Journal of Business Research xxx (2017) xxx–xxx

Contents lists available at ScienceDirect

Journal of Business Research

Barriers to implementing value-based pricing in industrial markets: A micro-foundations perspective

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ARTICLE INFO

Article history:
Received 16 September 2015
Received in revised form 13 March 2016
Accepted 12 April 2016
Available online xxxx

Keywords:
Value-based pricing
Individual barriers
Institutional logic
Micro-foundations
Industrial markets

ABSTRACT

Value-based pricing has the potential to improve differentiation, profitability, and value creation for industrial firms and their customers. However, while most of the pricing research considers the ways organizations set or get value-based prices, only few studies consider how individual managers influence the pricing process and what prevents them from setting and getting value-based prices. This is of critical concern, since it is not just organizations, but individuals within organizations who make pricing decisions—and their decision-making is influenced by institutional pressures such as socially prescribed norms, rationalized meanings, and beliefs about profitable approaches to pricing. This study addresses this gap in the current knowledge by adopting a micro-foundations perspective to pricing, and focusing on the barriers that individual managers encounter when implementing value-based pricing. Drawing on a single case study in a global industrial firm, and from interviews with 24 managers, this study identifies 11 individually, organizationally, and externally induced barriers to value-based pricing. The study also sheds light on the potential sensegiving strategies for overcoming these barriers.

1. Introduction

Product commoditization in industrial markets tends to drive pricing towards cost- and competition-based logics. In addition, the increased sophistication and purchasing power of buyers often lead to decreased margins, and to the diminished profitability of suppliers and service providers (Hinterhuber & Liozu, 2012; Ingenbleek & van der Lans, 2013). Consequently, leading industrial firms are adopting value-based business strategies to differentiate themselves from competitors and stay profitable (Anderson, Narus, & van Rossum, 2006; Keränen & Jalkala, 2014), but currently we still know little about what drives or prevents firms from adopting value-based pricing logics in industrial markets (Hinterhuber, 2008; Töytäri, Rajala, & Brashear Alejandro, 2015).

Prior literature suggests that industrial firms can facilitate the implementation of value-based pricing by developing and deploying corresponding resources and organizational capabilities (e.g., Dutta, Zbaracki, & Bergen, 2003; Johansson, Keränen, Hinterhuber, Liozu, & Andersson, 2015; Töytäri & Rajala, 2015). Given that capabilities are usually deployed through organizational routines and processes (Helfat et al., 2009; Winter, 2003). Recent research has investigated the organizational and institutional barriers that may impede value-based pricing (Töytäri et al., 2015). However, while the existing studies have looked at how organizations can implement value-based pricing, there is limited research on the role of individuals in this process. This is an important gap in the extant literature, since organizations do not implement pricing, individuals do (Hinterhuber and Liozu, 2017; Lancioni, Schau, & Smith, 2005).

In the literature on micro-foundations in strategic management (Felin & Foss, 2005; Hodgson, 2012), it is actors within organizations who are considered to enact temporary habits and practices that may become permanent organizational routines. In other words, such practices may become capabilities vested in the organization. Although many actors perceive value-based pricing as an appealing alternative to the traditional market- or cost-based pricing, sometimes deeply held beliefs among stakeholders may hinder the adoption of value-based pricing (Töytäri et al., 2015). While previous literature has shed light on the roles individuals may play in organizational change, there is a need for deeper understanding of the ways individuals may support or hinder the adoption of value-based pricing.

To fill this gap, this study explores the barriers to the implementation of value-based pricing that individual actors face in organizations. Our empirical study is focused on the intensely competitive industrial business-to-business exchange, where competing institutional logics

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http://dx.doi.org/10.1016/j.jbusres.2016.04.183

typically co-exist (Besharov & Smith, 2014). To address our research objective, we conducted a qualitative single-case study, and interviewed 24 managers in an industrial firm in the metals industry that has made significant investments into implementing value-based selling and pricing strategies.

The findings from this study illustrate different types of barriers to the adoption of value-based pricing, and the corresponding sensemaking strategies that firms can use to overcome those barriers. For scholars, the findings make important and novel contributions to the pricing and micro-foundations literature by illuminating the individually experienced barriers that create resistance to change towards value-based pricing logic, and examining how individual perceptions may influence the implementation of organizational change toward value-based exchange (Hinterhuber, 2008; Powell, Lovallo, & Fox, 2011; Töytäri et al., 2015). For practitioners, the findings provide insights into the ways managers can resolve the intrinsic and extrinsic conflicts of competing logics in their efforts to infuse business models with value-based pricing.

2. Conceptual background

2.1. Alternative pricing logics

Pricing is the key mechanism to share the value created between the customer and the supplier. The value created and the supplier cost define the available range to determine price (e.g., Kortge & Okonkwo, 1993) The literature identifies three types of pricing logic: cost-based, competition-based (or market-based), and value-based (Hinterhuber, 2008). The cost-based pricing logic is based on the calculus of the supplier's own costs as a pricing reference, and adds a target margin to arrive at the price. The competition- or market-based approach monitors the market prices of comparable offerings, and sets the price by focusing on the characteristics of the offering and its competitive position in the market (Liozu, Hinterhuber, Boland, & Perelli, 2012). They are usually the prevailing logics in the mature, commoditized, and goods-exchange dominant industrial markets, and characterized by low price and cost reductions, short-term value capture through increased bargaining power, buyer-driven interactions, and narrow conception of value (Anderson, Narus, & Wouters, 2014; Rajala, Töytäri, & Hervonen, 2015)

Value-based pricing logic, in contrast, is characterized by long-term and service-based exchange, relationship focus, value creation based on a holistic and shared value conception, seller-driven initiation of relationships, and an even power balance (Anderson, Wouters, & van Rossum, 2010; Töytäri et al., 2015). Value-based pricing logic requires a profound understanding of a customer's business model, business drivers, and processes, and ultimately, what customers value, instead of focusing on product/service attributes and a supplier's competitive position. However, despite its potential benefits to supplier–customer relationships, value-based pricing logics are rarely applied in industrial markets (Hinterhuber & Liozu, 2012).

Previous research has explored how value-based pricing can be implemented externally in supplier–customer relationships, and highlighted the role of proactivity, access to key stakeholders, quantifiable value propositions, trust, and differentiated relationships and/or offerings (Dutta et al., 2003; Hinterhuber & Liozu, 2012; Töytäri & Rajala, 2015). However, before an organization's value-based pricing logics can be deployed externally, they need to be adopted internally. Value-based pricing logic is an inherently more complex approach to pricing than cost- and competition-based logics, and requires new capabilities and organizational practices, and changes in a firm's business model and customer relationship management (Liozu et al., 2012; Nenonen & Storbacka, 2010). Essentially, the internal adoption and implementation of value-based pricing requires capabilities to adopt the change (Teece, 2007), capabilities and resources to implement and sustain the change, and a profound change in the firm's institutional logic that shapes its beliefs, attitudes, practices and actions (Thornton, Ocasio, & Lounsbury, 2012).

2.2. Institutional logics and value-based pricing

Institutional logic is defined as a socially constructed set of material practices, assumptions, values, and beliefs that shapes cognition and behaviour (Thornton et al., 2012). In the institutional theory literature, institutional logics have been seen as guiding individual actors' beliefs, attitudes, decisions, and actions. In addition, institutional logics have been suggested to influence the way in which individual actors make sense of their environment and evaluate their decision options on the basis of the underlying schemas of reasoning. The institutional tradition in organization theory views both institutions and organizations as products of common understandings and shared interpretations of acceptable norms of collective activity (Suddaby, Elsbach, Greenwood, Meyer, & Zilber, 2010).

Institutional logics serve as the interpretation schema for individual actors in organizations. As such, they guide the beliefs, attitudes, decisions, and actions of individual actors. Accordingly, individual actors make sense of their environment and evaluate their decision options on the basis of their adopted logic. Institutional theorists have argued that organizational fields are organized by a dominant logic (Reay & Hinings, 2009), and that institutional change is effectuated by a change in the dominant logic. Hence, most scholars explain institutional change as a transition from one dominant logic to another (Townley, 2002). However, a presence of multiple logics within organizational fields and in organizations is common in contemporary business markers (Reay & Hinings, 2009). Different logics may coexist for longer periods of time, blend, or compete, with different consequences for organizations (Besharov & Smith, 2014).

As value-based pricing is linked to the expected benefits to the customer as a pricing reference, it represents a different logic of pricing compared to those that focus on a supplier's own costs of production, or market prices. Value-based pricing has the potential to be favorable to both the buyer and the supplier (Anderson et al., 2010). For buyers, it emphasizes the realized value, and often gives suppliers an incentive to maximize the value created for buyers. For suppliers, it may increase the supplier's share of the customer wallet and the supplier's share of the value created in individual supplier–customer interactions (Terho, Haas, Eggert, & Ulaga, 2012). However, for industrial buyers, the cost- and competition-based pricing logic is the established institutional norm. Mature industrial relationships are characterized by repeat buying, competitive alternatives, and high buyer power. These forces drive prices toward low supplier margins. Industrial buyers tend to perceive cost or market-based prices as fair, and value-based sharing of the value may sometimes be perceived as unfair and greedy. This view is often shared by the supplier's representatives who interact with customers (Töytäri et al., 2015).

2.3. Micro-foundations of pricing

The micro-foundations perspective in strategic management literature asserts that organizational strategies and capabilities are the result of individual actors' activities and behaviors (Felin & Foss, 2005; Hodgson, 2012). That is, the way in which individuals act and behave over time defines and shapes the patterns of collective behavior in organizations, which in turn, are manifested as organizational routines and capabilities (Barney, 1991; Teece, 2007; Teece, Pisano, Shuen, & Wiley, 1997) once they become formalized or the norms of daily activities (Abell, Felin, & Foss, 2008; Alvesson, 2011). The capabilities and routines then cause the firm-level outcomes, such as strategies, business performance, and pricing strategies (Abell et al., 2008; Nelson & Winter, 1982). This means that individual activities, cognitive capabilities, sensemaking, and interpretation, whether intentional or unintentional,