

Module 4. Monetization Models

Introduction

Monetization models are the way startups will capture the value they generate for the customer and convert it into an economic equivalence.

Value of Monetization Models

Having a clear idea of the monetization model is important because it will allow estimating the capacity to generate cash flows in your startup and it will guarantee the sustainability of the business over time. There is also the possibility of making combinations between the different models to try to capture as much value as possible.

Therefore, it is useful to analyze how similar businesses are monetizing in the market to have references and be able to develop creative solutions to capture the most value.

Unit 4.1 Typology of Monetization Models

Normally, when an entrepreneur has an idea and wants to put it into practice, he or she thinks about how it will contribute to satisfying a social need or how it will create a trend. However, only a few entrepreneurs think carefully about how the business model will materialize and how profits will be achieved.

Entrepreneurs see technology as an opportunity to create new digital business models or they consider it as a key element.

Let's take a look at some monetization models:

1. Advertising

- Display ads on the web: the most traditional model would be Yahoo.
- Lead generation: clients pay to have access to qualified work requests (leads) made by potential clients.
- Location-based offers: they are usually related to mobile platforms that make location-based offers or advertisements.



2. Commerce

- Direct sales (retail or e-commerce): this is the most traditional way of earning money through the sale of physical products.
- Marketplace: it is a platform that enables different customers to do business with each other and monetization is achieved by capturing a small percentage of each transaction; examples of this would be eBay or Amazon.
- Overcapacity: This model is based on renting the percentage of unused space or use of a resource that is not used 100%; an example could be Uber.
- Sale and download of digital items: this is where a product is sold for a price, but the only thing that changes is that the distribution channel is the Internet.
- Virtual goods: these are generally virtual worlds where the customer pays to purchase items (coins, objects, weapons) that only exist in that environment. This model is very common in the online gaming world.
- Auction: customers bid for an item that starts with a low price, but the same customers increase it with bids; eBay is an example of this model (Megías, 2013).

3. Subscription

- Software as a service (SaaS): companies that offer their software dynamically and the customer pays flexibly for its use; for example, Salesforce.
- Content as a service: platforms that offer their content with the same philosophy as SaaS, that is to say, the customer pays in a dynamic and scalable way for the content which he/she wants to have access to. Some examples are Spotify and Netflix.
- Freemium: these are business models in which a large percentage of users do not pay for the use of the product or service (free). This is possible because a small percentage of them do pay for premium service; this is the case of Dropbox, for example, or Skype.
- Membership services: the user pays to be part of a closed club or group that enjoys a series of advantages and bonuses; for example, Amazon Prime.
- Paywall: a model that some media companies are exploring as a way of monetization and that implies that all users can access their content for free until a point is reached where, if they want to see more, they have to pay, for example, the digital version of the New York Times newspaper (Megías, 2013).



4. Peer to Peer (P2P)

- P2P lending: these are platforms designed so that users can lend money to each other while the platform obtains value by capturing a small percentage of the loan.
- P2P betting: these are sites where users can bet with each other while the platform manages the process (Megías, 2013).

5. Transaction Processing

- Merchant shopping: these are platforms that allow stores to handle payments in other ways, whether they are online or offline businesses; for example, PayPal (both online and offline).
- Purchase processing: these are platforms that are used for a business to process credit card payments and earn money by capturing a percentage of each transaction; this is the case of PayPal, among others.
- Logistics: these are companies that offer their logistics services to third parties. In many of the cases, it is actually about exploiting spare capacity or competencies learned by operating the core business model (Megías, 2013).

6. Licenses

- Per seat: a fixed price is charged for the use of licenses (usually software) for each user (Megías, 2013).

7. Mobile

- Paid application downloads: this is the traditional payment model in the mobile environment, in which a price is paid for downloading the application without any type of payment for its use.
- In-app purchases: this is a revenue strategy in which, within the application itself (often cheaper or free of charge), users can purchase items, modules or functionalities.
- In-app subscriptions: these are models in which the customer can subscribe to access content from within the app itself (Megías, 2013).

8. Gaming

- Freemium: models in which the game is free are common in the gaming world, but if you want to access advanced features or buy items or coins, you have to pay.



- DLC (downloadable content): these are expansions that can include new scenarios, characters, stories or weapons within the game and that allows extending the life span of the game and continuing to monetize it beyond its acquisition (Megías, 2013).

Finally, it is worth highlighting that there are as many monetization models as you can imagine. This is a very open area that stimulates innovation since there has been very little evolution in terms of alternatives for making a profit.



Unit 4.2 Pricing Process.

One of the most important decisions that you have to make as an entrepreneur is to define the retail price of a product or service.

The price variable can be defined as the exchange value of traded goods or services. The price of a product is established by the free play of supply and demand and by the type of market in which it operates: a competitive market is not the same as a monopolistic one, since the company's bargaining power varies.

The selling price of a product or service will depend directly on factors external to the company. The following are some of the most relevant ones:

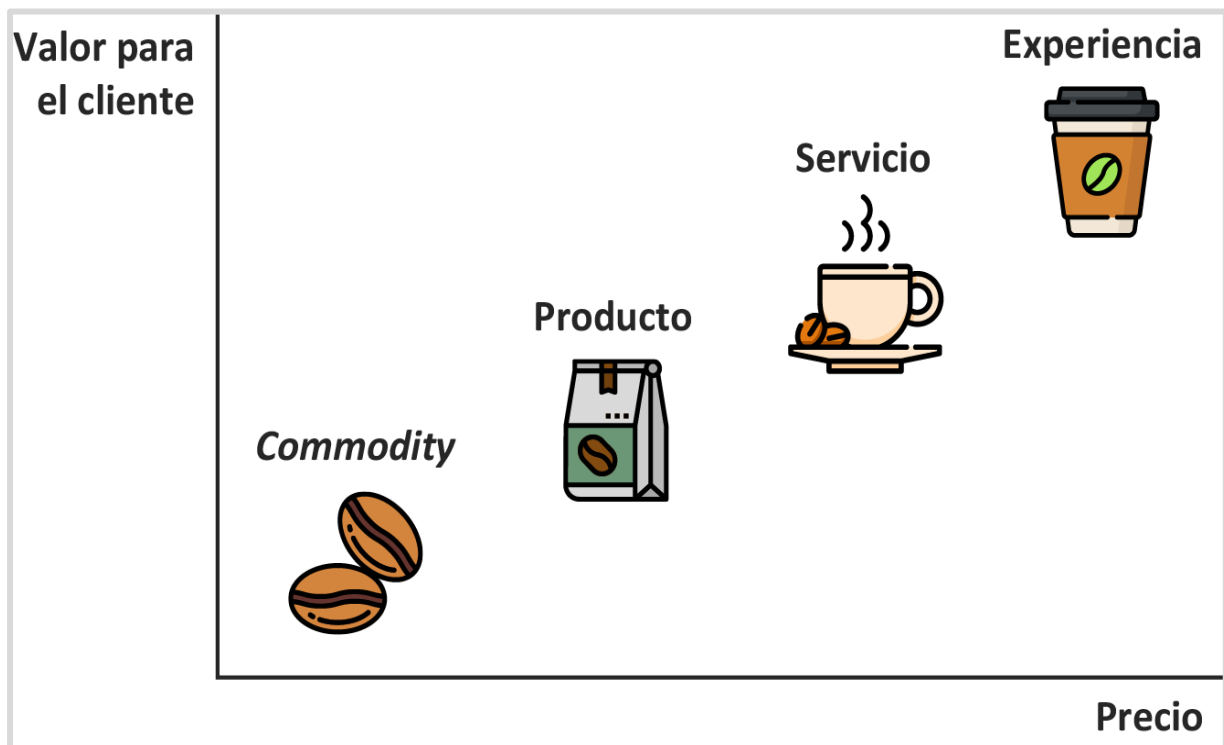
- Demand.
- Supply.
- Product quality.
- Quality of the raw materials from which it was manufactured.
- Exclusivity.
- Prestige.
- Brand.
- Competition.
- Localization.

Pricing does not always emerge from an economic and mathematical equation, there are qualitative factors that generate changes in the value perceived by the customer. This is defined as the result of the customer's comparison of the benefits received and the sacrifices made.

Customers have evolved and are no longer looking exclusively for the lowest price or good quality of a product, they are demanding value and rewarding those who deliver it. For users, value is much more than the amount of money paid for the product. Nowadays, the value added by the company's purpose and the shopping experience can be decisive.



Figure 1: Value and Price Impact



Source: [Untitled image on value and price impact], n.d., <https://bit.ly/35R1pm>

The English translation of this image is below.

Valor para el cliente	Customer value
Commodity	Commodity
Producto	Product
Servicio	Service
Experiencia	Experience
Precio	Price

Therefore, determining the selling price is rather an art and tries to capture as much customer value as possible to monetize it and transform it into economic value.

Today, disciplines such as revenue management and pricing management are working on this topic thoroughly to increase profit.

Traditionally, setting prices has been a manual process in which factors such as cost, expected sales and promotions were taken into account.

At present, pricing becomes an automated process through programming algorithms, which set the price based on sales made, customer behaviour, forecasting models and optimization algorithms. In this way, the software can determine and distribute optimal

prices. For example, Uber adjusts its prices based on the user's time, rush hours, location and previous trips.

The most traditional way to calculate the selling price of a product or service is through the gross profit method, which we will see below.

Gross Profit Method

This model involves charging the desired profit percentage over cost to the value of the product. For example, if the product costs ARS 100 and you want to have profitability of 30 %, the retail price is $ARS\ 100 \times 30\ \% + ARS\ 100 = ARS\ 130$.

The margin percentage will depend on your bargaining power in the market because if the product is a commodity or there are many substitutes, your bargaining power is low and you will have to adjust the margin to achieve sale.

According to Osterwalder and Pigneur (2011), there are two basic pricing mechanisms:

- 1) **Fixed:** predefined prices are based on static variables.
- 2) **Dynamic:** prices change based on market conditions.

Among the fixed pricing mechanisms, we can find the ones that appear in the table below.

Table 1: Fixed pricing mechanisms

List price	Fixed prices for individual products, services, or other value propositions.
Product dependent feature	Price depends on the number or quality of value proposition.
Customer dependent segment	Price depends on the type and characteristics of a customer segment.
Volume dependent	Price depends on the quantity purchased.

Source: Osterwalder and Pigneur, 2011, p. 33.

In the following table, we will consider dynamic pricing mechanisms.



Table 2: Dynamic pricing mechanism

Negotiation	Price negotiated between two or more partners depending on negotiation power and/or negotiation skills.
Yield management	Price depends on inventory and time of purchase (normally used for perishable resources such as hotel rooms or airline seats).
Real-time market	Price is established dynamically based on supply and demand.
Auctions	Price is determined in the bidding process.

Source: Osterwalder and Pigneur, 2011, p. 33.



References

[Untitled image on value and price impact]. (n.d.). Retrieved from <https://uadedigital.files.wordpress.com/2014/10/6.png>

Megías, J. (January 22, 2013). 90 formas de ganar dinero que puedes usar en tu modelo de negocio [90 Ways to Make Money that You Can Use in Your Business Model]. In *JavierMegias*. Retrieved from <https://javiermegias.com/blog/2013/01/formas-de-ganar-dinero-monetizar-modelo-de-negocio-ingresos/>

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