



WHITEPAPER

THE PRICE IS WRONG
A Diagnostic Guide to
Uncovering and Fixing Hidden
Profit Leaks

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Executive Summary

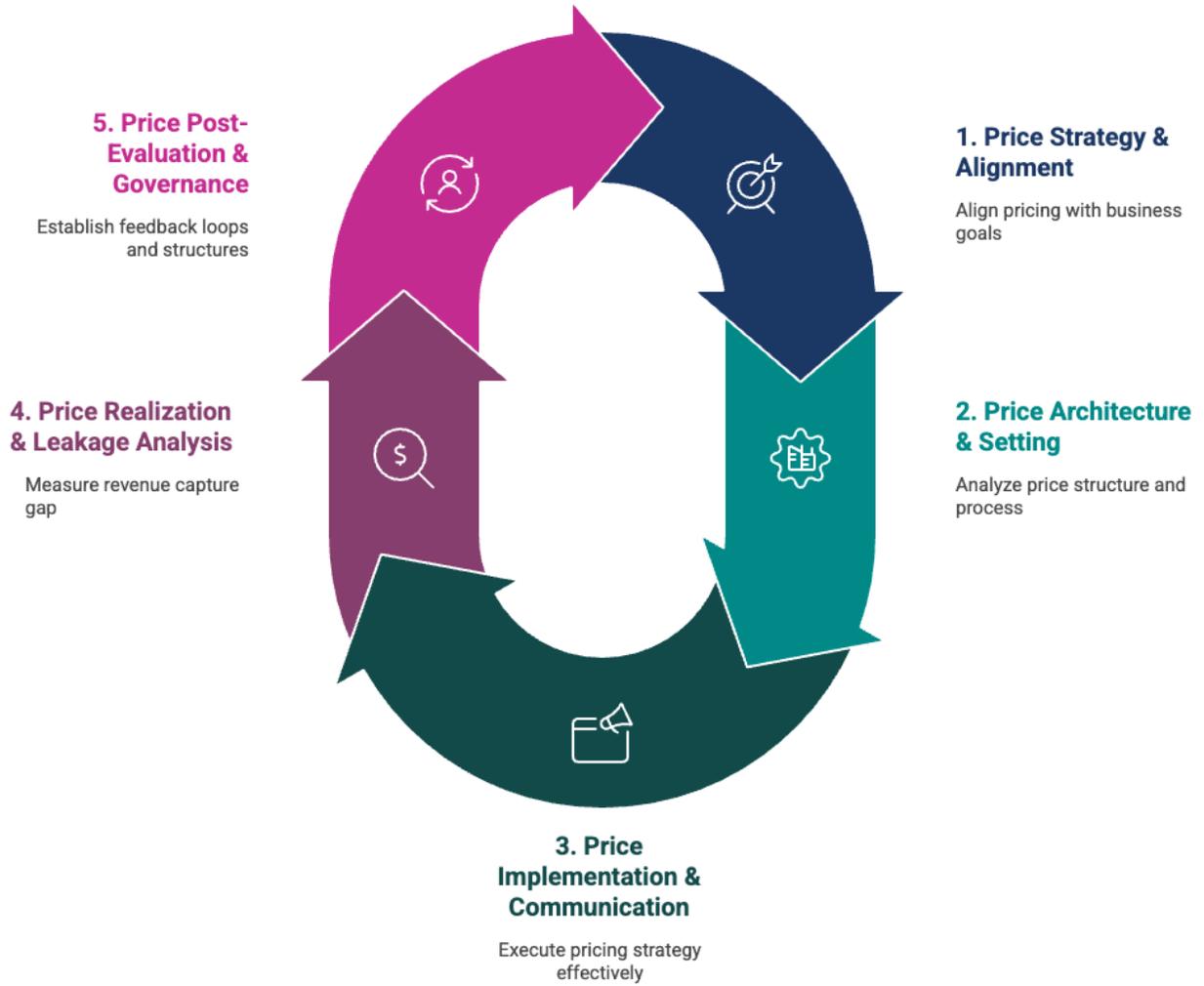
Pricing stands as the single most powerful lever for influencing corporate profitability, yet it remains one of the most misunderstood and poorly managed functions in modern business. Small adjustments in average price can yield dramatic changes in operating profit, far outpacing the impact of equivalent improvements in volume or cost reduction. Despite this, many organizations approach pricing with a dangerous combination of anecdotal evidence, historical inertia, and reactive tactics, leaving significant value on the table and unknowingly fostering deep-seated profit leaks. This systemic failure to manage pricing as a strategic capability represents a critical and often invisible drain on performance.

This whitepaper introduces the **Pricing Excellence Journey**, a comprehensive, five-stage diagnostic framework designed to help business leaders systematically assess their organization's pricing capabilities. By moving sequentially through Strategy, Architecture, Implementation, Realization, and Governance, this guide provides the critical questions and metrics needed to transform pricing from a source of pain into a sustainable engine for growth.

The core findings of this analysis are clear and actionable. First, pricing strategy must be explicitly and rigorously aligned with overarching corporate objectives; without this link, it defaults to a tactical and reactive posture. Second, the architecture of a price—its basis, structure, and mechanism—is a strategic choice that shapes customer behavior and must be designed to capture the value it creates. Third, a brilliant strategy is worthless without a go-to-market engine capable of executing it, a process that hinges on sales team incentives, robust processes, and clear communication. Fourth, the critical gap between a company's list price and the final "pocket price" must be meticulously measured through a Price Waterfall analysis to identify and plug sources of margin leakage. Finally, pricing excellence is not a one-time project but a continuous capability, sustained through diligent post-evaluation and a robust governance structure.

This document serves as a practical guide for any leader seeking to diagnose the health of their pricing function. It provides the tools to move beyond guesswork, identify precisely where pricing is hurting the business, and initiate a transformation toward a more disciplined, data-driven, and profitable approach.

Pricing Excellence Journey Cycle



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Introduction: Pricing, The Ultimate Profit Lever

Of all the levers a management team can pull to influence financial performance, none is more potent than pricing. A mere 1% improvement in the average price realized by a company can translate into an 11.1% increase in operating profit.¹ This impact dwarfs that of a 1% improvement in variable costs (7.8% profit lift), sales volume (3.3%), or fixed costs (2.3%). This extraordinary leverage makes pricing the fastest and most effective way for a company to increase profitability.¹

Despite this power, pricing is frequently the most neglected element of the marketing mix. Key pricing decisions are often made with less rigor than minor cost-cutting initiatives, based on gut feel, outdated spreadsheets, or a panicked reaction to a competitor's move.³ This common pathology—treating pricing as a tactical, reactive function rather than a core strategic capability—creates a fertile ground for hidden profit leaks to flourish, silently eroding margins and destroying shareholder value. The consequences are severe: companies either price too low and leave money on the table, or price too high and lose customers, all while being unable to diagnose the root cause of the problem.⁵

This whitepaper provides a diagnostic framework to address this challenge. It introduces the Pricing Excellence Journey, an end-to-end process model for systematically evaluating and improving an organization's pricing capabilities. This journey is not a linear path but a continuous cycle, comprising five critical stages:

1. **Price Strategy & Alignment:** Assessing the connection between pricing and high-level business goals.
2. **Price Architecture & Setting:** Deconstructing the price itself to analyze its structure and the process by which it is determined.
3. **Price Implementation & Communication:** Evaluating the organization's ability to execute its pricing strategy in the marketplace.
4. **Price Realization & Leakage Analysis:** Measuring the gap between the intended price and the actual revenue captured.
5. **Price Post-Evaluation & Governance:** Establishing the feedback loops and organizational structures needed to sustain performance.

The guiding principle of this report is to equip business leaders with a practical toolkit. At each stage of the journey, this analysis will present a set of pointed diagnostic questions and a list of essential key performance indicators (KPIs). This approach will enable organizations to perform a comprehensive self-assessment, pinpoint their specific areas of weakness, and begin the transformative journey from reactive price-setting to proactive value capture.

Part I: The Strategic Foundation - Diagnosing Your Price Strategy & Alignment

The first and most fundamental source of pricing failure is a disconnect from corporate strategy. Effective pricing is not a calculation performed in a vacuum; it is a deliberate instrument deployed to achieve a specific business objective.⁶ This section provides the diagnostic tools to assess whether a company's pricing strategy is a coherent extension of its business strategy or an unmoored, tactical afterthought.

1.1 Pricing as an Instrument of Corporate Strategy

Strategy must be the unambiguous starting point for any and all pricing decisions.⁶ Before any discussion of price points or discount structures, an organization must first answer the question: "What are we trying to achieve?" Pricing is merely one of the tools used to reach that strategic destination. The objective could be to maximize short-term margins, rapidly gain market share with a new product, create a "halo effect" to pull through sales of other portfolio items, penetrate a new geographic market, or simply survive a difficult economic period.⁷ Each of these distinct goals demands a fundamentally different pricing strategy. A strategy designed for market penetration, for example, will look radically different from one designed for profit maximization.

Without an explicit link to a primary corporate objective, pricing strategies inevitably drift. They become reactive, defaulting to simplistic cost-plus calculations or reflexive competitor-matching.⁴ This occurs because cost data is readily available internally and competitor prices are easily observed externally, whereas the data required for a truly strategic approach—deep customer value quantification—is difficult and costly to obtain.⁵ This path of least resistance leads to a strategic void where pricing becomes a series of ad-hoc, tactical decisions rather than a cohesive, proactive plan. The critical diagnostic, therefore, is not merely whether a strategy exists on paper, but whether it is actively and demonstrably driving toward a defined business outcome.

Diagnostic Questions:

- What is the single most important objective for this product or service over the next 12-24 months (e.g., maximize profit, capture market share, establish a premium brand perception)?
- How does our current pricing strategy directly support this primary objective? Is the link between the pricing approach and the strategic goal clear, concise, and understood across the organization?
- Have we "war-gamed" how this strategic choice will affect other parts of the business? For instance, will a penetration pricing strategy for a new product unacceptably cannibalize our existing premium offerings?

1.2 The Three Lenses of Strategic Pricing: Cost, Customer, and Competition

A robust pricing strategy must be informed by a holistic view of the market, analyzed through three distinct but interconnected lenses: cost, customer, and competition.¹⁰ These three factors define the strategic boundaries for any pricing decision.

- **Customer Value (The Price Ceiling):** The value that customers perceive in an offering—both its rational, economic benefits and its emotional, intangible benefits—sets the absolute upper limit on what a company can charge.⁵ This ceiling is determined by the customer's willingness to pay (WTP), which is a direct function of the value they believe they are receiving relative to their alternatives.
- **Costs (The Price Floor):** The total costs associated with producing and delivering an offering—including not just direct costs of goods sold (COGS) but all relevant overhead and cost-to-serve—establish the price floor.¹³ Pricing below this floor is unsustainable in the long term, making a clear understanding of the full cost structure a fundamental "ticket to play."
- **Competition (The Anchor Point):** The prices of competitive offerings and available substitutes act as powerful reference points that anchor customer perceptions of value and fairness.¹³ A company's pricing decisions must be made with a clear understanding of the competitive landscape and a plan for how to react to competitors' moves.⁶

These three lenses should not be viewed as a simple checklist but as a dynamic, interconnected system. A change in one lens directly impacts the others. For example, a competitor's 10% price cut (Competition) immediately alters a customer's perception of your product's relative value (Customer), which in turn changes the potential profit you can achieve at your current price point, even if your own costs (Cost) have not changed. A sophisticated pricing strategy, therefore, does not just consider each factor in isolation but models their interplay.

Diagnostic Questions:

- **Customer:** Do we have a data-driven, quantitative understanding of the economic and emotional value our product creates for different customer segments? Have we rigorously benchmarked this value against the customer's next-best alternative?
- **Costs:** Do we have a precise, activity-based understanding of our total cost to serve each customer segment and channel, going beyond a simple COGS calculation?
- **Competition:** Who does the *customer* consider to be our primary competitor, and what is that competitor's effective price? How does our value proposition quantitatively and qualitatively compare to that specific alternative?

1.3 Defining Your Competitive Pricing Game

To move from abstract principles to a concrete strategy, it is useful to diagnose the specific type of competitive environment a company operates in. The "Strategic Pricing Hexagon" framework provides a powerful typology for this purpose, categorizing markets based on characteristics like buyer and seller concentration, customer need diversity, and offer differentiation.¹³ Identifying which of these six "games" a company is playing helps clarify the most logical and effective pricing approach.

The six pricing games are:

1. **Value Game:** Played by firms with highly differentiated or breakthrough products (e.g., pharmaceuticals, luxury goods). Success depends on aligning price with customer value and defending that value through marketing.¹⁷
2. **Uniform Game:** Common for retailers and consumer goods companies serving a large number of buyers with similar needs. Success hinges on optimizing a single price for all customers by balancing volume and margin tradeoffs, often using price elasticity analysis.¹⁷
3. **Cost Game:** Prevalent in commoditized markets with fragmented sellers and powerful buyers (e.g., some industrial suppliers). Success is driven by cost efficiency, allowing for competitive cost-plus pricing.¹⁷
4. **Power Game:** Occurs in markets with a small number of both buyers and sellers and standardized offerings (e.g., hard disk drives). Game theory and negotiation are the primary tools for setting prices.¹⁷
5. **Custom Game:** Typical in B2B industries where a few suppliers sell customized deals to thousands of customers. Success comes from tailoring discounts and terms for individual customers while managing overall profitability.¹⁷
6. **Choice Game:** Played by companies that use behavioral economics to guide customers toward self-selecting from a structured set of offers (e.g., software-as-a-service tiers). The relative prices of the offers matter more than the absolute price levels.¹⁷

Diagnostic Questions:

- Based on our market's characteristics (e.g., many fragmented buyers, highly differentiated product, low marginal costs), which of the six pricing games are we *actually* playing today?
- Is our current pricing strategy *aligned* with the rules and success factors of that game? For example, are we attempting to play a "Value Game" with a commoditized product, leading to customer rejection, or are we playing a "Cost Game" when we actually have significant differentiation, leaving money on the table?

Part II: The Structural Core - Diagnosing Your Price Architecture & Setting

Once the strategic foundation is in place, the focus shifts from the "why" of pricing to the "what and how." A price is not just a number; it is a complex structure designed to translate a value proposition into revenue. A flawed price architecture can undermine even the most brilliant strategy by failing to capture the value it creates or by creating perverse incentives for customers. This section deconstructs the components of a price and the models used to structure it, providing the tools to diagnose whether the architecture itself is fit for purpose.

2.1 Deconstructing Price: The Three Pillars of Architecture

Before a specific price can be set, senior leaders must make foundational decisions about its architecture. This architecture consists of three core pillars that define how value is measured, packaged, and exchanged.¹³

- **Pillar 1: Pricing Basis (The "Per What"):** This is the unit of measure for the price. The critical goal is to align the pricing basis with the primary unit of value the customer receives. Common examples include per user/seat, per hour, per gigabyte, per transaction, or per mile.¹³ The choice of basis is not a mere technicality; it is a strategic decision that fundamentally shapes customer behavior. A per-seat model, for instance, incentivizes customers to limit the number of users to control costs, potentially through undesirable behaviors like sharing logins. A usage-based model, in contrast, encourages broad adoption and focuses the conversation on the ROI of each activity, aligning the provider's revenue directly with the customer's consumption of value.
- **Pillar 2: Offer Structure (The "In What Form"):** This pillar defines how different elements of an offer and different offers within a portfolio relate to one another. Common structures include good-better-best tiering, à la carte features, and product bundles.¹² A well-designed offer structure guides customers to the solution that best fits their needs while maximizing the provider's revenue. Tiered pricing, in particular, is a powerful psychological tool. The structure is often designed to make the middle tier appear to be the best value, framed by a low-price anchor (the "good" tier) and a high-price anchor (the "best" tier).¹⁷ The effectiveness of this structure depends less on the simple differentiation of features and more on the psychological framing of the choice presented to the customer.
- **Pillar 3: Pricing Mechanism (The "How It's Set"):** This defines the process by which a final price is determined. Mechanisms range from a fixed list price (common in retail) to a individually negotiated price (common in B2B), or from a market-driven price (auctions, bidding) to an algorithm-driven dynamic price (airlines, e-commerce).¹³ The choice of mechanism has significant implications for profitability and operational complexity. A highly negotiated model, for example, can lead to significant price variation and margin leakage if not governed properly.

Diagnostic Questions:

- **Basis:** Does our pricing metric scale directly with the value our customers receive? Are we inadvertently creating a disincentive for our customers to adopt or expand their use of our product with our current metric?
- **Structure:** Is our "good-better-best" tiering structured to effectively upsell customers, or do most customers cluster in the lowest-priced tier? Are the feature "fences" between tiers meaningful and based on real value drivers? Are we bundling products in a way that increases total revenue per customer, or are we simply discounting?
- **Mechanism:** Is our reliance on a negotiated price model creating excessive margin leakage and high sales overhead? Would a more structured, fixed, or dynamic model be more profitable for certain customer segments?

2.2 Choosing the Right Pricing Model

The architectural pillars combine to form a specific pricing model. The choice of model should be a deliberate one, aligned with the company's strategy, product type, and customer buying behavior. A mismatched model can lead to customer confusion, lost sales, and unrealized revenue.

A detailed comparison of common models reveals their distinct strategic applications:

Pricing Model	Core Principle	Ideal Market Conditions	Key Advantages	Critical Risks	Real-World Example
Cost-Plus	Price = Cost + Margin %	Commodity markets; government contracts where costs must be justified.	Simple to calculate; ensures costs are covered.	Completely ignores customer value and competition; leaves money on the table. ⁴	Manufacturing, Retail, Construction ¹⁹
Competitive	Price set at, above, or below competitor levels.	Mature markets with little product differentiation.	Simple to implement; can defend market share or be used aggressively to gain it.	Can lead to price wars; strategy is dictated by competitors, not customers. ¹⁹	Airlines, Gasoline Stations, Consumer Packaged Goods ¹⁹
Value-Based	Price based on the quantified economic and emotional value delivered to the customer.	Highly innovative or differentiated products; B2B solutions with clear ROI.	Maximizes margin; reinforces brand value; builds strong customer relationships.	Requires deep customer research and data; can be complex to implement and communicate. ²⁰	Apple, Tesla, Specialized Medical Devices ²²
Price Skimming	Launch with a high price, then lower it over time.	New, innovative products with high initial demand and little competition (e.g., tech gadgets).	Maximizes revenue from early adopters; helps recoup R&D costs quickly.	Attracts competitors; can alienate early buyers who paid the high price. ²⁰	Launch of new iPhones or game consoles ²⁰
Penetration	Launch with a low price to capture market share, then raise it.	Highly competitive markets; products where network effects are important.	Rapidly builds customer base and market share; creates barrier to entry for competitors.	Can trigger price wars; may be difficult to raise prices later; risks devaluing the brand. ¹⁹	Amazon Kindle, Dollar Shave Club ²²
Subscription	Recurring fee for ongoing access to a product or service.	Software (SaaS), media, services where value is delivered over time.	Creates predictable, recurring revenue; increases customer lifetime value.	Requires constant value delivery to prevent churn; high customer acquisition costs. ¹²	Netflix, Salesforce ²³

Diagnostic Questions:

- Does our chosen pricing model align with our customers' typical purchasing behavior and cash flow preferences (e.g., a preference for operational expenditure via subscription vs. capital expenditure via a one-time license)?
- Have we considered alternative models that might better capture the ongoing value we provide? For example, should a product sold with a perpetual license be shifted to a subscription or usage-based model?

2.3 The Process of Setting the Price

With a strategy and architecture in place, the final step is to determine the actual price points. This should be a rigorous, data-driven process, not an ad-hoc meeting based on opinion. A best-practice price-setting process involves a sequence of analytical activities.

- **Activity 1: Value Quantification:** The cornerstone of modern pricing is the ability to quantify the value a product delivers. This involves identifying the key value drivers for each customer segment and calculating their economic impact relative to the next-best competitive alternative.⁷ This process requires making "good-enough" assumptions and gaining validation from a cross-functional team of experts from marketing, sales, product, and finance.⁷
- **Activity 2: Customer Segmentation:** It is a critical error to treat all customers the same.²⁶ Segmentation must go beyond simple demographics to group customers based on their needs, their perception of value, and their willingness to pay.⁷ A company that understands these differences can create tailored offers and price points that maximize revenue from each segment.
- **Activity 3: Price Elasticity Analysis:** Price elasticity measures how sensitive demand is to a change in price.²⁸ The formula is $Ed = (\% \text{ Change in Quantity Demanded}) / (\% \text{ Change in Price})$.²⁹ While precise calculation can be complex, even simple estimations can be highly valuable. Asking questions like, "What would happen to our sales volume if we raised the price by 10%?" or using survey techniques like the Gabor-Granger method can provide crucial insights into how the market will react to price changes.¹²
- **Activity 4: Breakeven Analysis:** This fundamental financial calculation determines the sales volume needed at a given price to cover all costs.¹⁵ It ensures that the chosen price is not only palatable to the market but also profitable for the business.

Diagnostic Questions:

- Do we have a formal, documented process for setting a new price, or is it handled on an ad-hoc basis?
- Who is involved in the final price-setting decision? Is it a cross-functional team that includes product, marketing, sales, and finance, or is the decision siloed within one department?
- What specific, quantitative data (e.g., conjoint analysis, willingness-to-pay surveys, competitive price benchmarks, elasticity models) do we use to inform the final price number?

Part III: The Go-to-Market Engine - Diagnosing Your Price Implementation & Communication

A meticulously crafted pricing strategy and architecture are purely academic exercises if the organization cannot execute them effectively in the market. The implementation stage is where value is either successfully captured or squandered. Failure at this stage is common and often stems from neglecting the human, process, and customer-facing elements of a go-to-market plan. This section provides the diagnostic tools to assess the health of this critical engine.

3.1 The Human Element: Sales Team Enablement and Incentives

The sales force is the front line of price implementation, and their behavior is the single most important factor in its success or failure. Implementing a new pricing approach is as much a communication and change management challenge as it is an operational one.⁵ Organizations that succeed "overinvest" in programs to help their sales teams understand the rationale behind new prices, trust the data that supports them, and feel confident in communicating them to customers.⁵

However, training and communication alone are often insufficient. A deeper examination frequently reveals that the root cause of poor price implementation is a fundamental misalignment between the company's pricing goals and the sales team's incentives. A company's strategy may be to maximize long-term profitable growth, but a salesperson's compensation plan is often designed to maximize short-term commission, which is typically tied to raw revenue or the number of deals closed. When a customer pushes back on price, the salesperson faces a conflict: hold the line to protect the company's margin or offer a discount to close the deal and secure their own commission. The compensation structure almost always dictates this choice. Therefore, any pricing implementation plan that does not include a critical review and potential redesign of sales compensation is likely to fail.

Diagnostic Questions:

- Are our sales team's incentives aligned with our pricing strategy? Are they compensated based on the quality of the margin they realize, or are they paid primarily on gross revenue volume, which encourages discounting?
- Do our salespeople have the training, tools (e.g., value calculators, dynamic deal guidance), and confidence to articulate and defend the product's value proposition, or do they default to using discounts as their primary sales tool?
- Do we have a clear, well-defined, and consistently enforced process for discount approvals? Is it easy for a salesperson to get an exception, or is there a culture of discipline?

3.2 The Process Element: Overcoming Implementation Challenges

Bringing a new pricing strategy to life involves a complex interplay of organizational processes and systems. Common challenges that derail implementation include internal resistance to change, poor quality or inaccessible data, a lack of clear pricing governance, and slow,

cumbersome operational processes.³² A one-size-fits-all approach, such as a blanket price increase, often fails because it lacks the necessary precision and ignores differences across customer categories, channels, and product assortments.³⁴

Best practices for overcoming these hurdles include establishing clear, standardized internal procedures for price changes, investing in systems that ensure data integrity and create a "single source of truth" for pricing, and leveraging technology (such as CPQ systems) to automate and streamline workflows.⁵ A dedicated, cross-functional team or a clear owner for pricing is essential to drive these initiatives and ensure accountability.

Diagnostic Questions:

- How long does it take for a strategic price change decided in a management meeting to be accurately reflected across all of our customer-facing systems (e.g., ERP, CRM, CPQ, e-commerce website)?
- Do we have a "single source of truth" for pricing data, or is pricing managed in a series of disconnected and potentially conflicting spreadsheets across different departments?
- Is there a clear owner, function, or committee within the organization responsible for driving the implementation of pricing initiatives and holding people accountable for execution?

3.3 The Customer Element: Communicating Price Changes Effectively

The price of a product is a powerful signal to the customer about its value and the company's brand positioning.⁹ Consequently, communicating a price change—particularly an increase—is a delicate and critical task. A poorly handled price change can trigger customer churn, damage brand trust, and invite competitive attacks.

Effective communication is not a simple announcement; it is a reaffirmation of the value proposition. The most successful communications reframe the price change as a necessary consequence of ongoing value creation and investment in the customer's success. Instead of being a standalone, negative event, the price adjustment should be the logical conclusion of a continuous stream of communication about product improvements, new features, and enhanced service levels. The message transforms from a defensive "We have to raise prices" to a confident "To continue delivering the increasing value you've come to expect, we are adjusting our pricing."

A playbook for effective price change communication includes several key tactics:

- **Provide Ample Advance Notice:** Give customers sufficient time to understand and adjust to the new pricing. A minimum of 30 to 60 days is a common best practice, with longer notice (e.g., 90+ days) for major long-term agreements.³⁷
- **Be Transparent About the "Why":** Clearly and honestly articulate the reasons for the change. Frame it in terms of customer benefits, such as "to invest in innovations that benefit you" or "to maintain the high-quality materials you expect," rather than using vague, company-centric excuses like "due to inflation" without context.³⁷

- **Reinforce the Value Proposition:** Remind customers of the unique benefits they receive and highlight any recent or upcoming improvements that the price change will support.³⁸
- **Offer Options and Flexibility:** For loyal or long-term customers, consider offering ways to ease the transition, such as allowing them to lock in the old price for a specified period or offering alternative, lower-priced plans that may better fit their budget.¹⁸

Diagnostic Questions:

- Do we have a standardized process and messaging playbook for communicating price changes to customers, or is it handled on an ad-hoc basis?
- Do we test or model the potential customer reaction (e.g., churn rate impact) to a price increase before a full rollout?
- Is our entire customer-facing team—including sales, customer support, and field service—equipped with a consistent script and rationale to explain the price change confidently and professionally?

Part IV: The Profit Capture Test - Diagnosing Your Price Realization & Leakage Analysis

This section introduces the most powerful quantitative tool for diagnosing the effectiveness of a pricing program: the Price Waterfall. This analysis moves beyond strategy and intentions to measure what truly matters—the final price that a company actually captures. The diagnostic focus here is on quantifying the gap between the intended price (as per the strategy) and the actual price received (the reality of execution), thereby uncovering hidden sources of profit leakage.

4.1 The Most Important Pricing Metric You're Not Tracking: Price Realization

Price Realization is a critical metric that measures a company's ability to achieve its intended list prices in the market.³⁹ It is calculated as the ratio of the actual price realized to the list price, expressed as a percentage:

Price Realization %=(Price Realized/List Price)×100.⁴¹ This single metric serves as the ultimate report card for the entire pricing process, reflecting the combined effectiveness of strategy, architecture, and implementation.

Many companies make the mistake of focusing on metrics like list price, invoice price, or even gross margin. However, these figures can be profoundly misleading because they ignore the myriad of on- and off-invoice discounts, rebates, allowances, and other deductions that systematically erode the price before it reaches the company's pocket.⁴² Studies have shown that the final price paid by an end customer can be as low as 53% of the initial list price, representing a massive and often un-tracked loss of value.⁴³

4.2 Introducing the Price Waterfall: Visualizing Profit Leakage

The Price Waterfall is an analytical tool that provides a visual breakdown of the sequential deductions that reduce the list price down to the final, net "pocket price".⁴² By charting each component, it illuminates every point where value "leaks" out of a transaction. While it appears to be a purely financial tool, a price waterfall is more accurately an organizational X-ray. Each significant leak corresponds to a specific decision or process failure somewhere within the company. For example, a large leak from "unplanned freight costs" points to an issue in the supply chain, while a major leak from "special price exceptions" signals a lack of sales discipline and pricing governance.

The components of a typical B2B price waterfall are structured as follows:

Component	Description
List Price	The official, published starting price for a product or service. The theoretical maximum. ⁴⁶
<i>On-Invoice Deductions</i>	Reductions that appear directly on the customer's invoice, such as standard volume discounts or promotional pricing. ⁴⁷
Invoice Price	The price the customer is formally billed for (List Price - On-Invoice Deductions). ⁴⁶
<i>Off-Invoice Deductions</i>	Reductions that do not appear on the invoice but still reduce the net revenue received. This is a major source of hidden leakage. Examples include annual volume rebates, early payment discounts, marketing co-op funds, and allowances for damaged goods. ⁴⁷
Pocket Price	The net revenue the company actually "pockets" after all on- and off-invoice deductions are accounted for. This is the true measure of the realized price. ⁴⁶
<i>Costs</i>	Includes the Cost of Goods Sold (COGS) and any other variable costs required to serve the customer (e.g., freight, commissions). ⁴⁶
Pocket Margin	The final profit on the transaction (Pocket Price - All Costs). This is the true measure of profitability. ⁴⁶

4.3 Conducting a Price Waterfall Analysis: A Step-by-Step Guide

A price waterfall analysis is a powerful exercise that can reveal surprising and often uncomfortable truths about a company's profitability. A common finding is that the traditional ranking of customers by revenue is inverted when they are ranked by pocket margin. High-revenue customers often command the largest discounts and have the highest cost-to-serve, making them less profitable than smaller, less demanding customers.⁵⁰ Uncovering these realities is the first step toward fixing them.

A practical guide to conducting a price waterfall analysis includes the following steps ⁴²:

1. **Define Goals and Scope:** Begin by clarifying the objective. Is the goal to identify the most and least profitable customers? To understand the ROI of different discount programs? To find products that are consistently sold at a loss? The analysis should start with a clear question to answer.
2. **Gather Transaction Data:** This is often the most challenging step. The analysis requires granular, transaction-level sales data from ERP and CRM systems, including every line

item, discount, rebate, and allowance. Incomplete or inaccurate data is a common roadblock.⁴⁶

3. **Organize and Segment Data:** To derive actionable findings, the waterfall must be analyzed across different dimensions. This means segmenting the data by customer, customer segment, product, product line, sales region, and sales channel to pinpoint precisely where the largest leaks are occurring.
4. **Visualize and Analyze:** Construct the waterfall chart to visually represent the magnitude of each deduction. The key analytical task is to identify the largest "drops" in the waterfall and investigate their root causes. It is crucial to categorize deductions as either strategic "investments" (e.g., a well-designed volume discount that drives profitable growth) or uncontrolled "leakages" (e.g., ad-hoc discounts given by sales to close deals at month-end).⁴²

Diagnostic Questions:

- What is our average Price Realization percentage? How does this percentage vary by our key customer segments, product lines, and sales regions?
- Which specific off-invoice deductions (e.g., annual rebates, marketing allowances, freight costs) are causing the largest drop from our Invoice Price to our Pocket Price?
- When we re-rank our top 20 customers by total Pocket Margin instead of total revenue, how does the list change? Are our largest customers also our most profitable?
- Are there specific products or SKUs that are consistently sold with a negative pocket margin? Why are we allowing this to happen?

Part V: The Feedback Loop - Diagnosing Your Price Post-Evaluation & Governance

Pricing excellence is not a static achievement but a dynamic capability that requires continuous monitoring, learning, and adaptation. The final stage of the Pricing Excellence Journey focuses on establishing the feedback loops and organizational structures necessary to sustain high performance over the long term. This involves building a robust KPI dashboard to measure what matters and implementing a clear governance framework to ensure disciplined decision-making.

5.1 Building the Pricing Dashboard: Key Performance Indicators (KPIs)

An organization cannot manage what it does not measure. A dedicated pricing dashboard, populated with a balanced set of KPIs, is essential for tracking performance, identifying emerging issues, and informing strategic adjustments.²⁸ While many companies track high-level financial outcomes like revenue and gross margin, a mature pricing function also tracks leading indicators that measure the health of the pricing process itself. These KPIs should be reviewed regularly by a cross-functional team to trigger specific, pre-defined actions.

A comprehensive pricing dashboard should include metrics that map to each stage of the pricing journey:

Stage of Journey	Key Performance Indicator (KPI)	Formula / Definition	What It Diagnoses
Strategy & Alignment	Customer Lifetime Value (CLV) to Customer Acquisition Cost (CAC) Ratio	(Net Expected Lifetime Profit from Customer) / (Cost to Acquire Customer)	Measures the long-term profitability of the current strategy. A ratio below 3:1 may indicate a flawed strategy or targeting of unprofitable customers. ⁵²
Strategy & Alignment	Market Share	(Company's Sales / Total Market Sales) x 100	Tracks competitive position and the outcome of strategies aimed at share gain or defense. ⁵⁴
Architecture & Setting	Average Selling Price (ASP)	Total Revenue / Total Number of Units Sold	Monitors the effective price level and can reveal trends in product mix or discounting. ⁵¹

Stage of Journey	Key Performance Indicator (KPI)	Formula / Definition	What It Diagnoses
Architecture & Setting	Revenue Mix by Tier/Bundle	% of Total Revenue from Tier 1, Tier 2, etc.	Assesses the effectiveness of the offer structure in upselling customers to higher-value packages.
Implementation	Win/Loss Ratio	(Number of Won Opportunities) / (Total Number of Opportunities)	Measures sales effectiveness at current price points. A low ratio may indicate prices are too high or value is poorly communicated. ⁵¹
Implementation	Churn Rate Post-Price Change	% of Customers who cancel within X months of a price increase.	Directly measures customer resistance to price changes and the effectiveness of communication. ²⁸
Realization	Price Realization %	(Pocket Price / List Price) x 100	The ultimate measure of the gap between strategy and execution; indicates the level of price erosion. ³⁹
Realization	Pocket Margin %	(Pocket Margin / Pocket Price) x 100	Measures the true profitability of transactions after all costs and deductions are accounted for. ⁴⁶
Governance	Discount Exception Rate	% of Deals Closed with Discounts Outside of Standard Policy	Measures the level of sales discipline and the effectiveness of governance controls. A high rate indicates a culture of rogue discounting. ⁵⁸

Diagnostic Questions:

- Do we have a dedicated dashboard that tracks these pricing-specific KPIs, or are they buried within a larger, less-actionable financial report?
- Do we regularly review these metrics in a cross-functional leadership setting with the authority to act on the findings?
- How do we use these KPIs to trigger specific actions? For example, if the average discount exception rate rises above a certain threshold, what is our pre-defined response plan?

5.2 Establishing Pricing Governance: Who Decides?

Effective pricing requires clear ownership and disciplined processes. Pricing Governance is the formal framework of policies, procedures, roles, and systems that ensures pricing decisions are made consistently, transparently, and in alignment with the overall business strategy.⁵⁸ A common mistake is to view governance as a bureaucratic exercise that slows down the business. In reality, a well-designed governance structure *accelerates* effective decision-making. By creating clear, fast pathways for routine decisions (e.g., auto-approving discounts under 5%), it frees up leadership time to focus on the small number of decisions that are truly strategic, enabling greater agility in response to market changes.³³

The core components of a robust pricing governance framework include ⁵⁸:

- **A Cross-Functional Pricing Committee:** A dedicated body, comprising representatives from Sales, Marketing, Finance, and Product, should be established. This committee is responsible for overseeing the pricing strategy, reviewing performance against KPIs, resolving disputes, and approving major pricing changes or exceptions.
- **Defined Roles and Decision Rights:** The organization must clearly define who has the authority to make which pricing decisions. A simple discount authority matrix (e.g., using a RACI model) that specifies the level of discount a salesperson, sales manager, or VP can approve is a foundational tool for instilling discipline.
- **Documented Policies and Procedures:** The rules for setting new prices, managing the annual price review process, granting discounts, and handling exceptions must be formally documented and communicated. This creates consistency and reduces ambiguity.

Diagnostic Questions:

- Is there a single executive or a formal committee that "owns" pricing within the organization, or is responsibility diffuse and unmanaged?
- Do we have a documented and enforced policy for pricing authority (e.g., a sales rep can approve up to a 5% discount, a regional manager up to 15%, and anything higher requires committee approval)?
- How often does the cross-functional pricing committee (if it exists) meet to review performance data and make strategic adjustments to pricing policy?

5.3 The Pricing Maturity Curve

Organizations evolve in their pricing capabilities over time. A pricing maturity model can serve as a useful diagnostic tool for a company to self-assess its current state and identify the capabilities required to advance to the next level of performance.²

- **Phase 1: Ticket to Play:** Companies at this stage have emerging analytical capabilities. They are aware of market pricing and have basic competitive intelligence but rarely have dedicated pricing experts or sophisticated tools. Pricing decisions are often reactive.
- **Phase 2: Pushing the Boundaries:** These companies are masters of traditional pricing models and are actively experimenting with new variations like bundling and segmented offers. They have more granular data and a systematic, cross-functional process for reviewing performance and making adjustments, typically meeting at least monthly.
- **Phase 3: Pricing Pioneers:** The most advanced companies use pricing as a radical tool to drive large-scale sales growth and margin change simultaneously. They move beyond optimizing existing models to implementing entirely new business models and ways of working to find new pockets of value.

Diagnostic Question:

- Based on our current capabilities in data analytics, cross-functional collaboration, strategic experimentation, and governance, where does our organization honestly fall on this maturity curve? What is the single biggest gap preventing us from moving to the next phase?

Conclusion: The Path to Pricing Excellence

Pricing is the moment of truth where a company's entire value proposition is converted into revenue. As this analysis has demonstrated, this critical process is fraught with potential pitfalls, from strategic misalignment and flawed architecture to poor implementation and a lack of disciplined measurement. The result is a silent and persistent leakage of profit that undermines business performance. The path to correcting this is not a single project or a one-time fix, but the development of a sustained, cross-functional organizational capability.⁴⁴

The Pricing Excellence Journey provides a structured roadmap for this transformation.

- It begins with **Strategy**, ensuring that every pricing decision is a deliberate tool to achieve a specific corporate objective.
- It moves to **Architecture**, demanding a conscious design of the price's basis, structure, and mechanism to align with customer value.
- It confronts the realities of **Implementation**, focusing on the critical alignment of sales incentives and communication needed to bring the price to market effectively.
- It insists on empirical proof through **Realization**, using the Price Waterfall to measure the true pocket price and diagnose the sources of margin erosion.
- Finally, it closes the loop with **Governance and Evaluation**, establishing the KPIs and decision-making structures required for continuous improvement.

The journey toward pricing mastery begins with an honest and rigorous diagnosis. The following scorecard condenses the core questions from each stage of the journey into a high-level self-assessment tool. By convening a cross-functional leadership team to discuss and rate the organization's performance against these fundamental questions, a business can quickly identify its most critical areas of weakness and build the consensus needed to take the first step on the path to pricing excellence.

The Pricing Health Scorecard

Instructions: For each question, rate your organization's current capability on a scale of 1 to 5, where 1 = Major Problem / No Capability and 5 = Best Practice / Fully Capable.

Stage of the Pricing Excellence Journey	Key Diagnostic Question	Our Score (1-5)
1. Price Strategy & Alignment	Can we clearly and consistently articulate how our pricing strategy directly drives our #1 corporate objective for this product line?	
2. Price Architecture & Setting	Is our pricing metric (e.g., per seat, per use) fundamentally aligned with how our customers measure the value they receive from our product?	
3. Price Implementation & Communication	Are our sales team's financial incentives primarily aligned with maximizing realized margin and profitability, rather than just gross revenue?	
4. Price Realization & Leakage Analysis	Do we systematically measure our "pocket price" after all on- and off-invoice discounts, and do we know the exact sources of leakage for our key products?	
5. Price Post-Evaluation & Governance	Is there a formal, cross-functional committee with the clear authority to make and enforce strategic pricing decisions across the organization?	

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ABOUT KEENALYTIX

Keenalytix is a boutique consultancy where data-driven pricing and analytics meet actionable strategies. We specialize in helping businesses—ranging from startups to established brands—achieve sustainable growth through smarter pricing decisions and advanced analytics.



Our founder, Fred Puech, PhD, is an experienced consultant and thought leader specializing in pricing analytics and revenue growth strategies. Fred has successfully completed more than 120 pricing analytics engagements across multiple B2B and B2C industries. Fred is a regular speaker at the Professional Pricing Society.

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