ARTICLE IN PRESS
IMM-07110; No of Pages 12
Industrial Marketing Management xxx (2015) xxx–xxx
Contents lists available at ScienceDirect
Industrial Marketing Management

# Organizational and institutional barriers to value-based pricing in industrial relationships

Pekka Töytäri [1,*], Risto Rajala [1], Thomas Brashear Alejandro [2]

[1] Aalto University, School of Science, Department of Industrial Engineering and Management, Otaniementie 17, FI-02150 Espoo, Finland
[2] Eugene M. Isenberg School of Management, University of Massachusetts Amherst, 121 Presidents Drive, Amherst, MA 01003, United States

ARTICLE INFO

*Article history:*
Received 2 November 2013
Received in revised form 13 March 2014
Accepted 1 April 2014
Available online xxxx

*Keywords:*
Value-based pricing
Customer-perceived value
Value-based selling
Value quantification
Organizational capabilities

ABSTRACT

In their effort to differentiate themselves from cost-driven rivals, many industrial companies are beginning to serve their customers through value-based offerings. Such companies often engage actively in collaborative value creation with their customers. To capture a fair share of the value created, they need to adopt a value-based pricing approach. Therefore, value-driven competition necessitates value-based pricing (VBP). The present study explores the barriers to exercising value-based pricing and suggests ways to overcome those obstacles in putting value-based pricing into action in B2B sales. The study is implemented as an exploratory multi-case study applying an abductive research methodology. Our cases show that industrial sellers try to understand and influence their customers' desired value perception, influence customer-perceived value (CPV), and improve their bargaining position as means to overcome these barriers to improved value capture. Hence, our findings deepen the current understanding of value-based pricing in industrial buyer–seller relationships. In doing so, it contributes to the literature on customer value, organizational capabilities, business models, and sales management in previously unexplored areas. Moreover, the study provides guidance to business practitioners willing to develop value-based pricing as part of their business model.



## 1. Introduction

Research on business-to-business (B2B) marketing stresses the importance of pricing for every firm's profitability and long-term survival (Lancioni, 2005). Hinterhuber and Liozu (2012) emphasize that price setting requires discipline and should be congruent with other aspects of a firm's marketing strategy. Commoditization of offerings in mature markets and pronounced buyer power might drive price setters toward competition-based pricing or cost-based pricing (Farjoun, 2002; Ingenbleek, Debruyne, Frambach, & Verhallen, 2003), and lead to below-target profitability (Nagle & Holden, 2002). Hence, many industrial firms strive to renew their business models by increasing the number of value-adding activities in their offering portfolios. This renewal fundamentally affects their customer approach and emphasizes customer-perceived value (CPV) as the basis of their business strategies. Previous research suggests that while CPV is generally acknowledged as a necessary basis for business strategy, alone it is not sufficient for capturing value (Bowman & Ambrosini, 2000). Moreover, Blois and Ramirez (2006, 1027) argued that "although firms exist to help customers and organizations to create value, they only do so in order to capture part of that value for themselves."

As more firms adopt value-based business strategies, there is a call for a better understanding of the constituents of a pricing approach to support value capture (Monroe, 2002). Value-based pricing (VBP) is a potentially powerful tool to capture a fair share of the value created (Hinterhuber, 2004, 2008b). Previous research generally holds value-based pricing as a superior method for profit maximization (e.g., Monroe, 2002), and competitive advantage (Dutta, Zbaracki, & Bergen, 2003). However, there seem to be major obstacles in putting value-based pricing into action in business markets. Hinterhuber (2008a) reports that in many surveys of pricing approaches across industries, value-based pricing accounts on average for only 17% of the investigated pricing approaches. Among the reasons why VBP is employed so infrequently is that it features complicated customer specificity, which creates obstacles for marketers. VBP has been described as a sophisticated but complicated approach to pricing in business markets (e.g., Forbis & Mehta, 1981). It uses customer-perceived value as a pricing reference (while cost-based pricing refers to supplier cost, and competition- or market-based approaches link pricing to market prices). CPV-based pricing calls for understanding the sources, dimensions, and outcomes of value. In addition, using CPV as the reference necessitates the assessment of customer value and communication about it with customers. Hence, the following questions are posed: What are the barriers to value-based pricing in B2B relationships? How can suppliers overcome those barriers?

* Corresponding author.
*E-mail address:* pekka.toytari@aalto.fi (P. Töytäri).

http://dx.doi.org/10.1016/j.indmarman.2015.02.005
0019-8501/© 2015 Published by Elsevier Inc.

The purpose of the present study is to explore the barriers to exercising VBP in industrial buyer–supplier relationships, and suggest ways by which sellers can potentially overcome the barriers to adopting VBP for improved value capture. Through an empirical inquiry consisting of a multiple case study approach we analyze companies that have pursued VBP as part of their marketing strategy. Our study is linked to the academic discourse of buyer–seller relationships and builds on the notion that business relationships should be of value to all participants. Wilson and Jantrania (1994, 63) point out that a major issue in the life of a relationship pertains to how value is shared between partners, submitting that "the greater the value created, the greater the issues in sharing the value."

The remainder of this paper is structured as follows. The next section provides a conceptualization of customer-perceived value, value exchange, and value-based pricing to deepen the current understanding of the constituents of customer-perceived value as the basis for value-based pricing. Section 3 describes the research process and the methods used to gather data. The analysis reported in Section 4 follows the abductive research method of a systematic integration of empirical and theoretical knowledge (Dubois & Gadde, 2002) by presenting the findings with links to the relevant literature. The final section discusses the implications for research and practice, synthesizing factors that may impede the use of VBP and behaviors that facilitate it. In addition, we discuss the limitations of the study and suggest some opportunities for future research.

## 2. Customer-perceived value, value exchange, and value-based pricing

### 2.1. Conceptualization of customer-perceived value

In the literature, the creation of customer value is linked with achieving high business performance (Blois & Ramirez, 2006; Gosselin & Bauwen, 2006), long-term success, and survival (Eggert, Ulaga, & Schultz, 2006). Value has a number of attributes. *Value is subjectively evaluated*. It is perceived distinctly by customers (Ramirez, 1999; Vargo & Lusch, 2004). *Value is context-specific*. Customers judge the value in their specific use context (Kowalkowski, 2011), based on the customer's specific business situation, guided by institutional constraints (Zucker, 1987), and behavioral influences (Cyert & March, 1992). The *perception of value is dynamic*. The customer's perception of value may change over time in terms of both the relative importance and the business impact of different facets of value (Flint, Woodruff, & Gardial, 2002). *Value is multi-faceted*. The literature suggests different taxonomies of value, emphasizing, for example, the economic, strategic, and behavioral dimensions (Wilson & Jantrania, 1994); economic, technical, service, and social (Anderson, Jain, & Chintagunta, 1993), or product, service, know-how, time-to-market, and social (Ulaga & Eggert, 2005). The source of value can be a product, a relationship, or the network in which the relationship is embedded, or all of these (Lindgreen & Wynstra, 2005). These attributes of value influence the value perceived by the customer and, hence, influence value-based pricing.

Anderson et al. (1993) define value in business markets as the perceived worth in monetary units of the set of economic, technical, service, and social benefits received by a customer firm in exchange for the price paid for a product offering, taking into consideration the available alternative suppliers' offerings and prices. While, in addition to product-related value, this definition recognizes some elements of relationship-related value, Ulaga and Eggert (2005) defined customer value in business relationships as the trade-off among product, service, know-how, time-to-market, and social benefits, as well as price and process costs in a supplier relationship, as perceived by key decision makers in the customer's organization and taking into consideration the available alternative supplier relationships. Drawing on the above definitions, we define customer value as a four-dimensional construct: *Customer-perceived value is the difference between perceived benefits received and perceived sacrifices made by a customer. Both benefits and sacrifices are multi-dimensional concepts, combining operational, strategic, social, and symbolic dimensions of value.*

The conceptual framework identifies four *dimensions* of customer value: strategic, operational, social, and symbolic. Of note, economic indicators are not among the dimensions of customer value. Instead, economic measures focus on the outcome of customer value-based approaches in terms of operational performance or future-oriented catalysts of change (March & Sutton, 1997). The economic *outcome* is affected by a change in one or more of the following economic performance indicators: an increase in revenue, a higher profit margin (by a decrease in lifecycle cost of operation), a reduced risk of the expected economic outcomes (by improved stability of the operation), or a more efficient use of resources (such as better return on capital invested or more efficient use or process inputs) (e.g., Vitasek et al., 2012).

#### 2.1.1. Operational value

The *operational dimension* of value pertains to the operational performance of a company, and affects processes within the organization and at the organizational boundaries, toward customers and partners. Operational value results in lower operational costs or higher output value, or both.

Operational value is manifested as improved processes, improved process integration, and higher offering value. Processes are improved by better capabilities, resource efficiency, and process input improvements. Suppliers contribute directly to operational value with improved products and components featuring fitness for purpose, conformance, performance, and reliability (Ulaga & Eggert, 2005), product features, and ease of handling (Ritter & Walter, 2012). Relationship-related contributions affect operational performance through knowledge, process development, process outsourcing, process integration, cooperation efficiency, and risk avoidance (Hunter, Kasouf, Celuch, & Curry, 2004). Suppliers may also significantly increase the value of the customer's own offering (Brandenburger & Nalebuff, 1996). Achieving operational benefits incurs adaptation sacrifices, including process changes, competence development, installation, and integration (Ravald & Grönroos, 1996). Operational sacrifices are determined by the total cost of ownership (Anderson, Wouters, & Rossum, 2010; Ferrin & Plank, 2002). Relationship-incurred operational sacrifices include the risk of not actually receiving the benefits due to delays, failures, false promises, and other factors relating to future realization of the value. Relationships also incur governance and relationship management costs.

#### 2.1.2. Strategic value

The *strategic dimension* of value pertains to organizational change and survival. Strategic value involves leveraging existing capabilities or developing new capabilities through learning, know-how (Ulaga & Eggert, 2005), and innovation. Developing new capabilities and absorbing them from the external environment both support innovation for the future. Organizational learning in inter-organizational relationships may have long-haul and strategic benefits through the acquisition of skills and capabilities that improve environmental adaptation (March, 1991). Relationship-related strategic sacrifices include the erosion of own capabilities (Ritter & Walter, 2012), inability to adopt inputs (Cohen & Levinthal, 1990), unhealthy dependency (Williamson, 1991), lock-in, and a potential leaking of proprietary knowledge and intellectual property rights, with rising costs and lost competitive advantage as a result.

#### 2.1.3. Social value

Participation in a supplier relationship or network can influence the external status of a customer in a wider business network by inclusion in a high-image network, prestigious community or strategic alliance (Kothandaraman & Wilson, 2001) bringing, for example, improved legitimacy (Suchman, 1995). The potential benefits include lower cost