Virgin Mobile USA: Pricing for the Very First Time
Presentation Outline

Introduction
- Company Background
- Case Background
- Issue of Concern

Analysis
- Market Research
- All Options
- Theory Application
- Calculation

Conclusion
- Virgin Response
- Recommendations
- Inviting Questions
Virgin Group: Profile

- Virgin, a leading branded venture capital organization, is one of the world's most recognized and respected brands.

- Conceived in 1970 by Sir Richard Branson, the Virgin Group has gone on to grow very successful business in sectors ranging from mobile telephony, to transportation, travel, financial services, leisure, music, holidays, publishing and retailing.

- Virgin has created more than 200 branded companies worldwide, employing approximately 50,000 people, in 29 countries.

[Source: company website - Available from: http://www.virgin.com/AboutVirgin/WhatWeAreAbout/WhatWeAreAbout.aspx]
Virgin Group: Illustration

Company Background

Name: Richard Branson
Born: 1950
Lives: London and Oxfordshire
Status: Married with 2 children

Issue of Concern

1970's
1980's
1990's
2000's
Sir Richard Charles Nicholas Branson (born 18 July 1950), is an English entrepreneur, best known for his Virgin brand, a banner that encompasses a variety of business organizations. The name Virgin was chosen because a female friend involved in setting down the initial record shop commented that there weren't any virgins left amongst them. Today, his net worth is estimated at about £4 billion (US$7.8 billion) according to The Sunday Times Rich List 2006, or US$3.8 billion according to Forbes magazine.

[Source: Mediaman Australia
Virgin Group: Timeline

**Introduction**

A student magazine, a small mail order record company and a recording shop were founded/ opened under the Virgin name.

**1970s**

Virgin Atlantic Airways and Virgin Cargo launched.

**1984**

Virgin Broadcasting, Virgin Hotels, Virgin Megastores, etc.

**1988**

Virgin Rail, Virgin Games, Virgin Cola, Virgin Travel, etc.

**1990s**

Virgin Mobile, Virgin Bikes, Virgin Blue, Virgin Digital, etc.

**Conclusion**

[Source: company website - Available from: http://www.virgin.com/AboutVirgin/WhatWeAreAbout/WhatWeAreAbout.aspx]
Virgin Group: Some Pictures

Company Background

Case Background

Issue of Concern
Virgin Group: Companies in 2002

Company Background

Air Travel
Virgin Atlantic: 51%
Virgin Express: 59.8%
Virgin Blue: 29.1%

Mobile
Virgin Mobile (UK): 100%
Virgin Mobile (Aus): 75%
Virgin Mobile (USA): 50%

Financial
Virgin Money: 100%

Retail
Entertainment: 98.5%
Victory: 89%

Music
V2: 52.5%

Internet
VIRGIN Cars: 25%
VIRGIN Wines: 45%
VIRGIN Net: 51%
VIRGIN Student: 85.5%

Hotel & Leisure
Virgin Hotel Group: 91%
Virgin Active: 36%
Virgin Active S.A.: 27%

Drinks
Virgin Drinks: 100%

Rail
Virgin Retail Group: 51%
Theetrainline.com: 86%

Note: % indicates percent ownership

[Source: Adapted from Virgin Management Ltd.
Available from: https://www.blackwellpublishing.com/grant/docs/15Virgin.pdf]
Virgin Group: Company Values

We believe in making a difference. In our customers' eyes, Virgin stands for value for money, quality, innovation, fun and a sense of competitive challenge. We deliver a quality service by empowering our employees and we facilitate and monitor customer feedback to continually improve the customer's experience through innovation.

------- Virgin Group Website

[Source: http://www.virgin.com]
What Virgin Looks For?

- Is this an opportunity for restructuring a market and creating competitive advantage?
- What are the competitors doing?
- Is the customer confused or badly served?
- Is this an opportunity for building the Virgin brand? Can we add value?
- Will it interact with our other businesses?
- Is there an appropriate trade-off between risk and reward?
Why Mobile Industry?

- Rapidly growing industry.
- Typical market where the customer has been ripped off or under-served, where there is confusion and/or where the competition is complacent.
- Market segment (15-29 ages group) being ignored.
- Big players have not capitalized on this segment.
- Competitors slow to react to ever-changing customer mindset.
Dan Schulman was appointed CEO.

The company entered into a 50-50 joint venture with Sprint in which Virgin Mobile USA’s services would be hosted on Sprint’s PCS network.

Under the agreement, Virgin Mobile would purchase minutes from Sprint on an as-used basis.

The goal of Virgin Mobile USA is: to have 1 million total subscribers by the end of 2002 and 3 million by year 2006.
VirginXtras - Focus on Youth

The first to offer m-commerce services to all customers via VirginXtras, irrespective of their handsets.

- Access to MTV-branded accessories and phones
- Text messaging
- Rescue Ring
- Online Real-time Billing
- Wake up Call
- Ring tones
- Fun Clips
- The Hit List
- Music Messenger
- Movies
US Wireless Market Share in 2001

[Source: The Case]
Our Concern

“If we can figure out a way to create value so that we can successfully enter a very competitive and saturated market, and also create profitability with this target segment, then we will have truly accomplished something big.”
Calling Plans - Industry Prices

Contract Commitment - Minutes

[Source: Adapted from company data, Morgan Stanley Research]
Actual Prices Paid by Customers

Market Research

All Options

Theory Application

Calculation

[Source: Adapted from company data, Morgan Stanley Research]
Introduction

Analysis

Conclusion

Overall Goal in Choosing Pricing Structure

- Must reach our target market: Youth!
- Create a positive Lifetime Value (LTV) for every customer
  - We must be able to make money!

Market Research

All Options

Theory Application

Calculation
Three Main Options

1. Clone the Industry Prices
2. Price Below Competition
3. A Whole New plan

Options 1, 2?  Or 3?
Option 1: Clone the Industry Prices

- Simple message:
  - Pricing competitively
  - MTV applications
  - Superior customer service

- Better off peak hours
- Fewer hidden fees
Option 1: Price Structure

Industry and Virgin

[Source: Adapted from company data, Morgan Stanley Research]
Option 1: Benefits and Shortcomings

Pros and Cons

Easy to promote.
Consumers are used to ‘buckets’ and peak/off-peak distinctions.
Savings on advertising budget costs.
Simple packaging could save costs on high commissioned salespeople.

The target youth market is not stressed.
Hard for a new entrant to the market.
No flexibility in calling habits; always paying the same high price.
With no real price distinction, consumers are not willing to switch over just for the Virgin Extras features.
Option 2  Price Below the Competition

• Similar structure
  – Pricing slightly below the competition

• Maintain ‘buckets’ of minutes
  – Price per minute set below industry average in certain key buckets
  – Target young market that uses 100 to 300 minutes
Option 2: Price Structure

[Source: Adapted from company data, Morgan Stanley Research]
Option 2: Benefits and Shortcomings

- Maintain the buckets and volume discounts with price per minute set below industry average.
- Offer best off-peak hours and few hidden fees so consumers will know Virgin Mobile is cheaper, plain and simple.
- Expand the size of the market and result in greater sales and profits.

- Earnings from each consumer will be less.
- Sales growth does not necessarily mean big profits.
- Risk of being regarded as low-quality service, thus an unfavorable image.
- May trigger off competitive reactions.
Radically New Plan!

- Shorten or eliminate Contracts
- Prepaid service
- Handset subsidies
- Eliminate all hidden fees and off-peak hours
- Concept of LTV
Contracts

• Does it make sense to shorten subscription terms or eliminate them altogether?
  – Contract provide a hedge against churn
  – Estimated churn rises from 2% to 6%

• Allows 18yrs and younger to purchase the product
Currently 92% of subscribers have post-paid plans

Concerns:

• Prepaid arrangements now have prohibitive pricing
  - 35 – 50 cents per minute up to 75 cents
  - Phone use that is very infrequent
• Higher churn rate
• Recoup Acquisition Costs (AC)
• Morgan Stanley research suggests AC must be at or below $100 for prepaid to be viable
• Need a method to add minutes (such as Website)
Currently carriers purchase handsets from major manufacturers at a cost of $150-$300.

Carriers then subsidize the end user $100-$200 (becomes part of AC).

How do we minimize the AC?

Does this matter to our target market?
Hidden Fees

• Goal: Make the pricing very simple
  – “What you see is what you get!”
• Rolling all these normally hidden costs that include taxes and fees into the final price

Off-Peak Hours

• Consider the target market: Young People!
  – Minute usage is very different
The Business Customer

- **TWO DISTINCTIONS:**
  - Make calls during office hours
  - Rarely worry about the cost of calls (Finance Dept can deal with it)

- **PRICE INSENSITIVE!**
- Demand is INELASTIC
- A percentage decrease in price will have a smaller percentage increase in Quantity Demanded (Calls made)
The student customer

- **TWO DISTINCTIONS**
  - You make calls whenever necessary and can seek to avoid calls that come with a higher pricetag
  - Students CARE about the price of calls
- **PRICE SENSITIVE**
- **Demand is ELASTIC**
- A percentage decrease in price will result in a larger percentage increase in quantity demanded (calls made)
Mobile phone company revenue:

• The revenue gain from increased quantity must be greater than the revenue loss from dropping the price.

• Since our target market is Youth, whose demand is relatively elastic, downward adjustment in price is relevant!

A > B for Revenue Gain!
Option 1: Clone industry

- **Industry pricing**
  - Same price of handset offered
  - Same churn rate of 2%

- **Xtras**

- **Hidden Fee**

- **Off-peak hour**

Option 2: Price below

- **Industry pricing**
  - Same price of handset offered
  - Same churn rate of 2%

- **Xtras**

- **Hidden Fee**

- **Off-peak (1) hour**

- **Priced (5c) below**
Option 3 : New pricing structure: prepaid

Average monthly revenue from minute usage
= Avg. min + avg. minute charge

- Same price of handset offered
- Churn rate of 6%
### Calculation of LTV

$$LTV = \frac{M}{1 - r + i} - AC$$

<table>
<thead>
<tr>
<th>ARPU</th>
<th>CCPU</th>
<th>M</th>
<th>AC</th>
<th>LTV</th>
</tr>
</thead>
<tbody>
<tr>
<td>Average Revenue per user</td>
<td>Cash Cost per user = 45% of ARPU</td>
<td>Monthly Margin = ARPU - CCPU</td>
<td>Acquisition Cost</td>
<td>Lifetime Value</td>
</tr>
</tbody>
</table>

- Sale commission
- Advertising per gross add
- Subsidy cost

- $r$: retention rate = 1 – churn rate
- $i$: interest rate = 5%
Assumptions

- Year 1 is the immediate target
- Customer with us 1 year for prepaid
- Target average minute per month is 200
- Target average charge per minute is 15 cent

- Level of subscribers
  Option 1: same industry pricing -> less attractive
  -> 500,000 out of 1 million subscribers

  Option 2: lower cost -> attractive
  -> 750,000 out of 1 million

  Option 3: new pricing structure and features -> most attractive
  -> 1 million out of 1 million
<table>
<thead>
<tr>
<th>Item</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hidden Fee</td>
<td>$(6.00)</td>
</tr>
<tr>
<td>Off-peak (1) hour</td>
<td>$(3.00)</td>
</tr>
<tr>
<td>Priced below (5c)</td>
<td>$(10.00)</td>
</tr>
<tr>
<td>Option 1 Xtras</td>
<td>$12.02</td>
</tr>
<tr>
<td>Option 2 Xtras</td>
<td>$18.03</td>
</tr>
<tr>
<td>Option 3 Xtras</td>
<td>$24.04</td>
</tr>
<tr>
<td>Rev. from minute usage</td>
<td>$30.00</td>
</tr>
</tbody>
</table>
Xtras Value

Exhibit 3  Revenue from Mobile Entertainment Services


- 1999: 5.8
- 2000: 48.5
- 2001: 37.5

% of the market share

# of subscriber x 12 months
<table>
<thead>
<tr>
<th>Market Research</th>
<th>Industry Avg.</th>
<th>Option 1</th>
<th>Option 2</th>
<th>Option 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>ARPU</td>
<td>$52.00</td>
<td>$55.02</td>
<td>$51.03</td>
<td>$45.04</td>
</tr>
<tr>
<td>CCPU</td>
<td>$30.00</td>
<td>$24.76</td>
<td>$22.96</td>
<td>$20.27</td>
</tr>
<tr>
<td>M</td>
<td>$22.00</td>
<td>$30.26</td>
<td>$28.07</td>
<td>$24.77</td>
</tr>
<tr>
<td>AC</td>
<td>$270.00</td>
<td>$160.00</td>
<td>$120.00</td>
<td>$100.00</td>
</tr>
<tr>
<td>LTV</td>
<td>$44.29</td>
<td>$272.29</td>
<td>$280.94</td>
<td>$253.89</td>
</tr>
</tbody>
</table>

\[
LTV = \frac{M}{1 - r + i} - AC
\]
Option 3 - Break Even Point with AC and LTV

Let LTV = 0

\[ 0 = \frac{M}{(1 - r - i)} - AC \]

\[ -> M = 0.11 \times AC \]

\[ -> AC = \frac{24.77}{0.11} \]

If LTV = 0, AC = $225.

That is the max we can go with AC.

Now with AC at $100,
- For Ads budget, we can spend more
- For the handset, we can lower price or increase quality
Option 3 - Break Even Per customer

Revenue = Cost
Xtras + minute usage = CCPU + AC Cost

<table>
<thead>
<tr>
<th>Total Net</th>
<th>11.37</th>
<th>0 ~ Break even</th>
</tr>
</thead>
<tbody>
<tr>
<td>With Xtras</td>
<td>0.15</td>
<td>0.09</td>
</tr>
<tr>
<td>Without Xtras</td>
<td>0.21</td>
<td></td>
</tr>
</tbody>
</table>
Price Vs # of Subscribers

![Graph showing the relationship between price per minute and number of subscribers, indicating a loss area and a zero profit line.](image-url)
Pricing Strategy

Pricing Objective

Sales Maximization

Demand Estimate

Current market penetration of target market is only 25%¹
Create Demand amongst remaining 75%
Brand Switch by current users
Capitalize on Highly Elastic Demand of Target Market

Cost Estimates

Monthly Cost to Serve per Customer

Networking Cost
Customer Service Cost
Overhead Cost

Customer Acquisition Cost

Subsidy on Cell Phone set
Marketing Communication Cost
Sales commission

Pricing Strategy (contd…)

Competitors’ Prices
- ARPU of $52 with 417 minute of use
- 60 – 20 c per minute for less than 100 minutes
- 20 – 12 c per minute for 100 to 300 minutes (Virgin Target Market)
- 35 – 50 c per minute for Pre-paid Costumers (Virgin Target Market)

Pricing Method
- Penetration Pricing
- Costs per Unit is inversely related to Number of Subscribers
- Reduce CCPU by increase in Number of Subscribers
- Increase in Margin will follow
Final Price !!!!

15c per minute with Revenue of $30 per unit
(average use of 200 mins)
Target Virgin Xtras Revenue of 15.04
Total Estimated ARPU of $45.04