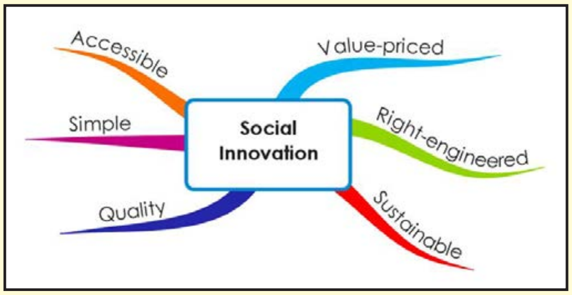
The Pricing of Social and Sustainable Innovation



In this article, the author argues that pricing sustainable and social innovations means using the fundamentals of value-based pricing and psychological pricing for emerging markets, for social innovations, and for sustainable offerings. He also presents six dimensions of social and sustainable innovations that are critical for successful marketing of these types of products.
Stephan Liozu, Ph.D., CPP, (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.

Developed traditional markets are not growing as fast as expected. Competition in these markets is fierce and, as a result, firms have had to find pockets of growth in non-traditional markets and customer segments through diversification. Some of these target markets might be in emerging markets and in under-developed countries. Diversification might also happen in the area of sustainable and social innovation, i.e. products and services that are friendly to the environment and/or that are socially responsible. This is not business as usual though. Products and services destined for these target markets do not look the same. The go-to-market strategies in response to specific markets and segments are vastly different. Pricing strategies and tactics must be carefully crafted and deployed to match the specific characteristics of customer needs and willingness-to-pay.

A recent MIT Sloan Management Review research report about sustainability, in collaboration with Boston Consulting Group (BCG), found an eye-opening disconnect between thought and action regarding sustainability issues (Kiron, Kruschwitz, Rubel, Reeves, & Fuisz-Kehbach, 2013). After interviewing 1,847 respondents from commercial enterprises around the world, BCG reports that the challenge is not in seeing the importance of critical social and sustainability issues. Close to 90 percent of executives believe a sustainability-oriented strategy is essential to long-term competitiveness. Nearly two-thirds of those surveyed rate social and environmental issues as "significant" or "very significant" sustainability concerns. Yet the report also suggests that only about 40 percent of respondents declared that their organizations are addressing these issues and capturing the potential of sustainability opportunities. Even more troubling, only 10 percent said their companies are fully tackling these issues and opportunities. This paper conjectures that the gap between beliefs and actions is a lack of understanding on how to manage social and sustainable innovations including how to price them to prospective customers in the relevant market.

Nature of Social & Sustainable Innovations

The first step of the process is to understand what social and sustainable innovations are all about. There might be some confusion on what sustainability really means. Lately, the concept of "sustainability" has been widely used in the business world and has been receiving a lot of attention in literature in recent years. Notable concepts of sustainable value for social innovation have been explored and introduced by experts such as David Cooperrider, Rosabeth Ross Kanter, Chris Laszlo or even Peter Drucker. Laszlo and Zhexembayeva (2011) define embedded sustainability as follows:

> "Embedded Sustainability is the incorporation of environmental, health and social value into the company's core business with no trade-off in price or quality. The goal is not green or social responsibility for its own sake. It is meeting new market expectations in ways that strengthen the company's current strategy or help it develop a better one."

That definition says it all. The key concepts are "no trade-off in price or quality" and "meeting new market expectations." Like any other innovation, social and sustainable innovations need great voice-of-customer research, outstanding understanding of customer willingness-to-pay, and astute marketing strategy.

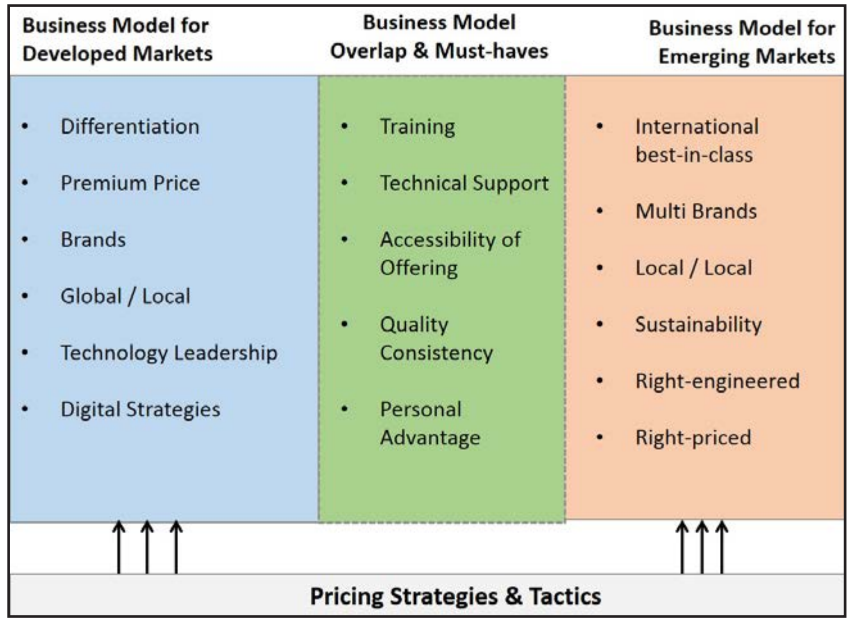
Social and sustainable innovation can be classified into four major categories as follows:

1. **Environment-friendly or "Green" Products**: These products are fairly straightforward to describe and to classify. From natural materials to recyclable packaging to Leed-certified products, firms have jumped on the bandwagon and introduced innovative products that respond to specific environmental specifications. They are however difficult to design, price, and market. Time and time again, we have witnessed companies trying to introduce green products to the market and these products do not sell well. Most of the time, marketers fail to do proper analysis of the target markets, or to conduct proper segmentation analysis, therefore attempting to extract an unjustifiable premium. Some firms "green wash" by launching new products just to create PR.

2. **Socially responsible Products and Services**: Socially responsible offerings are designed around users' social needs and are destined to be widely accessible to specific target markets whether they reside in emerging countries or developed countries. Socially responsible offerings are aimed at providing social solutions for categories of population that live in poverty or that cannot easily have access to them. For example, pharmaceutical companies offer special pricing and ordering programs for people in need of medications who cannot afford them. Another example is the latest push by soft drink companies to modify packaging size and calorie contents of the products available to kids in schools, in the spirit of wellness. These products and services serve a social purpose and contribute to the greater good of specific segments of population.

3. **Products for Emerging or Under-developed Markets**: Economic growth has moved East and South. Emerging markets are driving a large portion of the world GDP growth with no end in sight. A second category of smaller high-growth countries is catching greater attention: Indonesia, Colombia, Turkey, Chile and others. Under-developed countries are also attracting Western firms as a new middle class emerges and has more disposable income. Products and services falling in this category have to be carefully crafted to local market needs and are subject to very advanced need-based segmentation approaches. Johnson & Johnson, for example, has been very successful at entering the larger Indian hygiene market by designing simple and basic products that respond to the needs of a large market and that are priced based on local willingness-to-pay. Car companies are getting better at adapting models and brands to local conditions of different countries.

Figure 1: Business Model Adaptation for Emerging Markets



4. **Not-for-Profit Products and Services**: Non-profit organizations are in the business of raising funds and chasing grants. Most of them live year-by-year while many of them disappear every year especially when economic times are rough. These organizations have the responsibility to create a compelling story to donors, trust funds, and other institutional donors on how much value they bring to their communities. One of the ways to raise funds is to sell products in stores, on websites, or through catalogs. How is pricing set for these? Customers are buying these products on the basis of their support for the specific charity as well as to support particular people who raise funds. One example is the Re-Store outlets of Habitat for Humanity where donated building materials and pieces of furniture are sold to raise money. Products sold in museum stores and gift shops represent another great source of funds for non-profit institutions. Because of the emotional connection between supporters and the cause, special attention needs to be given to willingness-to-pay which can be translated into a willingness-to-support.

So What is Going Wrong?

Marketers make similar mistakes when designing and pricing social innovations. First of all, they miss the opportunity to respond to customer needs by over-engineering their offerings, making them too complex, or not attractive enough. Secondly they overprice these offerings thinking that customers will be willing to pay for green or sustainable products or for products serving social needs in developing or under-developed markets. In other words, they over-design or overprice their products or services. Finally, they do not consider a different business model for these specific segments. This is not business as usual and you need a tremendous level of thinking to define a hybrid business model as described in figure 1 for emerging markets for examples.

Many companies have entered emerging and developing markets by adopting a local-local strategy: local products designed for local customers. They have embraced the fundamentals of the value-based pricing methodology: careful segmentation of markets, assessment of willingness-to-pay for value drivers, pricing based on this willingness-to-pay, and communication to the market of the sustainable value messages. Value-based pricing in that case does not mean high prices or premium prices. That means pricing innovations based on the local customers' willingness-to-pay. Many companies complain that they cannot get a premium in emerging markets or for their green or sustainable technologies. They are looking at this the wrong way. By over-designing their offering, miscalculating willingness-to-pay, or copying-and-pasting their premium business models in emerging markets, they overprice innovations and miss their target markets.

Roadmap for Social & Sustainability Innovations

There are six dimensions of social and sustainable innovations that are critical for successful marketing. These dimensions apply to the four categories of products and services described earlier in the paper.

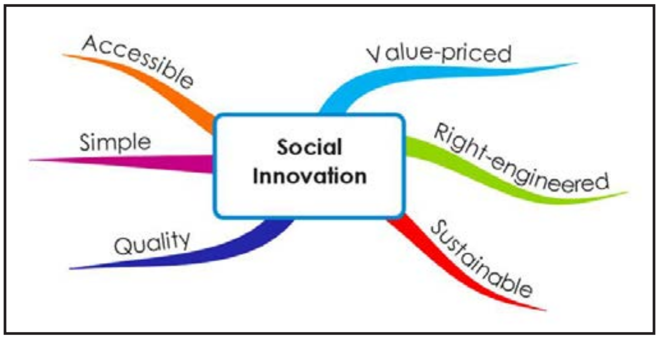
1. **Accessible**: Products, services and integrated solutions have to be widely accessible in geographies that might be vast and sometimes lacking infrastructure. Innovative offerings in the sustainability and social space might be available regionally thus missing a large chunk of the market. Accessibility to the relevant target markets is a must and might be achieved with a combination of physical and virtual approach. This is where

technology might become a critical ally in the development. You might be supporting a particular charity or not-for-profit group that is located on the other side of the country, but technology allows you to donate funds and to buy products on their web sites at the click of a button.

2. **Simple**: Time and time again, products and offerings are too complex for users to buy or to install. The capacity to reduce complexity through innovative thinking into a simple offering is a necessary skill for marketers in this specific space of social innovation. As Albert Einstein postulated: "If you cannot explain it simply, you do not understand well enough." This holds true for the pricing of these innovations. Pricing needs to be transparent and simple. Simplicity stimulates the diffusion curve of your social innovation to the early majority of buyers in your space.

3. **High quality**: Innovations for emerging markets and for the sustainable and social customer segments need to have high quality. There is no cutting corners or making compromises with quality. Right-engineered does not mean poor quality. High quality is what establishes the price/performance perceptions with relevant customers. Bottom line, consumers will not buy your product or services if the quality level is less than acceptable. This will hold true in whatever country or segment you sell into. So if you propose recyclable packaging for example, make sure you offer the same quality as with regular packaging if not better. The thinking that "green" customers will accept a trade-off between green and quality is a myth. They want both.

Figure 2: Social Innovation



4. **Right-engineered**: Do not produce and offer a Rolls Royce when customers only need a Chevy. In the past decade, many firms' business strategies fail in developing and emerging markets because they simply copy-and-paste their premium strategies in other markets. Innovation for social and sustainable innovation needs to be based on a local-local approach: local products for local customers based on sound quality and engineering designs. The same goes for the design of green and sustainable offerings. There are a plethora of offerings that are too complicated to purchase and too difficult to install. On top of that, the government tax incentives to invest in sustainable products required a CPA designation to decipher. Simple and right-engineered is better. One of these days, solar energy solutions for residential homes will be widely available, easier to install by the homeowners themselves, and priced competitively. They have a long way to go still. The same goes for what is required to charge a pure electric car. Simpler is better.

5. **Sustainable**: There are two important dimensions of sustainability: 1) offerings have to last a long time supporting our point 3 above; 2) offerings have to be friendly to the environment. The times of producing products for under-developed countries that contained banned chemicals or materials in developed countries are over. Emerging and developing countries can no longer be considered the "dumping ground" of unsustainable products that cannot be sold in developed markets. When customers buy products and services, they tend to spend a great amount of their disposable income thus they are paying attention to how long these will last and what benefits they might get from them. Customers have access to the same technology around the world and can quickly find out when companies cut the quality corner.

6. **Value-priced**: Pricing social innovation is based on the ability of an organization to right-engineer a product or service that is accessible, of high quality, and sustainable in nature. A socially responsible or sustainable offering does not mean high price. It means that some customers might be willing to pay for certain dimensions of the offering that resonate with them. Products and services destined for emerging markets have to be right-priced based on customers' willingness-to-pay and there disposable spending potential. Right-pricing based on perceived value requires that the offering be right-engineered to match customers' perceptions of quality and performance. This is what is currently happening with the iPhone in China. This is what happened to the elevated subway system in Bangkok when it was launched and the one-way ticket was priced at the equivalent of what people earned in one day. Pricing sustainable and social innovations requires the best value-based pricing science: segmentation, willingness-to-pay; value maps, economic value estimation, value communication.

Key Learning

Yes, ladies and gentlemen, pricing sustainable and social innovations means using the fundamentals of value-based pricing and psychological pricing for emerging markets, for social innovations, and for sustainable offerings. Cell phone companies do it successfully on the African continent. GE and Interface have transformed their business models around sustainability and eco-imagination while making good profits. Other Fortune 500 companies are extremely successful in BRIC countries. The challenge lies in three critical elements of business and innovation strategies: 1) designing local-local strategies; 2) right-engineering performance based on market needs and customer specifications; 3) pricing strategies based on customer willingness-to-pay by segment.

References

1. Kiron, D., Kruschwitz, N., Rubel, H., Reeves, M., & Fuisz-Kehbach, S. (2013). Sustainability's Next Frontier: Walking the talk on the sustainability issues that matter most *MIT Sloan Management Review - Research Report* (pp. 1-28).

2. Laszlo, Chris, & Zhexembayeva, Nadya. (2011). *Embedded Sustainability*. Stanford, CA: Stanford Business Books.