MARKETING

Smart Pricing

by Jagmohan Raju and Z. John Zhang

Two Wharton professors show how rethinking price itself - free, pay-what-you-wish, and more - creates profit.

BEST POINTS FROM THE BOOK

01 **Design the price; do not just set it.**

Cost-plus, matching rivals, and guessing at value all look inward. The book's firms redesign how customers pay - and profit follows the design, not just the number.

02 **Pay as you wish can beat a fixed price.**

Radiohead let fans name any price for In Rainbows; about 40 percent paid, averaging $2.26. It works when an extra customer costs almost nothing and buyers feel a fair bond with the seller.

03 **Free is a price, and it can win a whole market.**

Google gives search away and charges advertisers for access to the crowd. When serving one more user costs nearly nothing, the free side builds the audience the paying side wants to reach.

04 **A price war is a weapon - if you run the break-even math first.**

China's Changhong and Galanz started price wars on purpose and seized whole markets. The test is incremental break-even: after the cut, can volume rise enough to stay profitable? Fat margins and falling unit costs say yes.

05 **Think small: pennies, sachets, and slices open markets that big prices lock shut.**

Single-use shampoo sachets, $27 microloans, pennies-a-day framing, and fractional jet ownership all let small budgets say yes - and the yeses add up to fortunes.

06 **Publish the markdown schedule and let buyers sort themselves.**

Syms and Filene's Basement printed future price cuts right on the tag. Impatient shoppers pay full price today; patient ones gamble the item sells out and pay less later. Nobody has to haggle.

07 **Name your own price unlocks demand you cannot post publicly.**

Priceline hides the airline and the exact flight until after you pay, so carriers quietly sell seats that would fly empty - without cutting the fares everyone else sees.

08 **Judge profit per customer, not per sale - then subscriptions make sense.**

Amazon's Subscribe & Save discounts routine reorders by 15 percent and ships free. A customer's whole stream of orders can be worth far more than the margin on any single item.

09 **For status goods, the high price is part of the product.**

American Express charges $2,500 a year for its black Centurion card partly because the fee itself signals rank. Cut the price of a status good and you can cut the desire too.

10 **Charge only when it works, and the price can follow value instead of cost.**

Johnson & Johnson offered refunds when its cancer drug Velcade did not work for a patient. Where results can be measured, sellers can share the buyer's risk - and charge for outcomes, not inputs.

THE BOOK, IN SHORT

Most companies price lazily, in one of three ways: cost plus a margin, a glance at what rivals charge, or a guess at what buyers will bear. Two Wharton professors argue this throws away the most flexible lever in business. Their book tours nine inventive pricing tactics - one per chapter, each grounded in real companies - and explains the psychology and economics that make each one work.

It opens with pay as you wish, where Radiohead's In Rainbows download showed that fans will pay voluntarily when an extra copy costs almost nothing and they feel fairly treated. Next comes free as a strategy: Google gives search away because attention is the scarce currency, and in a two-sided market the free side builds the crowd the paying side - advertisers - wants to reach.

The middle chapters pair aggression with smallness. On price wars, Chinese makers like Changhong and Galanz cut prices on purpose to seize fragmented markets, armed with break-even analysis rather than bravado. Thinking small shows sachets, microloans, micropayments, and fractional ownership opening markets that standard prices lock shut. The automatic markdown chapter shows retailers like Syms printing scheduled price drops on the tag, so patient and impatient buyers sort themselves without a single negotiation.

Later chapters explain name your own price, where Priceline hides the seller's identity so empty seats and rooms sell without denting posted prices; subscription pricing, where Amazon's Subscribe & Save values a customer's whole stream of orders over any single margin; the snob premium, where a high price itself creates desire; and pay if it works, where sellers charge only when measurable results arrive.

The closing message is that pricing is both art and science - and, in the authors' words, pricing innovation is not for the timid. There is no single right model. There is a toolbox, and the win goes to firms that match the tactic to their customers, their costs, and their market.

DO THIS WEEK

Pick one thing you sell and write down three numbers: your cost, the rival's price, and what the customer actually gains. Then choose one tactic whose conditions you meet - pay as you wish if extra customers cost you almost nothing, a subscription if buyers reorder on a cycle, or a premium tier if status is part of the appeal - and test it for two weeks against your normal price, tracking both sales and profit.

Jagmohan Raju and Z. John Zhang, Wharton School professors, first published 2010. For founders and marketers who suspect their price tag is leaving money on the table.