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# Razors, Blades, And...Tech Platforms?

## The Evolution of Platform Pricing Strategies In Technology

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Everyone has heard the old marketing maxim “give ‘em the razor, sell ‘em the blades,” but not everyone has considered its implications for pricing and product strategy in technology businesses. The “razors and blades” model is often shorthand for a product platform strategy, particularly in consumer products businesses, and is frequently discussed in marketing and strategy circles. However, there are applications of this strategy to both pricing and the product roadmap that have implications for how tech industry CEOs and CMOs, investors in technology companies, and CIOs across industries think about their businesses. This article explores implications for investors and the C-suite by considering a variety of technology sectors.

## Risk and Power Dynamics in Platform Pricing

Economists refer to a pricing strategy where there is a platform element (e.g. razor) and a consumable or content element (e.g. blades) as a “two-part tariff.” Simply put, the two-part tariff model provides a helpful framework for thinking about risk and power dynamics in pricing strategy decisions, based on the relative pricing of each of the two components. A relatively high platform price increases risk to buyers, because there is a high cost associated with moving to the next generation of the platform, so CIOs or consumers without inside information face uncertainty about when they will next need to invest in upgrades. The implication for the tech company Csuite is that communication about the long term vision for a platform can directly impact the price the company can charge for the platform. This is why platform companies will sometimes communicate multi-year roadmaps.

In technology platforms, we also commonly see companies other than the platform maker providing content. This is an interesting departure from the single-company razors and blades model, because pricing is no longer a function of a single decision maker. The use of revenue sharing models for content (e.g. the Apple App Store) also means that platform makers need to factor both end customer and content partner reactions into the platform pricing decision. Of course, decisions about platform pricing and revenue sharing also impact how attractive the platform is to content partners in the first place—a massive strategic question all its own. As you’ll see, platform pricing strategies have evolved as the market moves from more static content like apps and downloadable media towards more dynamic, service-oriented content models.

## Razors and Blades 2.0: Static Content in Consumer Sectors

In consumer technology, examples of these two-part pricing strategies, and the associated risk dynamics, are both ubiquitous and familiar. In consumer sectors, there are a number of successful cases in which the consumable content (e.g. apps, movies, etc.) is more static in nature:

- Apple comes out with a new iteration of its iOS devices every 12-18 months. They charge high prices for the platform (the devices), and also take a percentage of revenues for

App Store downloads. In the App Store, providers charge comparatively lower prices for content. Developers can do this because Apple's platform is widely available and doesn't change much over time, so consumers face little risk in buying a device, and in return developers have access to a massive addressable audience.

- Game consoles, such as the new Microsoft and Sony offerings, are a much different story. Consoles are often sold at or near cost, with profits for both the platform manufacturer and game developers deriving mostly or entirely from game content and related services. This is because individual games are highly differentiated and vary widely in the breadth of their appeal, and the risk to a buyer of a new console coming out in several years is very high. Of course, newer consoles for the most part have maintained backward compatibility with legacy games to mitigate the buyer's perceived risk, but a new console introduction still immediately diminishes the value of older games to players, because they know that newer, better content will be available shortly.

There is a major implication of these examples for CEOs, CMOs, and investors in technology platform companies. The company's role in a platform—either as the platform provider or as a content provider—has a tremendous impact on the amount of market power the company has, and thus its ability to exert pricing power and capture value from end customers or content providers. It is important to note that this power dynamic is category specific. In Apple's world, there are few content providers with meaningful influence over it, while content providers can make or break a game console platform. This category specificity implies the need for careful study of the space, either in due diligence by investors looking at a space, or by corporate product and strategy teams considering a new product introduction.

## Razors and Blades 3.0: "As-a-Service" Content in B2B Sectors

Though much less visible than consumer verticals, the B2B technology sectors we see in our consulting work give us still more great examples of platform strategies. These case studies have the usual pricing and risk implications for both CEOs and CMOs selling solutions, and for CIOs purchasing them. They also provide powerful examples of how platform design can simultaneously create customer value through a rich content ecosystem, loyal customers for the provider, and stable cash flows for investors. These models differ from the B2C strategies mentioned earlier by adding a time element to the environment—customers in these spaces are "renting" solutions over time, rather than "buying" them once. One of the most powerful such examples of a platform strategy in B2B is the SaaS-based customer relationship management (CRM) solution from Salesforce and its AppExchange marketplace.

Salesforce launched the AppExchange in early 2006, two and a half years before Apple's App Store. Its goal at the time, according to Salesforce CEO Marc Benioff, was to "create an eBay of applications" on its platform. Today it offers around 2,000 apps, and boasts around 2 million app installations. The popularity of app stores in consumer tech, and the "appification" of all manner of tech spaces, has certainly made this a more standard model in B2B circles.

But why is Salesforce's model different from Apple's, or from those of the game console providers? In short, the biggest difference is in integration and standardization of data, and the implications that has for its users. Salesforce started as a SaaS-based alternative to traditional CRM. By definition, Salesforce customers have chosen to keep their customer relationship data within the platform, using a data structure defined by Salesforce. This is an important difference— for the most part, neither Apple nor game console makers retain central control of customer data that is used across apps, and they certainly don't control the structure.

The value of this data integration to CIOs of Salesforce customers is clear—it means that Salesforce becomes the central repository for all things customer-related, but it also means that Salesforce users can easily mix and match third-party apps, using an open

data standard and their own development architecture, to leverage that data to maximum benefit. This represents a sea change from big legacy enterprise software providers, who controlled both the data architecture and the codebase, making the solution much more closed than the current generation of cloud providers. Also, because Salesforce takes a share of the third-party app revenue, it has additional incentive to get customers on to the platform beyond its subscription fees.

Salesforce, and the app developers using the platform, capture even more of the value of this data integration than the CIO buyer. The most valuable aspect of integration to Salesforce is that it becomes more difficult for customers to leave, because customers are more reliant on the platform for both CRM and for the added functionality provided by third-party apps. This enhances Salesforce's likelihood of revenue stability—essential in a recurring revenue-centric business. We routinely hear similar stories of platform lock-in and its benefits to revenue stability in our tech-related private equity work, since our tech investor clients rely so heavily on stable cash flows to realize the value of their investment strategies.

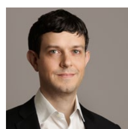
The benefit to third-party developers in this case is similar to the story of the Apple App Store. Developers do not need to worry about building a distribution platform or the size of the addressable customer base.

So what can tech company CEOs, CMOs, and investors learn from Salesforce? SaaS businesses, specifically those whose data has value beyond the core application in target enterprises or with target consumers, can enhance their built-in revenue stability through the use of a platform strategy. This is especially true in SaaS businesses involving centralized customer data, which can create value for customers and content partners in the process.

## Razors and Blades 4.0: Platform Expansion and More Service-Based Models

We expect these open platform strategies to continue gaining traction across tech verticals and employing similarly sophisticated pricing models. In consumer-facing tech businesses, we're already seeing the battle for "living room tech" heat up, with Google and Apple moving ever deeper into smart TV solutions. Both companies offer inexpensive platform solutions today (e.g. Apple TV and Chromecast) to provide more outlets for their app and media infrastructure, and both show interest in further entry into the space. The consumer platform ecosystems are also learning pricing strategy lessons from their B2B counterparts, moving to more subscriptionoriented models (e.g. the continued success of the subscription-based World of Warcraft environment and other multiplayer online games), a trend which we expect to continue. In B2B spaces, SaaS-based enterprise software providers like NetSuite—which already employs both a subscription-based pricing model and a burgeoning app store—are reaching scale sufficient to start opening their platforms to third-party development.

The C-suite and investor communities face major challenges as they contemplate the best approach to a platform pricing strategy. CXO's and boards need to understand the issues that impact the ability to exert pricing power, keep the platform accessible to customers, and maintain great app and media content on their platforms. To do that, they need to carefully evaluate the power dynamics of content partner relationships, the demands of customers from such a platform, and how best to assess the threats of both competing platforms and emerging substitutes. Executives and investors need a clear, unbiased perspective from a rich base of facts to face these challenges effectively. Given the sector-by-sector differences in these dynamics, there is substantial benefit in building this fact base through feedback from all ecosystem participants: platform owners, content providers, and customers. Armed with the right set of facts, executives can build strategic plans to sustain and build upon their positions within ecosystems, and investors can assess the impact of pricing strategy on the growth and stability of their investments.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