Case Title: Atlantic Computer: A Bundle of Pricing Options

Team Number:

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Team Member 1 Name	Contribution Case discussion, brainstorming, introduction, problem statement, appendix
Team Member 2 Name	Contribution Case discussion, brainstorming, recommendation
Team Member 3 Name	Contribution Case discussion, brainstorming, alternatives, appendix
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Case Evaluation: This case study was:

	1	2	3	4	5	
Boring				X		Interesting
Irrelevant					X	Relevant
Not Engaging				X		Engaging
Not Challenging				X		Challenging
Difficult to understand			X			Easy to understand
Not an effective learning tool					X	An effective learning tool
Inconsistent with learning objectives				X		Consistent with learning objectives

Rate the overall quality of the case study as a learning tool on a scale of 1 to 10 where 1 is lowest quality and 10 is highest quality. _9_ out of 10.

CASE #2

Points of Discussion

Situation:

- Atlantic computer is looking to enter the basic server market with Tronn
    - there is a growing need for low end systems
- Atlantic Computer
    - Largest player in the computer industry
    - Server market for 30 years – selling high-end performance servers (Radia)
    - 20% revenue market share of the high-performance market
    - key to make this product successful is to bundle it with PESA - makes it 4x faster
- Ontario Computer Inc
    - Solely focused on the basic server market
    - Has 50% of revenue market share in this market
    - Competitive pricing
    - They have online presence
- Overview of key players involved
    - Jason Jowers – youngest product manager, joined recently (4 months ago) after MBA, rotations in product management, responsible for pricing strategy
    - Chris Matzer – head of server division
    - Emily Jones – director of the division's R&D
    - Harry Fowler – director of new product marketing
    - Jairo Cadena - director of sales
- Market Overview
    - High-end server market growing 3% annually over the next two years
    - Basic server market is growing at 36% compounded between 2001-2003
    - If they followed convention the price of a basic server would be $2000
    - Software is typically provided for free to customers

Problem:
- Jowers needs to find the right price strategy for the "Atlantic Bundle" to be released in the basic server market, a market currently dominated by their competitor, Ontario Computer Inc.
- Jowers needs to figure out a way to get the salesforce behind whatever decision he decides to do with the PESA software, whether he charges for it or not.
- Atlantic Computer needs to be concerned with how the competition will react to whatever pricing strategy is pursued.

Alternatives:

- Charge for PESA software vs. Don't charge for PESA Software
1. status-quo price
2. competition-base price
3. cost-plus price
4. value-in-use price

Recommendations:

- Should charge for PESA
- 2:1 ratio
- Select a pricing option base on the calculations.
- Skim market
- Gain market share in order to increase brand loyalty.
- Increase online presence, the competition is beating us on this front.

INTRODUCTION

Atlantic Computer, Inc. is a major manufacturer of servers and various other high-technology products. It has established 30 years of experience in the server industry. Throughout those years, Atlantic Computer Inc. has achieved a sizable revenue market share in the high-end server market with its "Radia" server, but now Atlantic Computer is looking to expand into the basic server market with the "Tronn" server, loaded with the performance enhancing software "PESA" in a bundle dubbed the "Atlantic Bundle". The backdrop to this is the overarching concern of how to position and price the "Atlantic Bundle" with a variety of options on the table. Each option has a certain amount of impact both internally for the company and externally for customers and competitors.

In the case, we follow Jason Jowers, a recent MBA graduate struggling with his main task to figure out a pricing strategy for the "Atlantic Bundle" within a couple of weeks, in time for a technology trade show. Key influencers and stakeholders in Jowers' pricing decisions are Chris Matzer, the head of the server division; Emily Jones, director of the division's R&D team; Harry Fowler, director of new product marketing; and Jairo Cadena, director of sales. Among this miasma of differing perspectives and viewpoints, Jowers must make a cohesive decision regarding price and only has a limited amount of time to do so.

SITUATION ANALYSIS

It is important to look at the company in general, the market, competitors, and any key players in order to get a better understanding of the situation. All these analysis can be looked at in more detail in the Appendix. After conducting a SWOT analysis on Atlantic, we were able to determine that some of the company strengths are the fact that they are the largest player in the computer industry and have a strong brand image, as well as the big reduction of servers that their new product, Tronn and PESA, can bring. There is a growing need for low end systems, one of the reasons for the introduction of the "Atlantic Bundle". The expected growth of basic server market (36% in the next 3 years compounded annually) presents a huge opportunity for Atlantic to enter a new market and increase their brand recognition. However, their lack of knowledge and experience in the basic server market and the fact that their competitor, Ontario, dominates the basic server market (50%) will present a huge threat and will make the market penetration extremely difficult. Nonetheless, Atlantic has established a reputation for providing high quality, responsive post-sales assistance as opposed to Ontario's production process focus, which can serve as a key differentiator for the new product. (Full analysis in Appendix A) There are two markets in the servers industry: high-performance servers and basic servers. The server market was historically characterized by complex, robust systems capable of handling critical business applications. However, the internet and proliferation of applications in late 1990's has changed it. The high-performance servers market is the largest one, and is dominated by Atlantic with 20% of the revenue market share. The basic servers market is expected to grow 36% CAGR in the next 3 years. Ontario currently captures 50% of revenue market share. (Appendix B) This is the market Atlantic is looking to enter, with its new product "The

Atlantic Bundle". Ideally, the Tronn and PESA would be sold and used together, given that PESA would allow Tronn to perform up to 4 times faster than its standard speed, giving it a competitive advantage and product differentiation over Ontario. (Appendix C) The crucial decision now, is defining the right pricing for the product, and for this, there are several key players involved. The main contributor and decision maker is Jason Jowers, the youngest product manager in Atlantic who is in charge of getting the pricing right for the "Atlantic Bundle". (Appendix D)

PROBLEM STATEMENT

Jason Jowers needs to decide on a pricing strategy for the "Atlantic Bundle" while taking in various internal issues, and being cognizant of the effects each pricing strategy has on consumers and competitors, while trying to get Atlantic Computer ready for a launch in the basic server market.

ALTERNATIVES

There are four pricing options that the company can potentially deploy. We will discuss the pros and cons of each option based on the results from our calculations in this section.

First Calculations

First, we calculated the total projected sales units in the next three years to help with further calculations, as shown in Appendix E. Then we calculated the product price based on each pricing option, as shown in Appendixes F-I. From these findings we were able to calculate the total profit in three years for each of the pricing options. (Appendix J) Know Now we can take an educated look at the different pricing options.

Option 1

Status-quo pricing: Charge for Tronn only and give PESA away for free.

Pros

- Competitive low price.
- Free software for customers.

Cons

- Does not include the development cost for PESA.
- No emphasis on its software advantage. Product position might seem similar to Ontario's Zink.

Option 2

Competition-based pricing: Charge what the competitor is charging and give PESA away for free. In this case, the company would charge 4 times the price of a Zink server; we calculated the conservative price, which is 2 times the price of a Zink server.

Pros:

- Total profit after three years is the second highest.
- Free software for customers.

Cons:

- The price is high, whether we do four times or two times the price of a Zink server.
- Customers probably prefer having four hardware than two with better software.
- No emphasis on its software advantage.
- Not all customers will be able to capture a value equal to four Zink servers.

Option 3

Cost-plus pricing: Add up all the costs and a markup percentage to derive the price of the product.

Pros:

- Takes all costs associated with the product into consideration.
- Price is relatively low and reasonable.

Cons:

- Total revenue after three years is the second lowest.
- Does not center pricing around the customer needs.

Option 4

Value-in-use pricing: Charge based on the product's value to the customer. In our case, the price of PESA software is charged based on 50% of the money that a customer would save if he or she decided to use the Tronn servers.

Pros:

- Customer-oriented pricing strategy.
- Take into consideration the operation cost for the customers to use the product.
- Provide a rationale for a sales strategy.
- Generates the most revenue

Cons:

- Price is relatively high compared to the other pricing options.
- Customers might not want to pay for PESA.

RECOMMENDATION

For the Atlantic Bundle to be the most successful in the basic server industry, it should enter the market priced at $4199 (Appendix J). This number was calculated using the value-in-use method. One reason behind this pricing is that it will garner highest profit, $54,381,160, (Appendix J) as compared to the other three options. Similarly, this method will also garner $88,956,000 (Appendix J) in revenue. According to Appendix I and J, the suggested price for this product is $4200. The reason that our team

chose $4199 is because of Odd-Even pricing. This is a psychological pricing strategy which makes the customer feel that the price is lower than it actually is.

Although this pricing strategy goes against Atlantic's tradition of offering software tools to their customers for free, the PESA software tool causes the Tronn computer to operate at four times the normal operating speed. We have chosen to charge for the extra speed and ease because we would like to target the higher level of the basic server market. This is called the Skim Pricing Strategy. It is when you enter the market with a higher price, because people are willing to pay for quality.

The value-based pricing strategy is used because it is customer-centric. It evaluates all the costs that a customer will incur during the lifetime of the product, and evaluates the value of that product to the customer. As seen in Appendix I, the overall cost of the competitors Zink is $8,800 more than the Tronn. Because the customer will be saving so much money, over the long term is the justification for charging for the PESA software.

While the customer may be saving in the long run, this idea of long-term savings will be communicated by the sales team. The sales team will not be especially pleased that Atlantic will be charging for the PESA software, because it has been a tradition to not charge at all for added software. However, if the sales team could communicate to the customer that even if they are paying a larger upfront cost, they will have a superior product that will last, and save them money over the competitors in the long run. This way of thinking would not require any additional training to the sales force, although they will have to be able to communicate to the customer all of the added value, or augmented products, that Atlantic will give them. One example of an augmented product that Atlantic offers is their superior customer service.

There are two options for Atlantic's principal competitor, Ontario. Firstly, the introduction of Atlantic's bundle can cause Ontario to drive their prices down, in order to try to keep their tight hold on the mid to lower level of the basic server industry. Secondly, this could cause Ontario to be pressured to do more research as to come up with software tools that can rival PESA. Either way, Ontario will be in a tricky spot. They will not be able to research and develop a technology in such a time to immediately rival Atlantic, so they will in turn loose a portion of the market share that way. On the other hand, if they drop their prices, they may not make enough profit to continue, and would fizzle out in time. Either way, it is good news for Atlantic.

APPENDIX

Appendix A - SWOT Analysis

Strength	Weakness
· Largest player in the computer industry ·Strong brand image and positive perception · Reputation for providing high quality, responsive post-sales assistance · Product differentiation · Server reduction with Tronn + PESA (4 to 1) · Long term saving for customers (electricity, licensing fees, etc.) · Based on customer intimacy & product differentiation	· Sales force is does not know how to sell software, like PESA · They have provided software for free in the past. · Not sure what to price the product. The implementation cost can cause issues. · Lack of knowledge and experience in the basic server market (too many competitors) · No online marketing or sales Internal departmental conflicts.
Opportunity	**Threat**
· Growth of basic server market (36% in the next 3 years) vs high performance server (only 3% over 3 years) · Potential to use online sales and marketing · Advantage of having server reduction from 4 to 1, and providing more speed · Enter a new market to increase image	· Ontario dominates the basic server market (50%) (hard market penetration) · Brand Loyalty in the basic server market · Tronn and PESA can cannibalize Atlantic's other products · Ontario has an innovative and effective supply chain system (unique) · Ontario provides cheaper servers

Commented [p6]: The products target two different segments. They are not substitutes. How will they cannibalize sales?

Commented [p5]: This is an Internal Positive (Strength).

Appendix B - Market Analysis

High Performance Server	Basic Performance Servers
· Largest segment · Traditional use of servers to run complex applications · i.e. supply chain mgt., enterprise resource planning, business intelligence, etc. · Demand ~200,000 units next year (exhibit 1) · 3% growth in the next 3 years · Atlantic has 20% of revenue market share	· Basic computing capabilities · Simple, repeatable tasks (i.e. showing website information on the internet) · Demand ~50,000 units in 2001 (exhibit 1) · 36% CAGR in the next 3 years · Ontario captures 50% of revenue market share

- Server market was historically characterized by complex, robust systems capable of handling critical business applications
- Internet and proliferation of applications in late 1990's changed the market

Appendix C - Product Analysis

The Tronn	PESA
· Developed specifically to meet an emerging U.S. market opportunity · Product success is going to be our ability to sell the server with our new software tool	· Allows Tronn to perform up to 4 times faster than its standard speed · Specifically designed to make frequently requested information extremely accessible

<u>**Appendix D - Key Players Analysis**</u>

Key Players Analysis

<u>Jason Jowers</u>
- youngest product manager
- joined recently (4 months ago) after MBA
- rotations in product management
- responsible for pricing strategy

<u>Chris Matzer</u>
- Head of Server Division
- 20 year veteran (experience)
- "Software tools should be free"

<u>Emily Jones</u>
- Director of R&D Team

<u>Jairo Cadena</u>
- Director of Sales

<u>Harry Fowler</u>
- Director of New Product Marketing
- Jason Jower's boss

<u>**Appendix E – Projected sales units.**</u>

	2001	**2002**	**2003**
Total # of Units	50,000	70000	92000
Atlantic's Percentage of Share	4%	9%	14%
Atlantic's Share of Units	2000	6300	12880
<u>Total Share of Units in 3 Years</u>	<u>21180</u>		

<u>**Appendix F – Status-quo pricing calculations and final price.**</u>

	Price
Cost of Production	$1,538
<u>**Final Price**</u>	<u>$2,000</u>

Appendix G – Competition-based pricing calculations and final price.

	Price
Cost of Server (Tronn)	$1,538
Competitor Price	$1,700
Final Price	$1,700
Conservative Price (2 units)	$3,400

Appendix H – Cost-plus pricing calculations and final price.

	Price
Cost of Server (Tronn)	$1,538
Development Cost of PESA	$2,000,000
Number of units (over 3 years)	21180
Number of units with PESA	10590
Cost of PESA (per unit, over 3 years)	$188.86
Total Cost (1 bundle unit)	$1,726.86
Required Profit (%)	30.00%
Final Price	$2,245

Appendix I – Value-in-use pricing calculations and final price.

	2 Tronn Servers	4 Zink Servers
Price of Servers	4000	6800
Cost of Electricity	500	1000
Cost of Licenses	1500	3000
Cost of Labor	4000	8000
Total Cost	10000	18800
Savings over Zink	8800	
50% of Savings	4400	
2 Tronn + 2 PESA	8400	
Final Price	4200	

Appendix J – Projected profit after three years.

	Status-quo	Competition-based	Cost-plus	Value-in-use
# of Units	21180	21180	21180	21180
Price of Bundle	$2,000	$3,400	$2,245	$4,200
Total Sales Revenue	$42,360,000	$72,012,000	$47,549,100	$88,956,000
Variable Cost per Unit	$1,538	$1,538	$1,538	$1,538
Total Variable Cost	$32,574,840	$32,574,840	$32,574,840	$32,574,840
Total Fixed Cost	$2,000,000	$2,000,000	$2,000,000	$2,000,000
Total Cost	$34,574,840	$34,574,840	$34,574,840	$34,574,840
Profit	$7,785,160	$37,437,160	$12,974,260	$54,381,160

Appendix K – Value Disciplines Comparison

CUSTOMER INTIMACY

VALUE DISCIPLINES

PRODUCT LEADERSHIP
Atlantic Computer

OPERATIONAL EXCELLENCE
Ontario Computer, Inc.