THE STRATEGY AND TACTICS OF PRICING

A Guide to Profitable Decision Making

THIRD EDITION

THOMAS T. NAGLE
REED K. HOLDEN

PRENTICE HALL MARKETING SERIES

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To Dan Nimer,
Who labored alone
with vision and persistence
until others sought to share his wisdom

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Preface

"Pricing is the moment of truth—all of marketing comes to focus in the pricing decision."

When Raymond Corey wrote these words at the Harvard Business School in the early 1960s, marketing was just coming into its own as a strategic discipline that could drive the direction of a business. Unfortunately, few marketing practitioners actually took Corey's words to heart. Enjoying their new prestige and power to influence corporate strategy, they were reluctant to let financial considerations constrain their "strategic" thinking.

Instead, they focused on achieving market share and customer satisfaction, believing that high profitability would somehow naturally follow. Marketing academics also slighted pricing, offering little research and few courses on the subject. Whenever the subject of pricing problems did arise, professors assured their students that all could be solved indirectly by redoubling efforts to differentiate products and services.

These attitudes toward pricing changed radically when marketers encountered the challenges of the 1980s. Companies with leading brand names saw brand loyalty and their power over distribution erode from years of price "promotion" to defend market share. Even large companies often found profits unattainable, as smaller firms targeted and lured away the most profitable customers (a practice labeled "cream skimming" by the victims). Successful corporate raiders then showed that they could increase cash flow and profits, often by raising prices, even as they lost some share. In the 1990s, a brief counterrevolution took place, as e-competitors bought market share from more efficient bricks and mortar competitors. By the end of 2000, most e-competitors went bankrupt, while the remainder looked for ways to charge prices consistent with financial viability.

Not only marketing practitioners are now under the gun to show that their efforts can ultimately pay off at the bottom line. So also are marketing theorists. Companies have become almost maniacal in their focus on increasing shareholder value. Strategies defined in terms of market share or customer satisfaction alone get short shrift. For marketers to achieve respect and influence, the key is to show how their ideas can generate profitability. As a result, creative thinkers are integrating marketing thought with financial concepts.[1]

Successfully making that integration requires understanding not only what creates value for customers, but also how and when that value can be transformed into earnings per share. This does not mean that companies should regress to the days when they naively tried to increase profits by marking up costs with higher margins. It means understanding that strategic pricing is about much more than setting prices. It is about targeting markets that can be served profitably, communicating information that justifies price levels, and managing pricing processes and systems to keep prices aligned with value received.

These are not skills that have traditionally resided in finance or marketing departments. Strategic pricing is becoming a profession in its own right that bridges marketing, finance, sales, and top management. The Professional Pricing Society[2] reported in a survey of its members that pricing decisions were principally made by a pricing manager in 25 percent of the companies and by a cross-functional team in another 20 percent. Others cited were the marketing department (15 percent) and product manager (15 percent). Decentralized pricing by the sales organization was practiced in only 11 percent of these companies, and none had pricing principally made by finance. Although this is a biased sample, it is indicative that price in the most sophisticated companies is being proactively managed.

As in the first edition, the primary objective of this edition is to develop a practical and readable manager's guide to pricing, not a textbook. Our references are not necessarily to the seminal articles on the subject, but to those that are most managerially relevant and accessible. Professors will be happy to learn that an expanded Instructor's Manual for this edition includes new classroom exercises. We expect that the combination of clear writing and current, relevant examples will continue to make this the most popular reference on pricing for managers[3] as well as the most popular text in the classroom.

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1 Eugene W. Anderson, Claes Fornell, and Donald R. Lehmann, "Customer Satisfaction, Market Share, and Profitability: Findings from Sweden," *Journal of Marketing,* 58 (July 1994), pp. 53–66; Rolan Rust, Anthony J. Zahorik, and Timothy L. Keiningham, "Return on Quality: Making Service Quality Financially Accountable," *Journal of Marketing* 58 (April 1995), pp. 58–70; Rajendra K. Srivastava, Tasadduq A. Shervani, and Liam Fahey, "Market-Based Assets and Shareholder Value: A Framework for Analysis," *Journal of Marketing* 62(*1*), (January 1998), pp. 2–18.

2 Professional Pricing Society, *PPS Members 2001 Current Practices Survey* (Atlanta, GA: 2001). For additional information about PPS and the survey, go to www.pricingsociety.com.

3 As measured by amazon.com.

Acknowledgments

We cannot practically enumerate all those people to whom we owe a debt of gratitude, but collectively they have contributed substantially to the content of this work. We wish to renew our thanks to all who contributed to the first and second editions and whose specific contributions were acknowledged there. The success of those earlier works gave us access to client companies and managers from whom we have learned much more about pricing strategy and implementation than would have been possible from purely academic research. Many thanks to our students and seminar participants whose probing questions and challenging problems continue to keep our work interesting and relevant.

We gratefully acknowledge the advice of numerous experts in marketing, pricing, and business management whose published and unpublished insights we have incorporated into this text. While we could never enumerate them all, we wish to acknowledge our special debt to George Cressman, Kent Monroe, Dan Nimer, and Mike Marn. Richard Harmer has contributed immensely to our thinking about pricing over the past fifteen years. His work is defining "value segments," and his concepts of "segmentation fences" and "price metrics" are now widely adopted by pricing practitioners. He also contributed to our thinking about the role of income and affordability in pricing. Gerald (Jerry) Smith of Boston College coauthored two chapters in the second edition that have been revised and integrated into this edition, and he also added numerous examples and scholarly references to this edition. Jerry's exceptional intellect added much to our own insights. Barry Margeson added an insightful section to Chapter 12. Eugene Zelek, an antitrust attorney and believer in creatively managing within rather than reacting to legal constraints, wrote the section in Chapter 14 on the law.

It is easy to underestimate how much work beyond writing is involved in publishing a book. Allison Bray edited the revised chapters. Evelyn Hennessey managed manuscript preparation. Susanna Barmakian and Bonnie Walsh secured permissions. We would like to thank our colleagues at Strategic Pricing Group who were understanding and supportive of our need for "writing time" and who accepted additional management and project responsibilities to give us that time.

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