How Do You Know When the Price is Right?

by Robert J. Dolan

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An eight-step process can help you make better decisions.

How Do You Know When the Price Is Right?

by Robert J. Dolan

Pricing is managers' biggest marketing headache. It's where they feel the most pressure to perform and the least certain that they are doing a good job. The pressure is intensified because, for the most part, managers believe that they don't have control over price: It is dictated by the market. Moreover, pricing is often seen as a difficult area in which to set objectives and measure results. Ask managers to define the objective for the company's manufacturing function, and they will cite a concrete goal, such as output and cost. Ask for a measure of productivity, and they will refer to cycle times. But pricing is difficult to pin down. High unit sales and increased market share sound promising but they may in fact mean that a price is too low. And forgone profits do not appear on anyone's scorecard. Indeed, judging pricing quality from outcomes reported on financial statements is perilous business.

Yet getting closer to the "right" price can have a tremendous impact. Even slight improvements can yield significant results. For example, for a company with 8% profit margins, a 1% improvement in price realization – assuming a steady unit sales volume – would boost the company's margin dollars by 12.5%.[1] For that reason, even one step toward better pricing can be worth a lot.

To improve a company's pricing capability, managers should begin by focusing on the process, not on the outcome. The first question to ask is not, What should the price be? but rather, Have we addressed all the considerations that will determine the correct price? Pricing is not simply a matter of getting one key thing right. Proper pricing comes from carefully and consistently managing a myriad of issues.

Based on observation and participation in setting prices in a wide variety of situations, I have identified two broad qualities of any effective pricing process and a "to do" list for improving that process. Not every point will apply to every business, and some managers will need to supplement the checklist with other actions that pertain to their specific situation. But in general, by using these criteria as a guide, managers will begin to set prices that earn the company measurably greater returns, and they will gain control over the pricing function.

Strategy and Coordination

All successful pricing efforts share two qualities: The policy complements the company's overall marketing strategy, and the process is coordinated and holistic.

Marketing Strategy. A company's pricing policy sends a message to the market – it gives customers an important sense of a company's philosophy. Consider Saturn Corporation (a wholly owned subsidiary of General Motors). The company wants to let consumers know that it is friendly and easy to do business with. Part of this concept is conveyed through initiatives such as inviting customers to the factory to see where the cars are made and sponsoring evenings at the dealership that combine a social event with training on car maintenance. But Saturn's pricing policy sends a strong message as well. Can a friendly, trusting relationship be established with customers if a salesperson uses all the negotiating ploys in the book to try to separate them from that last $100? Of course not. Saturn has a "no hassle, no haggle" policy (one price, no negotiations) which removes the possibility of adversarial discussions between dealer and po-

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PAINTINGS BY JOHN T. O'CONNOR

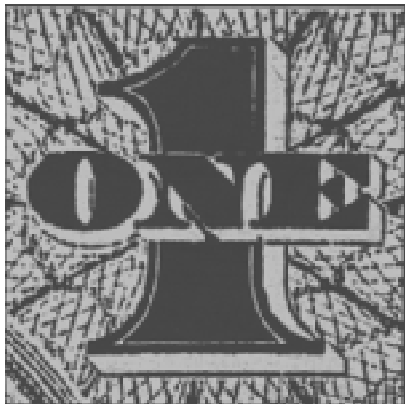
tential customer. Customers have an easier time buying a car knowing that the next person in the door won't negotiate a better deal.

The pricing policy for Swatch watches illustrates the same point. The company's overall message is that a watch can be more than just functional; it can be fun as well – so much fun, in fact, that a customer ought to own several. The company's price, $40 for a basic model, has not changed in ten years. As Franco Bosisio, the head of the Swatch design lab, noted in William Taylor's interview "Message and Muscle: An Interview with Swatch Titan Nicholas Hayek" (HBR, March-April 1993): "Price has become a mirror for the other attributes we try to communicate.… A Swatch is not just affordable, it's approachable. Buying a Swatch is an easy decision to make, an easy decision to live with. It's provocative, but it doesn't make you think too much."

For Saturn and Swatch, the pricing policy flows directly from the overall marketing strategy. This consistency, or even synergy, of price and the rest of the marketing mix is a critical requirement for success.

Coordination. There are typically many participants in the pricing process: Accounting provides cost estimates; marketing communicates the pricing strategy; sales provides specific customer input; production sets supply boundaries; and finance establishes the requirements for the entire company's monetary health. Input from diverse sources is necessary. However, problems arise when the philosophy of wide participation is carried over to the price-setting process without strong coordinating mechanisms. For example, if the marketing department sets list prices, the salespeople negotiate discounts in the field, the legal department adjusts prices if necessary to prevent violation of laws or contractual agreements, and the people filling orders negotiate price adjustments for delays in shipment, everybody's best intentions usually end up bringing about less than the best results. In fact, the company may actually lose money on some orders, and some specialty items positioned to earn high margins may end up returning margins in the commodity range.

Such was the case at a major truck manufacturer. Marketing set list



prices that were essentially meaningless because so many other functions then adjusted those prices for their own purposes. While salespeople chased volume incentives by offering the largest discounts they were allowed, finance and accounting were charged with making sure the company covered its variable costs on each order. In this case, the problem was exacerbated by shortcomings in the accounting systems, but the fundamental cause of the company's pricing dilemma was that the decision-making process involved people with different pricing objectives and different data. There was no coordinated process in place to resolve these conflicting objectives effectively. The company is still working on a long-term solution to the dilemma, but for the short term it has dealt with the problem by creating a separate pricing organization staffed by a group of senior executives that collectively acts as "pricing czar." The group is responsible for gathering input from everyone and then setting a price.

When considering the coordination of the pricing process, managers should ask the following questions:

- ☐ What is our pricing objective?
- ☐ Do all the participants in the process understand the objective?
- ☐ Do they all have an incentive to work in pursuit of the objective?

Proper pricing requires input from a number of people, but if there is no mechanism in place for creating a unified whole from all the pieces, the overall pricing performance is likely to be dismal.

Eight Steps to Better Pricing

Fitting a pricing policy to a marketing strategy and considering the relevant information in a coordinated manner are broad goals. The following eight steps deal with the essentials of setting the right price and then monitoring that decision so that the benefits are sustainable.

1. Assess what value your customers place on a product or service. Surveys show that for most companies, the dominant factor in pricing is product cost. Determine the cost, apply the desired markup, and that's the price. The process begins inside the company and flows out to the marketplace. To establish an effective pricing policy, however, that process must be reversed. Before any price is determined, pricing managers must think about how customers will value the product.

Consider how Glaxo introduced its Zantac ulcer medication to the U.S. market in 1983 to compete with SmithKline Beecham Corporation's Tagamet. Tagamet had been introduced in 1977 and by 1983 was the number one ulcer medication and the number one selling drug in the world. Zantac, however, offered superior product performance: It had an easier schedule of doses, it had fewer side effects, and it could be taken safely with many other drugs that were not compatible with Tagamet. Thus, its perceived value to the customer was very high. If Glaxo had allowed product cost to drive the price of Zantac, it might have introduced the medication at a lower price than Tagamet; it might have used a "follow the leader" pricing strategy. But Glaxo instead relied on Zantac's perceived value to the customer, initially pricing the drug at a 50% premium over Tagamet. Within four years, Zantac became the market leader.

Northern Telecom's pricing of its highly successful Norstar telephone system demonstrates the same principle. In 1988, as Northern's senior managers developed the company's strategy for competing with Pacific

Rim suppliers, they realized that initially, the inherent superiority of their product didn't matter; resellers would value Norstar only at the market price then being charged by most of Northern's competitors. Therefore, rather than considering Norstar's cost and setting a price that might have been higher than competitors', Northern's managers decided to introduce the Norstar system at the prevailing market level and then look inward to determine how they could reduce costs in order to make money at that price.

Northern's managers knew that over time, they could convince consumers that their system was better than the competition's; in other words, they knew that Norstar's perceived value would increase as the system proved itself in the marketplace. Although the system entered the market at a price below what it was actually worth, eventually, as Northern's competitors began to fight the commodity battle and lower their prices, Northern was able to maintain its price level, secure a price premium, improve margins as its costs decreased, and increase its share of the market.

In Glaxo's case, a conventional "figure cost and take a markup" approach would have resulted in forgone profits; in Northern's case, the result would have been a noncompetitive price and no sales. By turning the process around and letting value as perceived by the customer be the driver, each company found a better initial price level and the foundation for its future growth.

There are several ways in which companies can assess what value customers perceive a product or service to have. Careful market research is one way; managers also should tap employees with direct customer contact, such as the sales force, for undiluted information from the outside.

Before determining a price, managers must think about how customers will value the product.

2. Look for variation in the way customers value the product. By customizing prices, a company can earn much greater profits than it could expect with a single product/single price policy, yet many managers fail to recognize the benefits of customizing products and prices for different customer segments. A product will often have a much higher perceived value for an "ideal" customer than it will for an average prospect. If this is the case, a company would do well to separate the markets or segments and charge different prices accordingly. For example, consider how Polaroid Corporation introduced its SX-70 instant photography camera. Polaroid knew that some consumers – such as people in the photo-identification card business – would place a high value on receiving pictures immediately and on knowing whether or not the shots had come out properly. So the company segmented the market over time. Initially, to target those customers who "couldn't wait" for the new product, Polaroid offered the SX-70 to dealers at a price of $120 per camera; end-user customers paid more than $200 on average. Two years later, to capture the wider market, Polaroid offered the SX-70 line at prices that were less than half the introductory level.

The same principle applies in any business. Airlines, for example, attempt to treat business and pleasure travelers differently by offering cheaper fares with Saturday-night stay requirements to the latter. By developing products with slightly different specifications from the same platform, companies can customize pricing for segments that value the product differently.

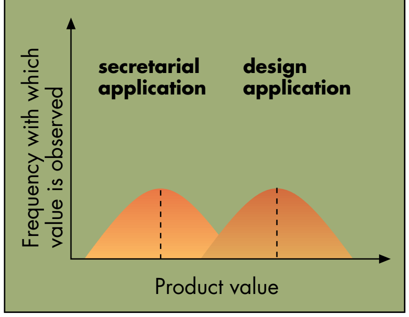
Customizing price not only is common; in some cases, it is the key to a company's financial health. Consider the magazine industry: The cost per copy of a magazine when a customer buys a subscription is dramatically less than the cost of a single copy purchased at a newsstand. Software manufacturers employ similar tactics: When they introduce a new version of a popular product, they offer discounted upgrade prices to customers who already use the old version. The manufacturers know that the users' ability to continue using the old version of the product makes them value the new product less than someone without the product altogether.

Simple differences in taste affect value variation to some extent – for instance, some people simply like Big Bertha golf clubs more than others. But managers will be able to spot value variation and opportunities for price customization by answering the following questions:

☐ Do customers vary in their intensity of use? Heavy users generally value a product more than light users, especially in the durable-product arena – golf clubs, television sets, cameras, and the like. Heavy users also may be more interested in added features or complementary products; a company can use ancillary products as a mechanism for differential pricing.

☐ Do customers use the product differently? Some customers will use a product differently from other customers, with a consequent difference in perceived value. For example, consider the coated air bubbles produced by Sealed Air Corporation, a supplier of protective packaging. The company recognized that for some applications of the product, viable substitutes were available in the market. But for other applications, Sealed Air had an immense advantage; for instance, its product offered superior cushioning for heavy items with long shipping cycles. Recognizing the extent of the advantages in various applications and understanding the value differential in each setting was the key to Sealed Air's product line expansion and pricing decisions. The insight helped

Same Product, Different Value



the company grow from $88 million in revenues in 1980 to more than $500 million 15 years later.

In many situations, companies find that a particular application for a product has a perceived value that is smoothly distributed around a mean. The mean for different applications, though, can be quite different. Take the case of a computer manufacturer offering similar workstations for two different applications: secretarial support and manufacturing design. (See the graph "Same Product, Different Value.") The mean value of the secretarial application is well above the company's costs – but also well below the value of the design application. In such a situation, customized pricing can be a great boost to profitability.

If markets are sufficiently large and show different means, a company should customize its prices. In some cases, customization can be accomplished without altering the product. This is possible if no information on the product can be exchanged and if the product cannot be resold between markets. For example, the computer won't be resold from the secretarial segment to the design segment. If information does flow between segments or if the product might be resold from one segment to another, product customization obviously would be necessary before prices could be customized. However, such an investment – in different brand names, software preloads, or added features – can well be worth it.

☐ Does product performance matter more to some customers, even if the application is the same? Before its acquisition by S.C. Johnson Wax Company, "Bugs" Burger Bug Killers guaranteed total pest elimination and commanded a price ten times the industry norm because it focused on those customers, such as hotels and hospitals, for whom the cost of failure was extreme. "Bugs" Burger's guarantee of "zero pests" had much more perceived value for those customers than it did for other potential accounts.

3. Assess customers' price sensitivity. Price elasticity, a key concept in economics, is defined as the percent change in quantity sold given a 1% change in price. If a company raises its price on a given product or service by 1%, how will the quantity of sales be affected? On average, the answer is that the quantity will drop by about 2%, but an "on average" answer is not very useful for managers trying to set price. Elasticities vary widely across product categories and even across brands within a category. Therefore, companies should analyze each individual situation. The most sophisticated pricing managers use market research procedures such as conjoint analysis to measure elasticities, but a good first step is simply to examine the important factors influencing price sensitivity in three broad areas: customer economics, customer search and usage, and the competitive situation.

A product's different applications often have different perceived value.

First, consider customer economics. Price sensitivity increases – and a company's pricing latitude thus decreases – to the degree that:

☐ The end user bears the cost as opposed to a third party. For example, until recently pharmaceuticals manufacturers have had greater pricing latitude because neither the prescriber nor the patient paid the bulk of the charges.

☐ The cost of the item represents a substantial percentage of a customer's total expenditure.

☐ The buyer is not the end user, and sells his or her end product in a competitive market. Price pressure from further down a distribution channel ripples back up through the chain. For example, one steel producer was able to obtain good margins by selling a component to buyers who then

Factors Affecting Price Sensitivity

Customer Economics
☐ Will the decision maker pay for the product him or herself?
☐ Does the cost of this item represent a substantial percentage of the total expenditure?
☐ Is the buyer the end user? If not, will the buyer be competing on price in the end-user market?
☐ In this market, does a higher price signal higher quality?

Customer Search and Usage
☐ Is it costly for the buyer to shop around?
☐ Is the time of the purchase or the delivery significant to the buyer?
☐ Is the buyer able to compare the price and performance of alternatives?
☐ Is the buyer free to switch suppliers without incurring substantive costs?

Competition
☐ How is this offering different from competitors' offerings?
☐ Is the company's reputation a consideration? Are there other intangibles affecting the buyer's decision?

produced specialty items for end users. Selling that same component to buyers who made products for commodity-like markets meant lower realized prices: The buyers were more price sensitive.

☐ Buyers are able to judge quality without using price as an indicator. In hard-to-judge categories, such as perfume, price sometimes has little impact because the consumer's assumption is that high price and high quality go together.

Astute managers can gain a further advantage by considering proper product configurations.

The customer's search for and use of a product affect sensitivity to the degree that:

☐ Consumers can easily shop around and assess the relative performance and price of alternatives. Advances in information technology have enabled consumers to increase their awareness of prices and access to alternative options. Over time, this ability is likely to lead to increasing price sensitivity for a wide range of products and services. Currently, sophisticated companies are using information technology to track supplier prices on a worldwide basis. Soon, consumers shopping at home by computer or interactive TV will be able to check the prices of many different suppliers.

☐ The consumer can take the time he or she needs to locate and assess alternatives. For example, in an emergency, speed of delivery may be crucial: Price will not be the primary factor determining the purchase.

☐ The product is one for which it is easy to make comparisons. For example, it is easier to compare cameras than it is to compare computers.

☐ Buyers can switch from one supplier to another without incurring additional costs. For example, Borland International, in marketing its Quattro spreadsheet package, stressed its compatibility with and similarity to Lotus 1-2-3 in order to position itself as an easy switch. This tactic put pressure on Lotus 1-2-3, increasing its price sensitivity.

Finally, regarding the competitive situation, a company's pricing latitude decreases to the degree that:

☐ There is limited difference between the performance of products in the category.

☐ A long-term relationship with the company and its reputation are not important, and the consumer's focus is on minimizing the cost of this particular transaction. (See the table "Factors Affecting Price Sensitivity.")

4. Identify an optimal pricing structure. Determining whether the company should price the individual components of a product or service, or some "bundle," is critical. Should an amusement park operator charge admission to the park, a fee for each ride, or both? Should an entertainment service like HBO charge by what it makes available or by how much viewers "consume"? Answering these questions incorrectly can be very costly. The resources allocated to thinking about pricing are often misallocated; most companies invest too little time, money, and effort in determining a pricing structure, and too much in determining the pricing at different levels within a given structure.

Two important issues to consider when creating a pricing structure are whether to offer quantity discounts and whether to offer bundle pricing.

Quantity discounts are frequently offered in industrial selling situations. For example, consider a manufacturer that must create a pricing policy given Buyer A and Buyer B, who value successive units of the product differently:

Units	Buyer A	Buyer B
1	$70	$70
2	$20	$50
3	$20	$40
4	$20	$35
5	$20	$30

For simplicity, let's assume that the seller knows these valuations and that one buyer will not resell the product to the other. The naïve pricing manager would say, What is the optimal price to charge? If the producer's cost is $20 per unit, the answer is $70. At this price, the company would sell one unit to each buyer for a total profit of $100.

The astute pricing manager, on the other hand, asks, What is the optimal pricing schedule? The insight lies in asking the right question. With the given cost and value parameters, the optimal pricing schedule will be as follows:

buy 1-	$70
buy a second-	$50 additional
buy a third-	$40 additional
buy a fourth-	$35 additional
buy a fifth-	$30 additional

With this pricing schedule, buyer A would purchase one unit at $70, and buyer B would purchase five units – one at $70, one at $50, one at $40, one at $35, and one at $30, for total revenues of $295. Given the $20 cost to produce, the profits on those transactions would total $175 – a 75% greater margin than that generated by the naïve pricing manager's optimal price of $70.

Bundle pricing is the second factor managers should consider when creating a pricing structure. For a manufacturer providing complementary products, like cameras and film, for example, the strategy should be to give up some of the initial profit potential on the hardware to increase the volume sold and consequently increase the potential demand for software.

Astute managers can gain a further advantage by also considering proper product configurations. The two products need not have a camera-and-film-type relationship to be bundled. Movie distributors often sell packages of films rather than selling individual film rights because the package values vary less across buyers than do the individual film values. Take the following two movies and their corresponding value to buyers:

	Buyer A	Buyer B
Movie 1	$9,000	$5,000
Movie 2	$1,000	$5,000
Total	$10,000	$10,000

Both Buyer A and Buyer B value the package of Movie 1 and Movie 2 identically at $10,000. If the company offers a bundle of Movie 1 and Movie 2, it can charge $10,000, yielding a total revenue of $20,000. If the movies are priced à la carte, on the other hand, the distributor would maximize revenue by selling Movie 1 to both buyers at $5,000, and Movie 2 only to buyer B for $5,000. Thus, optimal à la carte pricing nets only $15,000. Asking the question Should we price the bundle or the individual components? generates a 33.3% profit improvement.

5. Consider competitors' reactions. Pricing is more like chess than like checkers. A seemingly brilliant pricing move can turn into a foolish one when competitors have had their chance to respond. Price wars, for example, can easily be set off by poorly designed pricing actions. The lens through which pricing decisions are considered must be broad enough to permit consideration of second- and third-order effects.

Managers should ask themselves how any change in price will affect competitors. What will the competitor's first thoughts be upon seeing the change? They also should ask themselves, What would I do if I were the competition? And, Do I have an effective response to that action? Finally, they should consider the overall impact of the new price on the industry's profitability.

Consider how Eastman Kodak Company addressed its continuing share loss in the U.S. film market. In 1994, Kodak's share – 70% – was still the largest among industry leaders, but it was declining. The company's flagship product, Kodak Gold, sold at a 17% premium over Fuji film. Kodak could have cut prices but that would have been a very expensive move. What's more, it is unlikely that such an action would have achieved the purpose of reducing the price premium over Fuji. With a 55% gross margin on film, Fuji would almost surely have matched any straight price cut to maintain relative prices in the industry. Kodak instead introduced a low-priced brand, Funtime film, in larger package sizes and limited quantities – priced lower than Fuji film on a per roll basis.

Most often, any pricing action a company takes will provoke some response by major competitors. American Airlines' shift to value pricing, for example, elicited nearly identical programs from Delta and United within days. Philip Morris's price cut on Marlboro cigarettes was matched by R.J. Reynolds. But competitors' reactions may not be limited to price moves; one company's price cut may provoke a response in advertising or in another element of the marketing mix. Therefore, posing the question If I cut my price 5% in this product market, what price action will my competitor undertake? is only the beginning. A 5% price cut could provoke a response in any number of areas. Southwest Airlines, for example, responded to American's value-pricing move not with a price move of its own but rather with an advertising campaign proclaiming, "We'd like to match their new fares, but we'd have to raise ours."

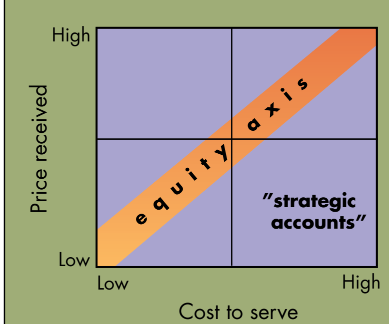
6. Monitor prices realized at the transaction level. The total set of pricing terms and conditions a company offers its various customers can be quite elaborate. They include discounts for early payment, rebates based on annual volume, rebates based on prices charged to others, and negotiated discounts. As M.V. Marn and R.L. Rosiello discuss in their article "Managing Price, Gaining Profits," (HBR, September-October 1992), while a product has one list price, it may have a wide array of final prices. The real net revenue earned by a product can also be heavily influenced by factors such as returns, damage claims, and special considerations given to certain customers. Yet although it is this "real" price (invoice plus any other factors) that ends up paying the bills, most companies spend 90% of their pricing efforts setting list figures. Treating the real price so casually can cost a company substantial forgone profits, especially in an intensely competitive marketplace.

Price setters must analyze the full impact of the pricing program, measuring and assessing the bottom-line impact. The interaction of the various pricing terms and conditions must be managed as a whole.

7. Assess customers' emotional response. When managers analyze how customers respond to a product's price, they must consider the long-term effects of the customers' emotional reaction as well as the short-term, economic outcome. Every transaction influences how a consumer thinks about a company and talks to others about it. Intuit prices its financial software Quicken at $35, and some believe that unit sales would be materially unaffected

If customers believe that a price is unfair, their negative reaction can be devastating for business.

The Dangerous "Strategic Accounts"



The Pricing Audit

Our pricing process...	H- high M- medium L- low	Current performance poor				excellent
(qualities)	Relevance	1	2	3	4	5
1. complements the overall marketing strategy						
2. is coordinated and holistic						
(eight steps)						
1. assesses value customers place on our product						
2. considers variation in perceived product value						
3. assesses consumer price sensitivity						
4. identifies an optimal structure						
5. considers competitive reaction						
6. monitors the transaction level						
7. considers customers' emotional response						
8. analyzes revenue versus cost to serve						
(your added elements)						

in the short term by a moderate or even substantial price increase. However, Intuit holds to this price because the vast majority of consumers have come to view it as a "great deal." This perception has two valuable effects. One, it enhances Intuit's reputation with its customers, paving the way for the introduction and sale of future products. Two, the customers have become Intuit "apostles": They tell others about how good the company is and why they also should purchase the product. The pricing forgoes some profits now to create an important benefit down the road.

Of course, the same lesson cuts both ways. If customers believe that a company's product or service is unfairly priced (even if the price is, in fact, only slightly above cost), the negative message they send to other potential customers can be devastating for business. Some consumers have registered complaints with a company that offers database retrieval services, claiming that they were being "ripped off," even though the company was, in fact, saving them many hours in manual search time. The problem was communication: The company was not properly explaining how it justified its price. The solution was to increase awareness of the massive investment required in reformatting, indexing, and storing the data to make the service possible. Again, the key is understanding customers' perceptions. Simple market research procedures can be used to assess consumer reaction in terms of both perceived fairness and purchase intention.

8. Analyze whether the returns are worth the cost to serve. An article by B.P. Shapiro, V.K. Rangan, R.T. Moriarty, and E.B. Ross ("Manage Customers for Profits (Not Just Sales)," HBR, September-October 1987), introduced the notion of the "customer grid," wherein each customer is plotted at the intersection of the revenue he or she generates and the company's cost to serve that customer. In a world of logic, fairness, and perfect information, one might expect customers to line up along an equity axis with a high correlation between cost to serve and price paid. In reality, though, this expectation is seldom met; indeed, the authors provided an example in which there was no correlation at all. Although customer value is crucial in pricing, managers also must consider the cost side, being certain to avoid the infamous "strategic accounts" zone. (See the graph "The Dangerous 'Strategic Accounts.'") These accounts – and they are typically very large – demand product customization, just-in-time delivery, small order quantities, training for operators, and installation support while at the same time negotiating price very aggressively, paying late, and taking discounts that they have not earned. These accounts don't get what they pay for; they get a lot more. They are facetiously called strategic accounts because that's the justification given when account managers are confronted with the fact that the company is losing money on them.

High cost-to-serve accounts can be terrific – if the price they pay is high enough. One of the most profitable automobile insurance companies in the business specializes in high cost-to-serve customers (that is, people who have a high probability of being involved in an accident). While other insurance providers have shied away from these customers, this company has embraced them, but it also has made them pay rates commensurate with their costs and the fact that nobody else is willing to serve them. In terms of the map, this company was able to identify these accounts and push them well up into the top right. Big risk along with very big price can be a winning combination.

One automobile insurance company found that big risk offset by big price was a winning combination.

Similarly, a commodity parts distributor makes three times the industry average return on equity by focusing on accounts that order small quantities and have a proportionally high cost to serve. While competitors specify a minimum order of $400, this supplier accepts any size order – but its prices are 20% higher. Although this policy precludes getting the big buyers, the company is extremely successful. It has lots of small accounts situated firmly in the top right portion of the industry price/cost map.

Judging a company's pricing activities against the qualities and actions I have outlined will give a good indication of the quality of the company's pricing process. "The Pricing Audit" scorecard should help. Consider the two preliminary qualities and eight action steps outlined above. Add any elements you feel appropriate for your situation. Rate each item for its relevance, and rank current performance on the one through five scale.

An effective pricing process can't be created or implemented overnight. It is not a matter of making one or two sweeping changes in strategy or organization. Rather, it means getting lots of little things right and staying on top of the process to make sure that any improvements are sustainable.

The author wishes to acknowledge with thanks the comments of Professors Earl Sasser and Ben Shapiro of the Harvard Business School and discussions with participants in the Advanced Management Program.

1. M.V. Marn and R.L. Rosiello report in "Managing Price, Gaining Profits," HBR, September-October 1992, p. 85, that for the 2,463 companies in the Compustat aggregate, a 1% increase in price realization yields contribution improvement of 11.1% on average.

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