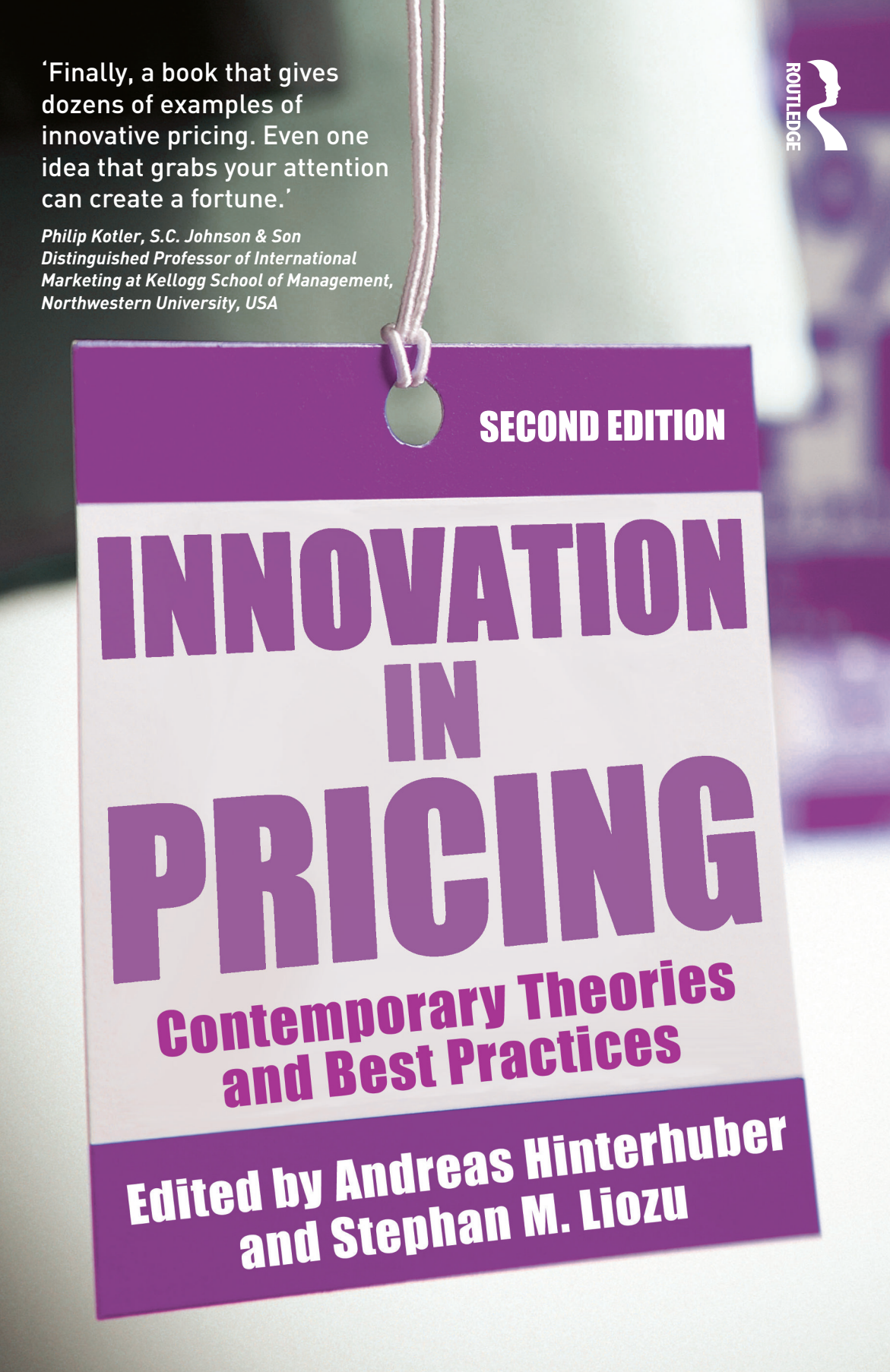
'Finally, a book that gives dozens of examples of innovative pricing. Even one idea that grabs your attention can create a fortune.'
Philip Kotler, S.C. Johnson & Son Distinguished Professor of International Marketing at Kellogg School of Management, Northwestern University, USA
ROUTLEDGE
SECOND EDITION
INNOVATION IN PRICING
Contemporary Theories and Best Practices
Edited by Andreas Hinterhuber and Stephan M. Liozu

Innovation in Pricing

Pricing has a substantial and immediate impact on profitability. Most companies, however, still use costs or competition as their main basis for setting prices. Product or business model innovation has a high priority for many companies, yet innovation in pricing received scant attention until the first edition of this groundbreaking book.

This new edition of *Innovation in Pricing* builds on the success of the first, examining the ways in which pricing innovation can drive profits through cutting-edge academic research and best practice case studies from leading academics, business practitioners and consultants in pricing.

The second edition has been fully revised and updated according to the latest developments in pricing, with:

- revisions to all chapters
- new chapters, including a chapter on business model and pricing model innovation
- a new introduction that makes explicit just what strategic pricing can do for your organization.

This book is the only book dedicated to innovation in pricing and is an essential read for business executives, innovation managers and pricing managers wishing to treat innovation in pricing as seriously as they treat product, service or business model innovation. It is also valuable supplementary reading for advanced students of marketing and sales.

Andreas Hinterhuber is a Partner of Hinterhuber & Partners (www.hinterhuber.com). He is also a visiting professor at the University of Bolzano, Italy. He has led consulting projects in pricing in B2B and B2C companies worldwide, including Lufthansa, Tieto, International Paper, Continental, SPX, Fercam, Swarovski and many others.

Stephan M. Liozu is Chief Value Officer of the Thales Group (www.thalesgroup.com). He is also an Adjunct Professor and Research Fellow at the Case Western Research University Weatherhead School of Management, USA. He is a Certified Pricing Professional (CPP), a Prosci certified Change Manager and a Strategyzer Business Model Innovation Coach.

Innovation in Pricing

Contemporary Theories and Best Practices

Second Edition

Edited by Andreas Hinterhuber and Stephan M. Liozu

Routledge
Taylor & Francis Group
LONDON AND NEW YORK

1 Innovation in pricing
Introduction

Andreas Hinterhuber and Stephan M. Liozu

Few companies treat innovation in pricing as seriously as they treat product or business model innovation. One key objective of this edited volume is to raise the importance of innovation in pricing, both in academia as well as in the industry.

A historical perspective on innovation in pricing

Five decades ago, in 1968, Elizabeth Marting edited the book *Creative Pricing*. This book is a collection of papers by 19 scholars and pricing practitioners on creative pricing approaches. The book covers the following topics: the role of pricing, pricing policy and objectives, nonfinancial aspects of pricing, pricing by distribution channel, pricing by product type, the use of computers in pricing and management of price changes. In the foreword, Elizabeth Marting comments (Marting, 1968: 5): "It is the thesis of this book that with sound planning, flexible techniques, and adequate support, pricing can be made to have a positive, productive impact on company profits; in short, that it can be creative." We agree. Pricing can and should be a topic of innovation and creativity.

In the first chapter, Oxenfeldt suggests (Oxenfeldt, 1968: 9), "The notion that pricing can be creative is itself quite creative and new." For decades, research in pricing has been dominated first by economic theory and later by cost accounting. We conjecture that price strategists and price setters have the opportunity to be creative, although "it runs counter to the writing and thinking of most economic theorists" (Oxenfeldt, 1968: 10).

The questions raised 50 years ago are still valid. The answers as to what constitutes an innovation in pricing have changed.

What is innovation in pricing?

Innovation in pricing regards instances in which companies innovate their pricing strategies, tactics or organization, or where companies use an understanding of consumer psychology to change customer perceptions of value and price in order to jointly increase profits and customer satisfaction (Hinterhuber & Liozu, 2014). The premise of this book is that most managers spend a disproportionate amount of time and resources on product or business model innovation while essentially

neglecting innovation in pricing. This book aims to change this by offering a collection of best practices and relevant research on innovation in pricing.

Contents overview

This book is the result of a rigorous selection process of the most insightful papers dealing with innovation in pricing. Our initial call for papers generated a high interest from both academia and pricing professionals. Ultimately, over 50 papers were submitted for review. After a review process we selected 25 papers. For this second edition, we added 3 and eliminated 5 chapters from the original first edition. They are organized in four sections: innovation in organizing the pricing function, innovation in pricing strategy, innovation in pricing tactics and, finally, psychological aspects of pricing.

Andreas Hinterhuber and *Stephan Liozu* provide a roadmap for innovation in pricing (Hinterhuber & Liozu, 2014). The authors identify a total of 21 alternative approaches of how companies can implement innovation in pricing strategies, in tactics and in the organization of pricing. Each of these approaches is illustrated with a short case study or example. This roadmap starts with a simple premise: about 95 percent of companies do not engage systematically in pricing innovation. Most companies invest heavily in product innovation and essentially neglect innovation in pricing. This is an error. The benefits of this roadmap are straightforward: by implementing two to three approaches of innovation in pricing strategy, tactics or organization companies can, this research suggests, substantially increase profits and customer satisfaction conjointly via pricing. This is the ultimate hallmark of an effective pricing strategy.

Innovation in organizing the pricing function

Stephan Liozu and *Kellie Ecker* examine options for the organizational design of the pricing function in firms. They conduct a literature review on centralization and decentralization. Four possible designs of the pricing function are proposed: centralized, decentralized, center-supported and center-led. The authors conjecture that center-led pricing, which combines elements of centralization with elements of decentralization, is superior to other organizational designs. The authors also present their own research on the effectiveness of center-led pricing. The authors hope that these research findings contribute to the ongoing debate on organizational design of pricing for performance.

Niklas Hallberg and *Linn Andersson* investigate the organizational barriers that prevent companies from implementing innovative pricing strategies, such as value-based pricing. This research, based on two case studies, identifies two main barriers: excessive decentralization and sales force incentive schemes. The authors also discuss how firms address these challenges: centralization of pricing authority and increased sales force control and training. The results of this study indicate that innovation in sales-force management and, more specifically, centralization of pricing authority are key success factors for the implementation of

value-based pricing through customer value map analysis, especially when sales force value-based pricing and value-based selling capabilities are not yet fully developed. Examining this interaction effect between decentralized pricing capabilities and the effectiveness of centralizing pricing authority is certainly worthy of future study.

Stephan Liozu, *Andreas Hinterhuber*, *Sheri Perelli* and *Toni Somers* explore the topic of the role of top executives in supporting and leading corporate pricing activities and programs. The authors report the results of a quantitative inquiry with 557 CEOs and business owners of firms from around the globe examining how CEO championing of pricing affects pricing capabilities and firm performance. The authors propose a structural model, which includes first- and second-order measurement models. The results suggest that the level of championing from CEO and business owners in pricing positively influences firms' decision-making rationality, pricing capabilities, level of collective mindfulness and pricing orientation, thereby leading to significantly higher firm performance. This study is thus a strong call to action for CEOs aiming to improve organizational performance. The main implication: champion the pricing function.

Ronald Baker and *Stephan Liozu* conjecture that the nature of senior management is changing. Firms face strong levels of competitiveness, and their business models are being challenged as a result. The authors suggest that value management at the organizational or corporate levels is becoming a number-one priority. Although chief marketing and chief commercial officers are highly qualified to manage value processes, they do so along with performing a multitude of other functions or processes that distract their attention from the core function of value management. The authors propose that chief value officers, whether functionally or process-oriented, offer CEOs an expert and an ally dedicated to leading value strategies and processes at the organizational level. With their expertise, drive and dedication, they manage business value centrally and make sure that all firm processes and functions are aligned to create, quantify and capture value. This focused attention on value leads to a transformation of the firm's DNA and the adoption of business value as the firm's *raison d'être*.

In an interview *Andreas Hinterhuber* and *Todd Snelgrove* explore how a Vice President of Value can drive profits in industrial markets. This emerging, fascinating and demanding position requires, of course, customer value quantification and documentation, creating case repositories of quantified value, capturing the voice of the customer for marketing and new product development and maintaining the organizational momentum in value-based pricing and selling. Value quantification is demanding; few companies excel at this capability. Among the not yet fully resolved questions is the issue of how to quantify the value of intangible elements in B2B, such as the value of relationships, brands or expertise. Quantifying intangibles, the authors suggest, essentially means translating intangible elements into tangible features that customers value.

Mark Stiving examines the difficult topic of measuring return on investment (ROI) for pricing systems investments (Liozu & Hinterhuber, 2014). The author clarifies the benefits of using IT-based pricing systems by explaining their three

biggest capabilities (execution, analytics and science) and the types of data typically used by these systems: customer master, transaction data, waterfall data and competitor pricing. The benefits of using IT-based pricing systems can be found in increased margin, increased win rates, more opportunities, lower costs and reduced liabilities. Finally, attention is paid to the set of steps to incorporate all these elements in an ROI study.

Innovation in pricing strategy

Stephan Liozu and *Katie Richardson* examine the role of business model innovation in the context of innovation in pricing. The authors highlight that innovation in pricing requires effective market segmentation, customer value quantification, change management, sales force training, management of distribution channels and an understanding of how to integrate new pricing models with legacy pricing structures. Finally, new pricing models should be tested before implementation.

Rafael Farrés further investigates the role of customer value-based pricing in industrial companies. The author makes it clear that even research-intensive, innovative companies should adopt a variety of alternative pricing strategies across their product and service portfolio. The author highlights firm and environmental conditions that make value-based pricing particularly suitable and illuminates under which conditions cost- and competition-based pricing approaches are appropriate for industrial firms. The author also presents a series of pricing tools that have enabled industrial companies to implement value-based pricing strategies: the price waterfall, the price-value map, turnover build-up, terms and conditions analyzer, the pricing explorer and the price-volume scatter plot. Especially for practicing executives at the beginning of the transformational journey towards value-based pricing, the discussion of these pricing tools and metrics will be useful.

Linda Trevenen proposes a grounded and practical essay on the art and science of customer segmentation, which she refers to as the heart of a profitable market strategy. In this chapter, she suggests that grouping customers based on what they value enables a firm to provide distinct offerings and prices to each of these customer groups. However, too often, many firms do not make the effort to segment their customer base or simply fall back along traditional segmentation lines – demographic or geographic – because these data are available and require minimal effort to distinguish between customer types. As a result of not applying a deeper needs-based segmentation, the firm is faced with price variability, lack of adherence to contracts and a culture of 'giving in'. The author makes a few recommendations that smart firms can apply for better customer segmentation: set boundaries and fences, create pricing policies and have a deeper level of customer understanding that leads to profitable growth. This chapter explains the importance of segmentation and the strategies and practical activities for deploying it, and it describes how to implement segmentation best practices into the organization so that a segmentation strategy realizes greater profitability.

Ralf Drews conjectures that, in many companies, the 'value-based pricing' of a new product offering is applied only after the product has passed all design stages in R&D. In addition, often the pricing approach is focused only on the

offering itself. Although it seems to be common practice, the author argues that this approach has major disadvantages. First, the pricing is neither considered nor made in the context of a company's other important value contributors. Second, the value of the product's features is unclear because they are not seen in the context of application. Last but not least, the new product is not tailored to the needs of a specific customer profile or to cultural buying preferences. If companies seek to create a product with superior value, it must be defined and priced before R&D even knows what it will look like. Furthermore, it is critical that the buying psychology of a specific customer be taken into account. In this unique chapter, the author describes how companies can achieve this and which critical success factors are necessary for this uncommon but useful approach.

Magnus Johansson investigates the role of pricing capabilities and processes in fast-paced B2B firms. Extant theory treats the two processes of value creation and value capture (i.e. pricing) separately. This chapter suggests departing from this conceptual separation when dealing with pricing and value creation processes in fast-paced business environments, such as the semiconductor industry. In these environments value creation and value capture are iterative and intertwined, value is co-produced together with customers, and there is a high uncertainty around the total value jointly created between the supplier and the firm. This chapter suggests that, in these circumstances, pricing processes have to be iterative as well and that price-setting authority has to be more localized. The contribution of this chapter is thus a sketch of required pricing capabilities and processes in highly dynamic environments, which are markedly different from capabilities and processes described by extant research in static environments.

David Dvorin, *Jered Haedt* and *Vernon Lennon* address one of the critical elements of the mergers and acquisition process: improvements in pricing. The authors propose a robust framework for assessing opportunities of improving pricing during the mergers and acquisition process; they also highlight how to implement price increases during this process. The authors finally summarize the impact of price improvements on the enterprise value of merged or acquired businesses.

Nelson Hyde discusses four widely held pricing myths. Pricing managers seem to believe that lower prices lead to higher volumes, that customers are price-sensitive, that prices have to be set at prevailing market prices and that lower prices increase the likelihood of closing the sale. These assumptions are, as this chapter suggests, myths that prevent companies from creating and communicating customer value and from implementing value-based pricing. Overcoming these myths thus enables companies to adopt customer value-based pricing strategies.

Todd Snelgrove traces the past and present of total cost of ownership (TCO) approaches and highlights in which direction TCO could evolve. As the 'sum of purchase price plus all expenses incurred during the productive lifecycle of a product minus its salvage or resale price' (Anderson & Narus, 2004), this approach is exclusively concerned with the cost side of customer value and neglects the value of customer-specific benefits (Anderson & Narus, 2004). In this chapter the author shows how TCO approaches can be expanded to incorporate the value of customer-specific benefits. Through case studies, this chapter illustrates the

difference between lowest initial purchase price, lowest TCO and an expanded view of TCO that includes the sum of all customer-specific value created. This chapter also highlights the importance of communicating the price and value premium in industrial markets. The contribution of this chapter is thus to illuminate that TCO can be compatible with customer value-based pricing.

Fernando Resende discuss how to optimize profitability through pricing in an environment where prices are negotiated. This chapter illustrates how suppliers of complex projects can reduce their own costs through scope optimization and service-level adaptations. This chapter also suggests ways to avoid price leakage through discount optimization and through a shared understanding of future required volumes, service levels and price developments.

Innovation in pricing tactics

Customer value communication is an integral element of pricing tactics. *Christopher D. Provines* analyzes a series of different value-communication tools in business markets. These tools differ by interactivity and complexity. Non-interactive tools are economic benefit claims that are developed based on observational studies or customer interviews. Interactive tools are decision-support analytical models such as ROI tools and value calculators. Complex interactive tools are workflow and business-model studies. This chapter then suggests using different value communication tools depending on the degree of outcome risk and the complexity of the product offering. In sum, this chapter offers an up-to-date summary of case studies and recent research on innovative ways to communicate customer value in B2B markets.

Harry Macdivitt reinforces the fact that understanding, using and communicating the value created for their customers is a challenge for many businesses. He claims that this results in an inability to respond assertively and confidently to customer demands for deep discounting. Margin erosion, premature commoditization and loss of market share follow. At the heart of the issue is the lack of a unifying framework for analyzing, quantifying and communicating value. In this chapter, the author introduces a framework for analyzing customer value. He illustrates the application using two contemporary case studies. The author claims that the proposed tool led to new insights and the creation of deeper, richer and more focused customer value propositions. This structured approach thus facilitates the implementation of customer value-based pricing.

Neil Biehn and *Craig Zawada* examine alternative approaches to measuring customer willingness to pay. The quantification of customer willingness to pay is clearly at the center of effective, profitable pricing strategies. The authors critically examine alternative approaches to measuring customer willingness to pay in industrial markets. The authors then illustrate the importance of measuring customer willingness to pay in five specific B2B pricing models: spot pricing, agreement or contract pricing, list or matrix pricing, subscription pricing and promotional pricing.

Steven Forth highlights the role of collaboration and conversations between stakeholders to implement innovative pricing approaches. Traditional pricing-management software is based on the analysis of transactions and its use has been limited to quantitatively oriented pricing experts. In this chapter, the author describes software for quantifying customer value. The software quantifies customer value to enable collaborative processes around the pricing of B2B goods and services in negotiated markets. Collaborative approaches facilitate customer value quantification. The author suggests that in the future, pricing will need to draw on and support a more diverse group than in the past.

The sales function has a fundamental role in the process of communicating and delivering value to customers. *Mike Moorman* proposes a sales-effectiveness framework composed of three parts to implement value-based selling. First, an analysis of competitors, customers and markets delivers customer insight. Then, the go-to-market-strategy is built on a segmentation strategy, a value-proposition strategy, a channel strategy and a robust sales process. Finally, operational excellence aligns sales resources, sales force capabilities, motivation, tools, marketing programs and sales support tools to implement value-based selling vis-à-vis customers. The key feature of this chapter is a structured approach blending customer, company and competitor insight (Hinterhuber, 2004) to implement value-based selling.

Psychological aspects of pricing

Ben Lowe, *Julian Lowe* and *David Lynch* provide a comprehensive overview of behavioral aspects of pricing. Behavioral economics has now definitely entered the mainstream research in management. In a recent special issue of the *Strategic Management Journal* (Powell et al., 2011), Levinthal (2011) asks the question, "A behavioural approach to strategy – what's the alternative?" Research examining behavioral and psychological aspects of pricing seeks to understand how customer perceptions of value and price are formed. Consequentially, the chapter analyzes the following salient aspects of behavioral pricing: factors driving customer value perceptions, the role of internal and external reference prices, fairness perceptions in pricing, implications for price reductions (e.g. discounts, coupons, free gifts) and price increases, price endings, price quality perceptions, consumer price knowledge and, finally, price setting in nonmarket contexts. This chapter emphasizes that customer willingness to pay is driven by both utilitarian value ("economic utility") and psychological value ("psychological utility"). As pricing and marketing managers gain an improved understanding of factors driving psychological value, their ability to set profitable prices also increases.

Carmen Balan specifically examines research on odd prices. Odd prices (e.g. 99 cents) have a long history. In 1965, the retailer Dave Gold discovered that charging 99 cents for all bottles of wine increased sales of all bottles, including those that previously had cost 89 cents or 79 cents. He exited the liquor business and became a highly successful entrepreneur after launching the 99 Cents Only

chain of stores (Porter, 2011). This chapter summarizes current research on odd prices, which points out that odd prices lead to increased demand due to both a level effect (i.e. customers underestimate prices) and an image effect (i.e. the product appears to be on sale). Odd prices still seem to work, although most of what we know stems from research in consumer-good markets. This chapter suggests both an increased use of odd prices in industrial markets as well as further research examining the effects of odd prices in B2B environments.

The next frontier in pricing

The final chapter in this collection is by *Kevin Mitchell*. This chapter highlights the evolution of the pricing profession over the past three decades. Pricing evolved from a clerical position to a tactical, commercial function to, finally, a C-level function deeply aligned with – and in many cases driving – company strategy. The author highlights the reflections of the Professional Pricing Society on critical elements for the future of the pricing function.

As the editors of this book, we have been honored to work with highly talented pricing practitioners and scholars from around the world. We feel blessed by the level of innovative and creative thinking that we have been able to bring to the surface by giving these experts an opportunity to share their thoughts, approaches and views. We thank all authors for their contributions to and participation in this exciting project.

It is our intention to contribute to the future evolution of the pricing profession. We are dedicated to making pricing gain the respect it deserves and to transforming the perceptions of pricing from a pure analytical and static science to a more strategic, innovative and impactful element of the marketing mix. Please join us in our journey to advance the pricing profession.

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2 Is innovation in pricing your next source of competitive advantage?[1]

Andreas Hinterhuber and Stephan M. Liozu

Is product innovation is a top priority for you? You certainly are not alone. Have you tinkered with your company's business model and considered business-model innovation? Great, but your competitors have done this already, and your customers may even expect it. But what about another area that is less recognized but yet a crucial factor in product innovation: innovation in pricing? Could it be your next source of competitive advantage? As a result of a series of interviews with CEOs and top management and after researching pricing practices at leading companies in the U.S., Europe and Asia (see "About the Research"), we estimate that less than 5 percent of companies have applied innovation to their pricing strategy, tactics or organization. Our research also shows that companies that implement innovation to their pricing activities significantly outperform their competitors. Thus, chances are good that innovation in pricing is your next and most powerful source of competitive advantage.

Based on our research, we develop a framework for action to kick-start innovation in pricing. This roadmap is a unique overview for both understanding current global best practices of innovation in pricing and for guiding organizations to successfully implement innovation in pricing. The roadmap, which lays out more than 20 possible avenues for innovation in pricing, will offer any organization, regardless of size, industry or nationality, a few key ideas on innovation in pricing. Our research suggests that this is enough. Many highly successful companies – Zipcar and Salesforce.com to name a few – have built their competitive advantage essentially around one, and only one, pricing innovation.

In this chapter, we first define innovation in pricing and discuss why it is too often neglected. Then, we develop our roadmap for action. Following that, we delve into the essence of the framework by showing how using innovation in pricing strategy, pricing tactics and pricing organization can lead to superior profits and increased customer satisfaction.

What is innovation in pricing?

Most companies, unfortunately, view pricing as antagonistic, a win-lose relationship with customers. What one party gains the other loses, or so goes the weakly held assumption. Our research shows innovation in pricing helps to break this

vicious cycle. Such innovation brings new-to-the-industry approaches to pricing strategy, pricing tactics and pricing organization with the objective of increasing customer satisfaction and company profits. As we show throughout our examples, the joint increase of company profitability and customer satisfaction constitutes the hallmark of innovation in pricing.

The experience of General Electric illuminates the importance of innovation in pricing. In the past the company was selling aircraft engines to airlines at or below cost in the attempt to recover profits through non-transparent maintenance contracts. Customer satisfaction was low-service contracts were expensive and capital outlays were high. GE struggled to bridge the gap between its own capital outlays and cash inflows. Innovation in pricing enabled the company to overcome both problems. Instead of selling jet engines, GE now sells "power by the hour," that is, usage rights to jet engines that include maintenance and spare parts. Customers pay only when the aircraft is flying and thus earn money. In contrast to maintenance contracts, GE now has every incentive to ensure that the jet engines perform. As a result, profits, as well as customer satisfaction, increase dramatically. In a very similar vein, the success of companies, such as Salesforce.com or Zipcar, is not based on product innovation but rests solidly on innovative approaches to pricing. Salesforce.com does not sell software but licenses usage rights to customers who appreciate the advantage of tying payments to usage intensity. Contrast this with traditional software pricing where customers pay a fixed fee regardless of the benefits experienced. Similarly, Zipcar's success in the car rental industry is not due to better vehicles or improved customer service, but lies predominantly with the company's pricing schemes, which give customers the option to pay for rental cars on a much more flexible basis – by the minute.

Innovation in pricing is thus already a source of competitive advantage for a small number of leading companies. It is less about numbers and much more about the appropriate model that will enable a company to grow profitably while at the same time providing superior customer satisfaction. If innovation in pricing is such a powerful tool to drive profitability, why are so few companies embracing it?

Why innovation in pricing is not a priority

Our research suggests that product or service innovation is a top-management priority for close to 100 percent of companies. But only 5 percent of companies introduce new-to-the industry pricing innovations. During our interviews, we find only one case of a company that has implemented an innovative pricing strategy. This company, a B2B equipment company, has, like GE and its "power-by-the-hour" approach, shifted from selling products to charging customers a given fee that reflects the enhanced productivity realized and which includes service, maintenance and performance guarantees. This new approach propels the company from an also-ran to an industry leader in terms of customer satisfaction, growth and profitability.

As interesting as this single case may be, it is an exception. The typical answer to our question of whether the company has engaged in any form of innovation in pricing is "No, we have not introduced any innovation in pricing." Many executives, who are frequently true pioneers in other fields, such as product innovation, marketing, finance or talent development, seem to hold the following weakly held conviction: "Pricing did not change that much over the past decade. Why should it change now?" This conviction may have been nurtured in part by the fact that, with the exception of a few pioneering studies (e.g. Hewitt & Patterson, 1961; Hinterhuber & Liozu, 2013; Nagle, 1983), academic research in this area is still scarce.

We contend that it is a mistake to underrate the position of pricing as enabler of innovation. Powerful advances in information technology as well as emerging dynamics in customer behavior are dramatically changing what is possible in pricing. Our research suggests that the following roadmap can provide a strong framework to guide innovation in pricing.

Roadmap for innovation in pricing

This framework (Figure. 2.1) starts with a simple premise: About 95 percent of companies have not systematically engaged in innovation in pricing. For these companies, pricing strategy is largely based on competition- or cost-based pricing, and pricing tactics are limited to discounting. Furthermore, these organizations do not have a dedicated function – for example, a chief pricing officer responsible for improving price setting or price-getting capabilities. The essence of the framework is the three key areas that our research suggests are critical in approaching any pricing innovation – strategy, tactics and organization. This framework should be used as a canvas for executives to facilitate the plotting of their current pricing practices. More importantly, by mapping out the universe of best-practice innovations in pricing, this canvas encourages executives to consider alternative approaches to pricing. Next, we break down the essential elements of the framework and look at innovation in pricing strategy, tactics and organization.

Innovation in pricing strategy

Good-better-best market segmentation

One way to implement innovation in pricing strategy is to move from a one-size-fits-all pricing policy to a policy with multiple price and value configurations, reflecting differences in value creation for different market segments. Good-better-best market segmentation offers customers a large number of products at different price points in order to address a broad array of customers having large variations in willingness to pay. Allstate, one of the most profitable auto insurance companies, is able to successfully compete against no-frills Internet competitors through a policy of price and value segmentation. Depending on the customer's brand/

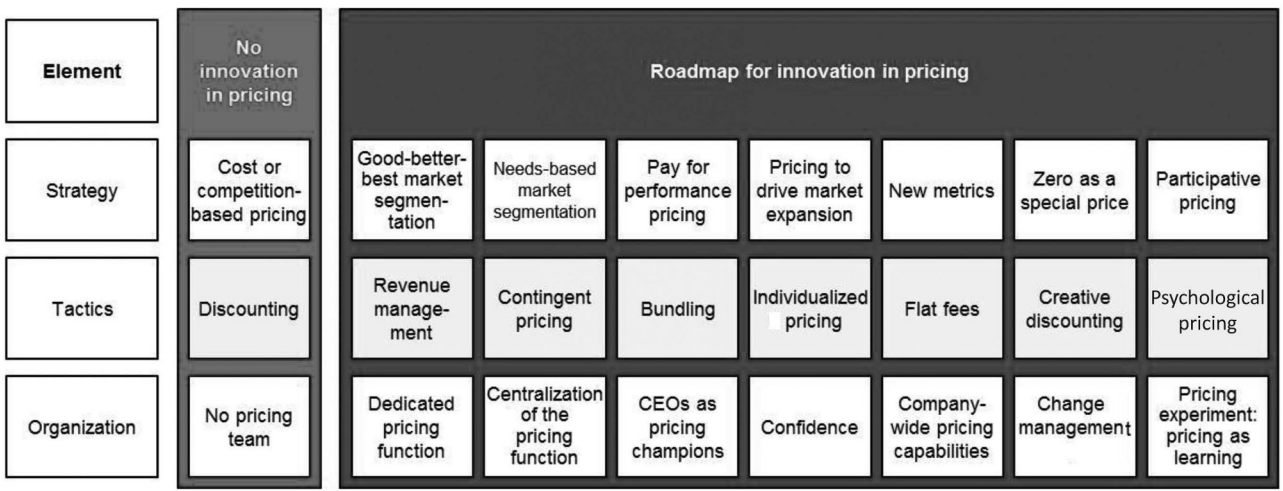

Figure 2.1 A roadmap for innovation in pricing

price sensitivity and her need for customer support, Allstate divides customers into four distinct clusters (high/low brand sensitivity and high-low self-service) and competes in these different market segments through four distinct brands, offering a substantially different customer experience at different price points.

Needs-based market segmentation

Although a good-better-best market segmentation is an innovation for many companies, this approach has an important limitation: Customers typically struggle to understand to which degree these different products meet their needs. In other words, customers have very specific and complex needs rather than just the desire to purchase a low price, mid-price or premium price product. Recent academic research suggests that needs-based market segmentation is the current gold standard in market segmentation (Best, 2012; Kotler & Keller, 2011). Practitioners agree: Hans Strasberg, CEO of Electrolux, the Swedish household appliance manufacturer, says, "Given the differences in what customers value, we have abandoned the traditional industry segmentation based on price and a 'good-better-best' hierarchy. Now our segmentation has as many as 20 product positions that relate directly to different lifestyle and purchasing patterns of consumers" (Knudsen, 2006: 76). A needs-based market segmentation allows the company to simultaneously offer a multitude of products in the premium as well as in the entry-level category with close to zero cannibalization, since these products are squarely targeted at clearly distinct needs of well-defined customers. Since the global rollout of its needs-based market segmentation approach, Electrolux has by far outpaced its competitors in terms of growth and profitability.

Pay-for-performance pricing

Here the seller is paid depending on performance outcomes determined conjointly with the customer. Consider the following example: The U.K., Sweden, Australia and Canada are among the few places where the reimbursement of new pharmaceutical products is closely tied to criteria reflecting the new product's incremental value over existing therapies. For new pharmaceuticals, the U.K. has a threshold range of £20,000 to £30,000 per QUALY (quality-adjusted life year). In this environment, Velcade (bortezomib) by Johnson & Johnson (J&J), a product for treating multiple myeloma, is considered not cost effective since treatment costs are approximately £3,200 per treatment cycle, or £40,000 per QUALY. Traditional pricing approaches would have suggested either to drop the price to reach the threshold (implying a price drop by up to 50 percent) or to exit the U.K. market. J&J, however, proposed an alternative pricing approach to regulatory authorities. Under the new pricing scheme, J&J links reimbursement to effectiveness. Only when patients respond fully to the new drug do they remain on therapy and the National Health System funds it. When patients show a minimal or no response the treatment ceases, and J&J bears the full cost. This new approach (full reimbursement in case of no response) reduces the costs for patients on therapy to

approximately £22,000 per QUALY. As a result, Velcade is today the market share leader in the U.K. while also being the most expensive therapy in this segment.

Advertising, industrial services (e.g. software, consulting, logistics and transportation) and complex engineering projects are other areas where pay-for-performance pricing is currently widespread. Performance-based pricing is costly in large part because monitoring is intensive. Nevertheless, we expect to see a substantial increase in these arrangements in other areas in the future, very likely in consumer-goods markets.

Pricing to drive market expansion

Rather than compete for market share, innovative pricing approaches expand the overall market. The pricing of Ford's Model T is an example: In the years between 1910 and 1925, Ford reduced prices by approximately 80 percent, thus expanding sales volume more than 50-fold. In his autobiography, published in 1922, Henry Ford states:

> Our policy is to reduce the price, extend the operations, and improve the article. You will notice that the reduction of price comes first. We have never considered any costs as fixed. Therefore we first reduce the price to a point where we believe more sales will result. Then we go ahead and try to make the price. We do not bother about the costs. The new price forces the costs down. The more usual way is to take the costs and then determine the price, and although that method may be scientific in the narrow sense, it is not scientific in the broad sense, because what earthly use is it to know the cost if it tells you that you cannot manufacture at a price at which the article can be sold? But more to the point is the fact that, although one may calculate what a cost is, and of course all of our costs are carefully calculated, no one knows what a cost ought to be.
>
> (Ford, 1922: 146)

In a very similar vein, IKEA does not allow costs to dictate prices. IKEA starts with determining prices based on what key customer segments are willing to pay. The company then works backwards to determine allowable costs. This focus on prices as drivers of cost allows IKEA to continuously expand the overall market for home furniture.

New metrics

Innovative pricing strategies align pricing with customer goals. This frequently leads to new pricing metrics. Theodore Levitt, a marketing professor at Harvard Business School, famously quotes Leo McGinneva about why people buy quarter-inch drill bits: "They don't want quarter-inch bits. They want quarter-inch holes" (Levitt, 1986: 128). Figure 2.2 shows how some companies benefit from implementing innovative pricing metrics. In all these cases, companies align the

Company	*Traditional pricing strategy*	*New pricing metric*	*Result*
BASF	Paint sold on a per kg basis to car manufacturers.	Outcome-based pricing. Price is set per painted car.	High customer satisfaction. Joint collaboration with customers to reduce environmental impact and paint consumption.
Michelin	Truck tires sold at largely fixed prices.	Michelin Fleet Solutions sells mobility. Pricing is based on performance (per km) and includes maintenance.	Initial difficulties (new business model), expansion across Europe at above-average margins.
Schindler	Elevators sold at cost-plus prices.	Sale of usage rights. Variable pricing based on distance and number of passengers transported.	Market share growth in competitive market; access to new customer segments.

Figure 2.2 Innovation in pricing – new metrics

basis of their own pricing policies with clearly defined customer outcomes. This interest alignment enables high customer satisfaction, thus overcoming customer resistance to a change in pricing approach.

Zero as a special price

Zero is a special price that uniquely captures customer attention (Shampanier et al., 2007). A number of companies seem to have mastered the art of profitable growth while essentially giving away the main product. Ryanair, with average flight revenues of 40€ per customer, barely breaks even on its flight operations. Yet it is Europe's most profitable airline, largely as a result of the profitability of its ancillary revenues from third parties, early boarding fees, baggage fees or onboard sales. Skype (Internet calls are free, fixed-line calls are sold at regular prices), Google (search is free, advertisement is sold), fast-consumption newspapers (given away for free, advertisement is sold) and open-source software (standard models are free, customized versions are sold) compete very successfully by using similar pricing strategies.

Participative pricing

Recent advances in information technology enable the customer to take an active part in pricing. Participative pricing comes in two forms: Name your own price

and pay what you want. Name your own price (NYOP) mechanisms ask customers to submit a bid price for a product. The customer receives the product only if this bid price is larger than an unknown threshold price. Priceline, of course, is a prime example in this respect. NYOP enables a large degree of price discrimination among customers. NYOP is more profitable than fixed prices if the seller is a monopolist; with competition, NYOP increases profitability if it allows a company to expand its current customer base with price-sensitive customers who would otherwise not purchase (Shapiro, 2011). NYOP also contributes toward mitigating competition, since customers differ in their bidding costs. NYOP firms thus target customers with low bidding costs while fixed-price sellers target customers with high bidding costs (Fay, 2009). Based on these considerations we thus expect that NYOP mechanisms will gain in popularity, quite likely in industrial markets.

Pay What You Want (PWYW) allows the customer full discretion in price setting. In contrast to NYOP mechanisms, sellers have to accept any price, including zero. Examples of PWYW pricing can be found in information services (e.g. Wikipedia), in museums (voluntary contributions), in the music industry (e.g. Radiohead) and in the hotel and restaurant industry. Fairness considerations, social norms and credible threats by the seller to switch back to fixed prices (Mak et al., 2010) seem to motivate customers to pay non-zero prices. In three experimental studies involving restaurants and cinemas, PWYWY pricing leads to lower average prices than previously posted fixed prices but higher revenues due to new demand. Thus, participative pricing can be beneficial for sellers as well as for customers (Kim et al., 2009).

Innovation in pricing tactics

Revenue management

Revenue management is probably the most successful tactical pricing innovation in service industries. Successful implementation increases company revenues by 3 percent to 7 percent and profits by 30 percent to 50 percent (Skugge, 2004). Revenue management varies price levels and bookable capacities conjointly to optimize profitability. This tactic has evolved from the travel industry (airlines, then hotels, then rental cars and finally cruise lines), to leisure services (golf courses, sport clubs, restaurants), to industrial services (freight transportation, advertising time) and finally to consumer services (equipment rental, home repair). It can be applied in industries characterized by the following features: fluctuating demand, existence of different customer segments, fixed and perishable capacity, high fixed costs, low variable costs and predictable demand. We anticipate that in the future, capital-intensive industrial manufacturers will consider applying revenue management to at least part of their supply. As a testimony, Infineon, a leading chip manufacturer, is currently experimenting with dynamic pricing (Ehm, 2010).

Contingent pricing

As an alternative to a fixed high- or low-price strategy, contingent pricing is an arrangement to sell a product at a low price if the seller does not succeed in obtaining a higher price offer during a specified period (Biyalogorsky & Gerstner, 2004). As an example, Caterpillar sells its spare parts to dealers with the option to repurchase the product at a 10 percent price premium in case another dealer or customer runs out of stock and has an urgent need for the product in question (Sheffi, 2005).

Bundling

Bundling – selling two or more products or services as a package – increases profits since it allows companies to appropriate a larger share of customer surplus if customers differ in their relative valuation of single components. Vacation packages, car accessories, software and subscriptions (e.g. Internet and print editions) are prime examples of bundling. Also here, innovative pricing tactics allow an increase in both customer satisfaction and firm profits.

Individualized pricing

Information technology enables service companies (e.g. insurers) to charge substantially different prices for identical products or services based on individual customer data. SunTrust, one of the largest U.S. banks, is implementing individualized pricing for car loans and home mortgages. The company uses software to search for instances where it undercharged customers willing to pay more for a home mortgage; the software also detects cases where the company lost business due to excessively high prices. The software finally produces an optimized, individualized price for different customers (Kadet, 2008).

Flat fees

Flat fees are gaining popularity. Telephone companies, train companies, health clubs, amusement parks, restaurants, Internet retailers (e.g. Amazon and its unlimited free shipping option of its Prime program) and even executive airline companies (e.g. California-based Surf Air) allow customers unlimited consumption for a fixed fee. Academic researchers document that pure economic interests do not motivate customer preferences for flat fees. Customers typically end up paying more with a flat fee than with a conventional pay-per-use plan, yet customer satisfaction is higher. Thus customers pay more and are, nevertheless, happier.

Creative discounting

Robust processes for defining and monitoring discounting practices are a prerequisite to drive profitability via pricing. Even if these processes are in place,

aggressive customers or aggressive competitors can exercise pressure on sales personnel to relax these rules and grant price concessions. Our own research shows that leading-edge companies apply creativity to their discounting practices rather than slashing their prices across the board. One example of creative discounting is *non-linear pricing* where prices develop non-linearly with product volume. This tactic can be found in air travel (special offers for spouses paying less than the full price in business class), banking services (monthly account fees drop with the number of products held by account holders) and in all instances where paid-for membership cards (e.g. Costco) entail purchases at discounted prices. Another example is in *steadily decreasing discounting* (Tsiros & Hardesty, 2010) where discounts are gradually phased out (e.g. in week 1 by 40 percent, in week 2 by 30 percent, in week 3 by 20 percent discount, etc.) as opposed to an immediate reduction in discounts under high-low pricing. Current research shows that steadily decreasing discounts lead to higher future price expectations of customers (prices increase over time as discounts are gradually phased out), which in turn leads to higher quantities purchased in the current period. *Bonus packs*: Current academic research (Chen et al., 2012) demonstrates the following counterintuitive finding: although customers should be indifferent between a 33 percent price reduction and a 50 percent bonus pack (both lead to the same per unit price), customers prefer the bonus pack, even in circumstances where the bonus pack leads to higher average prices than the discount (e.g. 35 percent bonus pack versus 30 percent discount). Customers thus associate higher numbers (e.g. 35 percent free product) with higher savings, although actual prices paid are higher. *Discount presentation*: common sense would suggest that presenting an offer as "pay only 60 percent" is equal to "get 40 percent off the regular price." Recent academic research (Kim & Kramer, 2006) suggests otherwise: the former discount presentation format results in higher perceived savings and higher purchase likelihood than the latter. The novelty and uniqueness of the discount presentation format appears as more persuasive to customers than traditional and known presentation formats. *Cross-market discounts*: When companies are active in more than one market, they can use discounts in one market to stimulate sales in the other market. Giant Eagle, a dominant retailer in Pittsburgh, also owns GetGo, a chain of gasoline stations. In 2008, the company started its highly successful campaign "Fuelperks!" where customers earn a 10 cent discount on each gallon of fuel upon a $50 purchase of groceries at Giant Eagle. For Giant Eagle this campaign has been tremendously successful, so much that its competitors filed (and lost) a lawsuit claiming unfair sales practices. Recent empirical research (Goić et al., 2011) shows that these cross-market discounts increase both firm profits and customer welfare as consumers pay lower prices. Also, creativity in discounting avoids blanket price reductions and improves both customer satisfaction and firm profitability. *Participative discounts* link reduced prices to specific actions of customers that support the company's strategy. These actions could be referrals or simply minimum purchase requirements. Recent research suggests that minimum purchase requirements can lead customers to feel happier when paying more (Yoon & Vargas, 2010). Customers who qualify for the minimum purchase requirement (e.g. $500)

and are offered a lower discount (e.g. 20 percent) end up being happier than customers who are offered a larger discount (e.g. 30 percent) without the minimum purchase requirement. Also here, higher customer satisfaction and higher profits coexist as a result of creativity in discounting. *Creative free*: Instead of fully charging for supplementary services (which customers could perceive as greedy) or giving them away for free (which hurts profits), leading companies apply creativity to select free supplementary services. For instance, Hilton Hotels in California allows free parking at its hotel facilities for all guests under one circumstance: It applies to electric vehicles only. In this way, the company actually improves its ability to charge for parking. In addition, through this policy customers perceive Hilton as environmentally friendly, even if they have to pay for parking.

Psychological pricing

Customer preferences in B2C and B2B markets are not stable; they are constructed. Research examining psychological aspects of pricing seeks to understand how customer perceptions of value and price are formed and how companies can favorably influence customer perceptions of value and price. Here are some examples of psychological pricing. *Advertised reference prices* (e.g. manufacturer-suggested retail price $299, now only $99) influence customer behavior, even if customers themselves know that these reference prices are inflated (Suter & Burton, 1996). A judicious use of advertised reference prices can thus influence customer choice towards higher margin products. In this respect, master salesman Steve Jobs provides an illuminating example. Before the launch of the iPad in 2010, the non-trivial question was, "How on earth will Apple convince its customers to pay about double the price of an existing tablet (the price of Archos, a competing product, was $250 at that time) and still leave an Apple store with the feeling of having obtained a bargain?" Enter Steve Jobs. At the launch event, he announced (Jobs, 2010): "Well, if you listen to the pundits, we're going to price it under $1,000, which is code for $999." Behind him the number $999 appears on the screen. He goes on: "And just as we were able to meet and exceed our technical goals, we have met our cost goals . . . And I am thrilled to announce to you that the iPad pricing starts not at $999, but at just $499." The number $499 replaces $999 on the screen. The audience roared. *9-endings:* More than 50 percent of posted retail prices end in the number 9. Customers perceive prices ending in 9 as lower than they actually are; they also associate 9 endings with special offers. Thus, 9 endings have both level and image effects (Stiving & Winer, 1997). Despite their widespread use and possible wear-off effects, 9 endings still seem to lead to higher sales (Anderson & Simester, 2003). The *compromise effect* is in effect when brands gain market share when they become intermediate, rather than extreme, options in a choice set. Customers are averse to extreme options. Pricing managers thus have the option to increase the likelihood that customers buy a premium product by adding a super-premium product to their product lines. It is well documented that companies such as Starbucks, Dell, FedEx and Amazon make heavy use of compromise effects to profitably influence customer choice.

Innovation in pricing for the organization

Few companies are organized for pricing. Less than an estimated 5 percent of all companies have a dedicated pricing team in place responsible for analyzing, developing and monitoring pricing capabilities. Innovation in organizing the pricing function is thus predominantly concerned with establishing novel approaches to increase the effectiveness of pricing itself. The following are potential starting points.

Dedicated pricing function

At its most basic level, innovation in pricing requires, for close to 95 percent of companies, the establishment of a dedicated pricing team. Typical responsibilities include the establishment of a price list that reflects customer value; the establishment of a performance-oriented discounting policy; the development of guidelines to communicate value and price to customers; the gathering of information on customers, products and sales personnel to analyze key performance indicators related to pricing (e.g. price deviations from target prices, discounting behavior by sales personnel, actual profitability versus target at customer level, etc.); the development of pricing tools; the capability assessment and development of sales personnel; and the chairmanship of pricing council.

Centralization of the pricing function

Recent research suggests that a center-led pricing design, which combines elements of centralization with elements of decentralization, increases firm performance (Liozu et al., 2012). Center-led pricing teams thus rely on a pricing office at the headquarters level to ensure consistency of a company's pricing strategy with overall firm strategic guidelines, to harmonize and to balance pricing policies across countries and business units and to build localized pricing capabilities and pricing teams in key countries and business units.

CEOs as pricing champions

Current academic research strongly suggests that active CEO championing of pricing positively and significantly influences pricing capabilities and firm performance (Liozu & Hinterhuber, 2013a). CEO championing of pricing poses high demands on CEOs. They need to recognize the importance of pricing, enthusiastically support the pricing function and provide resources – including CEO and top-management attention – to the pricing team, show tenacity when faced with obstacles when changes in pricing are needed, identify the key actors responsible to solve pricing problems when they arise and publicly show confidence in what pricing can to for customer satisfaction and for company profitability.

Confidence

Confidence may be the single most important intangible differentiator between high performing and low performing companies (Hinterhuber & Liozu, 2012).

Innovation in pricing requires confidence – the belief in own abilities to take on any challenge, a sense of purpose, a vision for the future, the confidence in the future, the conviction that own products/services deliver value, the courage to withstand customer price objections, the courage to implement price changes in the market and, lastly, the ability to say "no" to customer requests for price reductions. Our research suggests that giving confidence to sales personnel is a leadership responsibility, High performing companies have CEOs who instill confidence in their sales organization by encouraging them to set high standards for excellence, by enabling them to build an emotional reservoir gained through valuable experiences and by encouraging them to trust their own judgment.

Companywide pricing capabilities

Pricing capabilities are a complex bundle of routines that cover the three critical dimensions of pricing: the customer perspective (measuring and quantifying maximum willingness to pay, price elasticity and value-in-use), the competitor perspective (knowledge about price levels of competing products and ability to respond to market changes) and the company perspective (availability of pricing tools, existence of price-management processes, availability of trainings to develop employee skills in pricing). Current research shows that companywide pricing capabilities are positively related to firm performance (Liozu & Hinterhuber, 2013b). An increasing number of leading companies recognize the strategic role of pricing capabilities. Jeff Immelt, CEO of General Electric, states: "A good example is what we're doing to create discipline around pricing. . . When it comes to the prices we pay, we study them, we map them, we work them. But with the prices we charge, we're too sloppy" (Stewart, 2006: 65). As a result of this insight, Jeff Immelt has appointed a chief pricing officer responsible, among other tasks, for analyzing and developing pricing capabilities across business units and countries.

A periodic assessment of pricing capabilities allows companies to (1) analyze an organization's pricing capabilities over time and across geographical boundaries, (2) compare pricing capabilities both within and across firms and (3) plan and implement measures to develop pricing capabilities further. This benchmarking and improvement of pricing capabilities leads to increased organizational performance (Dutta et al., 2002).

Change management

Innovation in pricing fundamentally engages the organization in a change-management process. A new pricing approach is not "just a change of marketing signals" but "a new way of life" (Forbis & Mehta, 1981: 42). Engaging the organization to experiment with and implement new pricing approaches is thus fundamentally a change-management process that significantly exceeds the complexity of activities, such as changing list prices. New pricing approaches frequently require new capabilities, a new organizational structure, different goal and incentive systems, new processes and tools and new organizational

priorities. From an organizational perspective, innovation in pricing thus has to be treated like an ongoing change management process as opposed to a project with a finite life.

Pricing experiments: pricing as organizational learning

For some leading-edge companies, innovation in organizing the pricing function finally implies treating pricing as organizational learning. Amazon is an excellent case in point. The company changes the prices of its products several times a day and measures customer satisfaction, purchase patterns, profits and revenues after each price change in an ongoing attempt to identify the specific price point that delivers both high customer satisfaction and profits on any given time segment. For newly launched books, for example, the frequency and magnitude of price changes are larger than for those of established book titles, suggesting that Amazon places a strong emphasis on experimentation in the period shortly after new titles come to market (Pollono, 2011).

Counterintuitively, frequent price changes can be beneficial for consumers. In one of our recent studies for a diversified energy company that attempted to switch its customers from heating with fuel to heating with environmentally friendly wood pellets, the CEO struggled with the following paradox. Customers never complained about fuel prices but complained strongly about occasional price increases of the newly launched, innovative wood pellets. After conducting face-to-face interviews and a conjoint analysis with customers, the rationale becomes clear. Since prices for fuel vary constantly, price memory is impossible. In an attempt to be customer-oriented, the company had kept prices for wood pellets largely constant in the past, despite rising input costs. Paradoxically, this policy ends up hurting both customers and the company. Customers become obsessed with price and are very reluctant to switch to innovative products, even if doing so would be in their best interest: Although they are more expensive on a per unit basis, these innovative wood pellets actually lower total energy costs. Also, the company is worse off since some of these innovations have higher margins. After our analysis, this company now varies prices for wood pellets randomly around a predefined corridor. The ability of customers to remember price drops substantially if prices change frequently, significantly increases sales of innovative products. We emphasize that, in this case, stopping customers from fixating on price translates into higher firm profits as well as lower total costs to customers. Both parties are now better off.

Innovation in pricing increases value

As the examples of Ryanair, Zipcar, General Electric and our own research suggest, innovation in pricing is indeed possible even in the absence of product innovation. Figure 2.3 illustrates this point.

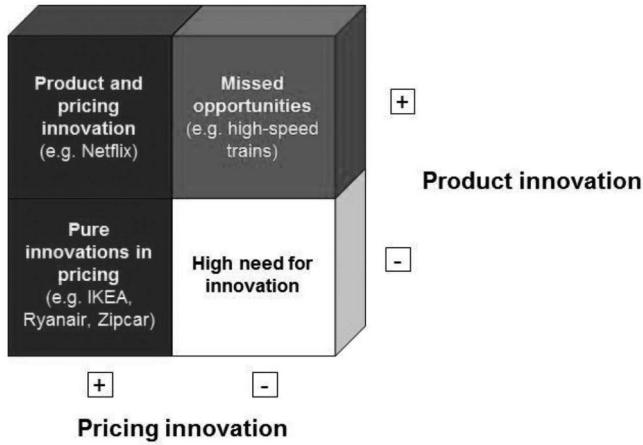

Figure 2.3 Innovation in pricing versus product innovation

Companies placing a high emphasis on product innovation without a similar emphasis on pricing innovation are missing important opportunities for value capture. For example, instead of pricing high-speed train tickets in Europe in line with airline tickets, many formerly state-owned railway companies have set prices at only moderate premiums over conventional train services. Pure cases of innovation in pricing are related to the majority of examples discussed so far. The underlying driver of superior profitability and customer satisfaction of GE, Zipcar and others have been the ability of these companies to apply innovation in pricing to a well-established product or service. The final category in the matrix contains cases of joint product and pricing innovation. Netflix is a prime example. The company's founders, annoyed with late fees, pioneered a new pricing structure and a new delivery format (streaming video).

This contraposition of product and pricing innovation also helps to spot potential discrepancies. Many companies attempt to launch tomorrow's products with yesterday's pricing strategies. Companies can and should develop unique pricing concepts to respond to the unique features of their new products and business models.

Our research certainly does not imply that companies should attempt to implement all innovative pricing approaches discussed here. Our joint experience in academia, in industry and in advising companies from around the world, however, strongly suggests that all companies, regardless of size, industry or geographic location, will be able to adapt two or three key ideas of our roadmap to design innovative pricing approaches that will increase profits and customer satisfaction.

About the research

Our research on innovation in pricing has two objectives. We first want to document to which degree an average U.S. firm practices innovation in pricing. Second, we want to provide a state-of-the art summary of what constitutes innovation in pricing in academic research and managerial practice. To meet our first goal, we conducted 50 interviews in 20 firms in the U.S. and Europe. Our respondents were CEOs, board members, business-unit managers and operating managers in sales, marketing, pricing and finance. We interviewed participants in these firms with open-ended interview questions and asked them to describe, in detail, pricing decisions and processes at their respective firms. In particular, we probed for instances of innovation in pricing. Consistent with a grounded theory approach, data analysis took place simultaneously with data collection. We listened to the audio recordings of each interview several times, and we read the transcripts of each interview repeatedly. To meet our second goal, we examined pricing practices in 70 large firms in the U.S., Europe and Asia by analyzing publicly available information and by interviewing managers at pricing workshops that we conducted in Europe and the U.S. We complemented this analysis with a rigorous literature review on cutting-edge academic research on innovation in pricing and marketing.

Note

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5 CEO championing of pricing and the impact on firm performance

Stephan M. Liozu, Andreas Hinterhuber, Sheri Perelli and Toni Somers

Introduction

Pricing – "the only marketing mix variable that generates revenue" (Rao, 1984: 39) – is a complex management challenge with indisputable impact on firm performance. As observed by Warren Buffet:

> The single most important decision in evaluating a business is pricing power. If you've got the power to raise prices without losing business to a competitor, you've got a very good business. And if you have to have a prayer session before raising the price by 10 per cent, then you've got a terrible business.
>
> (Frye & Campbell, 2011)

Yet, while pricing and firm profitability are inextricably linked (Lancioni, 2005), pricing has commanded scant attention by many scholars and practitioners (Avlonitis & Indounas, 2006). In particular, the role and influence of top management in the pricing process has been under-researched and under-appreciated.

Several studies have examined how firms make pricing decisions and how pricing decisions influence profitability (Ingenbleek et al., 2003; Smith, 1995). Others have demonstrated that CEOs, as architects of corporate strategy (Andrews, 1971), impact firm performance (Mackey, 2008) by committing organizations to specific courses of action (Harrison & Pelletier, 1997).

With respect to pricing, C-level involvement means setting the right objectives and incentives, driving organizational and cultural changes to support better pricing and taking responsibility for pricing strategy as a whole. Curiously, how and to what extent CEOs actually do this has not been directly studied.

To address this phenomenological gap, we surveyed 557 business owners, presidents and CEOs in firms from around the world to measure the effect of championing of pricing on firms' organizational design and relative performance. Our inquiry contributes to the fields of pricing and organizational behavior by linking championing behaviors on pricing to three organizational factors – pricing capabilities, collective mindfulness and decision making rationality – and

subsequently to relative firm performance. Most importantly, our data highlight the role of organizational champions in support of the pricing function and imply that purposeful championing of pricing influences organizational design for pricing and may impact perceived firm performance.

Theoretical background and hypotheses

The development of our theoretical research model (shown in Figure 5.1) draws from related streams on pricing literature, firm capabilities and a resource-based view of the firm and from critical dimensions of organization theory from a decision-making perspective, such as bounded rationality, organizational champions and collective mindfulness.

Pricing literature from an organizational perspective

Several studies have examined pricing practices from the perspective of organizational decision processes but only a handful have linked the bodies of knowledge on pricing and organizational behaviors. Cyert and March (1992), who studied pricing behaviors in a retail environment, suggest that, over time, simplifying "rules of thumb" emerge within the firm. They argue that prices are "negotiated" between various departments of the firm as a way to reach consensus and achieve negotiated objectives. Finally, they propose that cost-based pricing

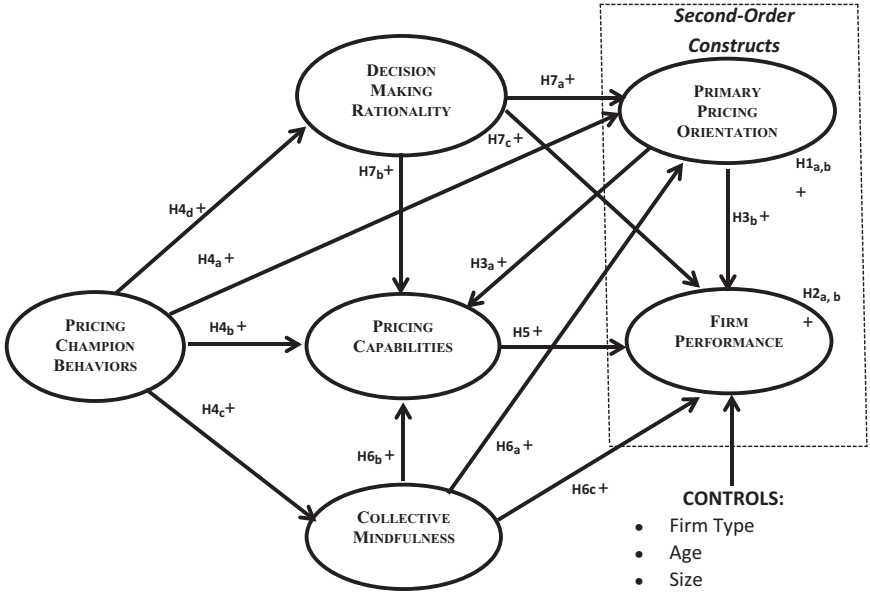

Figure 5.1 Research model and proposed hypotheses

practices are included among these rules of thumb or routines. Lancioni et al. (2005) researched the intra-organizational influence on business-to-business pricing strategies and, more specifically, the importance of interdepartmental rivalry and conflicting interests on the pricing process. The findings show that resistance to progressive pricing strategies emanates from many groups in firms, each of them "having parochial interests and agendas." The finance department that was ranked as the most difficult to work with in developing a comprehensive pricing policy created the most dominant resistance and roadblocks. Senior management was also ranked high because of its desire to control the pricing process. Finally, Ingenbleek (2007) conducted a meta-analysis of 53 pricing studies drawn from cost-principle theory, decision-making theory and marketing strategy. Although no empirical research was conducted, Ingenbleek proposed a conceptual framework and several directions for future research in the field of value-informed pricing. His review of the literature suggests that information sources represent a key resource to be acquired, developed and deployed within the firm. However, the availability of information does not guarantee success in value-informed pricing. The degree to which information is processed, interpreted, communicated and used can influence the implementation of it. Thus the pricing process within the firm can influence the management of information related to customer value perceptions. Ingenbleek (2007) made the following critical conclusions with regard to pricing literature: (1) it is highly descriptive and lacks statistical significance; (2) research insights on pricing practices are often not cumulative; and (3) theory about how price decisions are made in firms is limited. We build on the scholarly work of Cyert and March, Lancioni and Ingenbleek by bridging the fields of pricing and organizational behavior. Logically, there is not a unique way for defining prices. Before setting a price, the company must decide what is going to be the strategy for the product in addition to what will be the proposed objectives, since the clearer these decisions are, the easier it will be to establish prices (Hinterhuber & Liozu, 2013, 2014).

Pricing orientation and firm performance

The notion of pricing orientation in firms has not been appropriately defined and explored. A handful of academic papers reviewed pricing approaches in business markets (Hinterhuber, 2008b) while others discussed pricing practices and their relationship to new product market performance (Ingenbleek et al., 2003, 2010). Managerial pricing orientation "deals with decisions relating to setting or changing prices. It also includes price positioning and product decisions introducing new pricing points to the business unit's product or service mix" (Smith, 1995). Smith defined it as consisting of four dimensions (information getting and processing, pricing objectives, policies and beliefs, organizational decision processing and organizational responsiveness) and proposed four distinct managerial pricing orientations – cost, sales, competition and strategy.

We define pricing orientation by adapting the dimensions developed by Ingenbleek et al. (2001) – value-based pricing, competition-based pricing and cost-based

pricing. We consider pricing orientation from a firm's strategic perspective and define it as all pricing practices, methods, behaviors and processes leading to pricing decisions with the goal of maintaining and sustaining firm competitive advantage. Moreover, our methodological emphasis is placed on conceptualizing pricing orientation as a second-order factor and defining the three dimensions as first-order factors.

Hypothesis 1a: *There are three distinct dimensions of a firm's pricing orientation*.

Hypothesis 1b: *Each dimension contributes to a second-order construct of a firm's pricing orientation*.

Most pricing practitioners agree that pricing orientation and the lack of scientific and systematic return on investment (ROI) calculations for pricing strategies constrain visibility of pricing in the C-suite and restrain firm adoption of modern pricing approaches. In addition, marketing and pricing literature is silent about both the consequences of pricing orientations on overall company performance (Ingenbleek, 2007; Hinterhuber, 2008b) and, more specifically, on how value-based pricing might lead to superior firm performance. Perceived value-based pricing is a pricing practice whereby managers make decisions based on customer perceptions of product benefits and how these benefits are weighted by the customers relative to the price they pay (Ingenbleek et al., 2010). Ingenbleek et al. (2003) demonstrated that value-based pricing is a key pricing practice for obtaining larger returns and for creating a comparative advantage for the company's products. This was demonstrated in a study conducted by Füreder et al. (2014) on medium-sized companies in Austria that showed higher contribution margins when accompanied by the perceived value-based pricing strategy.

Competition-based pricing uses competitors' price levels and behavior expectations as key sources of information to determine pricing (Liozu & Hinterhuber, 2012). The main advantage of this approach is considering the actual pricing situation of the competitors. Its main disadvantage is that demand related aspects are not considered. Furthermore, a strong competitive focus among competitors can increase the risk of starting a price war in the market (Heil & Helsen, 2001).

Cost-based pricing is the simplest and most popular method for setting prices because it carries a sense of financial judgment, which involves adding a profit margin on costs, such as adding a standard percentage contribution margin to the products and services. First, sales revenue is determined; then the unit and total costs are calculated; followed by a check of the company's profit objectives; and, finally, establishing the prices. Thus, from a pricing professional perspective, it is necessary for customers to perceive enough value in products and commercialized services to justify the prices charged by the company.

Pricing strategies may be seen as a process that requires a good understanding of the internal structure of the company, a good knowledge of the market and a good knowledge of the diverse variables that comprise it and their interfaces. The price is considered one of the most impacting elements in companies' performance.

Ingenbleek et al. (2003) tested the relationship between pricing approach and new product success and found value-informed pricing had the overall strongest positive effect on product performance. A subsequent study (Ingenbleek et al., 2010) showed value-informed pricing positively influenced new product market (but not new product financial) performance, noting the latter link may require a more complex model including data on sales, costs and other information (Ingenbleek et al., 2010).

We believe firm performance may be better represented as a higher-order construct. Consequently, firms' relative performance is operationalized as a second-order factor measured by sales, profit and pricing. Conceptualizing firm performance in this manner recognizes that the construct's interpretation is derived from the content of the items used in its operationalization. Thus we posit:

Hypothesis 2a: *There are three distinct dimensions of a firm's relative performance*.

Hypothesis 2b: *Each dimension contributes to a second-order construct of a firm's relative performance*.

Hypothesis 3a: *The firm's pricing orientation will be related positively to its pricing capabilities*.

Hypothesis 3b: *The firm's pricing orientation will be related positively to its relative performance*.

Organizational champions

We define championing as "the persistent and persuasive communication of proposals that either provide the firm with new capabilities or allow the firm to use existing capabilities differently" (e.g. Floyd & Wooldridge, 1996: 55). Champions are valuable to organizations in that they are often able to mobilize company resources, generate momentum for a strategy (Noble & Mokwa, 1999) and spur on organizational innovation (Howell & Higgins, 1990). As a result, top managers have begun to recognize the importance of champions in the organization. Past research readily acknowledges the importance of champions and, more recently, the importance of fostering championing. Without champions, organizations may have a lot of ideas but few tangible innovations. The challenge facing management is to identify and effectively manage existing champions and to nurture potential champions (Howell & Higgins, 1990: 55)

Leaders can influence both functional management commitment and the adoption of innovative technology and practices in firms (March & Simon, 1958: 219). Top management support strongly impacts functional management commitment. This type of top management support is needed for initiatives, such as total cost of ownership (TCO) (Wouters et al., 2005) or value-based pricing (Hinterhuber, 2008a), that require inter-functional cooperation. Hinterhuber (2008a), for example, reported lack of support from senior management was an obstacle for 50 percent of respondents involved in value-based pricing implementation. Senior management support for customer-value management processes is a requirement

when firms try to implement a "philosophy" of doing business based on demonstrated value to customers (Anderson et al., 2007: 13). Senior management must "take a broader view of persuasively conveying this value merchant mind-set and culture to everyone working in the business and to the customers" (Anderson et al., 2007: 123). Hinterhuber (2008a: 49) argued that "senior management (support) can be obtained through various means, including lobbying, networking and bargaining. If such support is gained, middle-ranking executives can then implement value-based pricing strategies."

Top management plays a key role in defining and promoting corporate-wide priorities and new strategic programs but also in identifying, allocating and deploying strategic resources to support these programs (Chandler, 1973: 4). Executive experience, overall personality and risk aversion behaviors help determine the course and rate of structural adaptation and innovation (Chandler, 1973: 283; Jaworski & Kohli, 1993). The influence, skills and drive of upper management are a resource leading to better strategy and greater economic rents by firms (Barney & Clark, 2007). Leadership styles (authoritative versus participative) and backgrounds (legal, finance or marketing) also impact the organization (Chandler, 1973: 317; Simon, 1961: 159).

Scholars and practitioners have focused on the role of champions from a leadership perspective. Organizational champions have been defined as charismatic leaders (Nadler & Tushman, 1990), transformational leaders (Bass, 1985: 22; Wang & Huang, 2009) and champions of change (Nadler & Nadler, 1997: 98). Champions may exhibit a "constellation of behaviors" (Howell et al., 2005) that can be nurtured and learned, including "communicating a clear vision of what innovation could be or do, displaying enthusiasm and demonstrating commitment to it, and involving others in supporting it" (Howell & Higgins, 1990). They may increase "effort-accomplishment expectancies" by reinforcing collective efficacy, increase self-efficacy and collective efficacy by expressing positive evaluations (Tasa et al., 2007) and showing confidence in people to perform effectively and meet challenges (Nadler & Tushman, 1990).

Hypothesis 4a, b, c, d: *The more the involvement of the "champion on pricing," the stronger the firm's pricing orientation, (b) pricing capabilities, (c) collective mindfulness and (d) decision making rationality*.

Capabilities and resource-based view of the firm

According to the RBV, achieving a competitive advantage (Bamey, 1991) requires heterogeneous resources that are valuable, scarce, difficult to imitate and non-substitutable (Dierickx & Cool, 1989). Dutta et al. (2003) show that these conditions apply to pricing by describing pricing's two main activities as price setting within the firm and in regard to customers. Dutta et al. found that the pricing process is inimitable and imperfectly mobile (nontransferable) because a firm cannot simply buy the pricing systems and skills required for effective pricing but must

design, develop and enhance a proprietary pricing system to ensure it is suitable for both the firm's requirements and those of its customers. In addition, as an extension of the RBV, the capabilities perspective argues that value creation by firms is driven not only by resources but also by capabilities (Grant, 1996), which are the multifaceted collections of skills and expertise that are embedded in a company's processes (Peteraf, 1993).

Our research follows Dutta et al. (2003) in considering pricing as a specialized operational marketing capability that is grounded in the RBV. In their case study of a large manufacturing firm, Dutta et al. go beyond the external determinants of pricing to focus on the internal processes and routines that enable a company to set its prices successfully. According to Dutta et al., pricing is a capability that is "based on the combination of routines, coordination mechanisms, systems, skills and other complementary resources that are difficult to imitate" (p. 619); it takes a firm approximately five years to develop a pricing system, and the pricing capability cannot be learned through a training program but must evolve over time and from experience. Moreover, Dutta et al. show that a strong pricing capability enables firms to generate higher rents through such means as improving the match between prices charged and customer value.

Pricing capabilities are found to be positively related to company performance (Berggren & Eek, 2007; Dutta et al., 2002, 2003; Hallberg, 2008). In these studies, pricing capabilities are complex, difficult-to-imitate processes that span organizational boundaries. Thus we link pricing capabilities theoretically to firm performance based on the RBV and propose:

Hypothesis 5: *The firm's pricing capabilities will be related positively to its relative performance*.

Organizational mindfulness

Mindfulness, originally characterized by Langer (1989) as a state of alertness that is manifest in active information processing, includes creating new categories rather than relying on categories present in our memory; welcoming new information by being open and attending to changed signals; and welcoming more than one view and being aware of multiple interpretations. Fiol and O'Connor (2003: 60) observed, "The greater the level of mindfulness of decision makers, the more likely it is they will use decision making mechanisms to expand their search for information." Weick et al. (1999) extended the concept of individual mindfulness (Langer, 1989, 1997) to the collective, describing it as the widespread adoption and diffusion of mindfulness by the organization's members. Mindfulness helps organizations notice more issues, process them with care and detect and respond to early signs of trouble (Weick & Sutcliffe, 2007). Weick and Sutcliffe (2007) and Weick et al. (1999) describe five cognitive processes that constitute organizational mindfulness: (1) preoccupation with failure; (2) reluctance to simplify interpretations; (3) sensitivity to operations; (4) commitment to resilience; and (5) deference to expertise. We contend that these characteristics of high reliability

organizations can also be applied to the adoption and implementation of pricing strategies in firms.

Firms engaged in the development of modern pricing practices invest in developing pricing capabilities of their front-line personnel through pricing training for sales employees in order to equip them with tools and capabilities to achieve the firm's pricing goals. Sensitivity to operations also entails adjusting pricing programs by taking into account the knowledge of people who actually do the work (Weick & Sutcliffe, 2007). Commitment to resilience is strongly influenced by executive champions' internal development of shared beliefs, courage and resilience when implementing pricing strategies. Finally, firms defer pricing decision expertise and influence to center-led pricing teams. Decision makers in business units rely on the expertise of these specialized centers of excellence to optimize pricing decisions and the firm's performance.

Hypothesis 6a, b, c: *The firm's collective mindfulness will be related positively to (a) pricing orientation, (b) pricing capabilities and (c) relative performance*.

Decision-making rationality

Simon (1961: 93) posits that actual behavior of managers in firms when making decisions or making choices falls short of objective rationality in three ways: (1) the incompleteness of knowledge; (2) the difficulties in anticipation of the consequences that will follow choice; and (3) the choice among all possible alternative behaviors. Managers also suffer from a possible "bottleneck of attention" that impacts their ability to deal with more than a few things at a time (Simon, 1961: 90). Bounded rationality refers to the notion that rational actors are significantly constrained by limitations of information and calculations (Cyert & March, 1992: 214). Behavioral theorists conjecture that managers in organizations simplify the decision-making process by using various behaviors (Cyert & March, 1992: 264): satisficing (March, 1978); following rules of thumb (Schwenk, 1988) and defining standard operating procedures and organizational routines (Feldman, 2000; Pentland & Reuter, 1994). Others will define frames of reference (March & Simon, 1958: 159) that will be determined "by the limitations of the rational man's knowledge." Experienced managers will draw from their memory, training and experience (Simon, 1961: 134). They construct and use "cognitive heuristics" (Brownlie & Spender, 1995) or mental models (Porac et al., 1989) to simplify complex strategic issues and engage in intuitive and judgmental responses to decision demanding situations (Barnard & Andrews, 1968; Oxenfeldt, 1973). The resolution of uncertainty is "to create a rationality, a recipe or an interpretative scheme" (Brownlie & Spender, 1995) leading to a choice or a decision.

Hypothesis 7a, b, c: *The firm's decision-making rationality will be related positively to (a) pricing orientation, (b) pricing capabilities and (c) relative performance*.

Methodology

Data collection and sampling

Following the total design method (Dillman et al., 2009), a cross-sectional self-administered electronic survey was sent in April 2011 to 7,897 active members of the Young President Organization International (YPO). YPO is a for-profit organization with 18,000 business owner/executive members in 110 countries. Members of YPO must meet eligibility criteria, such as age (under 45 years old), title (President, Chief Executive Officer, Chairman of the Board, Managing Director, and/or Managing Partner), enterprise value (minimum $10 million), number of employees (minimum 50) and annual sales revenues (minimum $8 million for sales, service and manufacturing corporations, $160 million for financial institutions and $6 million for agency-type businesses). To our knowledge, no other empirical studies have used the YPO database.

Consequently, the survey was emailed to 7,897 targeted respondents of which 376 were returned for reasons of email discrepancies. Of the remaining 7,521, 902 surveys were returned partially or completed for a response rate of 12 percent. We deemed 557 usable for analysis. Our response rate is consistent with the surveys of other top executives (Hambrick et al., 1993; Simsek et al., 2010).

Eighty percent of the firms in our study identified themselves as manufacturing or service firms with the remaining classified as retail/distribution firms. Over half (61 percent) were business-to-business (B2B) firms vs. business-to-consumer (B2C). About 11 percent were publicly traded while 87 percent reported being privately owned. Seventy-three percent indicated they owned the firm. Half (50 percent) had fewer than 250 employees, 22 percent had 251–500, 13 percent had 501–1000 employees and 15 percent had more than 1,000 employees (of that, 3 percent had over 10,000 employees). Fifty-three percent reported the age of their firm as older than 10 years but less than 50 years old. Thirty-four percent indicated their firm had been in business for longer than 50 years. Business management was reported as the educational background of 48 percent of the respondents, 20 percent had technical, industrial or engineering backgrounds, 17 percent finance and accounting and 14 percent sales and marketing. Most (60 percent) of the firms were headquartered in North America, 13 percent in Europe, 11 percent in Asia/Pacific, 8 percent in the Middle East and 7 percent in Latin America.

Measure development and assessment

Although most scale items were adapted from those in the existing literature, a new scale was developed to measure a firm's pricing capabilities with slight modifications to reflect our focus. The scale was refined through pretests and pilot testing using established item development procedures and guidelines (Churchill, 1979).

Content and face validity were determined through a comprehensive review of the literature, pre- and pilot tests and assessment by a panel of practitioners and academics to ensure that measurement items covered the domain of the constructs

(Churchill, 1979; Nunnally, 1978). To assess the quality of the survey items, in-depth, face-to-face interviews with pricing practitioners were conducted using Bolton's "talk aloud" methodology (Bolton, 1993). We pretested all scale items with a small panel of academics and pricing and business practitioners. A pilot test involving 150 professionals representing pricing, business and general manager functions from companies in both manufacturing and service industries provided 70 complete responses. The survey was iteratively modified to incorporate all relevant test results. None of the pretest or pilot test participants was included in the final sample. The survey instrument is presented in the Appendix.

Behavior of champion on pricing

A 6-item scale adapted from Howell et al. (2005) was used to assess pricing champion behaviors (CBE). Each item was measured using a 7-point Likert scale anchored at the extremes by "strongly disagree" to "strongly agree."

Pricing capabilities

Since there was little empirical precedent to measure pricing capabilities (PC), a multiple-item scale was developed by the academic team in accord with an operational definition (Kerlinger & Lee, 1999), on relying on our fieldwork and on extant literature. We used 12 items ranging from 1 ("much worse than competitors') to 7 ("much better than competitors") to operationalize this scale.

Pricing orientation

We adapted the scales developed by Ingenbleek et al. (2001) to measure value-based pricing (VBP) (5 items), competition based pricing (COB) (6 items) and cost-based pricing (CB) (5 items). Items were measured using a 7-point Likert scale anchored at the extremes by 1 ("not at all taken into account in price setting") to 7 ("very much taken into account in price setting").

Collective mindfulness

The 12-item scale used to measure collective mindfulness (CM) was based on adapting existing measures (Knight, 2004) and conceptual definitions in the literature (Weick & Sutcliffe, 2007). Reluctance to simplify (4 items), sensitivity to operations (4 items) and commitment to resilience (4 items) were assessed using 7-point, Likert-type scales anchored with "strongly agree" at the extreme positive end and "strongly disagree" at the opposite end of the scale.

Decision-making rationality

Four items measured the level of analysis involved in decision-making. The four-item scale was developed and validated by Miller (1987). The 7-point scale was

anchored with "does frequently" at the extreme positive end and "does rarely" at the opposite end of the scale.

Firm performance

Similar to Morgan et al. (2009), firm performance was operationalized as a second-order construct consisting of three first-order reflective constructs – sales, pricing and profit performance. The measures for sales and profit were adapted from Morgan et al. (2009) and include six items, while the other two measures were from the work of Ingenbleek (2007).

The use of subjective performance measures was required for a number of reasons. First, because our sample contained many privately-owned firms for which objective accounting data on their performance would not be accessible, we followed the convention (Simsek et al., 2005; Simsek, 2007) of asking CEOs to compare their *firm's relative performance* to that of their competitors' on eight different dimensions for the past year (e.g. growth in sales, return on investment, return on sales and so forth) using a scale ranging from 1 ("much worse") to 7 ("much better") than competitors. Second, since firms in our sample were of various types and from various geographical zones, a multidimensional measure based on perceptual firm performance facilitates comparisons across firms and contexts, such as across industries, time horizons and economic conditions (Song et al., 2005). Finally, earlier studies have shown that perceptual performance measures tend to be highly correlated with objective indicators (Dess & Robinson Jr, 1984) and are used in strategy research (Anderson & Paine, 1975). Taken in the aggregate, subjective or perceptual measures of firm performance can provide a broad indication of a company's health (Quinn & Baily, 1994).

Firm-level control variables

We controlled for a number of likely determinants of performance by including demographic characteristics of the firm, such as firm type, age and firm size (Amburgey & Rao, 1996).

Non-response bias

A commonly used method for estimating the bias in strategy research (for examples see Armstrong & Overton, 1977; Simsek et al., 2010) is to compare early – those who responded within the first week (74 percent) – and late (26 percent) responses among the study variables; a late respondent is considered a proxy for a non-respondent. First, chi-square tests comparing demographic characteristics across the two groups revealed no significant biases when number of employees $\chi^2_{(4)} = 1.45$; $p = 0.835$), type of firm $\chi^2_{(2)} = 2.39$; $p = 0.303$) and age $\chi^2_{(4)} = 4.72$; $p = 0.317$) were examined. Next, one-way ANOVA tests, performed at the item level, indicated no significant differences in data derived from early vs. late

responders, except on 1 of the 58 (1.73 percent) study variables. Consequently, it appears that bias present from the time of response is due to chance.

Common method bias

Surveys from a single set of respondents can introduce common method bias (CMB) in the data. Consequently, we took several steps to mitigate, detect and control for a common method bias. We carefully constructed all survey items and, wherever possible, used pretested, valid, multidimensional constructs (Huber & Power, 1985). We varied the scale anchors and format in the questionnaire, performed a series of scale-validation processes before distributions and randomized questions.

Several *post hoc* tests determined the extent to which common method bias was present in our data. First, using Harman's single-factor test, all 58 items were entered into an unrotated principal components factor analysis to determine the number of factors necessary to account for the variance in the variables. Accordingly, if a single factor emerged or a single general factor explained most of the variance between the independent and dependent variables, common method variance may be present (Podsakoff et al., 2003). Our results indicated the presence of 10 potential factors (all with eigenvalues greater than one); each factor explained roughly equal variance and explained over 65 percent of the total variance. These results provide initial evidence that response bias does not appear to be a problem in the data (Podsakoff & Organ, 1986).

Second, we used the confirmatory factor analysis (CFA)-based Harman's single-factor test in which we hypothesized a single CMB factor as causing all the indicators. The CMB factor extracted 17 percent of the variance. A χ^2 difference ($\chi^2 = 17.021$, $p = 0.000$) test between the baseline with all the CMB paths free floating and the CMB with all paths equal to zero indicated items loaded significantly on the single factor, suggesting that CMV might be a source of variance in the observed items.

Third, an unrelated construct, a *marker* variable, determined *ex post* to have no significant correlation with other items in the constructs was added to the measurement model (Lindell & Whitney, 2001). Since we did not measure an unrelated construct *a priori*, we used a modified test in which a weakly related construct – CEO perceptions of pricing – and a 4-item scale was used (Pavlou & Gefen, 2005). High correlations among any of the items of the study's constructs and pricing perception would indicate common method bias. Since the highest correlation of pricing perceptions and the constructs was $r = 0.15$, there appeared to be minimal evidence of common method bias.

Fourth, we examined multi-collinearity and CMB with linear regression analysis on the study constructs and found low variance inflation factors. Further, multi-collinearity can be ruled out because no two predictor variables correlated more strongly than 0.70 (Hair et al., 2010). Finally, we examined the correlation matrix, as shown in Table 5.1, and found no highly correlated factors (highest

Table 5.1 Descriptive statistics, reliability, correlations and discriminant validity

Construct	*No. of items*	*M*	*SD*	*CA*	*CR*	*Construct*									
						1.	*2.*	*3.*	*4.*	*5.*	*6.*	*7.*	*8.*	*9.*	*10.*
1. **Champion on pricing**	6	5.54	.99	.846	.84	**0.71**	0.170	0.153	0.131	0.086	0.022	0.075	0.035	0.069	0.061
2. **Pricing capabilities**	8	3.35	1.53	.855	.92	0.412	**0.67**	0.091	0.173	0.081	0.029	0.108	0.125	0.182	0.178
3. **Collective mindfulness**	7	5.96	.72	.863	.92	0.391	0.302	**0.69**	0.036	0.100	0.034	0.058	0.059	0.033	0.061
4. **Decision-making rationality**	4	4.58	.97	.768	.88	0.362	0.416	0.190	**0.70**	0.053	0.023	0.136	0.010	0.024	0.028
5. **Value based**	4	5.52	1.12	.852	.85	0.293	0.285	0.316	0.231	**0.77**	0.066	0.071	0.036	0.051	0.052
6. **Competition based**	4	5.48	1.19	.870	.85	0.149	0.171	0.184	0.150	0.257	**0.77**	0.091	0.013	0.001	0.003
7. **Cost based**	3	5.16	1.24	.700	.76	0.273	0.328	0.240	0.369	0.267	0.301	**0.71**	0.037	0.016	0.032
8. **Sales performance**	3	5.38	1.05	.830	.84	0.187	0.354	0.243	0.098**	0.190	0.112**	0.192	**0.80**	0.185	0.235
9. **Price performance**	2	4.80	1.08	.690	.70	0.262	0.427	0.181	0.156	0.225	$0.016_{n.s.}$	0.125**	0.430	**0.73**	0.370
10. **Profit performance**	3	5.21	1.21	.930	.93	0.246	0.422	0.246	0.166	0.228	$0.059_{n.s.}$	0.178	0.485	0.608	**0.89**

Notes: All coefficients significant at $p < 0.001$ (one-sided test) except where noted.

M = mean; *SD* = standard deviation; CA = Cronbach's alpha; CR = composite reliability.

Square root of Average Variance Extracted (AVE) is bolded value along diagonal; values above diagonal are squared correlations.

* $p<0.05$; ** $p < 0.01$; *** $p < 0.001$.

correlation is $r = 0.61$), whereas evidence of common method bias should have resulted in extremely high correlations ($r > 0.90$). Based on these tests, multicollinearity is not present and common method bias does not appear to pose a problem with our analysis.

Confirmatory factor analysis

First-order factors

Four of the 6 constructs (champion of pricing, pricing capabilities, collective mindfulness and decision-making rationality) were measured as first-order constructs, while the other two (pricing orientation and performance) were operationalized as second-order factors in our CFA models. The measurement models were estimated using AMOS (Analysis of Moment Structures) software, a covariance-based structural equation modeling technique. In this model, no unidirectional path was specified between any latent variables.

The psychometric properties of the four latent constructs involving 25 items were evaluated simultaneously in one CFA.[1] The sample size of 557 was deemed sufficient, given acceptable values on the Hoelter's Critical N test,[2] and the model was expected to converge using maximum likelihood estimation.

As seen in Table 5.1, almost all correlations were significant. Discriminant validity was assessed by comparing the square root of the AVE associated with each construct to the correlations among constructs (Fornell & Larcker, 1981). To provide evidence of discriminant validity, the square root of the AVE associated with a particular construct must be greater than its correlations with other constructs (Fornell & Larcker, 1981). Accordingly, this is confirmed by the estimates provided in Table 5.1. Internal consistency reliability was assessed in two ways – using Cronbach's alpha (CA) coefficient and composite reliability (CR). Table 5.1 indicates each type of reliability exceeded the recommended 0.70 threshold (Fornell & Larcker, 1981; Nunnally, 1978), with one exception on the margin (CA =0.69 price performance).

Convergent validity can be assessed by examining individual item loadings on their theorized latent variables (Hair et al., 2010). All individual items loaded on their intended constructs and no undesirable cross-loadings emerged. An item is significant if its factor loading is greater than 0.50 (Hair et al., 2010). As shown in Table 5.2, the standardized factor loadings of all the items were significant ($p < 0.01$) and ranged from 0.53 to 0.86, meeting the threshold and demonstrating convergent validity at the item level.

It is recommended that multiple indices be considered simultaneously when overall model fit is evaluated.[3] We paid less attention to the sample size sensitive model chi-square ($\chi^2_{(256)} = 466.77$; $p = 0.000$). As an alternative to chi-square, we examined the Browne-Cudeck test of close fit (BCC) and compared the BCC value across the hypothesized, saturated and independence model (Browne & Cudeck, 1993). The BCC was lower than the saturated model, suggesting a good fit (Floyd & Widaman, 1995). Steiger and Lind's (1980) root-mean-square error of

Table 5.2 Measurement model results for first-order constructs

Constructs & items	*Regression weight*	*Standardized regression*	*Critical ratio*
Champion of pricing (CBE)			
CBE1	1.208	0.858	23.400
CBE2	1.000	0.806	21.991
CBE3	0.878	0.763	19.402
CBE4	0.782	0.559	13.732
CBE5	0.600	0.533	12.978
CBE6	1.003	0.650	16.504
Pricing capabilities (PC)			
PC1	0.918	0.691	16.993
PC2	0.860	0.660	15.816
PC3	0.912	0.770	19.889
PC6	0.894	0.590	14.122
PC7	0.833	0.617	14.708
PC8	0.775	0.575	13.483
PC9	0.814	0.556	12.875
PC12	0.851	0.585	14.039
Collective mindfulness (CM)			
CM5	0.797	0.763	18.864
CM6	0.708	0.645	15.649
CM7	0.569	0.617	14.721
CM8	0.600	0.642	15.345
CM9	0.610	0.680	14.978
CM10	0.602	0.659	15.837
CM11	0.660	0.713	16.473
Decision making rationality (DMR)			
DMR1	1.069	0.595	12.582
DMR2	1.430	0.713	13.596
DMR3	1.666	0.809	15.735
DMR4	1.296	0.616	13.020

approximation (RMSEA), with 90 percent confidence interval, was used to reflect both the fit and parsimony of the model at hand. The RMSEA, known as the most sensitive index to models with unspecified factor loadings (Hu & Bentler, 1998) was 0.038 and the 90 percent confidence interval was small (0.033 to 0.044), suggesting a close fit (Browne & Cudeck, 1993). The Normed χ^2 (1.823) at a ratio of less than 2:1 indicated a good "rule of thumb" model fit (Tabachnick & Fidell, 2007). We also used the Non-Normed Fit Index, NNFI (Tucker & Lewis, 1973), the Comparative Fit Index (CFI) (Bentler, 1990) and Incremental Fit Index (IFI) as other goodness-of-fit measures that are independent of sample size and reflect the proportionate improvement in fit of the measurement model over a more restricted baseline model. Hu and Bentler (1999) suggested values "close to .95" (p. 27) as indicating satisfactory fit. The NNFI, CFI and IFI all exceeded 0.95. Consequently, the measurement model was deemed acceptable to proceed to structural modeling.

Second-order factors

We conducted a second-order CFA of pricing orientation and relative performance to provide empirical support for their measurement at the second-order level. We modeled the items for the first-order factors as reflective items because they are moderately correlated among themselves (Bassellier & Benbasat, 2004). For pricing orientation and relative performance, all first-order factors had a significant ($p < 0.001$) relationship with their respective second-order constructs. The path coefficients indicate the factors' relative importance in reflecting the second-order constructs. Further, we assessed convergent and discriminant validity of the items and the contributions of the factors to the second-order constructs.

Figure 5.2a shows pricing orientation is operationalized as a second-order factor with the facets as its indicators (Gerbing et al., 1994). The facets define specific domains related to a firm's pricing orientation – value based, competition based and cost based. Each facet is defined by a one-dimensional set of items adapted from the literature (Ingenbleek et al., 2003). The items load 0.66 and higher on their respective factors, and the first-order factors are strongly related (0.50 to 0.59) to the pricing orientation dimension. Composite reliability ranged from 0.76 to 0.85, all AVEs exceeded the 0.50 threshold and squared multiple correlations ranged from 0.25 to 0.35, thus supporting H1a. Validation of this model

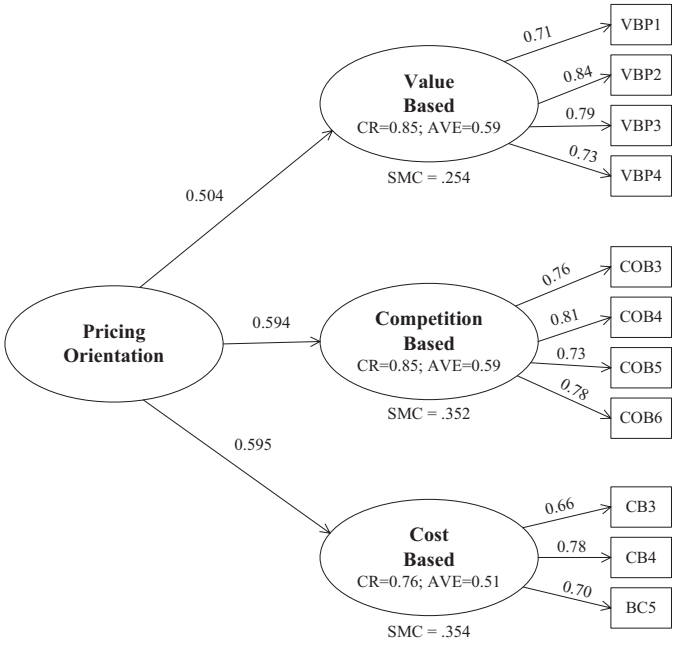

Figure 5.2a Second-order measurement model results for pricing orientation

Notes: Standardized estimates shown; Significant at $p < 0.001$.

Composite Reliability (CR); Average Variance Extracted (AVE); Squared Multiple Correlation (SMC).

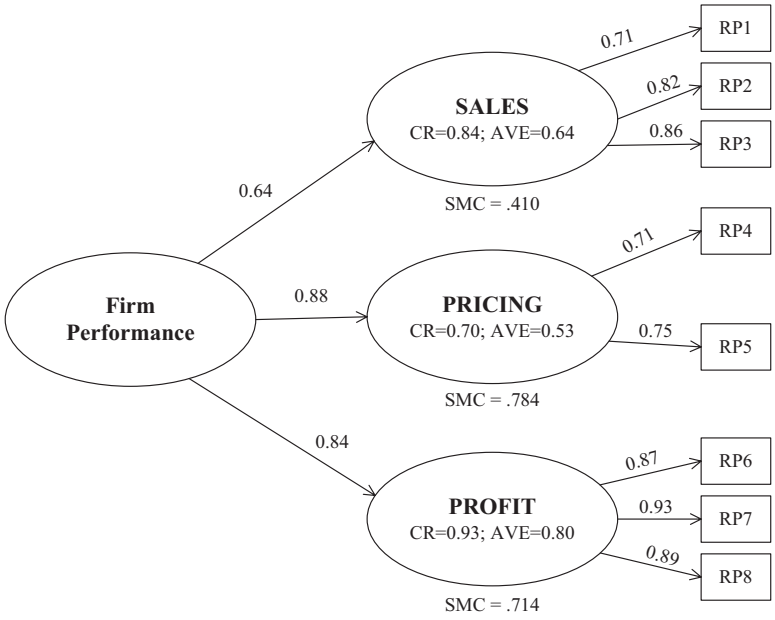

Figure 5.2b Second-order measurement model results for relative performance

Notes: Standardized estimates shown; All loadings significant at $p < 0.001$.

Composite Reliability (CR); Average Variance Extracted (AVE); Squared Multiple Correlation (SMC).

and support for H1b is demonstrated by several fit statistics (Normed $\chi^2 = 1.735$, CFI = 0.99, IFI = 0.99; NNFI = 0.98 and RMSEA = 0.036; $CI_{RMSEA} = 0.02–0.05$).

As seen in Figure 5.2b, first-order factors for firm performance had high loadings (0.64 for sales, 0.88 for pricing and 0.84 for profit dimensions; $p < 0.001$). Items loaded at 0.70 or higher on their respective factors and all were significant ($p < 0.001$). Composite reliability ranged from 0.70 to 0.93 and all AVEs exceeded 0.50 (providing support for H_{2a}) and squared multiple correlations ranged from 0.40 to 0.78 suggesting the correlations are below the 0.90 threshold considered acceptable (Bagozzi et al., 1991). Further, support for H_{2b} was found by acceptable goodness-of-fit statistics (χ^2/df = 1.806, CFI = 0.983, IFI = 0.98; NNFI = 0.98 and RMSEA = 0.05). These results suggest that it is appropriate to model pricing orientation and relative performance as multidimensional second-order factors (Anderson & Gerbing, 1988).

Power analysis

We relied on the MacCallum et al. (1996) framework to estimate the power of RMSEA fit measure. Consequently, since our objective was to test relationships between the constructs of interest, we used a "test of not close fit" for RMSEA in order to assess the adequacy of the sample size. Using a desired alpha of 0.05 with

256 degrees of freedom, a hypothesized population RMSEA of 0.05 and a sample size of 557, we calculated the statistical power to be 0.99 (Preacher & Coffman, 2006), which exceeds the commonly accepted criterion of 0.80.[4] Accordingly, we can be relatively confident that the sample is large enough to support the statistical inferences made regarding the relationships between the constructs.

Results

We tested our hypotheses using structural equation modeling (SEM). SEM was particularly appropriate because it allows estimation of multiple associations, simultaneously incorporates observed and latent constructs in these associations and accounts for the biasing effects of random measurement error in the latent constructs (Medsker et al., 1994).

The results are presented in Table 5.3. All hypothesized relationships are significant, except for two of the six (H3b and H7c), explaining 26 percent of the variance for relative performance, 28 percent for capabilities, 20 percent for pricing orientation, 15 percent for collective mindfulness and 13 percent for decision-making rationality. The fit indices for the model indicated this model reached an acceptable level for goodness of fit ($\chi2(17) = 27.79$; p = 0.047, $\chi2/df = 1.635$, CFI = 0.984, IFI = 0.985; NNFI = 0.96 and RMSEA =0.034; CIRMSEA = 0.01-0.05).

First, the hypothesized impact of pricing orientation on pricing capabilities (0.175, $p < .001$), H3a, was supported. However, pricing orientation (0.064) was not significantly related to performance (H3b not supported). Second, the champion of pricing had a positive and significant impact on pricing orientation (0.13, $p < 0.001$), pricing capabilities (0.22, $p < 0.001$), collective mindfulness (0.28, $p < 0.01$) and a strong impact on decision-making rationality (0.56, $p < 0.001$). These findings support H4abcd. Third, pricing capabilities (0.166, $p < 0.001$) impact on firm performance provided support for H5. Fourth, collective mindfulness is both positive and significantly related to the firm's pricing orientation (0.287, $p < 0.001$) and firm performance (0.173, $p < 0.001$), thereby validating H6 and H6b. Also, collective mindfulness had a significant impact on pricing capabilities (0.152, $p < 0.01$) providing support for H6c. Finally, decision-making rationality (0.132, $p < 0.001$) relationship to orientation and pricing capabilities (0.166, $p < 0.001$) provided support for H7a and H7b. Decision-making rationality (0.042) had no effect on firm performance, thus H7c was not supported.

We controlled for type of company, age and size. Since the firms participating in this study came from a variety of industries, it was necessary to control for the different industries under which the firms operated (manufacturing, service and retail/distribution). We controlled for firm size, which has frequently been used in previous studies involving firm performance (Morgan et al., 2009), and firm age. All three variables had no significant effect on performance.

Implications for the pricing field

Our objective was to improve our understanding of how CEO and top executive championing of the pricing within their firms might influence relative firm

Table 5.3 Structural model results

Hypothesized Paths	*Regression estimate*	*Standardized estimate*	*Critical ratio*	*Hypothesis supported*
$H3_a$: pricing orientation → pricing capabilities	0.175	0.156***	3.882	Yes
$H3_b$: pricing orientation → firm performance	0.064	0.060	1.453	No
$H4_a$: champion behavior → pricing orientation	0.127	0.147***	3.355	Yes
$H4_b$: champion behavior → pricing capabilities	0.217	0.223***	5.336	Yes
$H4_c$: champion behavior → collective mindfulness	0.282	0.391***	10.026	Yes
$H4_d$: champion behavior → rationality	0.560	0.362***	9.164	Yes
H5: pricing capabilities → firm performance	0.432	0.452***	10.750	Yes
$H6_a$: collective mindfulness → pricing orientation	0.287	0.239***	5.802	Yes
$H6_b$: collective mindfulness → performance	0.173	0.134***	3.396	Yes
$H6_c$ collective mindfulness → pricing capabilities	0.152	0.112**	2.797	Yes
$H7_a$: rationality → pricing orientation	0.132	0.235***	5.781	Yes
$H7_b$: rationality → pricing capabilities	0.166	0.263***	6.637	Yes
$H7_c$: rationality → firm performance	– 0.042	– 0.070	– 1.724	No
Controls:				
Age → firm performance	– 0.035	– 0.044	– 1.044	
Type of firm → firm performance	– 0.057	– 0.046	– 1.125	
Number of employees → firm performance	0.044	0.056	1.344	

Goodness-of-fit statistics:	R^2 rationality = 0.131
$\chi^2 = 27.795$; df = 17; $p = 0.047$	R^2 collective mindfulness = 0.153
Normed $\chi^2(\chi^2/df = 1.635)$	R^2 pricing orientation= 0.202
CFI = 0.984; IFI = 0.985; TLI = 0.958	R^2 pricing capabilities = 0.286
RMSEA = 0.034	R^2 firm performance = 0.264

* $p < 0.05$; ** $p < 0.01$; *** $p < 0.001$.

performance. Our intention was to construct a strong bridge between the fields of pricing and organizational behavior to contribute to the development of the pricing literature from an organizational perspective. Our findings shine a new light on the findings of previous studies and offer four substantive contributions.

First, our results support the proposition that a purposeful championing of pricing activities by top executives strongly influences the firm's organizational design to support the pricing process in critical areas (decision making rationality, collective mindfulness, capabilities and pricing orientation). Moreover, this study contributes to past research that readily acknowledges the importance of champions and the importance of fostering championing. "Without champions, organizations may have a lot of ideas but few tangible innovations. The challenge facing management is to identify, and effectively manage, existing champions and to nurture potential champions" (Howell & Higgins, 1990: 55). All relationships between championing behaviors and other organizational characteristics were positive and significant. Our study found strong links between championing in pricing, organizational design and relative firm performance. By providing evidence of these relationships, we uniquely begin the exploration of organizational drivers of the pricing function. Most scholars and practitioners agree that pricing receives scant attention from the C-suite (Hinterhuber, 2008a). Our conclusions suggest that once top executives realize the importance of pricing and purposefully decide to champion it, the impact on the organization and its performance is significant.

Second, our results support resource-based theory that pricing capabilities positively and significantly influence firm performance vis-à-vis competition. Previous studies on marketing capabilities suggest a positive link between pricing capabilities – a subset of marketing capabilities – and firm performance (Morgan et al., 2009; Vorhies & Morgan, 2005). However, these studies measured pricing capabilities as part of a much wider subset of marketing capabilities. Our findings show that pricing capabilities are significantly influenced by championing behaviors, decision-making rationality, mindfulness and overall pricing orientation. In turn, these capabilities in pricing positively influence firm performance vis-à-vis competition.

Third, our findings suggest that the role of executives in the corporate suite is essential for the design and sustainable implementation of pricing strategies in firms. A unique organizational architecture for pricing and the promotion of a culture of change and pricing knowledge diffusion should become a top priority for CEOs and other senior executives. By investing to build pricing capabilities that generate a sustainable and inimitable competitive advantage (Dierickx & Cool, 1989; Dutta et al., 2003), champions of pricing forge shared vision, a collective "can do" mentality and a sense of resilience in the firm that lead to superior levels of organizational efficacy (Bohn, 2001) and superior outcome. Dutta et al. (2002: 66) posit that "most CEOs will never set a single price. They can, however, give their managers the ability to win price wars, maintain price leadership and hold a competitive edge in pricing."

Finally, although we did not establish a significant relationship between decision-making rationality and relative firm performance, our results highlight

the criticality of creating an environment where pricing decisions are made on a more scientific and rational basis and not solely on intuition or gut feeling. Our findings indicate that greater levels of decision-making rationality influence the pricing orientation that firms adopt as well as their levels of capabilities in pricing. In recent years, there has been a resurgence of interest in intuition and gut feeling in decision-making theory due in part to the general dissatisfaction with the concepts of rationality and its limitations (Sadler-Smith & Shefy, 2004). Making decisions by intuition is increasingly viewed as a viable and acceptable approach in today's business context (Burke & Miller, 1999). Intuition may be an appropriate decision-making process in certain situations and business scenarios, especially in situations of uncertainty or turbulence (Khatri & Ng, 2000), novelty or in situations related to human resources. Scholars relate the intuitive skills of managers to the intuitive skills of chess masters or physicians (Simon, 1987). Experienced managers have in memory a large amount of experience, schemas and patterns gained through experience and organized "in terms of recognizable chunks and associated information" (Simon, 1987). Managers need to be able to combine both approaches to reach a greater level of decision effectiveness (Dane & Pratt, 2007; Simon, 1987). Intuition can then become a complement to an appropriate pricing decision after a thorough analytical and scientific process. This process conducted by pricing experts can help decision makers narrow the decision range and remove as much uncertainty and ambiguity out of the price-setting process as possible.

Limitations

Although this study collected empirical data to test our comprehensive research model, we acknowledge certain limitations and provide suggestions for future research. First, the sample was derived from the entire worldwide listing of CEO and business owners belonging to a professional society. Consequently, the relatively small sample size is a limitation in this study. A broader empirical survey is required to generalize our findings. Second, the performance measures utilized in this research are perceptual, although using perceptual or subjective data has been advocated in the strategic management literature (Dess & Robinson Jr, 1984). We cannot rule out that the observed performance differences could be a function of different firm goals rather than of differences in objective firm performance. As a consequence, caution should be taken when interpreting the performance results. Third, we used the key respondent approach to our survey study and directed our questionnaire to the CEO or business owner because they were best positioned to answer the questions; however, their responses may not be without some bias. Fourth, our research model is tested using cross-sectional data; we can report associations but are not able to determine causality because we implemented a passive observation design (i.e. survey). Fifth, even though the relationships between the constructs in our research model are argued based on theory, longitudinal studies should be done to offer stronger empirical evidence for the observed relationships. Finally, multiple measurement methods and data sources should be used to control potential common method bias in future studies (Burton-Jones, 2009).

Appendix: Constructs, definitions, coded items and source

Construct/Dimensions	*Definition*	*Items*	*Source*
PRIMARY PRICING ORIENTATION	The primary orientation used by firm respondents based on customer value, cost and competition information. Because the use of customer value, competition and cost information are a matter of degree rather than mutually exclusive categories, the result of the measure will report a primary firm orientation.	**To what extent does your organization take into account the following factors when setting prices for its products and services?** *(1= Not at all taken into account in price setting to 7 = Very much taken into account in price setting)* *Value-based pricing* **VBP1:** Advantages of the product compared to competitors' products/services **VBP2:** Customer perceived value of the products/services **VBP3:** Customer willingness to pay for the unique benefits of the product/services **VBP4:** Balance between advantages of products/services and price *__VBP5:__ Differentiated value drivers of our products/services compared to substitutes *Competition-based pricing* *__COB1:__ Price of competitors' products/services *__COB2:__ Competitors' current price strategy **COB3:** Likelihood of competitors' strength to react **COB4:** Market structure (number and strength of competitors) **COB5:** Degree of competition on the market **COB6:** Competitive advantage of competitors in the market	Adapted from Ingenbleek et al. (2003) Value-based pricing: 5 items (AC: 0.81) Competition-based pricing: 6 items (AC: 0.91) Cost-based pricing: 5 items (AC: 0.75)

(*Continued*)

(Continued)

Construct/Dimensions	*Definition*	*Items*	*Source*
		Cost-based pricing *__CB1:__ Variable costs of products/services *__CB2:__ Price necessary to break even __CB3:__ Investments in products/services __CB4:__ Target margin guidelines __CB5:__ Target return on sales levels	
DECISION-MAKING RATIONALITY	Rationality relates to the concepts of analysis, future orientation and planning, explicitness of the strategy and systematic scanning of the environment. These concepts all relate to the "synoptic and planning modes" and represent systematic, analytical decision-making. This contrasts with the purely spontaneous, intuitive modes found with severely bounded rationality.	**Indicate the extent to which your organization does the following activities to support pricing decisions.** *(1 = Does rarely to 7 = Does frequently)* **DMR1:** Applies pricing research techniques, such as conjoint analysis and pricing/value simulations, to make major product/service pricing decisions **DMR2:** Conducts brainstorming with senior management groups for novel solutions to pricing problems **DMR3:** Conducts formalized, systematic pricing review process as part of the product/service development process (like Stage Gate) **DMR4:** Uses staff specialists to investigate and provide recommendation on major pricing decisions	Adapted from Miller (1987). Level of analysis: 4 items (AC: 0.74)
PRICING CAPABILITIES	Pricing capabilities are part of marketing capabilities which concern the firm's adequate management of individual "marketing mix" processes such as product development and management, pricing, selling, etc. as well as marketing strategy development and execution. These capabilities may be rare, valuable, non-substitutable and inimitable source of advantage that can lead to superior firm performance.	**Rate your organization relative to your major competitors in terms of its capabilities in the following areas:** *(1 = Much worse than competitors to 7 = Much better than competitors)* **PC1:** Using pricing skills and systems to respond quickly to market changes **PC2:** Knowledge of competitors' pricing tactics **PC3:** Doing an effective job of pricing products/services *__PC4:__ Monitoring competitors' prices and price changes *__PC5:__ Sticking to price list and minimizing discounts **PC6:** Quantifying customers' willingness to pay **PC7:** Measuring and quantifying differential economic value versus competition	Construct definition included Morgan et al. (2009) and the researcher qualitative research (Liozu et al., 2011). Result of the pilot survey with 70 responses yielded an AC of 0.885 with these 12 items.

		PC8: Measuring and estimating price elasticity for products/ services **PC9:** Designing proprietary tools to support pricing decisions *__PC10:__ Conducting value-in-use analysis or total cost of ownership *__PC11:__ Designing and conducting specific pricing training programs **PC12:** Developing proprietary internal price management process	
CHAMPIONING BEHAVIOURS	Transformational leaders motivate followers to achieve performance beyond expectations by transforming followers' attitudes, beliefs and values. They take on the role of organizational champions by demonstrating specific behaviors to lead and support organizational implementations.	**To what extent do you agree or disagree with the following statements about your involvement with pricing?** *(1 = Strongly disagree to 7 = Strongly agree).* **CBE1:** I enthusiastically promote the pricing function **CBE2:** I express confidence in what pricing can do **CBE3:** I show tenacity in overcoming obstacles when changes in pricing are needed **CBE4:** I get pricing problems into the hands of those who can solve them **CBE5:** I get key decision makers involved in the pricing process **CBE6:** I act as a champion of pricing	Adapted from Howell et al. (2005):
COLLECTIVE MINDFULNESS	Weick et al. (1999) extended the concept of individual mindfulness (Langer, 1989) to the collective entities, describing it as the widespread adoption and diffusion of mindfulness by the organization's members. Mindfulness helps organizations to notice more issues, process them with care, and detect and respond to early signs of trouble (Weick & Sutcliffe, 2007). They describe five cognitive processes that constitute organizational mindfulness: (1) preoccupation with failure; (2) reluctance to simplify interpretations; (3) sensitivity to operations; (4) commitment to resilience; and (5) deference to expertise.	**To what extent do you agree or disagree with the following statements about your organization?** *(1 = Strongly disagree to 7 = Strongly agree)* *__CM1:__ Seeks input from diverse sources to solve problems *__CM2:__ Approaches unexpected events with novel solutions *__CM3:__ Expects employees are familiar with tasks beyond their immediate jobs *__CM4:__ Supports divergent viewpoints **CM5:** Fosters a climate that encourages open, ongoing communication **CM6:** Pays attention to real-time information **CM7:** Believes that regular updating and refreshing of our employees' skills are essential **CM8:** Strives to make ongoing assessments and continual updates in our operations **CM9:** Does not give up on solving problems **CM10:** Encourages employees to 'bounce back' from mistakes **CM11:** Takes steps to correct errors before they worsen *__CM12:__ Treats failures as indicators of reliability of operations	Adapted from Knight (2004) based on the work of Weick and Sutcliffe (2007) Reluctance to simplify interpretations: 4 items (AC: 0.80) Sensitivity to operations: 4 items (AC: 0.84) Commitment to resilience: 4 items (0.87)

(*Continued*)

(Continued)

Construct/Dimensions	*Definition*	*Items*	*Source*
PERCEIVED RELATIVE PERFORMANCE	Respondents' perceived evaluation of their organization's performance relative to their competition.	**Please evaluate the performance of your major line of business over the past year relative to your major competitors.** *(1 = Much worse/lower than competitors to 7 = Much better/higher than competitors)* **RP1:** Acquisition of new customers **RP2:** Increase of sales to current customers **RP3:** Growth in total sales revenues **RP4:** Absolute price levels **RP5:** Pricing power in the market **RP6:** Business unit profitability **RP7:** Return on sales (ROS) **RP8:** Return on investment (ROI)	Two items adapted from Ingenbleek (2007). Six items adapted from Morgan et al. (2009). Market effectiveness: 3 items (AC: 0.90) and profitability: 3 items (AC: 0.95) Our pilot survey with 70 respondents yielded an AC of 0.929.

Notes: *Item eliminated due to insufficient reliability and validity; AC = Alpha Coefficient.

Notes

1 Nine items were trimmed from the model because of insufficient reliability and/or validity.
2 This is the largest sample size at which we would accept the model at the 0.05 (sample size = 276) or 0.01 (sample size = 286) levels. Since our sample is 557 we can expect decreasing significance of the χ^2 statistic leading to possible rejection of the model based only on that statistic.
3 We selected normed chi-square (χ^2/df), the comparative-fit index (CFI), the incremental fit index (IFI) and the root mean squared error of approximation (RMSEA) based on their relative stability, robustness, uniqueness of information provided and independence of sample size. Recommended thresholds indicating good fit are χ^2/df < 3; IFI, CFI and NNFI > 0.90, and RMSEA < 0.05.
4 This is the power level at which an RMSEA of 0.08 is excluded from the RMSEA confidence interval. If the hypothesized RMSEA were the same as observed (0.038), then statistical power would still be 0.99.

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7 Interview

How a vice president of value can drive profits in B2B

Andreas Hinterhuber and Todd Snelgrove

A. Hinterhuber: What does a Vice President of Value do?

T. Snelgrove: That's a great question because you don't see the title in a lot of organizations. However, companies that create value and want to deliver that value to their customers realize that value quantification needs to be pulled together in a dedicated function.

A VP of value essentially coordinates value quantification and brings the voice of the customer inside, enabling companies to understand what customers really value, asking questions such as "What is the value that we're building into our products?" "Are my customers willing to pay for that?" "Do we have tools to quantify this value or is it just generic case studies that don't resonate well with my customers?"

A VP of value, for example, calculates the return on investment (ROI) on customer-specific business cases. A VP of value ensures that value messages are incorporated into marketing communication. A VP of value generates insights for the sales force to enable them to justify an only apparently high price by documenting and quantifying that the value in fact far exceeds price. A VP of value also works with new pricing models, exploring new ways to monetize competitive advantages. Finally, a VP of value also has the responsibility of driving a culture change. At least with my experience with all culture change projects, if companies do not have a full-time function, sales managers won't become experts and change programs become stale. In order to successfully implement change management, organizations need to have somebody whose full-time job is to constantly improve, refresh and drive relevant messages internally and externally.

A. Hinterhuber: A VP of value creates the organizational momentum in order to avoid that value quantification becomes stale. A number of companies already manages for value and quantifies value to customers. Tell me something that is counterintuitive or not yet widely known.

T. Snelgrove: I think there's one thing: value quantification might not be as hard as you think. Too many companies just throw their hands up and say, "We can't quantify the value," and I think there's a few reasons for that. One, they might have an engineering background where they want guarantees of future exact numbers, where with value quantification it is mostly about probabilities. Over time, you gain case studies that you can go back to and say, "We have done this. This is the average impact." It's not as hard to start the journey as one might think, but it is a journey and it needs focus.

One of the suggestions I have is that it's usually best to get somebody from outside the industry. People from the industry or from the company might be so myopic; they assume things are always the same as they have been. They don't ask those questions: "Why?" "What is that worth?" They don't get it as much. Having a fresh set of eyes come in and say "Okay, let's really challenge what is that feature, benefit and value worth." I guess that's point one. Point two is that customers are demanding it. They might not specifically say in the RFP, "Please demonstrate and document the exact value of your solution," but all the research shows that it's the predominant driver they're going to use to make the business decision.

A. Hinterhuber: Yes, B2B customers increasingly demand value quantification. What are main challenges of value quantification?

T. Snelgrove: I think there is a few things. One, and I think we've talked about this over the years; it starts with a company's culture. It does take time; it does take effort. It takes a little bit of resources. The payback is huge. Some companies might be measuring, rewarding and focusing their sales force on market share or sales volume, not on profit generation, value quantification and customer satisfaction. Yes, that might help the company hit a number today, but it's not going to help differentiate that company in the future, allowing more of these me-too copycats to come in.

Really working with customers prior to them starting the journey, the buying process journey. Getting there ahead of time so that they start to think differently of how they buy whatever you're selling in a product or service. To have the discussion, it's a complete cultural change for most sales organizations and it's not a normal selling process to go to a customer. You need to be proactive. What I always say is, "Where are they learning?" "Where are they challenging their own perceptions so that when the time does come to have a discussion around your offering, you frame the discussion around something different?"

A CEO once said to me – I'm somewhat paraphrasing – "How many ways do I have to discount in the marketplace, whether that's by competitive situation or market or whatever reason?" He said, "We have hundreds of different ways to discount. How many ways do I have or systems do I have not to discount and to get paid for my value?" Maybe I've got my focus and tools and processes on the wrong side or the wrong focus.

A. Hinterhuber: How would you describe the behavioral or psychological traits of those sales and account managers who are exceptionally well versed in value quantification? How, by contrast, would you describe the behavioral traits of sales managers who seem to struggle with value quantification?

T. Snelgrove: I think people must have an open mind because they might be continuing to hear procurement cares about price and does not care about value. So people have to stop and say, "If I can do this, if I can prove this, is there a benefit in doing this?" The answer frequently is positive. I spend a lot of my time with procurement, and I know that it is possible to have a meaningful discussion with procurement around what value is.

Next: Understanding that life is about ranges and probabilities. I say, "No, I can't guarantee that if we do X today that this will happen in the future." However, the technical background says it should be between this and this. Maybe we could set up a payment model that if this occurs, I get paid this, and if this occurs, this happens. A lot of technical people have difficulties with probabilistic models. Life isn't about guaranteed future states. It's about having reasonable, justifiable ranges and say, "We believe X will occur; here's why, here's how," and then working out contingency models that specify what happens if some of the assumptions are not met. I have always found that working with probabilistic models requires a culture change with technical people.

Finally, the openness to understand that you have to have the experts or the technical background, but that technology needs to be converted into a financial understanding. Value quantification requires an ability to convert advantages into an ROI analysis. Either sales managers become educated in financials – costs, revenues, risks – themselves or they bring somebody in. Sales managers need to be able to say, "Okay, what I've learned is technical. I need to now become just as conversant in the financial impact of that technical discussion."

A. Hinterhuber: Great comment. My take is: Many of the relationships we discover through research in business are probabilistic, not deterministic.

T. Snelgrove: Very well said. I will use that quote in the future. If someone could guarantee the future, they should probably be in the stock market.

A. Hinterhuber: Let us assume that you have a differentiated offer, that you have quantified your value and that you are dealing with a procurement organization that is convinced of the benefits that you offer but that is afraid of putting a criterion in the bidding documents where your company is the only one able to offer it. Any advice?

T. Snelgrove: Great question. A few things there. I think you need to highlight so much earlier in the sales cycle. To get the customer to buy into the logic, most companies I know that do call on government, but they admit that to get the initial order, they don't talk about the value differentiation as much because they're going to make up the value and the profitability for themselves afterwards. That's how they get the contract changed. Changes are where they make their money after contracts have been vetted.

Second, there is a lot of research that suggests that even government procurement is better off when including non-price factors in the bidding process. Public procurement is quickly moving towards purchasing based on total value and total profit added.

A. Hinterhuber: It means working with the procurement organizations to convince them that again, buying on value is in their own best interest, even if this means excluding some suppliers.

T. Snelgrove: Yes, procurement agencies need to define what they care about. Suppliers then need to think about how they can minimize the risk for the procurement function. Vitasek (2017) suggests that defining a value and a price model are highly effective in minimizing the perceived risk to procurement; in a very simplified way, these models specify in advance the payment accruing to a supplier based on pre-defined outcomes: the supplier will get X percent of the value created. As long as suppliers charge less than the value created and customers agree on the model, it's a win-win.

A. Hinterhuber: Let us discuss a case study of value-based pricing and value quantification.

T. Snelgrove: A large global paper company had requested that all major suppliers come and bid for being a supplier of industrial parts. While the commercial and pricing discussions were being discussed between the customer, the distributor and my company, I went for a plant walk.

An hour later we were meeting with the customer's procurement team. Our technical expert asked the customer group if they had any specific issues or problems that should be discussed.

All the representatives said, "Nothing . . . all good . . . the paper machines are running at specification." Then dead silence. I, as the non-technical person, asked if I may ask a question. I said, "I was just on a walk and noticed that you have a lot of pumps in your facility: What is the average mean time between failures (MTBF) of your pumps?" The technical person smiled and said that they were very satisfied as they were able to increase the average life of this pump population, from 2.5 years to 3 years, i.e. a 20 percent improvement. I congratulated them, then said "Just something to think about: Our company just did some work for a large global petrochemical company on increasing MTBF of pumps, and we were able to extend it from 13 years to 14 years." So I asked about the number of pumps and the number of facilities globally. To my knowledge the cost to repair these pumps, refurbish, replace was approximately $4,000. So I said, "So let's see how much cash could be generated by increasing the life of these production assets." I noted down the following summary calculations, noting that they referred to the impact of our products on just *one* critical outcome (see Figure 7.1).

Price of own offer:	$6,000,000
Price of next best alternative:	$4,500,000
Total cost of pump replacement: (*150 pumps at 20 factories, at $4,000 each*)	$12,000,000
Cost of yearly pump replacement:	$4,000,000
Benefits of increasing pump life by 5 years:	$20,000,000
Incremental investment over 5 years:	$7,500,000
ROI:	167%

The discussion was reframed from the price difference to what else we could do, what the expected financial impact would be, where we had done it before, how we would do it and how we would be rewarded if we beat the target or missed the target. As a "salesperson" I knew we were having an implementation discussion.

After the value-based agreement was signed I attended our first implementation meeting; the same group representing the customer was involved. They told me, "Todd, what we all liked about the ideas you brought us was that all your competitors wanted to talk about our key assets, ones that we know more how to operate more than you suppliers would ever, but you brought us a best practice from another industry, showed us some big financial impacts and calculated that number for us, and then were willing to get paid based on really delivering us a result."

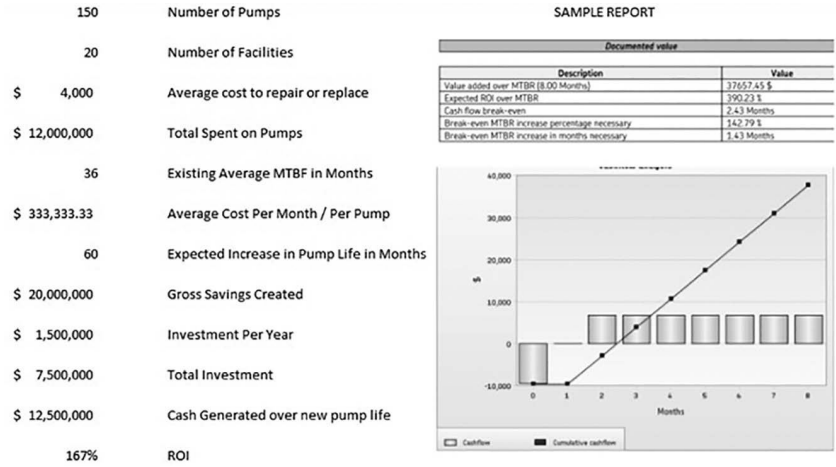

Figure 7.1 Case study on value quantification

A. Hinterhuber: Great example. I will start the next question with a statement. Value-based pricing does not imply performance-based pricing. If you buy a Volvo, you pay ex ante for value. Likewise, performance-based pricing does not imply value-based pricing. Key performance indicators (KPIs) are routinely added to cost-based pricing contracts. There is, however, an area where value-based and performance-based pricing intersect. This leads to the question: under which circumstances is ex-ante value-based pricing most appropriate in B2B? Under which circumstances is ex-post performance-based value-based pricing most appropriate?

T. Snelgrove: As sales people, pricing people, we need to give customers a choice and maybe not always say: "This is how you have to buy." If a company is just buying a product, one widget, one something, it has to be ex-ante. You cannot guarantee; it's not financially reasonable to invest the resources to track what actually happens. In the example we used in our book (Hinterhuber & Snelgrove, 2016) SKF would show what the value could be, but that means that customers installed it right and used it right and maintained it right.

In a one-off relationship, pricing is typically ex-ante: we would show hundreds of examples, the probability, the minimum and maximum. As long as the customer feels that the numbers are reasonable, that the risk is low and the speed at which it happens is quick, that's a great situation. An example,

energy savings. You can do a very simple calculation to show what that is worth. I would be willing to pay for that; it is a hard dollar; it's not a bunch of maybes and hopefuls in general.

Ex-post performance pricing really requires a holistic view and a very deep relationship with customers. In an outcome-based contract suppliers and customers typically need to work together to achieve high-level KPIs jointly defined.

But the point is suppliers need to give customers choices. We cannot tell customers how to buy. Each choice needs to be clear and concise with risks and rewards.

On a side note, I would also say I spend a lot of time with procurement and I tell procurement if the supplier is going to claim that they're better and they have all these case studies of why they're better, and they may have a tool to calculate it, but then you push them, and this is a negotiating tactic and you say, "Mr. Supplier, okay, fine. Are you willing to get paid partially based on achieving that benefit for me?" They throw up their hands and say no. I start to question how much does that company really believe in its value if that company is not willing to be paid based on value.

By contrast: the fact that you as a supplier are willing to get paid based on value just dramatically increases your credibility vis-à-vis customers. You take the risk. It is also a negotiation tactic.

If you as a supplier claim to be better, but are not willing to get paid that way, I'm going to challenge you even more.

A. Hinterhuber: In the example we mentioned – SKF at 15 versus the competition at 10 – the price structure is ex-ante, I presume?

T. Snelgrove: Very much so. We're going to tell your maintenance people how to lubricate this. We're going to tell them what, how to install it so the energy usage is lower. Telling somebody to do something and making sure they do it the right way are two different things. Like you said, this is an ex-ante situation. If the customer said, "Well, I want to guarantee I get that result," we'll say, "Okay, now that relationship has just changed. We will come in, install, operate and maintain your machines, and therefore we guarantee you're going to get this. Now because you're going to get a guarantee of value, I'm going to need to get an investment to pay for all that." You give them the choice.

In this example the question is thus: Do I believe that it's reasonably going to happen? Is the risk reward good enough? You're asking me to pay $5 for $30, it's a 6 times ROI. That leaves me a lot of wiggle room. Let's say that I don't need to get it perfect to get a win for me. A lot of those examples that are listed there are immediate. I'm much happier to pay more for

that because it's measurable, it's quicker. There's a high probability. If the ROI was much smaller, very long term and very vague in how it would be done, the premium you'd be able to get for that is much, much lower.

A. Hinterhuber: In a nutshell: value-based performance-based pricing requires a strategic, collaborative relationship with customers where value is co-created.

T. Snelgrove: 100 percent, there's got to be trust, it has to be much more holistic. I believe that more and more of this will occur. Outsource the mailroom. I want a result. I'm willing to pay you to bring me that result as long as the result can be clear and concisely measured, and there's value for both sides in the discussion. I think there'll be a lot of businesses moving toward that in the future.

A. Hinterhuber: I am skeptical on this point. As I highlight in a current paper, value-based performance-based pricing has its own challenges: substantially increased transaction costs, an incentive for suppliers to reach minimum performance thresholds and cheating are just some of the typical problems that customers experience with this pricing approach.

T. Snelgrove: Very much so; that's why I mean again, the business case has to be there for both sides and the reward needs to be there. You shouldn't take on risk just to get back to your threshold. There needs to be reward that's good enough for both sides to make the investment, so of course, I agree with you 100 percent.

A. Hinterhuber: Back to value-based pricing: what are typical value-capture rates? In our example – price difference 5, value difference 30 – the rate is 17 percent. In your own experience is this typical or is this rather on the low side?

T. Snelgrove: Very good question. According to research by Jim Anderson (Anderson et al., 2014) tiebreaker sales, where product features are not quantified, still justify price differences of 4 percent to 6 percent: terms are better, conditions are better, the return policy is better, whatever those things are. He says here you have to stop and say when the term value pricing is used, are you trying to find just a minor differentiator to get you that minor price difference? Or is the product or service going to be measurably different? I think that's one thing to stop and think about.

Two, as you said, the range. I think a lot of it depends on the hardness of the value. The more risk I have to take, the less I'm willing to pay for it.

If it was a situation where you came to me and said, "Todd, I'm going to save you $1 million in energy this year" and if the calculation was sound, I would be willing to pay say 90 percent of that value. I can see it, I can touch it and I can feel it.

It really comes down to credibility and to who is willing to take on the risk. If I really, really, really believe that it's going to happen, I'm willing to pay more. If I believe there is a small chance, I'm willing to pay less. I think you run anywhere between 10 percent and 90 percent. Sorry to give such a huge range, but I think those are some of the characteristics to look at.

Finally we should remember an important point: Sometimes you can get compensated not just by price premiums but also by volume. One of the things that procurement can do relatively easily is increase market share. Maybe you are only going to get a 10 percent price premium or 20 percent price premium, but you double your market share. Don't always look at the price as the only way to capture the value you created

A. Hinterhuber: I appreciate the comment. You suggest that looking only at price could be shortsighted because there could be a way to realize price through volume.

T. Snelgrove: Very much so.

A. Hinterhuber: Back to price structure: In your experience, what is a typical split, assuming that pricing is based on value, between traditional, ex ante value-based pricing and performance-based, value-based pricing?

T. Snelgrove: It probably is 50 percent for ex ante value-based pricing, based on brand, experience, performance or other elements.

Performance-based pricing will come in two variants: only 5 percent of volume might be 100 percent performance-based because of the numerous reasons we talked about, such as the amount of investments required on both sides to make it happen.

For the other remaining 45 percent of volume or so we could implement simpler versions of performance-based pricing. If we didn't create X amount of value, we were at risk: we would have to write a penalty, or discount after the fact, something if we couldn't prove the value. If we did prove the value, we would get more. Sometimes more was more price. A lot of times more was more market share.

Again as I said, in performance-based pricing we should take continuum view rather than an either-or view.

If you're selling through an OEM to their end user, it becomes a little more difficult to have a pure performance-based. Yes, you can work on warranty reduction cost or things like this, but because the value chain is so long, it becomes a little muddied of where the value was created and realized. I think it's also the type of customer relationship or market strategy channel.

A. Hinterhuber: Value quantification relies heavily on collaboration with customers. How do you get customers to sign off case studies of quantified customer value?

T. Snelgrove: That's an interesting and good question. I think they have to see there's something good for them, not a negative. I mean one, what we always did was say, "Here's the process we will use to create, define value. When it goes to this stage of the implementation, this happens. When this happens, somebody signs off on it." They're signing off on it so that they get credit within their own company. This happened, this is what it was worth, etc. Again, some of that can be projection, some of it can be actual; it depends on the calculation.

I've seen situations where people that were signing off on value were actually being punished financially. For example, if you sign off on a cost savings, Mr. Maintenance Person, we're going to take that money out of your budget. We basically disincentivize them for doing anything. Too often, the benefit goes across a total organization. It happened here, here and here. We make it very clear early on what the processes are. Best-case scenario is we agree on the formulas that will be used and on the numbers that will be used.

The reason why, if you're trying to calculate the value after the fact then this comes back to that zero sum game mentality. If I agree with your calculation, that means you're going to get a bonus or there won't be whatever, so maybe I don't believe energy's 10 cents, it's only 6 cents. At the beginning we say okay, sometimes energy's 10, sometimes energy's 6, it depends on all these different variables. Let's call it 8 cents as an average.

The more you agree up front about the numbers and the formulas, the less reluctant people are. We always put something in our value agreements like the following: If we find out that there are processes or procedures in place that will minimize the effectiveness of the agreement, then everything is null and void.

One example was where a copy of an email was obtained with inter-company people from procurement saying if anybody signs off on a cost savings, it'll come out of your budget and with a strong hint that you would be reprimanded. Not fired, but reprimanded. Right away I was like: "Okay, you didn't bargain in good faith."

I also spend time seeing the more people buy into it, the more they'll want to do more of it. Some companies are good at saying okay, we have cost savings or value targets for each of our division, shift, etc., so they want to be involved in having their name say, "Hey, look what I did for my company." It is also about individual motivation to be able to contribute to something of value for the company as a whole.

A. Hinterhuber: Let us assume a customer is unwilling to sign off on a quantified value proposition. Are there softer ways a supplier could use to get to a similar result? A case study or a testimonial might work as well in the end.

T. Snelgrove: Yes, 100 percent, all this is part of a negotiation. If the customer wants X, they have to agree to maybe do a case study with us if we do Y. If, on the other hand, the reluctance to sign is the result of a perceived confidentiality of information, we will take ranges or round numbers.

Just a final note there, I've heard that some companies or some people are reluctant to sign things off because they take it as a personal detriment to their past history or their past experience: By me signing this, I'm admitting that for the last 10 years I've been costing the company a half million dollars a year because I wasn't doing something. By signing off on this, I look bad. It actually becomes a negative.

The message needs to be reframed. We as a company are only going to win if we become more efficient in the future. This is about us all getting better and replicating those things, so I think it's how it gets presented and rolled out.

A short story: We had a benchmarking tool that would allow companies to see opportunity for improvements. Then we would use a value quantification tool to show the profit improvement opportunity in monetary terms. I was in Saudi Arabia at the time. The customer was very resistant. It was going very badly. The customer spent the whole time explaining why the opportunities for improvement were not applicable to them because they were in the desert. They had all these excuses.

We took a coffee break and I said to my colleague, "Do you mind if I just try to reframe this when we come back in?" He goes, "Hey Todd, try anything right now." I said, "Gentlemen, I think what's important to know, and it's our fault for not explaining this earlier, is that we believe that you, your team can be much better if you had the resources, the training, the people that you need. Your management team is not giving you those resources because they don't see the payback. What we're giving you now and saying hey, here's the business case. If we have this amount of money or this investment, this is the payback we could get."

I was amazed at how it changed the mindset. It wasn't you're doing bad because it was you, it's not. You guys have been firefighting and doing the best you can. Boss, give me the money, whatever that is, $100,000 and look how much better I could be.

This is to help you get the tools you need to do your job better, which at least in my world; everybody wanted more resources and this. They need to see value quantification as a way to help them get those resources. Value quantification is a business case that they can bring to their management.

A. Hinterhuber: Todd, this is great. Framing is essential in value quantification. Your experience suggests focusing on future opportunities, not on past problems. Great piece of advice.

T. Snelgrove: Thank you.

A. Hinterhuber: One more question on value quantification. What is the role of intangible elements in value quantification? How easy is it for B2B customers to accept the fact that they have to pay at least in part for something which is intangible?

T. Snelgrove: I think there are a few things there. One, it's important to enumerate all the intangibles or value placeholders, to use a term coined by Jim Anderson and colleagues (Anderson et al., 2006). Maybe I don't have a specific number, but there's value in my responsiveness. There's value in our relationship. I always challenge myself to not give up too easily in the ability to quantify what that value is. Again, maybe we don't have to give an exact number to it, but to make the intangible element a little harder.

An example I use, relationship. We've had a 10-year relationship. My engineers know your engineers, etc. I say okay, the price savings you could obtain by switching us out is where I'm going to make a number, $50,000. Yes, that's a lot. That $50,000 equates to 2 1/2 weeks of your purchases. Okay. Do you not think that the relationship we've had for 10 years is going to take you more than 2 1/2 weeks for the next company to come in, find out who they should talk to, find out what the top 10 problems are, start the five projects we got going halfway through the system and they're coming out the other end with actual results. . . It's a reframing of the number, not to be threatening but just to reframe. What I find is people saying, "I never looked at it that way."

It's a value placeholder but they'd be taking the numbers and reframing them in a way that makes them say "Wow, you're right. I mean it would take us so much longer to switch in cost or startup cost with the other vendor. It's not worth it." One, enumerate them and again, just put a basic number there. Two, don't give up on trying putting a number to it. The example that's used a lot is buying from offshore suppliers. Start doing, how much more time do you think on average the engineers need to talk just to clearly understand what the other one's saying? Even if it's only 30 minutes a week, whatever, these types of "what ifs" make a difference. I'm not guaranteeing anything.

I'm just doing reasonable what ifs. It gives them a little more comfort that there's some reasoning behind it.

A. Hinterhuber: On which intangible elements do you get the biggest pushback from customers? Which elements, by contrast, are easier to sell?

T. Snelgrove: I think that's where the sales force stops and they leave the customer phrases like "With well we have a good relationship". When you're dealing with professional procurements, the word, "relationship," means you get together and have coffee. I mean, I mind paying for that. Until you discover and you can prove that the relationship means speed, for example.

Again, I think it's our responsibility to do a little more work there. One example, brand. For my world, my product inside somebody else's product, a brand will be more important. The user's buying a big machine and it's coming equipped with the best product in the marketplace on it. I would then be saying to their sales force, "You should be selling that as part of your sales value proposition to your customers." Even if you could get 1 percent more for your machine because you're using our stuff versus somebody else's, you'll have this ROI.

Professional procurement, when they hear the word, "Brand," they hate it because to them they're paying more for a logo and they actually think it's a big waste of money. I wouldn't use the word "brand" unless you've got something behind it. You have got to show what an intangible element, such as a brand, actually means.

A. Hinterhuber: The key is to turn an intangible element into a tangible element that matters. The sales force has to be able to convert intangible elements into revenue/margin growth, cost reductions, and so on.

T. Snelgrove: Yes, and they don't need to be perfect. You just need to give them a little more meat. Even if, based on our reports, I just put $1 there and say we know it's worth more. We don't know what the number is, but I mean our people work together, they know each other. Just think how long it'll take for them to get to know the next person. Again, I'm trying to take an abstract element and make it more tangible. I also find using day-to-day examples makes it more relevant to people. They can smile and nod and go, "Okay, that makes sense, okay, you're right, you're right, I didn't think of it that way."

Another final comment: whenever you're doing a value quantification, don't stretch for every last dollar. Too often people will say brand and then let's put a number, $100,000, that's what it's worth. The number's so big it doesn't make sense. Now I'm going to be resistant. I'm not saying it has to be a $1 or for sure not worth 0, but even if you put a range in there. Say it's between this and this or something; don't try to oversell.

A. Hinterhuber: Credibility is paramount. You rather err in the customer's favor.

T. Snelgrove: Yes, for sure. I think that that makes the customer feel even happier when they know that they will get X amount in value, but that a lower number has been assigned in the value quantification models. We actually get this but he only put that number down.

A. Hinterhuber: Do you have any further comment on pricing and value quantification that we missed so far?

T. Snelgrove: I just think really quickly and I'll quote here you in this. You and Stephan Liozu talk about the difference between price setting and price getting (Hinterhuber & Liozu, 2012). It needs to have the pricing people work with the sales people as part of the team to figure out how do we do this and have the same kind of metrics and KPIs so they're part of the same group and working toward a common goal. If your organization has plenty of ways to discount, but you don't have plenty of ways to get paid more for value to price properly in the beginning, or to get a risk reward for the work that you do, I think maybe that's an area to reinvest with. Finally, the rise of professional procurement will continue. We're seeing it in industries I never thought would be possible, such as the medical world. Your value proposition, if you're not the lowest priced person, needs to be tangible and take the time and effort to quantify it, and you've got to start somewhere with value quantification and you can build something that has credibility, resonance and improves the competitiveness of your customers.

A. Hinterhuber: Todd, this was a great exchange of thought on the emerging role of a Vice President of value. I thank you for the privilege of a first-hand intellectual exchange.

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