

The New Product Conundrum

A classic problem: Four marketing directors are sitting in a conference room debating the question of staying with an older, market-tested product, or replacing it with a new one that provides new features and benefits.

The research director reports that her studies suggest that demand for the existing product in the coming year has an 80% probability of staying around its historical levels of 8 million units, but in the 20% likelihood that a competitor launches a new product, demand could fall to only 6 million units. As for the new product's potential, her research suggests that demand has a 60% likelihood of being enthusiastically received by the market and reaching 10 million units. Worst case, she estimates it will do no worse than the lowest forecast for the old product at 6 million units.

The director of pricing has done some analysis of price elasticity and concluded that if they keep the price of the old product at \$10, they are likely to achieve only the lower volume estimates. However, to achieve the historical volume levels of 8 million, they will need to reduce the price to \$8. With the new product, he estimates that they could charge \$13 per unit at the 6 million unit level, and would only have to drop the price to \$9 to achieve the 10 million unit potential.

The director of advertising tells the group that she believes they may have to spend as much as \$2 million more on advertising and promotion if they elect to launch the new product, just to create the same levels of awareness of the existing product.

The director of product management relays the results of a production cost investigation he undertook with the operations staff in which they estimated that the tooling costs for the new product have a 70% chance of staying under \$1 million, but there is a 30% chance that it could go as high as \$3 million. Further, he reports that due to the aging production line in the existing product, there is a 90% chance that maintenance costs can be held to \$2 million, but a slim 10% chance that they might go as high as \$6 million if a critical machine breaks down.

The vice president of marketing walks into the room and says, "I have a meeting with the CEO in 30 minutes and I need an answer ... Should we stay with the tried-and-true product, or take a chance on the new one?"

Well it only took us 20 minutes and a \$100 software plug-in to come up with not just the answer (given the specifics above), but a platform to do sensitivity analysis and see how the answer would change if the assumptions changed.

In this case, launching the new product would be expected to add \$18.4 million in profit over staying with the current product. Decision: Launch.

