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Are pricing policies an impediment to the success of customer solutions?

Arun Sharma [a,*], Gopalkrishnan R. Iyer [b,1]

[a] Department of Marketing, University of Miami, P.O. Box 248147, Coral Gables, FL 33124, United States
[b] Center for Services Marketing & Management, Florida Atlantic University, Department of Marketing, 777 Glades Road, Boca Raton, FL 33431, United States

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ABSTRACT

In an era of declining pricing power and increased global competition, customized solutions appear to be an effective way to build competitive advantages without the debilitating effects of price competition. Solutions involve provision of an integrated combination of goods and services that are designed to meet a business customer's specific needs. Premium prices and higher margins can be extracted by solution providers, who now have considerable incentives to design and market innovative solutions for their customers. We examine the applicability of various pricing frameworks and pricing practices in the context of two industries — business process outsourcing and power generation equipments. Our interviews suggest that firms predominantly use traditional pricing strategies; new strategies for solution pricing are only emerging; and, successful firms are currently using hybrid pricing models. We find that the solutions that we observed among practitioners are not what theory would suggest as true solutions but what would be described by theory as bundled products. We also find that solutions are in the eye of the beholder, i.e., if customers can de-bundle offerings, they are not true solutions. We extend our findings to academic theory and to the practice of developing and pricing solutions.

In the last two decades, increased competition due to globalization and therefore, increased commoditization of products, have led firms in several industries to competitively differentiate their offerings through the development and sales of solutions (Cova & Salle, 2007; Matthyssens and Vandenbempt, 2008; Tuli, Kohli, & Bharadwaj, 2007). Solutions represent a move away from product-centric marketing in an attempt to integrate services into the product within a customer-centric marketing approach (Sawhney, 2006; Sheth, Sisodia, & Sharma, 2000; Vargo & Lusch, 2004). As Evanschitzky, Wangenheim, and Woisetschläger (2011) note: "Solutions are individualized offers for complex customer problems that are interactively designed and whose components offer an integrative added value by combining products and/or services so that the value is more than the sum of the components. Solution Selling is a relational process comprising the definition of the customer requirements, customization and integration of goods and services, their deployment, and post-deployment customer support." A few critical dimensions of solutions, as evolved from prior literature, can be explicated from such a definition. One, solutions involve a high degree of integration of various product components as well as services (Cova & Salle, 2007; Krishnamurthy, Johansson, & Schlissberg, 2003; Sharma, Iyer, & Evanschitzky, 2008). Two, the solution is an offering customized for the customer as compared to a pre-designed and developed offering that needs to be sold (Davies, Brady, & Hobday, 2006; Sharma, 2006a; Tuli et al., 2007). Three, a well-developed solution offered to the customer must be greater in value than its component products and services (Sharma & Molloy, 1999; Sharma et al., 2008).

One important motivation for developing integrated solutions is meeting customer needs more specifically with a resulting increase in revenues, margins, and/or share of customer spending with the solution provider (Sawhney, 2006). However, while there is evidence that several firms are moving from products to offering solutions to their customers (Davies et al., 2006; Sawhney, 2006), it is not clear whether they are able to recoup the additional costs of customization, integration and organizational changes that are pre-requisites to success in solutions selling (Gulati, 2007; Krishnamurthy et al., 2003; Sawhney, 2006). From the customers' perspective, the higher-priced solution should offer benefits greater than what may be obtained from component products and services. Thus, from the solution provider's as well as the customer's perspectives, appropriate prices appear to be critical for solutions selling success. However, extant literature offers little guidance on pricing strategies that solution providers could use or how prices affect customer perceptions of the solution.

In this paper, we examine the importance of appropriate pricing of solutions to solution selling success. We complement a theoretical review with insights obtained from a qualitative study and conclude on the importance of pricing as well as the prevalent practices that may hinder solutions selling success. In the following sections, we review the literature on solutions selling and understand the points of views of both buyers and providers of solutions. We focus on the issue

* Corresponding author. Tel.: +1 305 284 1770.
E-mail addresses: asharma@miami.edu (A. Sharma), giyer@fau.edu (G.R. Iyer).
[1] Tel.: +1 561 297 0917.

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of how solutions could be priced and review extant pricing approaches and apply them to the specific instance of pricing solutions. We then examine pricing practices in two industries — business process outsourcing and utility equipment manufacturing. The data from these two industries suggests that firms predominantly use traditional pricing policies and such policies may be one of the reasons for the lack of success of solution selling. Based on our review and empirical study, we conclude with some suggestions for future research and implications for managers.

1. Imperatives for solutions selling

The growing popularity of customized solutions, in academia and in practice, can be explained by examining the value of solutions for provider and customer firms (Davies et al., 2006; Sawhney, 2006). First, for the seller facing profit erosion due to competition and commoditization (Sharma, 2006b), solutions enable capturing higher margins from added services, including consultancy services (Matthyssens and Vandenbempt, 2008). Second, customized offerings of solutions rather than merely marketing pre-developed products allow for unique customized configurations of products and services for sets of similar customers at costs much lower than developing custom products individually for each customer (Davies et al., 2006; Sheth, Sharma, & Iyer, 2009). Thus, marketers can adopt a "solutions factory" approach by altering and replicating an initial solution developed for one customer for other similar customers (Davies et al., 2006; Sharma & Molloy, 1999). Third, customized configurations of products and services are better insulated from competitive imitations since these configurations involve specific applications of capabilities by the seller that cannot be easily copied by others (Davies et al., 2006). Finally, solution providers can develop competence in offering a broader range of customized solutions, thereby targeting not only diverse markets but also different divisions or applications for the same customer firm. Solution providers could leverage capabilities and existing partnerships with suppliers to target different customer segments (Gulati, 2007). The co-creation of solutions in the buyer–seller network enables embedding the relationship and devising higher value solutions for the customer (Cova & Salle, 2008; Gulati, 2007; Sharma, 2007; Windahl & Lakemond, 2006).

For the customer firm, it has been argued that solutions offered by marketers provide a greater value as compared to the value of components comprising the solution (Sharma et al., 2008). Customer value emerges through the solutions provider's focus on the customer's problems (Gulati, 2007) and development of solutions that not only create new value for the customer (Sharma & Molloy, 1999; Sheth & Sharma, 2006, 2008) but also provide "exceptional value" (Cova & Salle, 2007). Thus, it appears that solutions create a win–win situation where both the selling and buying firms benefit from solutions that are customer-focused and provide new and unique customer value while at the same time, contributing to increased margins and enhanced competitive position for the seller.

2. The implementation of solutions selling

A different reality however, emerges when one considers the fact that the move from products to solutions may not be easy or even, applicable, to many firms and industries (Gulati, 2007; Krishnamurthy et al., 2003; Tuli et al., 2007; Windahl & Lakemond, 2006). Solution selling approaches are particularly apt for situations where there are high degrees of customization along with high degrees of technical integration (Krishnamurthy et al., 2003). The solution provider needs to recover not only the costs of integration but also the additional expenses of understanding each customer's unique needs, the design and development of solutions, and engaging in an organization-wide transformation that is focused on the solution to customer needs (Cova & Salle, 2007; Johansson, Krishnamurthy, & Schlissbert, 2003; Sharma & Molloy, 1999; Tuli et al., 2007). We propose and summarize the solutions pricing imperatives based on the recovery of such costs in Table 1.

Table 1
Pricing imperatives for solutions selling: the provider's perspective.

Solution selling imperative	Pricing challenge	Pricing imperative
Ascertain customer value	Research how solution provides incremental value to customer	Solution price must provide savings in transaction and other costs for the customer; it should be lower than the cost of customer acquisition of necessary skills
Design and develop the solution	Ascertain and apportion costs of technical and commercial integration	Solution price must recover the incremental costs of integration incurred by the provider
Transformation of organizational structure and processes	Consider costs of structural changes, different sales training and longer sales cycles	Solution price must capture cots over duration of the solution
Create a "solutions factory"	Evaluate economies obtained from replicated solutions	Solution price can be set for a pre-determined integration

The greater the degree of customization and therefore, integration, customers may not be able to unravel the solution in terms of its components and thus, the value as well as its intangibility would be the greatest. Otherwise, customers may perceive the solution merely as a bundle of products and/or services (Johansson et al., 2003; Stremersch & Tellis, 2002). As Stremersch and Tellis (2002) emphasize, bundling can take the form of price bundling or product bundling or mixed (both product and price) bundling. While price bundling involves selling two or more products (or services) at a discount, product bundling has no such constraints on price. In price bundling, the integration of products does not create additional value for the customer and therefore, the customer expects a discount on the bundle. Since the provider needs to capture the higher costs of integration and the accompanying organizational-wide transformation to create the solution, perceptions of the solution as merely a bundle would detract from recovery of such costs.

We propose and show in Fig. 1 that when the degree of technical integration is low despite a high degree of commercial integration, buyers would be able to unbundle the solution in terms of its components. Since the customer is now buying a variety of products and services as part of one package, the "solution" is merely a price bundle. Customers may expect a discount for such a price bundle (Stremersch & Tellis, 2002). Thus, in solutions where the degree of technical integration is low, the customer would be reluctant to pay the premium charged by the provider. On the other hand, when there is a high degree of technical integration but low level of commercial

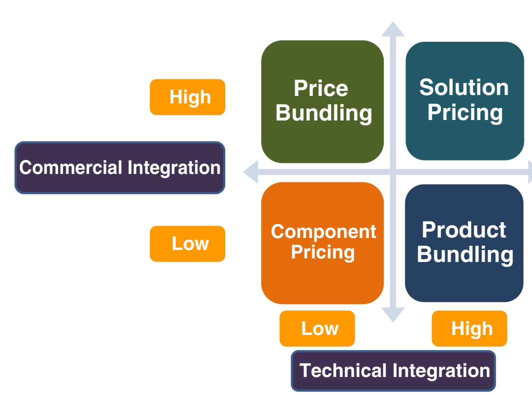

Fig. 1. Levels of integration and customer price perceptions.