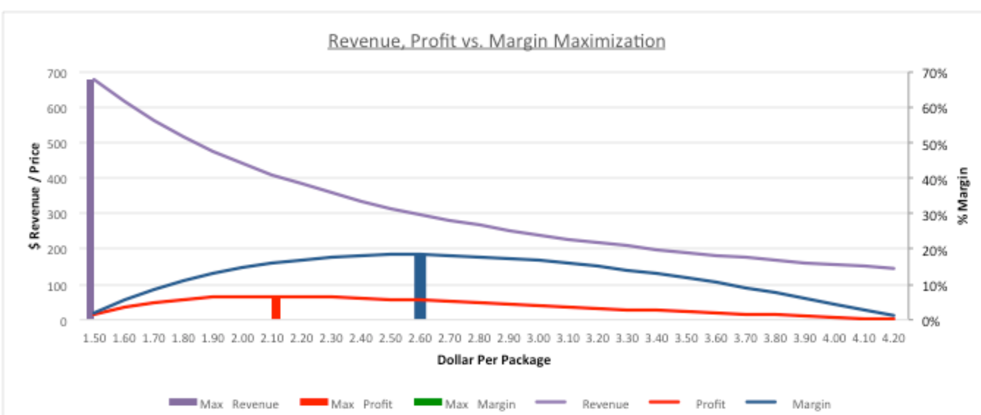
Pricing Process Guide

Process for Setting Pricing Objectives

"What's the Point of Running if You're on the Wrong Road."
German Proverb

In 1995, Harvard Business Review published an article that asked the question that confronts all executives with pricing responsibility, "How Do You Know When the Price is Right,"[1] While the article acknowledges it is important to ask what is one's objective when setting prices, it focuses only on the steps to set strategies assuming that the objectives are clear. It is my experience that this is often an unwise assumption. One of the key difficulties of developing effective pricing strategies is that the crucial step of setting clear objectives is skipped, like it is in this article. The fact is that there is no right price independent of objectives. Furthermore, there is no right price strategy without consideration of objectives, the constraints of the enterprise in achieving them, and the secondary impact of other stakeholders. These include consumers, competitors, intermediaries, partners, and public opinion – all of whom have their own objectives. This Maada Minute focuses on what are the common barriers to unclear objectives and why that creates problems in knowing the right price. Subsequent Minutes will focus on how to improve objective clarity, despite these barriers, and how different objectives drive different strategies.

Why is lack of clear objectives a problem? As a quick illustration for a hypothetical product, the graph below shows how different objectives drive different optimal price points. How this graph is developed is the subject of a Tool Guide, but this graph shows how, given price elasticity and costs, optimal prices for this imaginary product depends upon whether one wants to maximize $ Revenue, $ Profits, or % Operating Margin.



---

[1] Dolan, Robert, "How Do You Know the Price is Right?", Harvard Business Review, Sept-Oct 1995. Retreived from https://hbr.org/1995/09/how-do-you-know-when-the-price-is-right on June 22,2017.

<u>Barriers to Objective-Setting:</u>

There are three common barriers to setting clear pricing objectives.

1. The problems with pricing usually start at the top, which is why I first seek clarity with superiors before conduct pricing workshops with their subordinates. These problems may arise because:
   - Senior leaders do not fully understand the role of price in their business models and in achieving results. This leaves it up to their deputies to infer objectives, and they may come to different conclusions across responsibilities.
   - Conflicts between short and long-term objectives may arise from changes in incentive structures, capital investment plans, and market maturity. Actively balancing between short and long-term objectives is required of senior management, but conflicting priorities between these two horizons can be a major source of confusion for those setting prices.
2. A second pricing objective-setting barrier is what I call the portfolio effect. While senior leadership must consider the accumulated effect of price and mix changes across the portfolio, the objectives for specific elements of the portfolio may be very different from one another and that is the level where pricing needs to be executed. Ideally, each element of the product portfolio would have a clear purpose. This is not easily done, and it also may be difficult for the product line management to accept since careers and incentives are often affected by those role assignments.
3. A third barrier is the diffusion of price authority, which aggravates the portfolio effects. Pricing, despite its central importance, is usually not the responsibility of any one person or function. Therefore, there are many decision-makers involved in setting pricing, each with their own mental models and incentives that can lead them to different conclusions. The involvement of intermediaries or regulators in setting pricing to end-consumers further complicates the process to set unified pricing objectives.

<u>Solutions:</u>

Experts often recommend addressing the process barriers to price objective-setting by:

1. Appointing a pricing leader or council, along with a supporting pricing function, to lead and enforce more consistency across business functions and product portfolios on pricing issues. For example, this is a conclusion of Stephen Liozu, in his book, <u>The Pricing Journey</u>,[2] but I have seen many consultants advocate the same thing.
2. Coordinating pricing processes that integrate multiple points of view into a common, pricing vision.

It is hard to argue with the logic of these recommendations, but these solutions assume current time-use inefficiencies in analysis, planning, and coordination; that the addition of more administrative resources will generate a positive return; or that there will not be

---

[2] Liozu, Stephan M. The Pricing Journey: The Organizational Transformation Toward Pricing Excellence, Stanford: Stanford University Press, 2015.

negative consequences to the removal of pricing authority from the current decision-makers. Some companies are not willing to bet on this, and so they need to make choices among which organizational and process changes will pay-off for them.