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MONETIZING INNOVATION

HOW SMART COMPANIES DESIGN THE PRODUCT AROUND
THE PRICE

WILEY

Monetizing Innovation

How Smart Companies
Design the Product around
the Price

**Madhavan Ramanujam
and
Georg Tacke**

WILEY

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Praise for *Monetizing Innovation*

“Too many startups focus on product engineering, ignore the customer, and end up failing. We launched last year using the approach in this book, and it led to twice the targeted revenue growth and made the difference between the success and failure of our company. Starting with the customer, market, and price is the only approach for product success.”

—Spenser Skates, co-founder and CEO, Amplitude Analytic

“This book is a very practical guide to the difficult decisions that have to be made during the product development process. It’s a must-read for anyone responsible for product development.”

—Mark James, senior vice president of global pricing and product, DHL Express

“Many savvy marketers have adopted the important paradigm shift in pricing—moving from cost-based pricing to customer value-in-use pricing. The authors of *Monetizing Innovation* persuasively explain the next, equally important, paradigm shift: moving value-in-use thinking from the end of the new product development process to the beginning. Companies that apply this wisdom will see a vast improvement in their ability to identify and capitalize on key market opportunities.”

—Robert Dolan, Baker Foundation professor, Harvard Business School

“Madhavan Ramanujam and Georg Tacke use their decades of experience working with companies across the globe to identify the best ways for organizations to innovate profitably. Their book explains how to shift focus—from the product to the customer, from internal concerns to external needs, and from company costs to buyer willingness to pay. Also, and maybe even more importantly, they tell you what not to do with your company’s new ideas—to help you avoid product failures.”

—Kevin Mitchell, president, The Professional Pricing Society, Inc.

“Coupling customer-driven engagement with up-front pricing strategies enables innovators to avoid failure. *Monetizing Innovation* provides an insightful and pragmatic strategy for innovation and pricing.”

—Cary Burch, chief innovation officer, Thomson Reuters

“Way too many R&D teams dedicate their lives to the development of poor product ideas. *Monetizing Innovation* offers game-changing concepts that help create winning products and optimize product margins. It will also make the lives of product development teams more meaningful and fun!”

—Ralf Drews, chairman of the board and CEO, Greif Velox Maschinenfabrik;
former CEO, Dräger Safety

“I have had the pleasure of working closely with Madhavan over the years and his work has made a significant impact on companies I am involved with. His book challenges existing thinking that puts pricing at the very end of the innovation cycle and presents a fresh alternative that is realistic to implement. It is a must-read for entrepreneurs and executive management.”

—Greg Waldorf, CEO, Invoice2go; board member, Zillow

“Understanding and anticipating what customers value is more critical than ever in this Information Age and the authors’ ‘nine steps’ provide a methodology that can be applied to any industry.”

—Nigel Lewis, vice president of aftermarket solutions, Caterpillar

“Pricing power is one of the best predictors of stock price performance over the long run. With *Monetizing Innovation*, Madhavan and Georg address how important it is for pricing to go hand-in-hand with product innovation and design. Not only is the book full of insight and useful information, it dismisses some common fallacies.”

—Chet Kapoor, managing partner, Tenzing Global; board member, BrightCove

“When it comes to understanding pricing and monetization, the team at Simon-Kucher is second to none. Any entrepreneur looking to refine their value proposition and pricing strategy should read this book.”

—Sheila Lirio Marcelo, founder, chairwoman, and CEO, Care.com

“*Monetizing Innovation* bridges that chasm between mediocre product innovation and trailblazing business transformation. Now product, marketing, and finance teams can all point to a single source of truth—which provides invaluable insights, skills, and ideas to boost product ROI.”

—Duncan Robertson, partner, Paxion Capital Partners; former CFO, OpenTable

"*Monetizing Innovation* is an excellent book, recommended for organizations that want to optimally target customers and design their products around the price to maximize profitability."

—Marta Navarro, pricing and upselling director, Renault

"We live in an era where customer knowledge allows for smarter product design. *Monetizing Innovation* explains the alchemy of 'going to market' and pricing strategies to ensure success. It is a must-read for executives navigating the rapid change in customer expectations."

—Hilary Schneider, CEO, LifeLock

"*Monetizing Innovation* clearly describes why you need to put your customers' needs, value, and willingness to pay at the core of your innovation process. I have successfully and repeatedly implemented principles outlined in this book to drive business strategy and have seen massive ROI."

—Vishaal Jayaswal, vice president of client solutions and value strategy, Cox Automotive

"Capital-intensive innovation businesses like semiconductors have watched helplessly as their average selling price and margins have declined. In *Monetizing Innovation*, Madhavan and Georg show how to create winning solutions for well-defined, defensible customer segments that will drive the top and bottom line. If you are in the semiconductor business and want to make money, you need to read this book."

—Mike Noonan, co-founder at Silicon Catalyst; former executive at NXP, GlobalFoundries, and National Semiconductor

"It is essential to master the art of *Monetizing Innovation*. To achieve this, a company needs to have an established culture of innovation so that a constant stream of good ideas can be realistically evaluated for their monetization potential."

—Jens Müller, COO, Securitas Deutschland

"One would think that the pharmaceutical industry already knows it all in terms of monetizing innovation, given that the market perspective nowadays is already deeply ingrained in R&D planning. But this book shows how important this topic is across industries, and how much we can learn by looking beyond our own industry."

—Andreas Altemark, GMACS, Bayer Pharmaceuticals

“Solid price thinking and research used to be one of the few dependable and repeatable secret weapons skilled and experienced entrepreneurs could count on for giving them meaningful customer traction and a cash flow advantage over the newbies and incumbents. With Madhavan and Georg’s excellent new book, *Monetizing Innovation*, it is now clearly no longer a secret.”

—Allan Pedersen, CEO, Zensur.io; managing partner, Triple P Capital

“*Monetizing Innovation* is very relevant in any global context, especially India, where product innovation is just taking off. However, due to the nascent market, companies are struggling to justify investing in high-risk projects since they may or may not yield long-term returns. This book gives them the blueprint they need to remain competitive.”

—Aditya Singh, associate vice president of product, Flipkart

“Innovations can achieve true economic success only when your customers find real benefit from your idea and are, more importantly, willing to pay for it. *Monetizing Innovation* provides the necessary frameworks and checklists to ensure that your ideas can truly achieve such success.”

—Lothar Kriszun, speaker of the Group Executive Board, CLAAS

FOREWORD

Innovation is my family business. My grandfather was a master electrician, master machinist, and inventor who came up with a new kind of fire alarm. My father is a physicist who worked day and night at the massive Bell Laboratories research and development facility in Murray Hill, New Jersey, which now has his picture at the door.

Growing up as a Bell Labs kid, I often wondered why these scientists, the smartest guys in the room for sure, were working in what looked and smelled an awful lot like a dungeon. Why weren't they rich and powerful? Of course, it may be that money and success weren't their goals, or there may be truth in the saying: *Good at chess is bad at life*.

But let me put it another way: Why don't all innovations become successful products? Why do so many fail?

This book has the answer.

Consider the way most companies turn ideas into products and services. They start by analyzing costs, a whole constellation of them: headcount, material inputs, machinery, tech requirements, infrastructure support, and on and on. They subtract these expenses from estimated revenues and out pops the expected profit. On that basis, the company places its bets.

But hold on: where did the revenue number come from? There was no careful scrutiny of detailed inputs. Generally, there was nothing more than an educated guess. That's a wild asymmetry of precision. It's even more reckless when you consider that the two elements—revenue and expense—are equally important in determining viability.

But it's much worse than that. With few exceptions, companies do not examine which features are important to the customer, and which are only important to the inventor. They do not know whether the customer

wants one flavor, or a choice of many. They do not know if the customer will pay, wants to pay once, or will subscribe.

This is unfair to the innovator. The innovation team should know whether they are wasting their long nights on a concept that will go nowhere. They should know—as is often the case—when a change to the vision could dramatically increase its appeal. But that requires knowledge companies just don't have.

For the CEO, the executive team, and the R&D chief, this book lays out a battle-tested plan for getting back in control. It is based on the work that Simon-Kucher & Partners has done for hundreds of businesses, including my own. It's a straightforward plan, but not a simple one. Much of it counters the prevailing wisdom. There is no "move fast and break things," but there is a lot of "look before you leap."

It may be my bias, but I read it as a love letter to inventors—tough love in spots, but love nonetheless. Those scientists back at Bell Labs with Far Side cartoons taped to every door, the hard-working garage visionaries, the men and women of R&D teams everywhere, they all want the same thing. They want their ideas to come to life. They don't want them to die ignominious deaths on some back shelf.

And for my fellow corporate executives, this is a manifesto. I know of no other book that makes such a clear case for ensuring great new ideas will succeed, or that so clearly explains why we're wasting billions of dollars right now. Ironically, given the title, *Monetizing Innovation* isn't all about the money. Instead, as the authors would say, it's about going from "hoping" to "knowing." It's about taking control of your company's future.

—Eddie Hartman
Co-Founder and Chief Product Officer of
LegalZoom
January 2016

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—Madhavan and Georg
March 2016

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Part One

The Monetizing Innovation Problem

How Innovators Leave Billions on the Table

A Tale of Two Cars

Let's begin with a story about two new cars launched by two well-known, established car companies. One launch went very, very well; the other went very, very wrong.

The first car in our story was launched by Porsche, a relatively small player in the multi-trillion dollar global automotive industry,¹ renowned for its 911 sports car that will take you down the road at nearly 200 mph.

In the early 1990s, Porsche was speeding off a financial cliff—if not at 200 mph, then pretty rapidly. Annual sales were a third of what they had been in the 1980s. The company's manufacturing processes were inefficient and defective. The new CEO, Wendelin Wiedeking, at 41 years old the youngest of a new generation of German auto manufacturing executives, decided to institute Japanese-style manufacturing techniques and quality improvements. Costs fell and sales rose, and the company was able to avoid disaster.

The new CEO had bought Porsche some time. He knew the company needed a fundamental change—something different, something new. It needed, as most companies eventually do, to innovate—or risk losing everything. It needed a new car.

In the second half of the 1990s, the company began planning an automobile that was far outside the sports car niche it had focused on

successfully for 50 years. Porsche decided to make a sport-utility vehicle—an SUV—a family car associated not with racing's checkered flags but with soccer moms and soccer dads slumped behind the wheel mournfully recalling their lost youth.

Porsche called its new car the Cayenne.

A Porsche SUV? It didn't make sense. The Porsche brand was about speed and power, daring and engineering, not about loading up the family car with groceries and taking Emily, Mike, and their little friends to their Saturday games. What did Porsche know about SUVs? It had never built one before.

But Porsche had done its homework. Specifically, it had designed and built the product—the Cayenne—around the price.

When most people hear the word “price,” they think of a number. That's a *price point*. When we use the term price, we are trying to get at something more fundamental. We want to understand the *perceived value* that the innovation holds for the customer. How much is the customer willing to pay for that value? What would the demand be? Seen in this light, price is both an indication of what customers value and a measure of how much they are willing to pay for that value.

Porsche understood all this when it set about creating the Cayenne. Porsche's top executives knew they had a bold, perhaps even revolutionary, concept. They also knew the car would be a tremendous risk. They instructed their product team to rigorously determine what the customer wanted in a Porsche SUV and, importantly, how much they were willing to pay. The message was clear: If the customer was not willing to pay a price that would ensure success, Porsche would walk away from the Cayenne.

Long before the first concept car rolled out of the Engineering Group center in Weissach, the product team conducted an extensive set of surveys with potential customers, gauging the appetite for a Porsche SUV and evaluating prices to find an acceptable range. They were pleased to find that customers were enthusiastic. Analysis showed that customers were willing to pay more for a Porsche SUV than they would for comparable vehicles from other manufacturers. The potential for a hit was there.

This meant that Porsche could invest in building its SUV.

But what exactly should it build? Porsche wasn't about to risk creating a car with a bloated design. Every single feature stood trial before the customer.