A pricing process can set prices or it can discover them.

The prices our customers actually pay are determined in the end by the markets we choose to be in and how we choose to position ourselves in those markets so a strategic pricing process does not set prices, it discovers them; it finds out what prices are consistent with where we are in the market and where we want to be.

To set a price rather than discover it can create the illusion that the pricing process controls financial outcomes, an illusion reinforced by the observation of the marginal short term financial effects that result from marginal changes in price.

Shouldn't we at least set a minimum price?

To set a price rather than discover it actually is an indirect way (a shot in the dark) to position ourselves in the market, i.e. to establish what kinds of customers we actually will target and how many we are likely to get.

An important byproduct from a strategic pricing process is information for strategic development and decision-making: e.g. "if we choose to be in such and such a market, positioned in such and such a way, then the incremental financial consequences appear at this time to lie in such and such a range and here is why."

Pricing is an effort to identify the value that a customer will attribute to a product or service, so prices will vary with the customer as well as with the characteristics of the product or service.

In many of our businesses, value is created by the selling process itself and for those businesses the sales process is not so much a controllable cost driver as it is a valuable good whose price must be discovered along with the price of the product.

Only customers can tell us what their price is for our product and their buying behavior is the only way they can tell us, so to set a price is to initiate an experiment to discover how many and who the customers are for this product at that price with those sellers.

Benefit costs for most insurance products depend critically upon who the customers are and/or how they behave so to set a price is also to initiate an experiment to discover what the benefit costs are for this product at that price with those sellers (given these underwriting processes.)

Experiments by their nature produce confidence intervals not clear cut answers so price-setting ought to be an active experiment, one that probes the boundaries between what is known and unknown about whatever aspects of customer and seller behavior or costs are most important to sustain the long range success of a particular strategic direction.

For most insurance products a price increase will result in a benefit cost increase combined with a volume decrease (and vice versa) so even in the most narrow tactical sense the important outcomes to observe from a pricing experiment are the relative slopes of the price, variable expense, benefit cost and volume lines together with (importantly) any signs of changes emerging in those relative slopes.

Incremental pricing experiments generate answers about the behavior of the marginal customer or seller, i.e. the next one in line or the one nearest the end of the range.

Price usually affects customer or seller behavior as a threshold phenomenon rather than smoothly.

Smaller pricing experiments made more often will generate more and better answers than bigger pricing experiments made less often.

For short term contracts (for example, most forms of medical insurance) the first effects from a pricing experiment seem to show up almost immediately in renewal and sales volumes and in collected profit margins, but some longer term effects (such as on true earned margins and/or the feedback phenomena from competitor response) may be slower to emerge.

For longer term contracts more subtle advance indicators may be required to read the outcome of a pricing experiment, because reported financial results are slow to emerge (and consist largely of estimates, anyway) while gross sales results over a short time can be influenced by too many imponderables to read accurately.

What agents or other sales people say about prices is never sufficient evidence to make a pricing decision or to judge the results of one. What they can be motivated to do, collectively, is what matters and what they say about prices is evidence solely for their own motivational state.

As a growth company aiming for financing self-sufficiency our tactical price positioning should always be aggressive within marketing tactics that are pushing at least one parameter to the limit. For example, if sales of a given product or option already are nearing the foreseeable limits of either our capacity to handle or the sales channel to absorb then marketing tactics ought to push up the margins for that product or option to the limit of customer or regulatory tolerance (using a combination of price increases or service, benefit or marketing economies.) On the other hand, if margins for a given product or option already are more than acceptable within existing or attainable capacity levels then marketing tactics ought probe the maximum potential to trade excess margin for increased sales (using the optimum combination of service/benefit enrichment, marketing expenditures, or price decreases.)

Even tactical pricing decisions are the consequence of (tactical) marketing decisions.

Unless there is clear evidence of a sustainable long term market trend in that direction, a quoted price decrease is usually a bad idea (if there is any other way to get the required result) because it can be the most difficult step to reverse.

A compromise price is usually the worst pricing decision. Nobody believes in it, so nobody is accountable for its outcomes.

The best pricing process is one that structures measured accountability for the outcomes of pricing decisions.

The people responsible for the pricing process in our affiliates know what they are doing better than we ever will so Aetna International's pricing principles are designed not to prescribe anything new but to articulate, illuminate and support what the affiliates already are doing, to facilitate cross-fertilization from one affiliate to another, and to provide comfort to management.

Pricing direction is strategic in nature and the managing director of each affiliate is accountable for all material pricing decisions in that affiliate.

Each managing director ought to be able say roughly what returns are embedded in his existing book of business, what returns are implicit in his strategy for the future, what direction his current pricing is pushing his returns, how that relates to the other major factors driving his returns, and what business assumptions are important to all those answers.

Each managing director ought to be able say roughly what price positioning is consistent with his long term strategy, what aspects or components of pricing are most critical to the strategy, how his current price positioning stacks up to those requirements, how he knows, and what he is doing about it.

Material pricing decisions need to be controlled as part of the strategic development framework for each affiliate and the outcomes of material pricing decisions need to be reflected within the affiliate's financial and operational management processes.

The mechanics of the pricing process usually involve pro forma financial calculations or projections per unit of sales, such as per unit revenue receipts, per unit benefit costs, per unit expense costs and per unit capital consumption, creation, and release, along with the anticipated timing of each element in the projection.

The actual financial consequences of a pricing decision will reflect the actual effects of the pricing decision on volume (how many customers for what size of sales) and market positioning (what kinds of customers, where, from which sellers or channels, and with what total relationship to us) as much as or more than it will reflect the results of pro forma financial projections per unit of sales.

Aetna International's pricing principles require that appropriate pro forma financial projections per unit of sales will be performed and evaluated as part of the pricing process, but allow that there are many acceptable ways to perform such projections and to evaluate the results.

It is less important to fine-tune the assumptions used in making pro forma financial projections per unit of sales than it is to translate those assumption into simple operational terms so that an accountable decision-maker can use the pro forma projections effectively as a tool.

The combination of business strategy and financial strategy drives pricing strategy.

Aetna International's business strategy is to create shareholder value as a growth company defined as a 20% or greater long term annual growth rate in reported earnings after tax, which can be sustained only through equal or greater long term annual growth rates in sales and revenue.

Aetna International's financial strategy is to achieve a long-term rate of return on capital (ROC) on an embedded value basis at a margin above the risk adjusted cost of capital to finance growth.

Acceptable ROC requires acceptable margins.

Aetna International's strategy seeks to combine high growth with acceptable margins through (a) superior choice of what markets to enter and when, followed by (b) superior delivery of customer-perceived value, leading to (c) superior sustainable competitive positioning.

Any conclusion that a price level required to sustain 20% long term annual growth in the market will not in the long run deliver acceptable margins amounts to a conclusion that the particular market, product line, or competitive positioning does not by itself fit Aetna International's strategy.

Aetna International's strategy is to enter emerging markets early enough in the exponential part of their growth phase so that price (considered in total across the whole product package) will not be the driving competitive issue and 20% or greater long term annual growth rates will be achievable for a number of years by winning a reasonable share of the new growth in the market itself rather than by competing to take away share of the existing market.

Aetna International's strategy is to sustain 20% or greater long term annual growth rates beyond a new market's exponential growth phase by exploiting scale and customer relationships created in that early growth phase to expand sales at less cost and effort than for unsupported new customer sales in a mature environment.

Within the general framework of Aetna International strategy each affiliate will have a stated and approved overall business and financial strategy that includes targeted levels by broad market segments for growth, ROC and any other benchmarks important to the specific strategy.

A specific pricing decision within one of the affiliates can be evaluated only against that affiliate's stated and approved overall business and financial strategy and can be evaluated only versus the alternative pricing decisions actually available at the time in that market, including (implicitly at least) alternatives such as "make no change" and/or "leave the market."

There is no such thing as an Aetna International target return or target profit margin for pricing purposes.

Pricing is an optimization process, given the strategic decision to take a certain position in the market.

Returns and profit margins are the results of strategic decisions about what markets to be in and how to be positioned in them, of operational decisions about organizing and executing the strategy, and (only then) of how effectively the pricing process has optimized what's left to it.

Aetna International's pricing principles require that material pricing decisions be made in the context of:
(a) a documented formal evaluation, signed off by
(b) an accountable executive, who links
(c) pro forma financial projections per unit of sales, to
(d) an operational (hence judgmental) estimate of the true incremental financial effects of the pricing decision, versus
(e) an approved long term business strategy for the affiliate (one that encompasses acceptable long term growth rates in sales, revenues and reported earnings; acceptable long term ROC; and any other benchmarks for the affiliate's strategy), adjusted for
(f) stated shorter term tactical marketing considerations, together with
(g) identified early indicators to track the emerging accuracy of the estimates, and
(h) a commitment to measure and follow through on what the indicators say.

We will provide some examples, or preferred formats, for the foregoing ingredients (a through h) of good pricing management.

Our pricing policy will be that these ingredients of good pricing management be present, not that they follow any specific formats or examples.