

The Pricing Function in Industrial



Of three main approaches to pricing in industrial markets — cost-based, competition-based and value-based — the latter is considered superior by most marketing scholars and pricing practitioners. Yet paradoxically, few industrial firms adopt customer value-based pricing. In this article, the authors outline their recent research designed to explore how organizational factors affect the adoption of a pricing orientation in industrial firms, how managers in these firms make pricing decisions and what roles they play in the firm's pricing process. Stephan M. Liozu, CPP (Doctoral Candidate, Case Western Reserve University, Weatherhead School of Management) is President & CEO Ardex America. He can be reached at Stephan.Liozu@ArdexAmericas.com.

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Despite its critical importance, its revenue-generating power and despite growing competitive intensity, practitioners and marketing scholars agree that pricing is a neglected area in industrial marketing (Noble & Gruca, 1999; Shipley & Jobber, 2001; Hinterhuber, 2004; Hinterhuber, 2008; Cressman, Jr., 2009). The pricing field is under-researched and under-published compared to other elements of the marketing mix (Noble & Gruca, 1999). Empirical research from McKinsey & Company reported by Clancy and Shulman in 1993 shows that less than 15% of companies do any systematic research on pricing (Hinterhuber, 2004). Less than 2% of all articles published in major marketing journals cover the subject of pricing (Malhotra, 1996). Recent articles from renowned practitioners and researchers still report major failures in pricing strategies (Hinterhuber, 2008; Cressman, Jr., 2009). There are myths in the area of pricing that are common and do not seem to be formally addressed in the field of practice despite being commonly reported in pricing literature. Many industry managers consider pricing a headache and many firms have “thrown in the towel” on pricing. They complain that they have no control over prices since “the market sets the price and (they) have to figure out how to cope with it” (Dolan & Simon, 1996).

Of three main approaches to pricing in industrial markets — cost-based, competition-based and value-based — the latter is considered superior by most marketing scholars (Anderson & Narus, 1998; Cressman, Jr., 1999; Nagle & Holden, 2002; Ingenbleek et al., 2003; Hinterhuber, 2004) and pricing practitioners, (Forbis & Mehta, 1981; Dolan & Simon, 1996; Nagle & Holden, 2002; Fox & Gregory, 2004). Yet, paradoxically, few industrial firms adopt customer value-based pricing. A meta-analysis of pricing approach surveys between 1983 and 2006 reveals an average adoption rate of 17% (Hinterhuber, 2008). Cost-based and competition-based approaches still play a dominant role in industrial pricing practice (Coe, 1990; Shipley & Bourdon, 1990; Noble & Gruca, 1999; Ingenbleek & Debruyne, 2001).

So in essence, the pricing function in industrial firms has yet to

become as widely established and as able to substantiate its added value as other functions such as new product development, quality control, etc. In order to investigate roles, responsibilities, and competencies of the pricing function in industrial companies, we designed a qualitative inquiry based on semi-structured interviews with managers in small and medium-sized U.S. industrial firms. By probing the “lived worlds” of these executives, our hope was to understand the place of pricing in the firm, discover the pricing processes and how firms organize for pricing.

Our results reflect similarities and differences in the experiences of managers in industrial firms using the three pricing orientations. They suggest strong contrasts among these firms and their leaders with respect to how they organize for pricing, manage the pricing process, manage the transition to more advanced pricing orientation and develop internal capabilities to face uncertain and ambiguous decisions.

Research Design

Methodological Approach

We conducted a qualitative study using semi-structured interviews to develop a grounded theory (Corbin & Strauss, 2008) about how organizational factors affect the adoption of a pricing orientation in industrial firms. We aimed to get a better understanding of how managers in these firms make pricing decisions and what roles they play in the firm's pricing process.

Sample

Our sample consisted of 44 managers in 15 small and medium U.S. industrial firms. Relying on the principle researcher's professional network and advice by the Professional Pricing Society, we identified over 36 small and medium U.S. firms in three industries: building materials, transportation products and resins & plastics products. We contacted managers in each firm for initial qualification with respect to their pricing orientation. The intention was then to request participation in the research project from small and medium firms using the three basic pricing

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orientations. Fifteen of the qualified companies agreed to participate in our study.

Of these 15 companies, 7 were small (size between 50 and 380 employees) and 8 were medium-sized with between 900 and 2200 employees.

Six firms (providing 18 interviews) used cost-based pricing, five (resulting in 14 interviews) used competition-based pricing and four (yielding 12 interviews) used value-based pricing. Two to four interviews were conducted at each firm. Respondents included fifteen CEOs or top executives, eighteen sales and marketing managers with full or partial responsibility for pricing, and eleven finance and accounting managers with decision-making authority. The firms were geographical diverse and interviews were conducted in ten U.S. states.

Data Collection

The primary method of data collection was semi-structured interviews conducted over a three month period from April to June 2010. Thirty-seven interviews were conducted in-person at the respondents' place of employment and seven were conducted by telephone. The interviews, averaging 60+ minutes, were digitally recorded and subsequently transcribed.

We focused on managers' experiences in making pricing decisions and in participating in the firm's pricing process. We asked open-ended questions to elicit rich and specific narratives and used probes when needed to clarify and amplify responses. Informants were first invited to talk about themselves, their backgrounds, and their work. We then asked them to describe their specific experience with the most recent pricing decision made in their firm or a very recent meeting during which pricing was discussed or a pricing decision was made. Third, informants were asked to focus on the most significant pricing decision made in their firm over the past 12 to 24 months and to describe that experience in great detail. For both questions we used probes to provoke specific details about the pricing process. Finally, we asked the respondents about their experience with pricing innovation. The overall goal was to elicit experience-based practitioner perspectives on the organizational factors that influence the firm's pricing orientation.

Data Analysis

Consistent with a grounded theory approach, data analysis commenced simultaneously with data collection. The audio recordings of each interview were listened to several times and the transcripts of each interview read repeatedly. Three stages of rigorous coding

then followed. First, all of the transcripts were "open-coded", a process that requires the researcher to identify every fragment of data with potential interest (commonly called "codable moments" (Boyatzis, 1998)). These "codable moments" were sorted and assigned to pre-existing or new categories that included similar excerpts from other interviews. In a second phase of coding ("axial coding") these categories were further refined as we compared and contrasted them, a process that resulted in the emergence of patterns and themes. Finally, in the third phase of the coding process ("selective coding"), we focused on key categories and themes that generated our findings.

Findings

Finding 1: Pricing is an orphan in industrial firms using cost or competition pricing orientation.

No dedicated pricing function exists in the 11 firms in our sample using cost or competition pricing orientation. In these firms, pricing activities are highly fragmented, followed informal pricing review processes, and focus only on margins versus prices (7 out of 11 firms). By contrast all firms using value-based pricing have dedicated pricing functions (involving 3 to 15 members), track specific pricing KPI's and conduct pricing reviews at regular intervals.

Finding 2: In the absence of a dedicated pricing function, prices are largely determined by the sales function.

In the 11 firms using cost-based and competition-based pricing, the locus of both tactical and strategic pricing responsibility is situated in the sales function. In all firms using value-based pricing, the pricing function reports into the marketing organization. In these industrial firms, marketing is responsible for strategic pricing resulting in greater integration of pricing programs in the overall marketing planning process.

Finding 3: Firms using value-based pricing designed formalized processes and established centralized or center-led pricing expertise

All firms using value-based pricing create specialized units composed of highly skilled professionals supporting the pricing decision-making process. These units include a dedicated pricing team, senior pricing managers or a specialized market research team, value assessment or value-in-use engineering teams. The role of these units is to provide project-related support to manag-

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ers who make business unit-specific pricing decisions. This phenomenon of specialized expertise is illustrated by the following interview excerpts:

“We have dedicated (functional) managers. They don’t do anything else, and then just (customer research), and this is observation of the customer. It’s videotaping of the customer. It’s understanding what is the unarticulated needs of the customer, and of course, also the articulated needs” (CEO of a Firm Using Value-based Pricing)

“In a development group...there’s three people like (name) who are development managers. We’ve got hundreds of development people in the world...That’s all they do. They don’t sell a thing.....So they’re doing the advanced design, advanced development.” (Business Leader of a Firm Using Value-based Pricing)

In these firms, pricing responsibility is centralized and the department provides pricing support to the entire organization. Our

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findings suggest a definition of centralization in which knowledge and capabilities are concentrated to create the concept of a center of excellence for pricing. Five out of six sales and marketing respondents in firms using value-based pricing indicate that this central pricing function acts as a strong resource to improve managerial pricing management. None of the firms using cost-based pricing (0 out of 6 firms) report the existence of a centralized pricing function. Expertise centralization is illustrated by the following quotes:

“...we have three full-time equivalents for voice of the customer studies. We have that centrally. So whenever we develop a product for this market, we get them here and they set the whole system because it’s a very formal thing” (CEO of a Firm Using Value-based Pricing)

“We tap into our corporate sales and marketing (team) (and) say, “Hey, they’ve got professionals that know the terminology, the theory, and the strategy associated with pricing in general.” And you do a little bit of negotiation role-playing and that sort of thing. So that’s probably once a year or once every year and a half” (Marketing Manager in a Firm Using Value-based Pricing).

All firms using value-based pricing report greater formalization of their pricing process as well as other related activities as the first quote below demonstrates. Respondents declare using stage gate processes for new product introduction, voice-of-the-customer management processes, and automated price deviation processes embedded in the firms’ ERP systems. Three out of four of these firms implement formal pricing review processes and underline

the need for strong pricing discipline to improve the robustness of the pricing process.

“We have the prices structured in the system, the what we call the profit desk underneath the pricing team can look to see whether or not the price points are too low, or are at least profitable and value-based enough to go, regardless of what business or trade it is. It’s all set up, up front in the system” (Pricing Manager in a Firm Using Value-based Pricing).

“More (of) the formality is around costing and the stage gates are you either proceed or don’t proceed based on costing (and) cost targets. We set a cost target based on the margin expectations...So we put more formality around costing analysis, and there’s less formality around the pricing...it’s funny how this works” (CEO of a Firm using Cost-based Pricing).

“It’s not reviewed formally. I guess I would call it informal. It’s a process, but it’s not something we sit down and have a meeting to review all the quotes...I’d say that’s a little more informal” (CEO of a Firm Using Cost-based Pricing).

Finding 4: The level of focus on specific pricing training programs varies greatly by pricing orientation.

All firms using value-based pricing in our sample emphasize the importance of training and designed specific formalized training programs for both existing and newly hired personnel. Only one of the six firms using cost-based pricing, however, has a formalized training, despite recognizing its importance. The following excerpts illustrate the contrast by pricing orientation.

“train, train, train, train...we are just making a contract with a training company in the U.S.... to really teach them value selling, strategic selling and distribution management... that’s a program for the next 18 months” (CEO of a Firm Using Value-based Pricing)

“You know I don’t think we’re going to do formal training on it” (CEO of a Firm Using Cost-based Pricing).

“No, we haven’t done (training) and honestly that’s probably something that you know we should be doing (CEO of a Firm Using Competition-based Pricing).

Firms using value-based pricing also focus on developing internal capabilities in the areas of market research (4 out of 4 firms), pricing research (3 out of 4 firms) and the development of proprietary tools (4 out of 4 firms) to capture and quantify customer value that are more sophisticated than those described by firms using cost-based and competition-based pricing. Top executives (4 out of 4) and sales and marketing respondents (4 out of 6) in these firms using value-based pricing are among the respondents who reinforce the importance of these proprietary tools to support the implementation of the total cost of ownership and value-in-use pricing methodologies.

Finding 5: Pricing is not perceived as field subject to innovation.

When asked about a recent pricing innovation in their firms, respondents are first surprised since they do not consider pricing to be a field subject to innovation. Managers in firms using cost- or competition-based pricing do not design or implement any innovations in pricing at all: Managers in these companies refer to basic pricing activities such as approvals of rebates or naming a full time cost analyst. Even within firms practicing value-based pricing, pricing innovations are rare: Some of these firms report the critical necessity to innovate because of the declared difficulty in the sustainable implementation of value-based pricing. Firms face greater complexity in their segmentation practices, in their distribution model or in the management of pricing data which triggers a need to make changes and innovate.

In sum, this research shows that within industrial companies the pricing function is in most cases static with few instances where industrial companies self-report to engage in innovation of pricing practices, tactics, or strategies.

Discussion

Our research uncovers stark differences in key organizational characteristics among firms with different pricing orientations.

Our discussion focuses on two areas: first we examine the current state of the pricing dimension in the industrial marketing concept; next we discuss specific actions that might be required to increase the effectiveness of the pricing function. Following this discussion, we summarize our proposal for a road ahead for industrial pricing.

The Position of the Pricing Dimension in Industrial Marketing

Previous research studies from marketing practitioners and scholars reports that pricing is a neglected area in industrial marketing (Noble & Gruca, 1999; Shipley & Jobber, 2001; Hinterhuber, 2004; Hinterhuber, 2008; Cressman, Jr., 2009) as well as an under-researched and under-published field compared to other elements of the marketing mix (Malhotra, 1996; Noble & Gruca, 1999). Our findings confirm this phenomenon. In 11 out of the 15 companies comprised in our sample, the pricing function does not exist. In these firms, pricing activities are highly fragmented and pricing strategies are not clearly defined. Even more paradoxical is the fact that managers in 13 out of 15 firms report a severe lack of pricing capabilities with their sales force. Yet 11 out of 15 firms completely delegate tactical and strategic pricing activities to the sales function.

These findings ring as a warning bell to marketing academia and the pricing profession in general. We posit that there is a need for more professionalization and promotion of the pricing function in industrial markets. The pricing profession should tackle the perception that pricing is a complex function that is too often associated with finance and accounting.

The Road Ahead for Industrial Pricing

The transformation of the pricing profession in industrial firms requires the combined positive impact of the five elements which are described below.

More Academic Research – Our findings point to the need for more research on industrial pricing preferences and practices. First, the dimensions of the three pricing orientations (cost, competition and customer value) need to be articulated and empirically validated. Second, while the marketing literature documents the relationship between market orientation and firm performance, there are no empirical studies on the relationship between pricing orientation and firm performance. Marketing scholars and practitioners claim the superiority of value-based pricing, but we so far lack of empirical studies substantiating this claim. Empirically documenting the ROI of the pricing function leads to greater visibility of the pricing function with top executives and makes it easier to justify critical investments in pricing capabilities, systems and methods. Recent academic research undertaken at Pennsylvania State University’s Institute for the Study of Business Markets and at Georgia State University’s Center for Business and Industrial Marketing (Ulaga, 2001) is critical for the pricing profession to create knowledge, to bring documented and tested evidence of their positive impact on firm performance and to educate practitioners.

Systematic Academic Curriculum – Tomorrow’s marketing leaders should be equipped with the most relevant and rigorous academic knowledge on pricing. Pricing should become an integral and systematic part of the marketing curriculum: Currently, only about 9% of business schools offer a course that has a significant emphasis on pricing (McCaskey & Brady, 2006).

Figure 1: Conceptual Model



Greater levels of Innovation in Pricing – Our results show that industrial managers generate hardly any innovation with regards to pricing. Industrial pricing requires innovation, experimentation and specific training programs. Experimentation is an important requirement for the internalization of new pricing concepts, frames of reference, language and forms of interaction. The transformation of pricing orientation requires that the organization learn through a process of experiential learning (Kolb, 1984; Kolb et al., 2001) or through trial-and-error experiments (Pfeffer & Sutton, 2006). Experimentation matters because “it fuels the discovery and creation of knowledge and thereby leads to the development and improvement of products, processes, systems and organizations” (Thomke, 2003: 1).

Collaboration among Academia and Practice – We posit that the profession requires a coordinated and collaborative profession-wide transformation process which involves academia, practitioners, consultants and professional associations such as the Professional Pricing Society. This dialog and collaboration among these parties leads to the definition of a research agenda and common goals for the profession.

Professionalizing the Pricing Function – Joe Podolny, former dean of the Yale School of Management states: “An occupation earns the right to be a profession only when some ideals, such as being an impartial counsel, doing no harm, or serving the greater good, are infused into the conduct of people in that occupation” (Podolny, 2009). The professionalization of the pricing function requires: the establishment of a code of ethics for the pricing community, the development of capability matrices and of formal entry requirements for pricing professionals, pricing governance mechanisms and dedicated career paths for pricing professionals in companies, and emphasis on continuous formal learning. Some of these activities are already underway; much, we feel, remains to be done for pricing to become a true profession.

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