

Pricing on Purpose

Creating and Capturing Value

By Ronald J. Baker | John Wiley & Sons, 2006

Introduction

Ronald Baker's seminal work challenges the deeply entrenched cost-plus pricing paradigm. Drawing on economic theory and real-world examples, Baker makes a compelling case for value-based pricing as the path to sustainable profitability.

"The purpose of any business is to create wealth for its customers. Profit is the oxygen for the body; it is not the point of life."

Core Thesis

Value determines price, not cost. Baker repudiates Marx's Labor Theory of Value in favor of the Subjective Theory of Value (Austrian economists, 1871):

- **Value is subjective** — determined solely by the customer
- **Price determines cost** — not the other way around
- **Cost-plus pricing is obsolete** — a relic of the Industrial Age

VALUE → PRICE → COST

The Pricing on Purpose Chain (vs. Cost → Price → Value)

The New Business Equation

Replace: Revenue = Capacity × Efficiency × Cost-Plus Price

Profitability = Intellectual Capital × Price × Effectiveness

Three types of IC: **Human** (people), **Structural** (systems), **Social** (customers, networks)

Why Cost-Plus Pricing Fails

- Focuses on internal costs rather than external customer value
- If costs determined value, no business would ever fail
- Pricing mistakes simply vanish — no learning opportunity
- Creates a self-imposed artificial ceiling on profitability

The Four Ps of Marketing

Product = Seed & planting | **Promotion** = Fertilizing | **Place** = Land selection | **Price** = The harvest (most important signal to customers)

Key Frameworks & Strategies

Price Discrimination & Segmentation

Charge different prices based on willingness to pay — increases welfare by making products accessible to more people.

Baker's Law

"Bad customers drive out good customers." Be selective about who you serve — less is often more.

Critical Principles

- **No such thing as a commodity** — differentiation always exists
- **Pricing is an art, not a science** — requires judgment and iteration
- **1% price improvement** can increase net income by 7-11%
- **Effectiveness over efficiency** — businesses exist to create wealth
- **Price-led costing** — set price first based on value, then manage costs

Practical Applications

- **TIP Clause** — "To Insure Performance" success pricing
- **Chief Value Officer** — appoint someone responsible for value
- **After Action Reviews** — learn from pricing decisions
- **Customer Value Conversations** — let customers participate

Final Takeaways

- Customers determine value — always look outward, not inward
- Price transmits the most important signal about your worth
- Intellectual capital, not physical assets, drives wealth creation
- Pricing deserves a promotion to executive function

"Cost is a fact, pricing is a policy, and value is subjective. Focus on creating value, set prices to capture it, and let costs follow."