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# Behavioral issues in price setting in business-to-business marketing: A framework for analysis

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ABSTRACT

Business-to-business pricing research has often focused on developing rational and normative frameworks and models for pricing issues, strategies and tactics. However, there has been less attention given to behavioral models that help us understand the realities of pricing and how managers actually set prices. Specifically, there has been less attention given to the various individual and group influences on the price setting process. We apply insights from a steadily increasing body of literature on behavioral decision making to identify some relevant behavioral issues that may affect managerial price setting processes in business-to-business contexts. We conclude with some implications for theory building and practice and an agenda for future research.

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Research on pricing in business-to-business markets is sparse, though some recent articles have shed light on various aspects of pricing, including supply chain pricing (Voeth & Herbst, 2006), price planning (Lancioni, 2005b), pricing in international markets (Forman and Hunt 2005), and pricing of integrated solutions (Sharma & Iyer, 2011). In addition, recent research has also called attention to the study of value-based pricing (Hinterhuber, 2004) as well as the need to understand the impacts and influences of key managers (Lancioni, Schau, & Smith, 2005), including the CEO (Liozu & Hinterhuber, 2013), on price setting.

While normative frameworks have been suggested in the past for price setting in business-to-business contexts, research has also suggested that managers take decisions that appear to deviate from what could be considered optimal given the application of these frameworks (Kopalle, Mela, & Marsh, 1999; Liozu, 2013; Urbany, 2001). However, what is "optimal" can only be determined from the idiosyncratic environmental and organizational context of the firm as well as the firm's intended pricing objectives. Moreover, while there is some research in organizational buying behavior that contends that individual managers' interpretations and cognitive processes affect purchasing decisions (Barclay & Bunn, 2006; Wilson, McMurrian, & Woodside, 2001), similar research on pricing in industrial markets is only in its infancy. For example, Lancioni et al. (2005) demonstrate that managers often face internal "roadblocks" from within their organizations in the price setting process. On the other hand, Liozu and Hinterhuber (2013) find from their empirical study that CEO championing of pricing activities actually enhances the firm's pricing capabilities and contributes to better firm performance.

Approaching the field of business-to-business pricing from the perspective of behavioral decision making, which contends that managerial cognitive biases are key sources for deviations from optimal decisions, we attempt to understand the impacts of managerial factors on the price setting process. Our primary objective is to build a case for the study of managerial cognitions that could affect the use and application of normative frameworks of price setting. With this objective in mind, we attempt to make three distinct contributions to the current sparse research in the area of managerial influences on business-to-business pricing. First, we extend insights from behavioral research from various disciplines, including behavioral economics, management and behavioral finance, to understand how behavioral issues may contribute to the price setting process. While most existing research on business-to-business marketing focuses on the customer or the purchasing manager (e.g., Anderson, Thomson, & Wynstra, 2000), we place our attention on the manager in the selling or marketing firm. Second, we offer a preliminary framework that contends that managerial issue identification, cognitive biases and heuristics intervene in the price setting process, specifically in the observed outcomes of normative decision frameworks. Prior literature on price setting has shown that managers often use pricing objectives that may not be appropriate given the

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environmental and organizational context (Carricano, 2014; Griffith & Rust, 1997). Also, managers may rely too much on one method of pricing (e.g., the cost-plus method), while ignoring other methods (Nagle, Hogan, & Zale, 2010). Moreover, they may not view pricing as a dynamic strategy that needs to be altered with response to changing contexts (Monroe & Cox, 2001). Finally, given the paucity of behavioral as well as prescriptive research on price-setting in business-to-business marketing, we offer some implications for theory as well as an agenda for future academic research that would enhance our understanding of how managers set prices. In this context, we also offer suggestions and implications that could result in enhanced managerial decision competence and thus, improvements in the price setting process in business-to-business markets.

The rest of this paper is organized as follows. In the next section, we take stock of current research in business-to-business marketing, in general, and pricing in particular, and call attention to understanding managerial factors that could impact the price setting process. We then selectively review the literature on behavioral decision making from various disciplines and identify some factors that may impact price setting in business-to-business markets. We then offer some implications for theory and practice as well as an agenda for future research.

## 1. Understanding managers' impacts on the price setting process

Scholars have proposed several rational and normative frameworks for decision making with respect to prices (see, for examples, Morris & Calantone, 1990; Noble & Gruca, 1999; Oxenfeldt, 1973; Tellis, 1986). Such a normative focus is indeed warranted given that pricing is often viewed by managers in tactical rather strategic terms (Dutta, Bergen, Levy, Ritson, & Zbaracki, 2002), and most managers are daunted by the complexities of developing elaborate pricing plans for their products (Lancioni, 2005b). However, at the same time, researchers are aware that most firms do not always make the correct strategic decisions and in the context of pricing, these could have severe financial implications for the firm (Cudahy & Coleman, 2007; Hinterhuber, 2004; Sharma & Iyer, 2011). In fact, a recent survey revealed that 70% of executives do not believe that their firms have clear pricing strategies (Accenture, 2011). Baker, Marn, and Zawada (2010a) suggest that most firms do not invest in pricing infrastructure and for a Global 1200 company, a one-percent improvement in average prices of services and goods could lead to an 8.7% increase in operating profits.

Researchers have also uncovered that managerial price setting suffers from various issues ranging from selection of inappropriate objectives to misunderstandings of the concept of value and how it relates to price (Hinterhuber, 2004; Hogan & Lucke, 2006; Morris & Calantone, 1990). Moreover, significant opportunities are lost given that even marginal increases in prices could yield significantly more profits as compared to other strategic or tactical actions (Hinterhuber, 2004). Apart from a failure to adjust prices to account for changes in industry demand when pricing through a product's lifecycle (Baker, Marn, & Zawada, 2010b), significant concerns arise when companies set prices lower than what the market could pay (Eugster, Kakkar, & Roegner, 2000). This is because low prices contribute to lost opportunity and in markets that are often inelastic, represent errors that do not, even fortuitously, translate into increased sales. Indeed, there is considerable evidence from practice that errors in pricing may have serious consequences for the organization (Baker et al., 2010b; Eugster et al., 2000; Johansson, Krishnamurthy, & Schlissberg, 2003; Krishnamurthy, Johansson, & Schlissberg, 2003).

Research on pricing in business-to-business marketing had been traditionally inspired by approaches within economics. The primary assumptions are that customers (or, purchasing firm's representatives) use a rational calculus in responding to prices and that marketing firms set their prices rationally with a view to cover costs and achieve broader firm-level objectives. The rational behavior hypothesis has largely remained unchallenged, even though the discrepancies between economic theory and pricing practices have been highlighted in the past (e.g., Hall & Hitch, 1939). In fact, most academic approaches to pricing are either descriptive studies of pricing practices or normative frameworks offering prescriptions on rational price-setting behaviors. What is lacking is a cumulative understanding of the price setting practices followed by firms and the factors that contribute to successful practices (Ingenbleek, 2007).

Since buying decisions in business-to-business markets are taken within an organizational context, it made sense to assume that firms behaved rationally to maximize their own firms' objectives and that the individual decision makers' preferences and tastes mattered very little, given the pursuit of organizational objectives. Similarly, normative models for developing pricing in the business-to-business marketing context are motivated by the premise that marketing firms set their prices rationally with respect to some clear and coherent objectives and after due analysis of the context and circumstances.

Thus, pricing research in business markets has largely ignored the role of the individual manager in pricing decisions and the idiosyncratic impacts they may have on the price setting process. This is in sharp contrast to other areas of business-to-business marketing, most notably organizational buying decisions, where the roles and impacts of individuals and groups are explicitly considered. For example, even the earliest comprehensive frameworks of organizational buying, such as those offered by Robinson, Faris, and Wind (1967), Webster and Wind (1972) and Sheth (1973) explicitly considered the fact that the purchasing manager as well as informal groups within the organization, such as the buying center, played a part in organizational buying decisions. Later research and frameworks have also explicitly recognized the role of buying center groups in various aspects of organizational buying decisions (e.g., Bellizzi, 1979; Johnston & Lewin, 1996; Kauffman, 1996; Kohli, 1989). In contrast to strictly rational economic frameworks, these models consider multiple influences on organizational buying. More specifically, they include individual influences on organizational buying calling specific attention to the organizational buyer's personal values and needs, as in the Webster and Wind (1972) model, and to the buyer's psychological world, as in the Sheth (1973) model.

Webster and Wind (1972) acknowledged that organizational buying may be affected by factors that are not strictly rational and economic. They labeled these influences as “nontask” factors and considered a variety of individual, social, organizational and environmental forces that affected otherwise rational economic organizational buying decisions. In Sheth's (1973) model, expectations and background, among other factors such as differences in information sources, search behaviors, perceptual distortion and satisfaction with past purchases were posited to influence decisions makers in industrial buying. Both these models consider and incorporate deviations from rational economic processes in their accounts of organizational buying.

Apart from the vast body of research on buying centers, there is also research within organizational buying literature on the influence of individual managers on the buying processes and decisions. While some research focuses on the demographics of managers, including their education, experience and position within the organization, there is also explicit recognition of the fact that individual managers may use different decision rules for evaluations, or may frame the decision context differently (Crow & Lindquist, 1982; Qualls & Puto, 1989). Moreover, individual managers may vary in their risk perceptions and how they manage such risks (Hawes & Barnhouse, 1987; Kauffman, 1996; Puto, Patton, & King, 1985). An early review of the organizational buying research also revealed individual managers' personality and motivation have been topics of research on the buying process (Johnston & Lewin, 1996).

More recently, organizational buying research has also focused on subjective evaluations by individual managers and buying centers (Brown, Zablah, Bellenger, & Johnston, 2011; Brown, Zablah, Bellenger, & Donthu, 2012). Specifically, research on perceptions of the business-

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