Book Review

The strategy and tactics of pricing: A guide to growing more profitably (6e)

Thomas Nagle and Georg Müller
Routledge, Abingdon, United Kingdom, 2018, 352 pp., ISBN: 9781138737518

Journal of Revenue and Pricing Management (2017) **16,** 640–643. doi:10.1057/s41272-017-0106-0;
published online 18 July 2017

Thomas Nagle has left a mark so profound that, in pricing, there is a time before and a there is a time after the publication of *The Strategy and Tactics of Pricing*. Before, that is, in 1987, most companies – but not all (!), as expanded below – had not quite understood the importance of pricing as an activity: When Dick Braun, currently Vice President of Pricing at Parker Hannifin, started his career in pricing in the 1980s, a senior executive commented: "Poor guy, there is nothing you can do about prices". That was the environment when Tom Nagle wrote the first edition of the book. And it is probably to a fair degree Tom Nagle's contribution that these comments are relegated largely to the past. Simplifying a bit, pricing, historically, was built on two main foundations: cost accounting and economic models. Cost accounting provided a justification for cost-based pricing; the economic models largely assumed that prices were the result of market forces.

The lasting contribution of the book is a process for managing prices strategically. This is where the book, now in its 6th edition, broke new, unchartered territory. The lasting contribution is a frontal assault at the economic models. A second, fundamental contribution is the framework for customer value-based pricing. The framework is not new. But no one has developed it quite as elegantly and as convincingly as Tom Nagle. This framework has a huge influence on the way managers define, quantify and communicate value.

The intellectual origins of Tom Nagle's framework of value-based pricing are in value analysis and value engineering, cost reduction techniques pioneered by Lawrence Miles in the purchasing department of General Electric (GE) in the 1950s (Miles, 1961). Value analysis gained popularity in the following decades to determine maximum purchase prices for new and existing products (Falcon, 1964). The turning point came when Mack Hanan in the 70s and later on two McKinsey consultants, John Forbis and Nitin Mehta, used customer value analysis to determine selling prices (Forbis and Mehta, 1981; Hanan, 1970). Neil Rackham took it from there (Rackham, 1988). Once the floodgate was open, dozens of others in sales, pricing and marketing followed. The most widely cited, but also most pragmatic, model of determining value in the context of value-based pricing, the one to which this writer is also quite sympathetic, is the one by Tom Nagle. We must, however, remember: Long before consultants and academics had advocated the superiority of value-based pricing, executives at companies such as DuPont, GE, and International Harvester had pricing policies firmly built on customer value: DuPont executives, for example, comment in the late 1950s: "Our price is based on the obvious ways of conducting a business.… We

make an appraisal of the use value of the product to the consumer, as well as of its worth in relation to the competitive counterpart or alternative materials" (Kaplan *et al*, 1958, pp. 150–151). Managers at GE and International Harvester similarly set prices based on either customer value estimates or customer return-on-investment calculations. In the 1950s, pricing practices at some large, US companies were already mature and fully cognizant of the importance of setting prices based on value. It was, after all, a sellers' market.

Books that dealt with pricing existed already prior to this book. First and foremost, Kent Monroe *Pricing: making profitable decisions* (1979) is potentially most similar in approach and philosophy to this book. Long before that, Walton Hamilton and colleagues in *Price and price policies* (1938) conjectured that there was one lens which could help to understand the diverse set of activities taking place in American industries in the early days of the twentieth century better than any other lens: prices and price policies. The analysis of pricing policies in the automotive, tire, gasoline, cottonseed, dress, whisky and milk reveals how prices affect costs, demand and competition. By way of example, this book is one of the first accounts highlighting how Ford rose from a marginal producer of automobiles in 1904 to the world's largest automotive producer in the 1920s largely as a result of price policies: low prices to drive market expansion (Hinterhuber and Liozu, 2014). Hamilton also discusses instances where "prices are set down without regard to personal value received" (1938, p. 25) – as if value received should be the primary consideration for setting prices. Next is the book by Kaplan (1958) with insights in pricing processes, policies and goals that deserves to be read still today: an early treatise on value-based pricing in large US companies. Later, Marting edits the book *Creative Pricing* (1968). While working on the first edition of the book, Tom Nagle writes a paper arguing that pricing, in many companies still a technical task, should be strategic and thus creative (1983). Oxenfeldt (1975) proposes a process for incorporating the reactions of customers, competitors and resellers into the pricing decision for new products.

This, in a cursory summary, is the history of pricing. With Tom Nagle's book pricing became strategic. Treating pricing strategically involves thoughtful decisions about value creation, offer configuration, allowable costs, customer selection, price communication, management of customer expectations, price levels and price discrimination across customer segments (p. 9). Pricing becomes strategic because otherwise independent activities are coordinated to achieve the objective of sustainable profitability. Strategic pricing is the result of performing six distinct activities that Nagle calls the "value cascade" (p. 10): value creation, value communication, price structure, pricing policy, price setting and price competition. The chapters of the book follow this structure: chapters 2–7 are dedicated to these six steps, the other chapters deal with approaches to measure price sensitivity, price–volume–cost analysis, pricing in special situations, creating a strategic pricing capability and, lastly, ethical and legal aspects of pricing. The chapters on pricing in special situations (e.g. transfer pricing, pricing during recessionary times) and on creating a strategic pricing capability are new in this edition. What readers will miss from prior editions are the formulas for breakeven sales calculations for complementary and substitute products (Nagle and Holden, 2002, p. 255). These are valuable. Another chapter present only in the early editions is the chapter on pricing in competitive bidding situations (p. 220). In other words: It is clear that for serious professionals the last edition cannot suffice. The third edition, for example, must also be purchased.

The literature is mostly up to date. Some propositions of this book have been developed from first principles, i.e. without empirical support. This requires courage and clarity in reasoning. The book and the propositions could have been more convincing if studies

supporting these propositions – which, interestingly, have been conducted without reference to these propositions – would have been cited. As an example: Nagle lists a series of effects influencing customer price sensitivity: switching cost effect, difficult comparison effect, end-benefit effect, expenditure effect, shared-cost effect, etc. Many of these effects are built on general principles: subsequent independent studies have in fact shown that prices are higher (and presumably customer price sensitivity is lower) when these effects are in place: see, for example, a recent study on the shared-cost effect with customers paying for taxi rides (Balafoutas *et al*, 2017). Another example: Nagle's mantra on pricing policies, *the* quotable quote since the earliest editions, is to "to treat every proposal or request for a price exception not as a one-off event but as an opportunity to create or change a policy that would be applied to all similar situations in the future" (p. 98). This is necessary because the absence of well-defined pricing policies will cause discounts to become embedded and costly. This is the principle. A recent study by consultants finds just that (Chapnick *et al*, 2014): a survey of 83 sales managers in Fortune 500 companies finds, first of all, that about 60 per cent of companies grant price exceptions about half the time, and that half of these discounts are between 10 and 24 per cent. Discounting is widespread and substantial, nothing new. Interestingly, this study finds that about half the companies see a drop in prices to all customers in less than a year, once price exceptions have been granted. This study also compares key metrics of companies that frequently grant exceptions to those that rarely do – customer retention and customer satisfaction, two factors that sales managers frequently cite to justify discounting – and finds no difference. Discounts spread, but they do not seem to help in improving customer satisfaction and retention: these are very convincing arguments for the price policies that Tom Nagle advocates.

This is a very good and very important book. Weaknesses? A digression is due: In the early 1990s, at the start of a world soccer championship, soccer journalists, always critical, dissected every individual player of the world's best teams. They finally came to Diego Maradona: "perfect player – weaknesses: none". For pricing managers and academics interested in a book highlighting the principles of strategic pricing based on value this simply is the best book. Other highly recommended books: On pricing in different industries: *The Oxford Handbook of Pricing Management* by Özer and Phillips (2012); on revenue management: *Pricing and Revenue Optimization* by Robert Phillips (2005); on the organizational implementation of value-based pricing: *The pricing journey* by Liozu (2015). On other topics – value quantification, pricing psychology – there are other books and writers.

REFERENCES

Balafoutas, L., Kerschbamer, R. and Sutter, M. (2017) Second-degree moral hazard in a real-world credence goods market. *The Economic Journal* 127(599): 1–18.

Chapnick, D., Glatz, K. and Gordon, M. (2014) *The Value of Pricing Discipline – A Vantage Partners Sales Study on the Impact of Pricing Exceptions*. Boston, MA: Vantage Partners.

Falcon, W.D. (1964) *Value Analysis, Value Engineering: The Implications for Managers*. New York, NY: American Management Association.

Forbis, J.L. and Mehta, N.T. (1981) Value-based strategies for industrial products. *Business Horizons* 24(3): 32–42.

Hamilton, W.H., Adams, M., Abrahamson, A., Meiklejohn, H., Till, I. and Marshall, G. (1938) *Price and Price Policies*. New York, NY: McGraw-Hill.

Hanan, M. (1970) *Consultative Selling*. New York, NY: AMACOM.

Hinterhuber, A. and Liozu, S. (2014). Is innovation in pricing your next source of competitive advantage? *Business Horizons* 57(3): 413–423.

Kaplan, A., Dirlam, J. and Lanzillotti, R. (1958). *Pricing in Big Business: A Case Approach*. Washington, D.C: The Brookings Institution.

Liozu, S. (2015). *The Pricing Journey: The Organizational Transformation Toward Pricing Excellence*. Stanford, CA: Stanford University Press.

Marting, E. (Ed.). (1968) *Creative Pricing*. New York, NY: American Management Association.

Miles, L.D. (1961) *Techniques of Value Analysis and Engineering*. New York, NY: McGraw-Hill.

Monroe, K.B. (1979) *Pricing: Making Profitable Decisions*. New York, NY: McGraw-Hill.

Nagle, T. (1983) Pricing as creative marketing. *Business Horizons* 26(4): 14–19.

Nagle, T. and Holden, R. (2002) *The Strategy and Tactics of Pricing: A Guide to Profitable Decision Making* (3rd ed.). Englewood Cliffs, NJ: Prentice Hall.

Oxenfeldt, A.R. (1975) *Pricing Strategies*. New York, NY: Amacom.

Özer, Ö. and Phillips, R. (Eds.). (2012) *The Oxford Handbook of Pricing Management*. Oxford, UK: Oxford University Press.

Phillips, R. (2005) *Pricing and Revenue Optimization*. Stanford, CA: Stanford University Press.

Rackham, N. (1988) *Spin Selling*. New York, NY: McGraw-Hill.

Andreas Hinterhuber
Hinterhuber & Partners, Innsbruck, Austria.
E-mail: andreas@hinterhuber.com