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Industrial Marketing Management 34 (2005) 111–114
INDUSTRIAL MARKETING MANAGEMENT

Pricing issues in industrial marketing

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Accepted 31 July 2004
Available online 10 March 2005

Abstract

Developing an effective pricing strategy today is becoming a difficult task for industrial marketing managers. The failure of firms to totally understand the implications of their pricing decisions often leads to missed opportunities and eventually lowers profits. Price setting and implementation are multidimensional processes affecting customers, products, cost recovery efforts, produce margin levels, customer retention, market share, and domestic and international sales. This issue of *Industrial Marketing Management* provides some insights into the complexities of this process for managers by examining pricing on several levels, including the organizational influences on industrial pricing, the factors affecting international pricing, the importance of pricing in controlling supply chain costs, the influence of information on pricing decisions, the degree to which the Internet and reverse auctions are affecting customer relationships with their suppliers, and the importance of developing a strategic pricing plan.

Keywords: Pricing strategy; Auction; Industrial marketing

1. Introduction

Industrial marketing is a field that is challenging and complex. To be successful, a company and its management group must have a comprehensive understanding of what the challenges are and have a well thought out strategy to take advantage of them. The challenges are numerous and include the development and introduction of new products, controlling costs, competitive analysis, responding to competitor market strategies, prospecting for new customers and new market segments, developing long-term relationships with current customers, building, quality, building value and service into the company's product portfolio, and pricing. All of these challenges require that a firm take a strategic view of each area and develop the appropriate plan and implementation program for each one. Unfortunately, one of the areas is often overlooked when it comes to planning and implementation, and that is pricing. The reason for this is that "...price is often the centerpiece of strained relations with a customer; the weapon competitors are using to steal market share; and the source of conflicts within the company as those with the spreadsheets, pro forma income statements,..." (Dolan & Simon, 1996, p. ix) and the lack of accurate cost information in the setting of prices.

Industry managers continually complain that pricing is a headache and not an opportunity for increasing profits. Many firms have "thrown in the towel" on pricing. They blame this on the fact that they "determine (their) costs" but are forced to take their industry margins. They also 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, p. ix).

What are industrial business managers to do to view the price setting process as an opportunity? What is the cause of this frustration in pricing? What are some of the organizational obstacles to setting prices in firms? What are the price setting opportunities firms can take advantage of in the management of their supply chains? How can the departmental conflicts over pricing in industrial firms be over-

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doi:10.1016/j.indmarman.2004.07.009

come? What are the challenges industrial firms must deal with in international pricing? What role does the Internet play in the price setting? Also, what are the impacts of reverse auctions on industrial price setting, and what impact are they having on maintaining customer relationships? Of course, it is not easy to provide simple answers to these questions, but in this issue of *Industrial Marketing Management*, the authors provide some insights into the challenges and opportunities facing industrial pricing managers in the future. They include:

(1) Viewing the supply chain as an opportunity to reduce costs and improve product profit margins through more effective pricing.
(2) A better understanding of the intraorganizational influences on industrial pricing strategies.
(3) The recognition of how to better manage the influence of internal and external determinants on international pricing strategies.
(4) An understanding of how the Internet influences the flow of information between vendors and their customers and the effect it has on pricing.
(5) An understanding of how reverse Internet auctions affect pricing in the management of customer relationships.
(6) The need for the development of a strategic pricing plan to coordinate price setting, tactics, and policy with an effective implementation program.

2. Supply chain management and value pricing

Supply chain systems were for years regarded as simply channels of distribution. From this perspective, the focus of channel management was on making each firm in the distribution channel more efficient and productive. Each firm operated on its own, seeking to make the highest profits and acting independently to price its products and services. With the advent of supply chain management and the concept of a supply system emerging, the perspective of industrial managers changed from one of an "...*intrafunctional* vision, where the focus was on the individual firms in the channel, to an interfunctional view where emphasis is now placed on the cooperation that occurs between firms" (Lancioni, 2000, p. 2). The closer relationships have made customers more value conscious in their purchases from their suppliers and less brand loyal. This has increased the opportunities for more creative pricing strategies and the extraction of higher profit margins in supply chains.

Christopher and Gattorna point out in their article *Supply Chain Cost Management and Value Based Pricing* that profit margin opportunities are decreasing due to the fact that companies are losing control of their costs because of outsourcing. This has limited cost control to "...only those costs that are contained within the four walls of their business entity" (Christopher, 2005). They point out that today's price competition takes place not between companies but between supply chains. (Christopher and Gattorna). The proper view of costs in setting prices has to be "end-to-end," (Christopher, 1992) since all costs in price setting will be reflected in the price of the finished product in the final marketplace.

The authors point out that contract manufacturing has also reduced the degree of cost control of industrial firms. Since cost control is gradually being dispersed throughout the supply chain, it makes sense for a company to seek cost reduction in the wider supply chain. They point out that this can be accomplished by "reducing the cash-to-cash cycle" (Christopher and Gattorna). Another strategy for higher margins is through the alignment of a company's supply chains with its customers' logistics needs, thereby creating more value and more stable pricing (Christopher and Gattorna). By managing and designing supply chains to fit the logistics requirements of customers, including delivery times, packaging types and design, inventory levels, just-in-time programs, warehouse and depot locations, inbound and outbound transportation strategies, and purchasing programs, an industrial firm can set its prices based on the tangible value-added it provides through its supply chains.

3. Obstacles to effective industrial pricing

An important dimension to price setting in industrial firms is the impact that the firm's internal organization and political system, as reflected in interdepartmental coordination and rivalry, has upon price setting (Lancioni, Schau, & Smith, 2005). The authors point out that a company's pricing strategy has a substantial economic impact on the firm in contrast to other financial management options available to it. For example, they present the fact that only a 5% decrease in the average selling price of an industrial product increases earnings-before-interest-and-taxes (EBIT) by an average of 22% (Lancioni et al., 2005). They point out that price setting is difficult given the plethora of internal and external economic political influences that shape a firm's pricing decisions. The authors conducted a study of leading US industrial firms where they examined the departments in companies that make pricing strategy development difficult and identified potential courses of action to overcome the obstacles to the price setting process. The authors discovered that, in a majority of industrial firms, the finance department puts up the most obstacles to effective price setting and execution.

4. Managing international pricing strategies

In developing international pricing strategies, industrial marketing managers typically take into account a wide array of factors that are both internal and external to the firm. A major concern is how managers consider these factors in terms of influencing their final choice of an international pricing strategy. The level of difficulty in formulating an effective international pricing strategy is compounded by the fact that they must consider multiple foreign markets with their own respective cultural, language, and economic, legal, and political differences. The authors point out that an international pricing strategy is influenced by the internal factors of cost levels, profit maximization objectives, ROI levels, and capacity utilization levels. The external influences on international price setting include buyer sensitivities to prices, barriers to entry, distribution infrastructures, and the economic trends in each country.

The balance that industrial marketing managers place on each group of factors in developing and executing international pricing strategies is important. The research "...attempts to assess the determinants that guide managers' emphasis on those factor types...." (Forman & Hunt, 2005). The specific internal factors analyzed in the study include factory utilization levels, internal cost structures, and market rate contribution. The external factors considered in the study include the price sensitivity of buyers, the switching costs incurred by buyers when choosing among the array of products to purchase, and the barriers to entry in foreign markets.

5. Internet information transfer and pricing

The article looks at how increased information transfer shapes pricing strategies through an examination of the levels of coverage and treatment options in the healthcare industry. Under the label of market-driven healthcare, the research centered on the increased consumer participation in healthcare decisions and marketplace responses to more active end-users, specifically treatment availability and cost-containment (Herzlinger, 1997). Developing from the market-driven perspective, a new form of health care benefit delivery has emerged, formerly known as the "defined contribution health plan." Now termed *consumer-driven healthcare*, this model gives consumers choice with respect to healthcare benefits while establishing equilibrium between supply and demand (Maillet & Halterman, 2004). In essence, consumer-driven behavior drives price where quality of an offering is weighed against competing offerings.

The research demonstrated that information transparency is a new reality for industrial markets, and that this information transparency has a dramatic impact on costs and prices as exemplified in the healthcare market. Although this study does strongly support the impact of increased information flow on pricing, it demonstrates that information transparency can both increase and decrease costs with corresponding impacts on prices. In essence, cost and price impacts depend on the nature of the information accessed and the use of the information.

6. Reverse Internet auctions and pricing

Reverse auctions in logistics and procurement have grown dramatically since the advent of widespread Internet usage in the late 1990s. "A literature review indicates that scholars and practitioners are reaching a consensus around a trade-off between the value and benefits of gaining lower prices versus losing long-term relationships with suppliers. Yet at the same time, a quiet evolution has come about in the economics and management literature, opening the way for new more relationship friendly auction designs" (Daly & Nath, 2005). In this article, a series of guidelines and principles are developed that describe how managers may collect the economic pricing advantage of reverse auctions—yet retain the long-term benefits of relationship marketing.

In a reverse auction, "...the buyer creates a request for quotation (RFQ) that describes the details of the requirements and posts the RFQ to the marketplace. Vendors prepare and submit bid packages that include the asking price and other details like their proposed method of handling the project. The buyer typically has several criteria for choosing a bidder, like price, quality, delivery date, and payment terms. Depending on the fit among such criteria, the buyer chooses the best bid...." (Daly & Nath, 2005). The advent of the Internet totally transformed the auction process. "Online auctions differ from their physical counterpart in several ways, like reduced transaction costs for both buyers and sellers; accessibility to more participants by reducing restrictions, such as, geographical proximities; ease of setting the durations of the auction process depending on the product and/or service being transacted; no fixed time of entry for the participants; and the ability to dynamically alter the auction lot size" (Daly & Nath, 2005). Internet auctions even have a phenomenon called *buy-out pricing* that is a declared price at which the auctioneer is ready to forego the auction and sell off the item immediately (Lucking & Reiley, 1999).

The article suggests that it is possible to design auctions more conducive to long-term investments and relationships by subsidizing relational partners, making payments for losing bidders, even renegotiating final contract bid prices and specifications, steps that will improve industrial customer relations and develop long-term channel partnerships.

7. Strategic price planning

Price planning is one of the most overlooked areas in industrial marketing. Traditionally, emphasis is placed on product development, advertising strategy and distribution channel formation before any consideration is given to pricing, The result is that industrial pricing decisions are made quickly without the necessary market and cost factors included in the final decision.

Developing a pricing plan requires that a company commit to a set of objectives, a course of action, an operational strategy, and a set of control and review procedures dedicated to making the management of its pricing process a success. (Lancioni, 2005) Generally, the plan must be coordinated with the other activities involved in market planning that "...consist of analyzing marketing opportunities; researching and selecting target markets; designing marketing strategies; planning marketing programs; and organizing, implementing, and controlling the marketing effort" (Kotler, 2003, pp. 471–472). Putting a pricing plan in place may not be easy due to the many organizational and operational hurdles that exist in a firm. There are two factors that make it difficult to establish a separate pricing plan in a firm: (1) the perception that it is too dependent on the other elements in the marketing mix and (2) the difficulty of establishing a pricing organization in a firm (Cravens, 1997).

The article discusses the principle parts of a general marketing and pricing plan that includes:

(1) A summary of the pricing strategies and recommendations of the company.
(2) An overview of the current market-pricing situation.
(3) A SWOT analysis of the markets the firm is a part of.
(4) The pricing strategy(s) that the firm is currently employing in its market segments.
(5) The pricing objectives that the firm has established to guide its overall pricing strategy.
(6) The pricing programs that will be used to accomplish the pricing objectives.
(7) The monitoring mechanism that will be used to review the results of the executed pricing strategies (adapted from Kotler, 2003).

8. Conclusions

There is a real need for "...managers today to view pricing and price setting as a strategic process and not as a series of quick "knee-jerk" decisions. A short-term perspective of pricing only results in lower sales volumes, lost customers, lower market share, and decreased profits" (Lancioni, 2005). Putting a plan in place will take time because it requires a culture change in industrial firms, but once it is initiated, the long-term benefits will be substantial.

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