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PRICING FOR PROFITABILITY

PRICING FOR PROFITABILITY

ACTIVITY-BASED PRICING FOR COMPETITIVE ADVANTAGE

JOHN L. DALY



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To my wife,

Nancy J. Daly

Her contributions helped make this book a reality

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PREFACE

Most pricing books have been written by marketing professors. These books concentrate on techniques that enhance revenue, as if maximizing revenue were the same as maximizing profit. However, profit equals revenue minus expenses, and profit can only be maximized when the interrelationships between revenue behavior and cost behavior are clearly understood. No single business discipline can provide this insight and it is my belief that pricing decisions are best made by teams of people from various business disciplines bringing their own viewpoints from marketing, sales, cost accounting, engineering, economics, and business strategy to the pricing process. *Pricing for Profitability* is intended to be used by people from all of these disciplines. This is a sharply different approach from other popular pricing books. As a whole, the book is designed to give everyone involved in the pricing process a comprehensive understanding of how to use pricing to derive a competitive advantage and increase profitability.

Pricing practice has rapidly evolved in the past few decades. Early computer spreadsheets such as VisiCalc gave corporate financial managers the power to perform pricing and profitability analyses that were simply impossible with pencil and paper. Like many corporate controllers, one of the very first uses that I found for these new tools was to develop a model for pricing the products that my small company produced. I used what I called “rational” methods to study costs. When the common-sense techniques of activity-based costing were first described to me, our own techniques were far enough advanced that I could honestly say, “Oh yes, that is the costing method that we use.” I wrote my first article on the uses of activity-based costing for pricing in 1993, coining the term *activity-based quoting* for that article. I later concluded that *activity-based pricing* was a better description for these techniques because all companies price their products, whereas only some businesses prepare actual quotes.

Pricing for Profitability is designed to provide tools that will allow companies to consistently earn a real economic profit on the things that they sell. It is about the interrelationships of price and sales volume, and sales volume and cost. Other pricing books treat the relationship between price and cost lightly, as if cost were a minor consideration in pricing strategy. My own consulting experience has shown that too many companies unknowingly price their products at a loss, sometimes a substantial loss, because they have not understood these interrelationships.

The objectives of activity-based pricing are as follows:

- Establish price based on a solid knowledge of customer demand and product cost.
- Never unintentionally price a product at a loss.
- Know how much of price is profit.
- Generate a superior financial return through superior financial knowledge.

This book has been organized so that it can be read at several different levels of detail. There are 12 chapters. Chapter 1 provides an overview of the book and Chapter 12 provides a summary of all of the other chapters. The chapters in between provide an in-depth look at 10 different topics followed by chapter summaries. Chapter 7, “Activity-Based Pricing,” gets to the heart of what the book is all about. A glossary of terms may be found in the back of the book. These terms are italicized in the text the first time that they appear.

The field of activity-based pricing is in its infancy. There will undoubtedly be issues that I have not thought of or practices that I did not discover in my research. The techniques that we use today are likely to look primitive by the standards of a decade from now. I invite readers of this book to contact me with their thoughts on this topic, so that future editions of *Pricing for Profitability* truly can be a collaboration of all of the best minds on the topic.

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