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Editorial: The micro-foundations of pricing

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ABSTRACT

In this editorial we define the core research questions that fall into the domain of this special issue: Research on the micro-foundations of pricing aims to explore how individual traits or individual activities influence pricing activities or performance at the organizational level. As current research and the papers in this special issue suggest, adopting a micro-level perspective is necessary to building better theories: Organizations do not act, individuals do. Understanding the complex causal relationships between individual traits and behaviors and organizational outcomes is of interest to both researchers and managers. It is our hope that this special issue on micro-foundations, on fallible and not easy to model traits, cognition, and decisions, advance the theory and practice of pricing.

1. What are micro-foundations?

Research on the micro level of organizational decision making has witnessed a surge in interest. In a dedicated special issue in the *Strategic Management Journal* (Powell, Lovallo, & Fox, 2011), Levinthal (2011) asks, "a behavioral approach to strategy—what's the alternative?" The *SMJ* Editors state, "strategic management theory lacks adequate psychological groundings" and that "until strategy theory builds stronger foundations in psychology, it will struggle to explain the facts of firm performance" (Powell et al., 2011, p. 1370). Recent developments in finance, organization theory, and strategic management have moved micro-level aspects of decision making solidly within mainstream research. The literature on pricing, however, has not yet dedicated attention to the examination of its micro-foundations, although pricing quite strongly influences company performance (Nagle & Holden, 2002). While arguably journals do publish studies examining aspects related to micro-foundations (Che-Ha, Mavondo, & Mohd-Said, 2014; Mousavi & Kheirandish, 2014; Raghubir, 2006), there is, as of today, no systematic research on the micro-foundations of pricing. This special issue can probably claim to be the first one dedicated exclusively to the micro-foundations of pricing. This exclusivity is not for lack of interest: a call in *Industrial Marketing Management* on "Psychological micro-foundations of business-to-business decision making" is open while this issue is going to press.

Research on the micro-foundations of organizational decision making is based on the following premises (Hodgson, 2012): "Organizations are made up of individuals, and there is no organization without individuals" (Felin & Foss, 2005, p. 441); "Nothing is more fundamental in setting our research agenda and informing our research methods than our view of the nature of the human beings whose behavior we are studying" (Simon, 1985, p. 303); "Strategic management should fundamentally be concerned about how intentional human action and interaction causally produce strategic phenomena" (Abell, Felin, & Foss, 2008, p. 492). The simple idea is "not only are individuals and ordinary activities important in conferring capabilities their uniqueness, but […] they are in some ways the only relevant things" (Salvato, 2009, p. 397).

Research on the micro-foundations of pricing seeks to understand how individual traits or individual activities influence organizational activities in the domain of pricing or organizational performance. The pricing domain includes determination of list prices, price-setting practices, price realization, price negotiations with customers, freedom to set prices/grant discounts to customers, price flexibility, price communication, value quantification, price perception, information processing on competitor prices, information processing on customers/customer needs, information processing on costs, incentive systems, bonus systems, headquarter support on pricing, CEO championing of pricing, and pricing capabilities.

The interest in the micro-foundations of pricing springs from the simple recognition that organizations do not act – individuals do. As scholars, however, we tend to attribute to organizations properties which only individuals can have. The literature speaks of "organizational capabilities" and describes organizations as "innovative"; however, organizations do not have capabilities, individuals do; organizations

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are not innovative, individuals are. This special issue thus explores how individual characteristics and behaviors affect pricing activities or performance at the organizational level.

2. Micro-foundations in managerial practice

Research on micro-foundations is relevant for management practice and has public policy implications. Two salient examples: First, a current paper examines the factors that explain overall policy choices and the overall risk inclination of banks (Hagendorff, Saunders, Steffen, & Vallascas, 2016). This study finds that, contrary to expectations, remuneration explains only about 4% of bank behavior. Style, i.e. a banker's personality, talent, and work ethic, explains more than half of the variation in bank risk taking during the global financial crisis. Banker personalities seem to drive bank behavior much more than bonuses. This research thus suggests that a reduction in the risk-seeking behavior of banks could be achieved not by more regulation, but by a higher emphasis on individual traits in the process of personnel selection, promotion, and dismissal. Second, behavioral profiling to identify managerial talent is gaining prominence in companies such as McKinsey, Airbnb, LinkedIn, and Deutsche Bank. Dissatisfied with traditional methods – for example, tests, assessment centers, or academic results – of identifying future high potentials and of reducing turnover of new recruits, these and other companies make heavy use of behavioral profiling (Noonan, 2016). Management practice thus has a keen interest in understanding how individual characteristics influence decisions and performance at the organizational level.

3. The papers in this special issue

In total the call for papers for this special section generated 25 papers. Four submissions were desk-rejected. Of the remaining 21 papers seven papers were accepted after three rounds of revision on average. These seven papers all explore how individual traits or individual activities influence organizational activities or organizational performance. We briefly present these papers following the outline below (see Fig. 1).

One paper explores the link between individual-level activities and characteristics and organizational performance. "Value quantification capabilities in industrial markets," by Hinterhuber, explores the behaviors and traits that influence value quantification capabilities, that is, the sales manager abilities to convert competitive advantages into quantified, customer-specific monetary benefits. These behaviors and traits are risk taking and creativity, sales manager questioning style, customer-oriented selling, and cross-functional collaboration. This paper also documents a positive relationship between value quantification capabilities and firm performance. This paper, based on a survey of 131 US sales and account managers in industrial markets, thus contributes to the emerging stream of research on selling and value-based-selling capabilities.

The other six papers examine relationships between individual behaviors and traits and organizational activities, broadly defined. "The micro-foundations of pricing strategy in industrial markets: A case study in the European packaging industry," by Hallberg, examines the micro-foundations of industrial pricing strategy implementation. This paper, based on the analysis of 26 interviews in three European industrial companies, finds that the implementation of pricing strategies is severely constrained by individual-level traits and routines, specifically individual judgment, human capital, and commercial experience. Individuals, the study suggests, strongly matter in the context of pricing strategy implementation. This paper is thus part of a rich and emerging stream of literature that highlights the strategic nature of pricing: strategic, since it encompasses a resource and activity configuration that is valuable, rare, difficult to imitate, non-substitutable, and embedded in a firm's organization (Barney, 1991) and that thus enables the firm to build a competitive advantage and to achieve superior profitability as a result of pricing (Hinterhuber & Liozu, 2012).

The paper "Retailers' and manufacturers' price-promotion decisions: Intuitive or evidence-based?," by Bogomolova, Szabo, and Kennedy, examines how manufacturers and retailers make price-promotion decisions. This paper, based on 34 interviews with managers from European, US, and Australian companies, finds that the manufacturer and retailer decisions to use price promotions are driven heavily by habits and imitation, and much less by a deliberate analysis (e.g., goal setting, identification/evaluation of alternative courses of action, implementation, analysis of actual against expected results, learning and improvement). This paper thus highlights the need to understand much better the role of habits, intuition, or untested assumptions in the context of changing pricing practices. It is a further contribution to the frequently observed price rigidities in practice (Watson, Wood, & Fernie, 2015): habits are difficult to change, and research on how to do so successfully appears highly promising.

The paper "Purchase decision regret: Negative consequences of the steadily increasing discount strategy," by Gabler, Landers, and Reynolds, examines how individual characteristics influence buying propensities in the context of steadily increasing discount strategies. With this pricing strategy, customers have to balance the benefits of savings against the risk of missing out on a particular deal altogether. The study, based on a sample of non-student US consumers, finds that materialism and price consciousness both impact the decision to buy. This study also contributes to the fascinating debate between action bias and its opposite, the omission bias, that is, the preference for harm caused by omission over equal harm caused by action (Baron & Ritov, 2004). In this purchase situation, consumers seem to exhibit an action bias: inaction regret is stronger than action regret. This research thus contributes to the emerging literature on biases in the context of pricing decisions (Hinterhuber, 2015), an area that is bound to attract further research interest.

In "Presenting comparative price promotions vertically or horizontally: Does it matter?" Feng, Suri, Chao, and Koc examine whether differences in presentation of comparative price promotions affect price perceptions. This paper, based on a number of studies with non-student populations, suggests that presenting prices in price promotions vertically leads to faster and more accurate price computations. This paper also suggests that vertical price presentations rely more on visuospatial resources, whereas horizontal price representations rely more on verbal memory resources. This study also sheds light on consumer characteristics – math anxiety – that influence price perceptions. This paper clearly shows the need for more research highlighting the role of psychological traits in influencing price perceptions in both B2C and B2B.

The paper "Value-based pricing in competitive situations with the help of multi-product price response maps," by Dost and Geiger, proposes a method for eliciting empirical willingness-to-pay distributions for several products at the same time. By using individual willingness-to-pay ranges to build price response maps, this paper shows how to set profit- or revenue-maximizing prices for a portfolio of products. It suggests that the multi-product price response maps can be fruitful for a number of marketing and competitive simulations. Multi-product price response maps are thus important pricing tools that can facilitate the implementation of value-based pricing for product portfolios.

The paper "Barriers to implementing value-based pricing in industrial markets: A micro-foundations perspective," by Töytäri, Keränen, and Rajala, examines the micro-level activities that act as barriers to the implementation of value-based pricing. This paper, based on 24 interviews in a single company, identifies three categories of barriers that individuals face when implementing value-based pricing: individually induced, organizationally induced and externally induced barriers. Individually induced barriers: employee attitudes, experiences, and capabilities act as powerful forces inducing employees to stick to cost-based pricing, although employees in other parts of the company successfully implement value-based pricing. Organizationally induced barriers include company culture, processes, tools and customer selection mechanisms. Externally induced barriers include industry norms, the