

Chapter 4

Pricing in the Digital Age

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ABSTRACT

Consumers have greater ability than ever to compare prices on products using the Internet. Also, information goods can be sold at much lower prices because of greatly reduced or almost non-existent costs of production. However, because of the ease of pirating information goods, company pricing strategy must take steps to offset losses from unauthorized copies of digital goods. An overview of traditional pricing strategy is presented, followed with research findings of specific actions to undertake for optimal pricing strategy in various scenarios. Discussions of versioning, windowing, bundling and unbundling, with recommendations for use of each, follow. This chapter explores the pressures placed on prices, the strategies companies use when setting price, and provides examples and discussion of sales methods on the Internet for both physical and digital goods.

INTRODUCTION

Pricing items for sale in the Digital Age, whether they be information goods, services, or physical products is far more complex than its corresponding number in traditional marketing settings. Nonetheless, as the population moves inexorably toward more interactive transactions and global customers become the order of the day for most

businesses, learning to adapt to this relatively new medium is essential.

The Internet provides a variety of sources for products and services unparalleled in the history of commerce. Whereas before a customer in a large city might compare prices by going from one store to another in town, and then choosing the best deal, customers can now easily check multiple websites offering identical products and choose which one has the best price. The ordeal of comparison shopping with one's feet has an alternative. In the case of rural buyers, or those in

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foreign markets with limited choices, having no options at all except the local dealer or a catalog has been supplanted. These developments all point to a greater degree of price transparency, wherein the customer need not wonder whether or not they are getting the best deal possible. With a few clicks of the mouse, they can be relatively assured of an optimal exchange.

Comparisons of physical goods for best price are very easy on the Web. Model numbers and specifications are identical across suppliers and retailers, so the only question remaining is what the item costs and what the additional charges are for such ancillary services as shipping and handling. Similarly, shopping for some commodity services such as airline tickets or concert tickets from Ticketmaster or its competitors is simplified on the price front. Knowing one's destination, price comparisons can enable the consumer to choose the best option for their budget, in many cases eliminating a middleman's fees.

Why is identifying and setting an optimal price so important to the company? Revenues from sales provide the capital essential to operate the firm. Making less money than possible will lead to disgruntled stockholders and a drop in stock prices. Declining investment generally results in the company being less competitive, less able to invest in research and development or innovations that ensure its continued success in the market. Proper pricing strategy is at the heart of financial success for the firm.

The chapter will proceed as follows. It will define what information goods are to better understand the need for a fresh approach to their pricing strategy. Next will be a discussion of the underpinnings of pricing—corporate objectives and their effect on pricing policy, constraints on pricing, influential factors and the actual methods chosen to set price. Within each of these functional areas of pricing strategy will be a discussion of how pricing on the Web differs from traditional models and what academic researchers have found to be optimal strategies in the digital realm.

The chapter concludes by presenting some novel digital product pricing strategies that could be used in the future.

BACKGROUND

Information Goods

The terms information goods and digital goods will be used interchangeably throughout this chapter. Such products are items that can be transmitted electronically to the consumer, have few or no variable costs related to their reproduction, and minimal to no distribution costs depending on their channel. The variety of products fitting this description is fairly wide. It includes the following items: online content for news, stock quotes or research; software; music; entertainment such as movies or videogames; electronic teaching cases; e-books; graphics or clip art; ringtones. This list is expected to expand rapidly as more and more products are converted to digital form (Sundararajan, 2004).

Information goods are special in economic terms. While the initial cost of creation may be quite large—millions of dollars for a movie or videogame—duplication costs are extremely low. Also, it is quite difficult in many cases to ascertain the quality of a particular product. Whether one will like a song by an unknown artist or a movie can only be judged after obtaining the work for inspection.

Lal and Sarvary (1999) note that goods have both digital and non-digital attributes. The former are those characteristics that can be conveyed through the Internet and, for the most part, are features that can be evaluated through visual inspection. The Web has the ability to enlarge the number of digital attributes over those found in catalogs or even in traditional stores. For example, samples of music can be listened to over one's computer before making a music purchase. Non-digital attributes are such things as fit (e.g. of

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