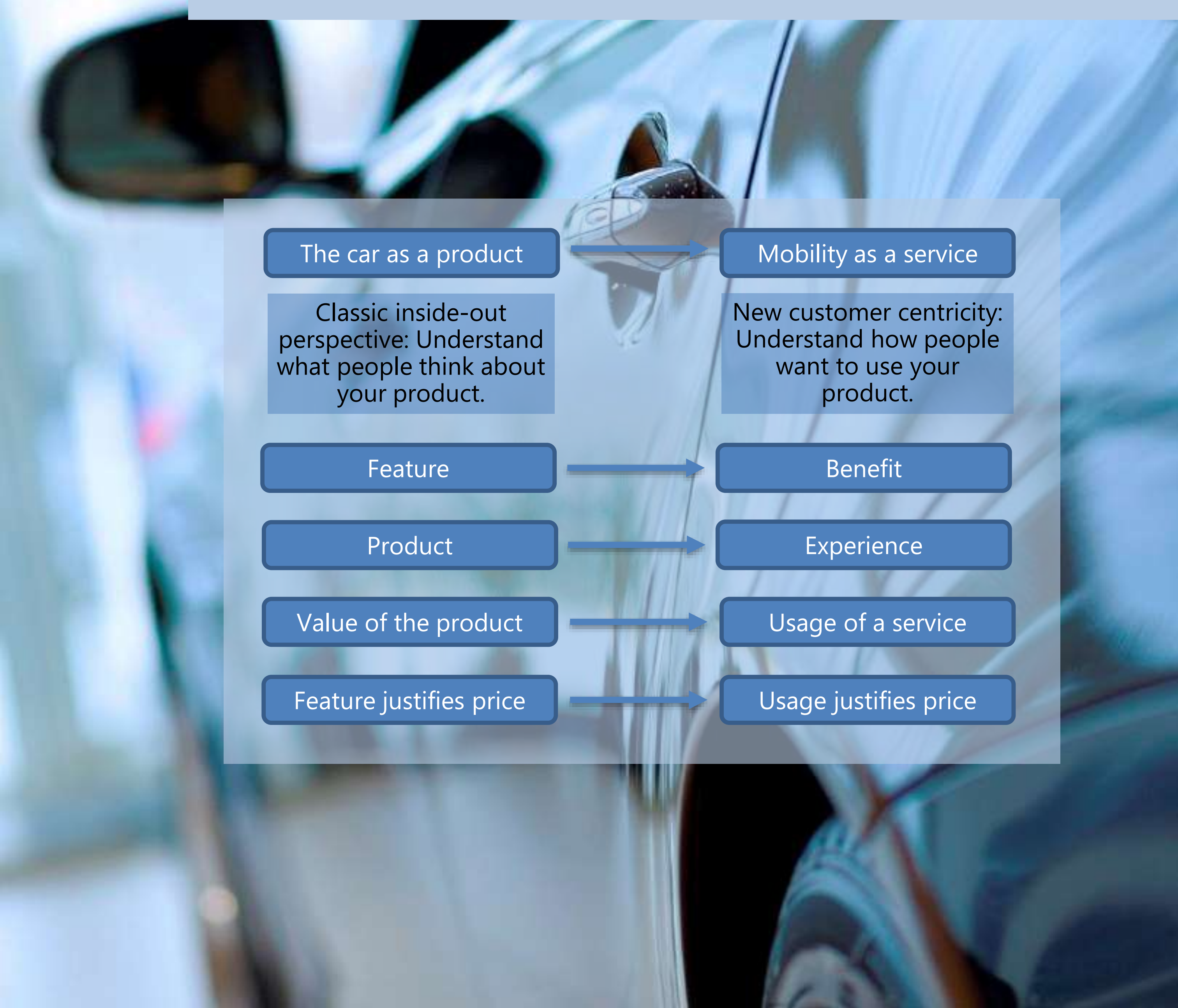
More potential customers:
Entry barriers (purchase price) decrease, so the potential customer base increases.

Rethink customer centricity

It's true – in the medium-term at least – that car sales will continue to be the main source of revenue for most manufacturers. However, digitalization simultaneously offers new opportunities to develop innovative revenue models. This process will gain even more momentum when autonomous driving reaches its next stage.

The monetization of these new opportunities requires a new way of looking at customers, who will henceforth value usage and experience rather than mere ownership. Just selling them services as an add-on and training the sales staff will no longer suffice.

Seeing customers from the perspective of a fully digital company becomes crucial. A new customer-centric approach constitutes the key challenge for car manufacturers if they are to successfully compete in the new world of services.



The transition from manufacturer to service provider

Phase 1: Product-centered business models

- The **product** is the key offering.
- Customers pay for **ownership.**
- Profitability is ensured via **cost cutting, market penetration, and reduced product life cycles.**

Phase 2: Hybrid business models

- The product is **enhanced and complemented by services.**
- Customers pay for **ownership** and **usage.**
- **The boundaries between product and services dissolve,** and must be actively managed.
- Sales evolves from **selling to upselling.**
- **Management of the customer relationship** together with **situational pricing** starts to become crucial for profitability: one has to identify the **touchpoints** when specific services can be sold to customers and those **situations** when price acceptance is high.

Phase 3: Service-based business models

- **Services** become the key offering.
- Customers pay for **usage.**
- Products become merely a **vehicle for services** (mobility, entertainment, etc.).
- **Customer relationship management** and **situational pricing** will remain crucial for profitability.
- Dynamic pricing for differentiated customer segments and selling situations becomes vital.

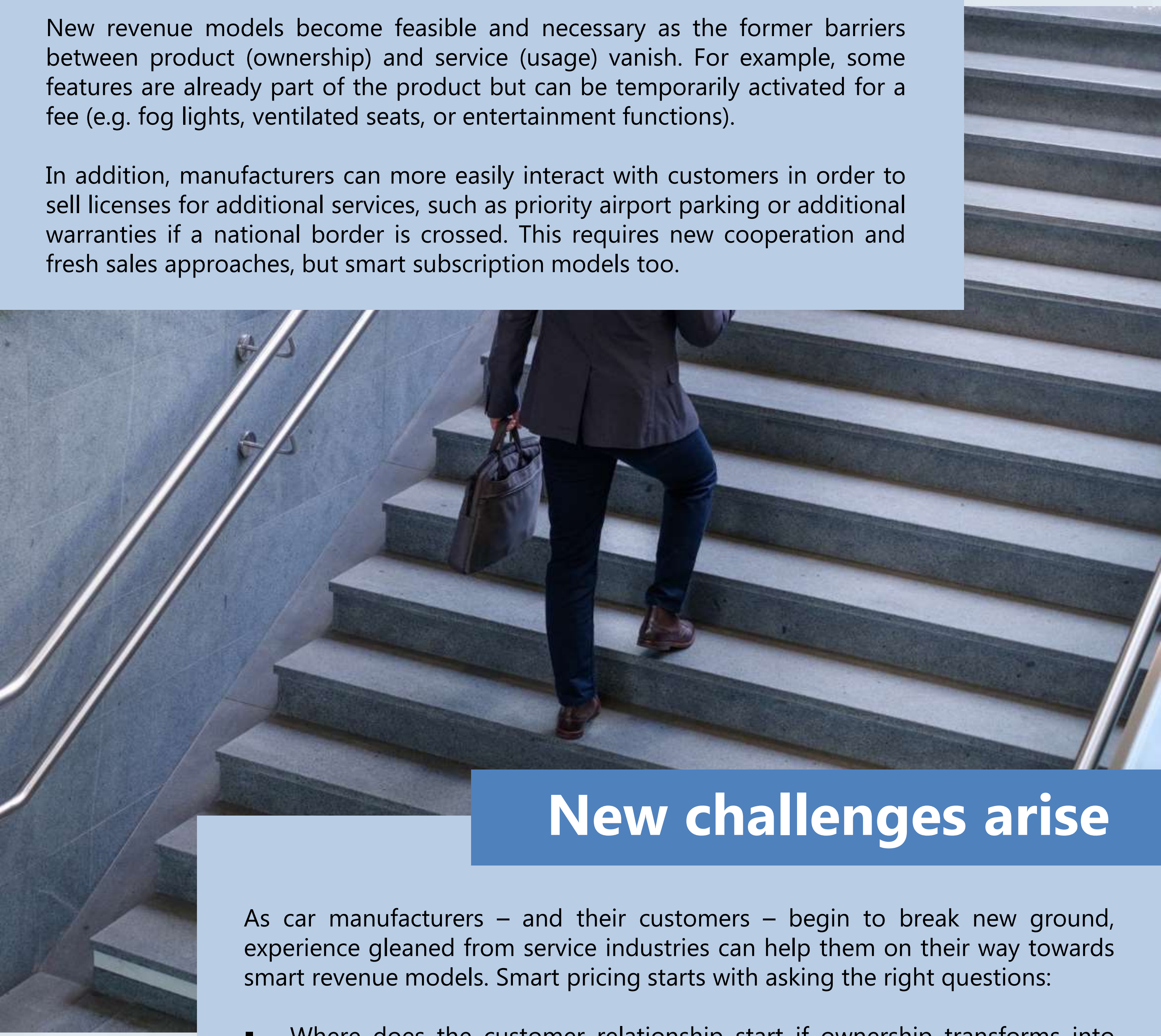
Common pricing mistakes to be avoided

- **Avoid cost-based pricing**:
  Marginal provisioning costs for services are small, so pricing must be value-based rather than cost-based.
- **Avoid the freemium trap**:
  Freemium (some basic product functions are offered free of charge, and consumers can purchase additional premium content) is an acquisition tool, not a sustainable business model.
- **Less is more:**
  Offer fewer – but essential – services with a compelling story which customers actually use, rather than many that they don't.

Design smart revenue models

New revenue models become feasible and necessary as the former barriers between product (ownership) and service (usage) vanish. For example, some features are already part of the product but can be temporarily activated for a fee (e.g. fog lights, ventilated seats, or entertainment functions).

In addition, manufacturers can more easily interact with customers in order to sell licenses for additional services, such as priority airport parking or additional warranties if a national border is crossed. This requires new cooperation and fresh sales approaches, but smart subscription models too.



New challenges arise

As car manufacturers – and their customers – begin to break new ground, experience gleaned from service industries can help them on their way towards smart revenue models. Smart pricing starts with asking the right questions:

- Where does the customer relationship start if ownership transforms into usage?
- How does the consumer context (location, time of usage, situation) interact with price acceptance for services?
- What is the know-how that we can gather from service industries? For example, in relation to pricing structure, level, dynamics, or communication.
- How can one incorporate human decision-making into the design of smart service proposals?
- How can one create scale and network effects for certain features without being obliged to offer free products or elements?
- What are the prerequisites (IT, legal, processes, positioning, etc.) for establishing new subscription models?

Early mistakes in pricing strategies may have irreversible consequences

When considering new business models, one is tempted to adopt trends in the digital world. Successful companies such as Spotify or LinkedIn rely on a so-called ‘freemium’ pricing strategy whereby some basic product functions are offered free of charge, and consumers can purchase additional premium content. However, people often overlook the fact that freemium business models can only be applied to a very limited degree because they suffer from a major downside.

It's vital to successfully transition a large number of freemium users to become paying customers; this constitutes a pain point for many freemium service providers because conversion rates are typically very low. Many digital applications never turn into a successful business because they start in – or become part of – a vicious circle that focusses exclusively on penetration whilst ignoring monetization (see diagram below). The same argument applies to pricing strategies that incorporate frequent significant discounts: Both strategies are suitable for acquisition purposes, but are inappropriate as underlying business models because in the long run they accustom consumers to knock-down prices and fail to deliver sustainable revenue streams.

A holistic understanding of customer motivation and behavior is key if one is to build a successful business and pricing model for one's products and services.

A holistic pricing strategy

Classic approaches to pricing that mainly focus on price levels are unable to master the challenges faced by modern mobility service providers. In addition to the traditional price level criteria, a successful pricing strategy must consider all the relevant aspects of pricing strategy (shown below in the 'four aspects of product-as-a-service' diagram).

In order to create this kind of holistic pricing concept, insights from behavioral economics and behavioral pricing provide tools that can help to establish tailor-made communication, optimized product portfolios, and acquisition promotions that don't threaten the long-term business model.

Four aspects of product-as-a-service

Classic approach to pricing

Price levels

- Products, services, content
- Price points and corresponding market reach

Communication & framing

- Naming
- Price optics and signals
- Situations and touchpoints

Structure & tiering

- Number of options and offerings
- Relationship between options and offerings
- License scheme
- Payment period

Dynamics & promotions

- Long-term price development
- Rebates and discounts

Guiding principles

Here are some guiding principles if one is to bring offers and pricing to the next level. Pricing is the first step, not the last (i.e. design your product outside-in, not inside-out):

- Develop continuous usage habits (e.g. to best match customers' budgeting).
- Dismiss classical approaches to pricing (e.g. cost-plus pricing, competition-based pricing, etc.).
- Design tactical reference prices (e.g. app prices).
- Develop differentiated offer structures (e.g. virtual, intangible, tiered products).
- Manage prices actively (e.g. versioning, price changes).
- Analyze usage data (e.g. to develop new products).

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2017	Award from *brand eins*: "Best Consultants" in Pricing, Trade und Technology
2016	Award from *brand eins*: "Best Consultants" in Pricing and Trade
2015	Image study: Gold for "Innovation", Silver for "Consulting Expertise"
2014	GRIT Report: Top 20 most innovative market research institutes in the world
2013	ESOMAR: Winner of "Research Effectiveness Award"
2012	ESOMAR: Winner of "Research Effectiveness Award"
2012	Image study: Gold for "Innovation"
2010	ESOMAR: Winner of "Award for the Best Methodological Paper"
2010	German Market Research Prize: Winner of "Best Study"

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