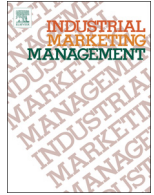




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The general theory of behavioral pricing: Applying complexity theory to explicate heterogeneity and achieve high-predictive validity[☆]

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ABSTRACT

Building behavioral-pricing models-in-contexts enriches one or more goals of science and practice: description, understanding, prediction, and influence/control. The general theory of behavioral strategy includes a set of tenets that describes alternative configurations of decision processes and objectives, contextual features, and beliefs/assessments associating with different outcomes involving specific price-points. This article explicates these tenets and discusses empirical studies which support the general theory. The empirical studies include the use of alternative data collection and analytical tools including true field experiments, think aloud methods, long interviews, ethnographic decision-tree-modeling, and building and testing algorithms (e.g., fuzzy-set qualitative comparative analysis). The general theory of behavioral pricing involves the blending of cognitive science, complexity theory, economics, marketing, psychology, and implemented practices. Consequently, behavioral pricing theory is distinct from context-free microeconomics, market-driven, and competitor-only price-setting. Capturing and reporting contextually-driven alternative routines to price setting by a compelling set of tenets represent what is particularly new and valuable about the general theory. The general theory serves as a useful foundation for advances in pricing theory and improving pricing practice.

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1. Introduction

Strategy theory has converged on a view that the crucial problem in strategic management is firm heterogeneity—why firms adopt different strategies and structures, why heterogeneity persists, and why competitors perform differently.

[(Powell, Lovallo, & Fox, 2011, p. 1370)]

Powell et al. (2011, p. 1371) go on to define “behavioral strategy” as follows: “Behavioral strategy merges cognitive and social psychology with strategic management theory and practice. Behavioral strategy aims to bring realistic assumptions about human cognition, emotions, and social behavior to the strategic management of organizations and, thereby, to enrich strategy theory, empirical research, and real-world practice.” “Merges” is the operative word for describing, understanding, predicting, and influencing behavioral strategy and its sub-fields including behavioral pricing.

The focus on capturing heterogeneity, realism, and the centrality of the merging tenet builds from the behavioral theory of the firm's

perspective that organizations comprise differentiated subunits with conflicting goals, resources, and time horizons (Cyert & March, 1963). Marketing, pricing, and organizational buying strategies are largely political processes within specific contexts; these contexts involve coalition building, bargaining, and conflict resolution among representatives of differentiated subunits with conflicting goals, resources, and time horizons (Cyert & March, 1963; Pettigrew, 1975). However, while including strategy as a political process, behavioral pricing theory goes beyond this perspective to include cognitive science theory and findings especially on how executives transform information into knowledge and how they create and apply useful algorithms (i.e., rules on how-to-decide that usually lead to desirable outcomes) in selecting choices outcomes (e.g., acceptable specific price-points and increases/decreases in prices). Examples of such cognitive science advances in behavioral pricing in business-to-business contexts include the studies by Morgenroth (1964), Howard and Morgenroth (1968), Joskow (1973), Woodside and Wilson (2000), and Woodside (2003). These B2B studies and additional studies in business-to-consumer contexts (e.g., Woodside, Schpektor, & Xia, 2013) support the conclusion that the general theory of behavioral pricing is an insightful and useful blending of cognitive science, complexity theory, economics, marketing, psychology, and implemented practices in explicit contexts.

The core contributions of the present study and the general theory of behavioral pricing include explicating and solving the principal dilemma for advancing theory and research on behavioral pricing—that is, the need to generalize beyond the individual case and the need for

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specificity (reporting the nitty-gritty details necessary for deep understanding that captures the requisite complexity/heterogeneity within the individual case). Solving the dilemma includes embracing several steps possible but rarely taken-in-combination in pricing research; these steps include going into the field to perform “direct research” (Mintzberg, 1979) and embracing the major tenets of complexity theory (Byrne, 1998, 2005; Manson, 2001; Simon, 1962; Urry, 2005). The major tenets of complexity theory include the proposition that multiple paths lead to the same outcome/price, that is, “equifinality” occurs—alternative asymmetric combinations of indicators (i.e., algorithms) are sufficient but no one combination is necessary for predicting the occurrence of a specific pricing decision. A second tenet: causal asymmetry occurs, that is, indicator configural models that accurately predict a high price-point are not the mirror opposites of the indicator configural models that accurately predict a low price-point. A third tenet: both low and high price-points are antecedents to purchase in different sets of complex antecedent configurations. A corollary to the third tenet: both low and high price-points are antecedents to non-purchase in different sets of complex antecedent configurations. A fourth tenet: no one necessary antecedent condition is sufficient for purchase (e.g., low price alone is insufficient for purchase). A fifth tenet: theorists and practitioners never explicate all necessary conditions; thus, mistakes occur and learning is a continuing process forevermore.

Another complexity theory tenet is that, “Relationships between variables can be non-linear with abrupt switches occurring, so the same “cause” can, in specific circumstances, produce different effects.” (“The Complexity Turn,” Urry, 2005, p. 4). Thus, an increase in customer demand may be an outcome of a price increase “in specific circumstances [contexts]” and an increase in demand may be an outcome of a price decrease in other specific contexts. The same point is relevant for demand decreases and price increases and decreases. The general theory of behavioral pricing includes explicating the specific configural contexts for the occurrences of all four price-demand relationships: demand increases associating with price increases and decreases and demand decreases associating with price increases and decreases.

The complexity turn to behavioral pricing practice and theory includes the tipping-point tenet as Urry (2005) and Gladwell (2002) describe. “Moreover, if a system passes particular thresholds with minor changes in the controlling variables, switches occur such that a liquid turns into a gas, a large number of apathetic people suddenly tip into a forceful movement for change (Gladwell, 2002). Such tipping points give rise to unexpected structures and events whose properties can be different from the underlying elementary laws” (Urry, 2005, p. 5). In behavioral pricing models such tipping points frequently involve replacing a negative with a positive response to one issue in a string (i.e., path or recipe) of questions and answers for a given complex configuration of antecedent conditions. Examples of such “causal complexity” (Ragin, 2000) appear in empirical examples later in the present study.

Following this introduction, Section 2 presents the general theory of behavior pricing in the form of the theory’s major tenets and by illustrating applications of these tenets in industrial marketing and B2B-service contexts. Section 3 describes complementary research methods useful for examining the tenets of the general theory and advancing new tenets. Section 4 discusses limitations in the study. Section 5 offers practical implications for planning and implementing pricing strategies in B2B contexts. Section 6 concludes with comparisons between the microeconomic and rational view of pricing decisions/outcomes and the general theory of behavioral pricing. Section 6 includes implications for further theory development and new research in behavioral pricing.

2. The general theory of behavior pricing

The three major objectives of the general theory include capturing heterogeneity of pricing decisions by marketers and responses to

pricing decisions by customers; building isomorphic models of information-in-use within real-life contexts—of marketing and customer organizations participating in price-setting and price-responding (customer price-responses include evaluating, negotiating, and accepting/rejecting proposal and specific price-points of a vendor); and achieving high predictive validity (accuracy) that includes highly accurate predictions via heuristics-in-use by the vendors and the customers in deciding issues relating to setting and accepting/rejecting products/services for different price-points. Not all pricing researchers value these objectives highly; Joskow (1973) points out that some researchers criticize attempts to construct models of actual decision-making processes. Friedman (1966) argues that it is not a function of economic theory to recreate the real world, but to construct theoretical paradigms that predict well. Joskow (1973) responds to Friedman’s perspective with evidence that current (i.e., symmetric-based) models of regulated firms do not predict pricing behavior very well. “In addition, the value of ‘as if’ models declines as we not only become interested in predicting how firms behave given current structural interrelationships, but begin to ask questions about structural changes aimed at changing the nature of firm responses. For those interested in public policy analysis regarding regulated [utility] industries, a more detailed [nuanced] understanding of firm decision processes, decision processes of regulatory agencies, and their interrelationship appears to be in order” (Joskow, 1973, pp. 119–120). This behavioral theory perspective is relevant for less regulated industries as well—a more detailed understanding is necessary (that is now lacking) of firm pricing-decision processes, customers’ decision processes in evaluating and responding to marketers’ responses to RFQs (request for quotation), and the subsequent process-dynamics—and final price points offered and accepted/rejected.

In his data collection during 1970–1971 on advancing a behavioral theory of pricing in highly regulated firms, Joskow (1972, 1973) did manage to take the necessary step of doing direct research but his data analysis is limited to symmetric testing via regression modeling. The idea of testing for sufficient but not necessary outcomes via algorithm modeling was advocated more than two decades later by McClelland (1998) and advanced substantially by Charles Ragin in several publications including his masterwork, *Ragin* (2008). Asymmetric theory and analysis of Joskow’s (1972) behavioral pricing data await doing. However, unfortunately Joskow (2015) reports that his Ph.D. dissertation (Joskow, 1972) does not include the data and the data are no longer available.

2.1. The most in-depth behavioral pricing study

Unfortunately, the most in-depth, available, behavioral study of firms engaging (i.e., colluding illegally in this case) in setting prices in a business-to-business industry (Eichenwald, 2001) does not provide details with respect to conversations and decisions regarding specific price-points in the price-fixing meetings. Eichenwald (2001) does not report on customers’ responses to the pricing decisions made by the colluding industrial (agricultural chemicals) marketers. The development of ethnographic pricing models using the price-collusion original data set awaits the researcher willing to wade into the court records and the FBI (U.S. Federal Bureau of Investigation) files—the multiple decision processes and outcomes in these processes that are available over a five-year period. Such research on decision processes of price setting and changes in B2B contexts rarely is available but the literature does include example studies (e.g., Howard & Morgenroth, 1968; Morgenroth, 1964; Woodside & Wilson, 2000).

2.2. Capturing heterogeneity

To capture heterogeneity, the general theory of behavioral pricing does not rely alone on the use of written surveys with fixed-point scales and symmetric statistical tests of observable choices by vendors and

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