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IMU Research Insights
002

Rules for Successful Competitive Pricing in Business Markets

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BUSINESS SCHOOL

Executive Summary

Relevance of study

- The price pressure of customers and competitors is the most critical issue for most suppliers in business markets.

Investigated industries

- Business-to-business markets (e.g., machinery, automotive, chemicals, consulting, software/IT services)

Key contributions

- The study shows how firms can lower the risk that their managers with pricing responsibility give excess price concessions.
- The study addresses major pitfalls in firms' competitive pricing and shows how to professionalize competitive pricing.

Method

- Paper-and-pencil survey of more than 200 firms
- Informants: managers with primary responsibility for pricing (e.g., Sales Director, CEO, Marketing Director, Key Account Manager)

Findings

- Firms perceive themselves as premium suppliers, with a price frequently too low compared to value.
- In addition, in most business-to-business markets, firms strive for lower prices in the future.
- Soft factors rather than hard factors are crucial to understand as to why managers give price concessions.
- Firms should avoid rewarding their pricing managers based on sales objectives.
- Firms should engage in value-based and proactive pricing.
- Firms should rely on customer- and competitor-related price information from neutral / external sources.
- Firms should align and set up the right organizational structure that helps to professionalize pricing.

Agenda

- Topic Relevance and Key Questions
- Study Characteristics
- Study Results
- Managerial Implications
- Contact and Further Information

A lack of strategic understanding of competitive pricing can destroy a firm's margin and the industry's profitability.

When making competitive pricing decisions, firms often:

- Misperceive their own and their competitors' price-value positioning in the market.
- Misinterpret customer and competitor reactions. (Homburg/Jensen/Schuppar 2005)
- Lack strategic foresight. (Montgomery/Moore/Urbany 2005)
- Believe that the market dictates their pricing.
- Prefer cost-based and competitor-based pricing to value-based pricing. (Schuppar 2006)

Major pitfalls in competitive pricing:

- Firms deliberately give away margin when negotiating prices with their customers.
- Firms unconsciously intensify price competition and initiate price wars.
- Firms destroy the profitability of their business models (e.g., in the airline sector).

Topic Relevance and Key Questions

Our study provides an understanding of major pitfalls in firms' competitive pricing behaviors and shows how to professionalize competitive pricing.

Key Question 1:	Why and how do biases in a firm's perception of its price positioning and competitive pricing lead to increased price competition?
Key Question 2:	Why do managers give excess price concessions in order to close deals?
Key Question 3:	How can firms increase their success and profitability with respect to competitive pricing?

Study Characteristics

Our recommendations are based on a broad sample of 230 firms from diverse business-to-business industries. They are generalizable across industries.

Study design

Method

- Standardized questionnaire (paper and pencil)
- More than 240 items/questions
- Duration: approx. 30 minutes

Sample

Target group:

- Firms/SBUs in business-to-business markets
- Senior managers/board members responsible for pricing (e.g., Sales Director, Marketing Director, CEO)

Target industries:

- Professional services: e.g., Consulting, Facility Management
- Industrial goods: e.g., Machinery, Automotive, Chemicals, Utilities

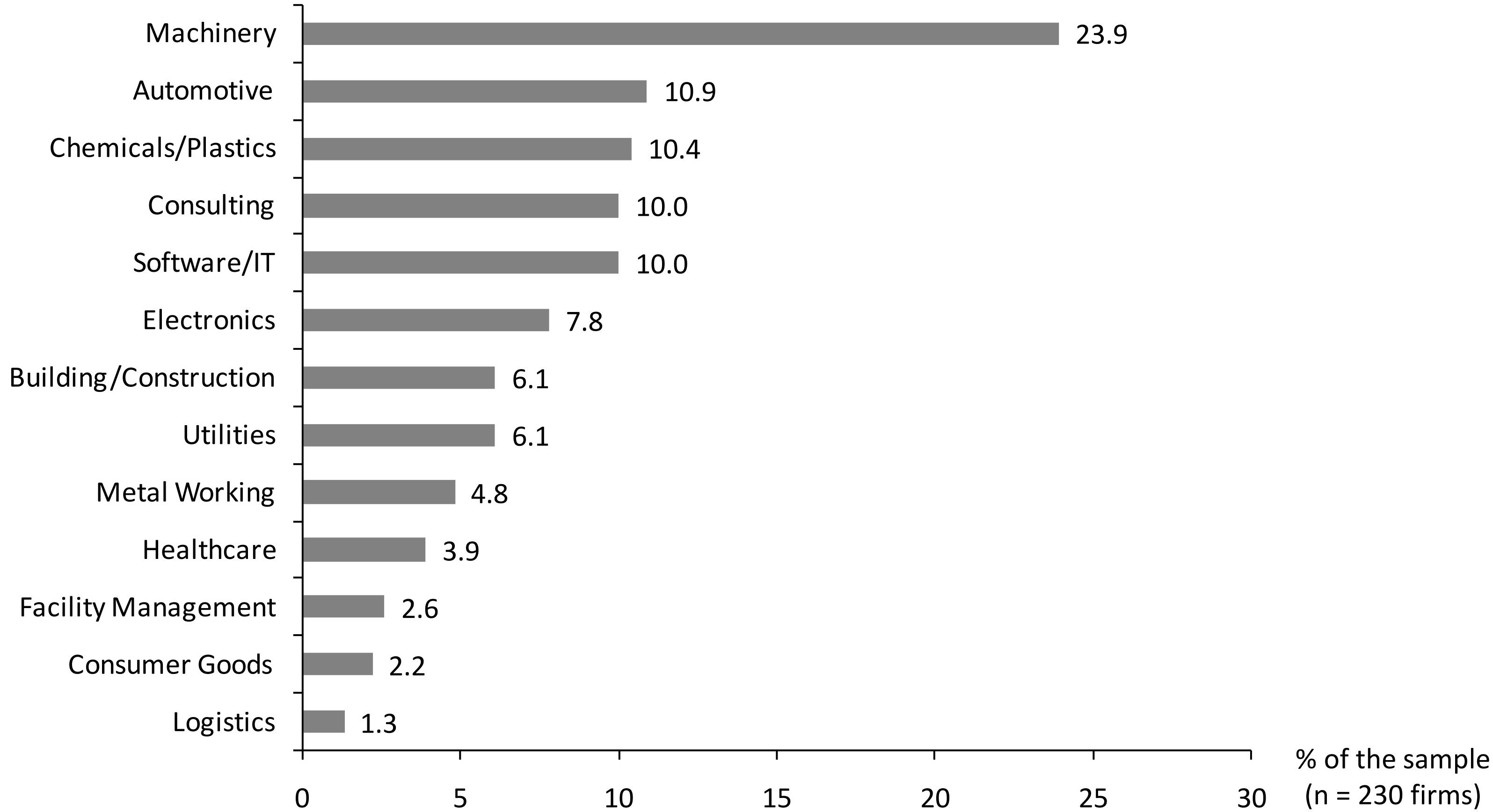
Response: 230 firms/SBUs

Data Collection

Spring 2008 (& fall 2011 for validation purposes)

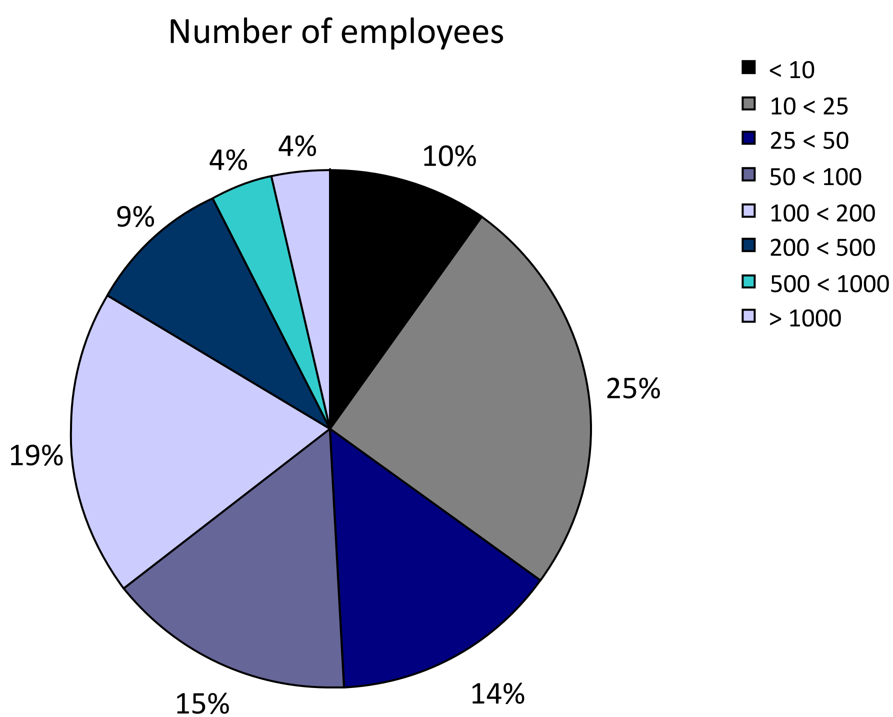
Study Characteristics

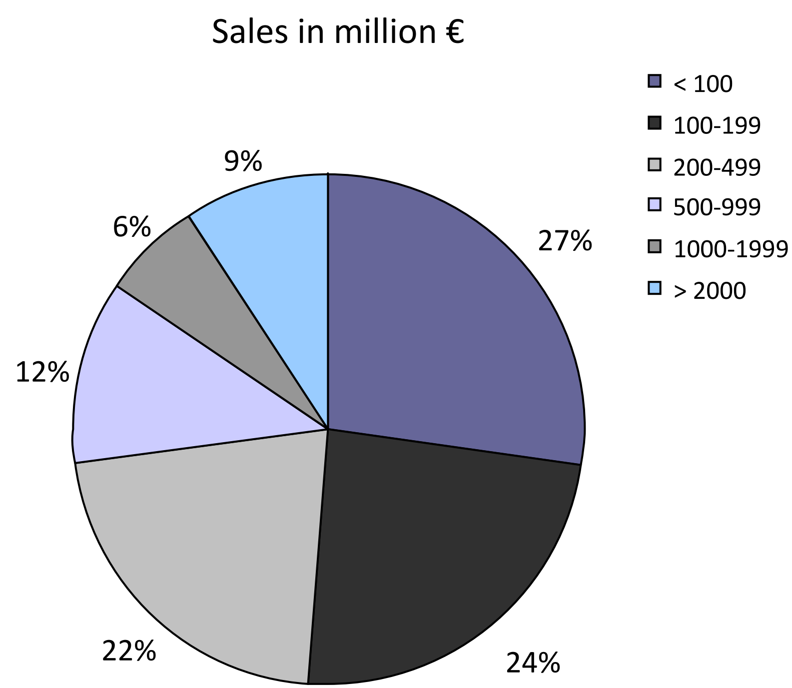
The sample represents major business-to-business markets and firms in Germany, covering both industrial goods and professional services.



Study Characteristics

Firms/SBUs of all sizes participated in the study. Results are based on a balanced sample of small, medium, and large firms/SBUs.





(n = 230 firms)

Study Results: Key Question 1

Most firms perceive themselves as high price and high value suppliers. But: for 40% of the firms, the perception of the price-value positioning is not in balance.

	Relative value		
Relative price	**Low**	**Medium**	**High**
High	0.0 %	**17.8 %**	**Premium price-positioning 38.4 %**
Medium	0.5%	**Medium price-positioning 20.5 %**	**20.1 %**
Low	**Low price-positioning 0.5 %**	0.5 %	1.8 %

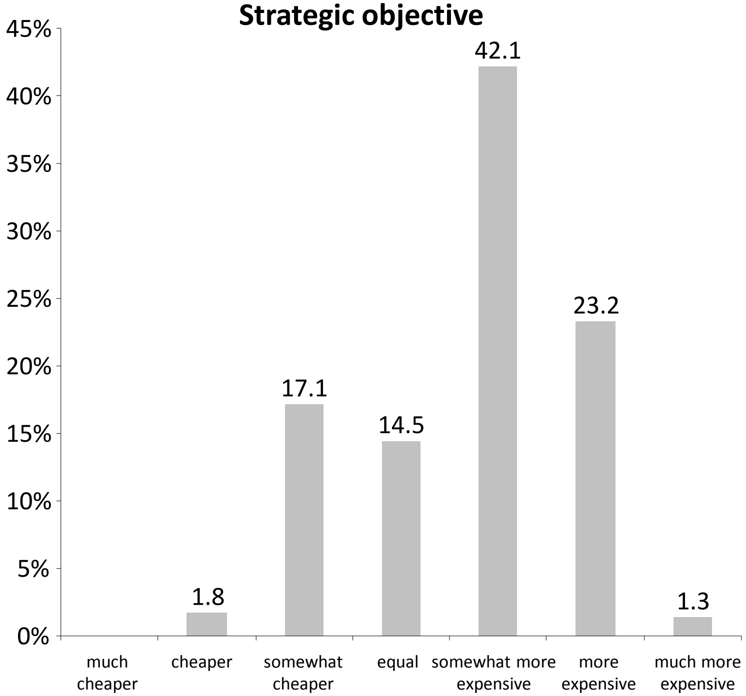
No stable position in the long term

High danger to foster price competition

The firm's relative price-value positioning is fairly balanced.

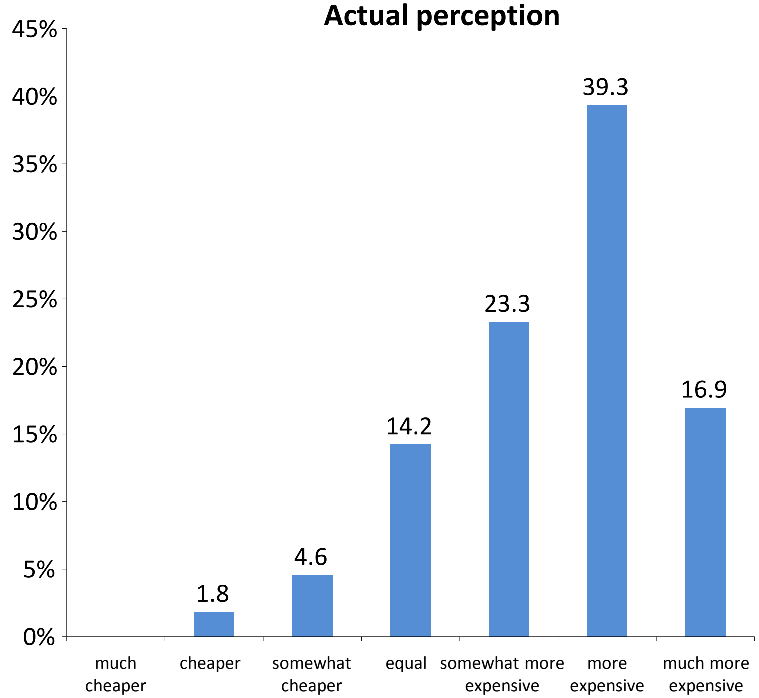
Most firms believe that they are actually more expensive than fixed in their long-term pricing strategy. This bias also implies a high danger that firms foster price competition.

Own price positioning in the market:
Strategic objective



67% strive for a price positioning above the industry average

Own price positioning in the market:
Actual perception



80% indicate that their price actually is above the industry average ⇨ indication for a biased perception

In most industries, firms perceive themselves as premium suppliers, with a price relatively too low compared to value. This is a dangerous state! Even worse, firms intend to lower their prices across industries (in particular: utilities, software/IT, and automotive).

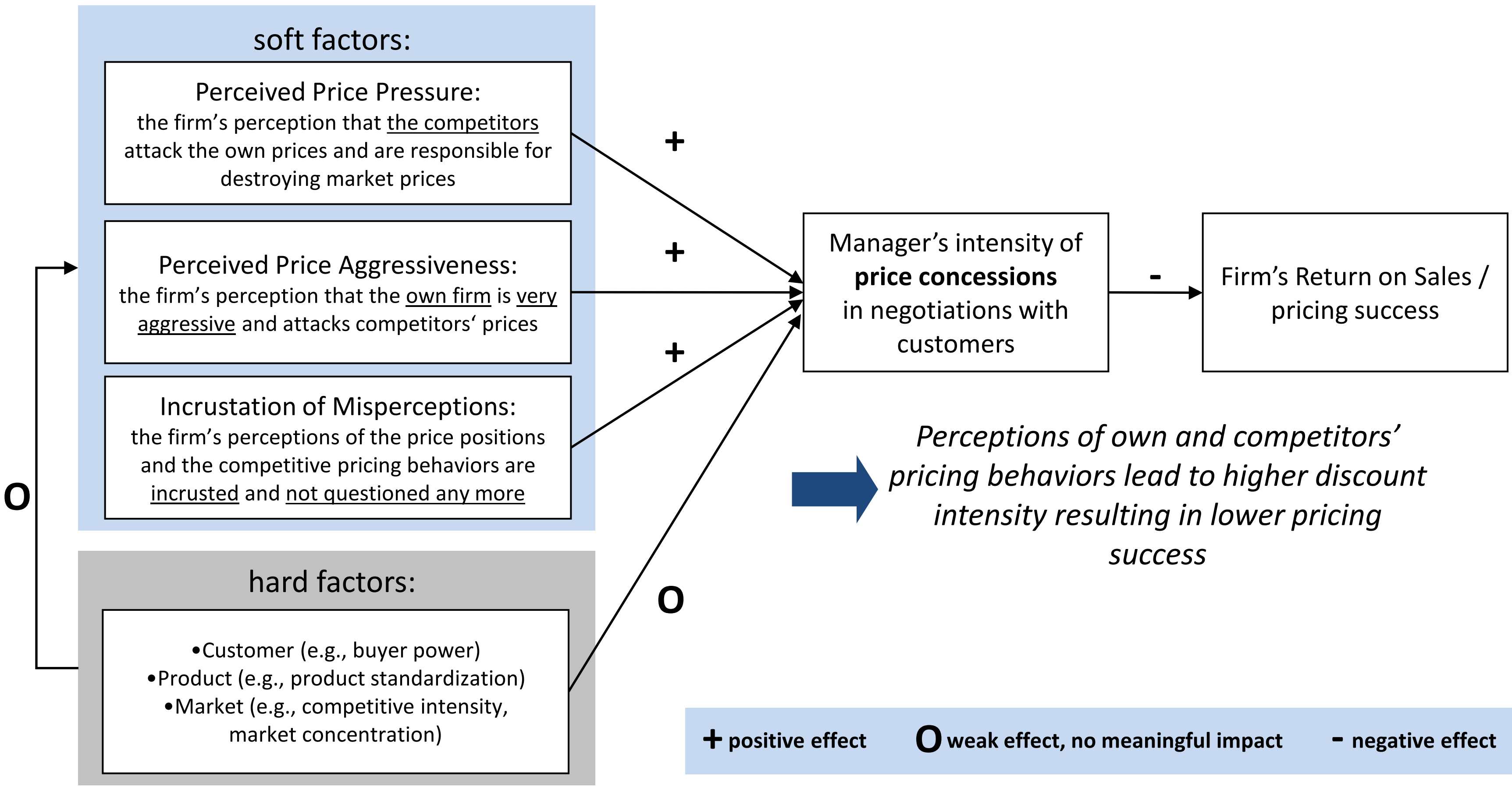
Industry	Actual perception of price positioning	Actual perception of value positioning	Actual perception of price positioning relative to value	Discrepancy between actual and intended price positioning
Machinery	**75.3**	73.6	+2 %	+13 %
Automotive	66.3	**80.7**	<u>-14 %</u>	+9 %
Chemicals/Plastics	75.0	72.1	**+3 %**	+9 %
Consulting	72.1	75.8	-4 %	+5 %
Software/IT	73.6	79.0	-5 %	+16 %
Electronics	71.3	79.2	-8 %	+12 %
Building/Construction	73.2	76.8	-4 %	+8 %
Utilities	<u>60.7</u>	<u>68.5</u>	-8 %	**+18 %**
Metal Working	68.3	73.3	-5 %	<u>+3 %</u>
All firms	**71.8**	**74.8**	**-3 %**	**+10 %**

Index values scaled from 0 (very low) – 100 (very high) (%)

bold = highest value, <u>underlined</u> = lowest value

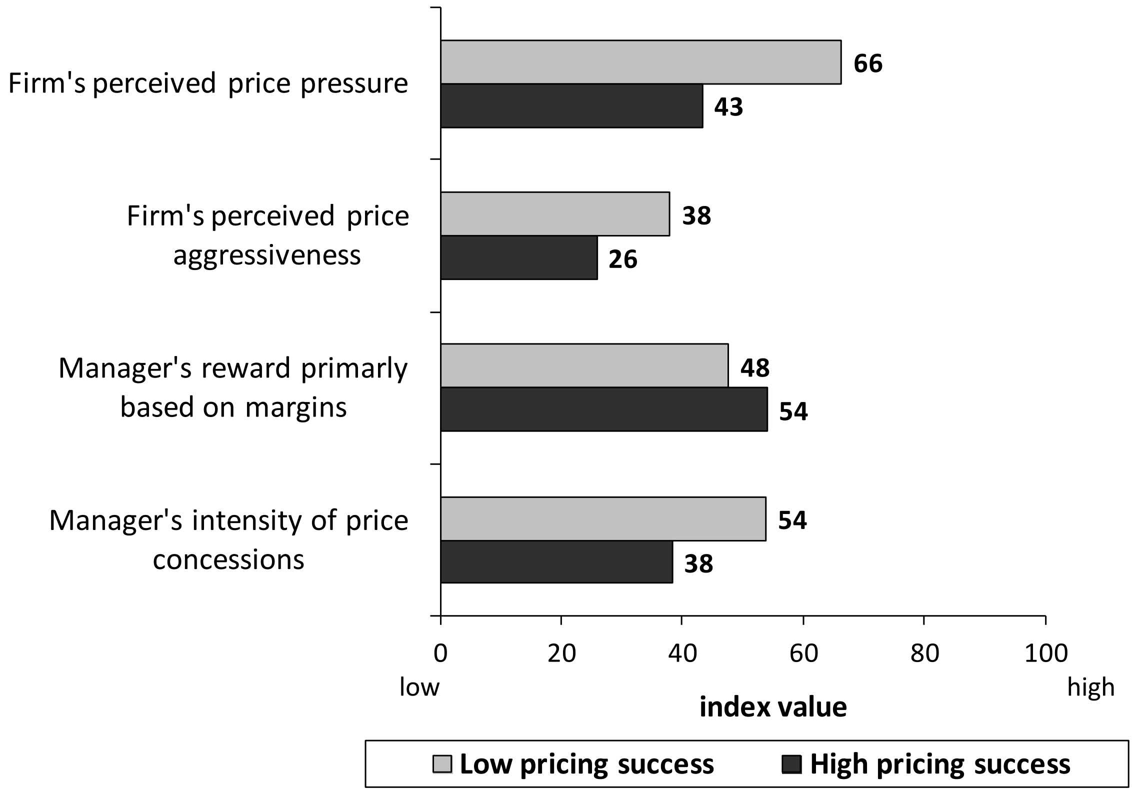
Study Results: Key Question 2

A manager's pricing is affected by the firm's <u>perceptions / shared beliefs</u> related to price competition. Soft factors rather than hard factors foster the destruction of margins.



Study Results: Key Question 2

When firms perceive themselves as price aggressive and a high price pressure, managers give higher price concessions. This is especially the case when managers are rewarded based on sales, instead of having margin/profit-based incentives.



Study Results: Key Question 2

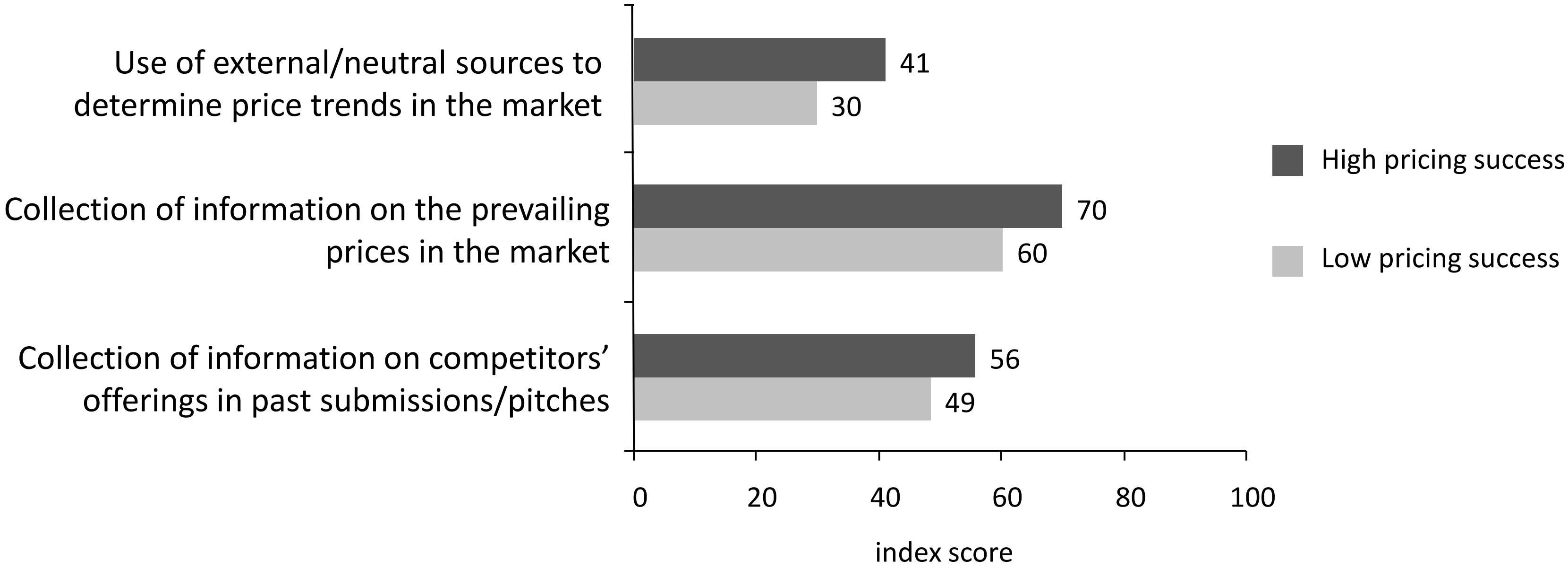
Software/IT firms give unreasonable high price concessions (notably in comparison with consulting firms); profit-based rewards are not common for the utilities sector.

Industry	Manager's intensity of price concessions	Manager's reward primarily based on profits	Firm's perceived price aggressiveness	Firm's perceived price pressure
Machinery	48.0	51.0	34.7	55.5
Automotive	41.8	51.5	**43.8**	62.8
Chemicals/Plastics	44.5	**59.7**	26.3	52.5
Consulting	<u>36.2</u>	54.8	<u>21.7</u>	<u>44.7</u>
Software/IT	**59.0**	56.8	33.7	45.3
Electronics	52.8	46.5	34.7	58.7
Building/Construction	47.2	57.0	23.3	**64.0**
Utilities	37.5	<u>33.3</u>	29.2	49.2
Metal Working	38.8	37.0	36.2	60.5
All firms	**45.5**	**51.0**	**31.5**	**53.3**

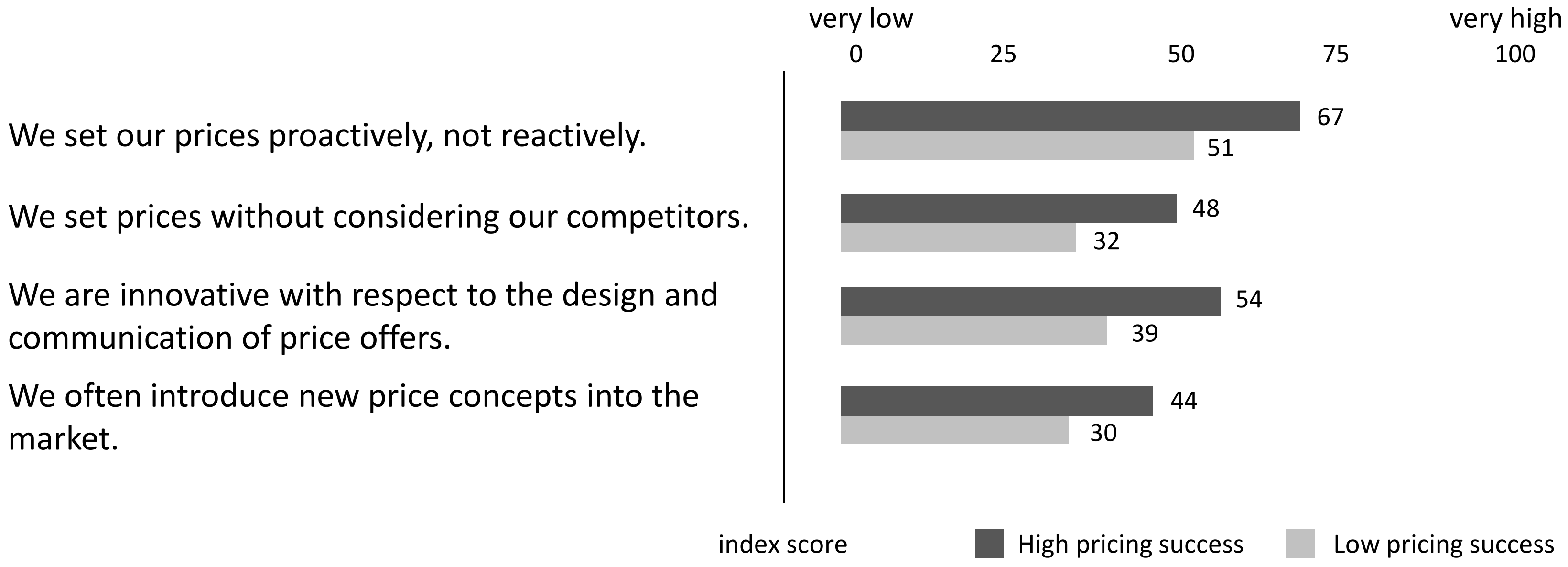
Index values scaled from 0 (very low) – 100 (very high) (%)
bold = highest value, <u>underlined</u> = lowest value

Study Results: Key Question 2

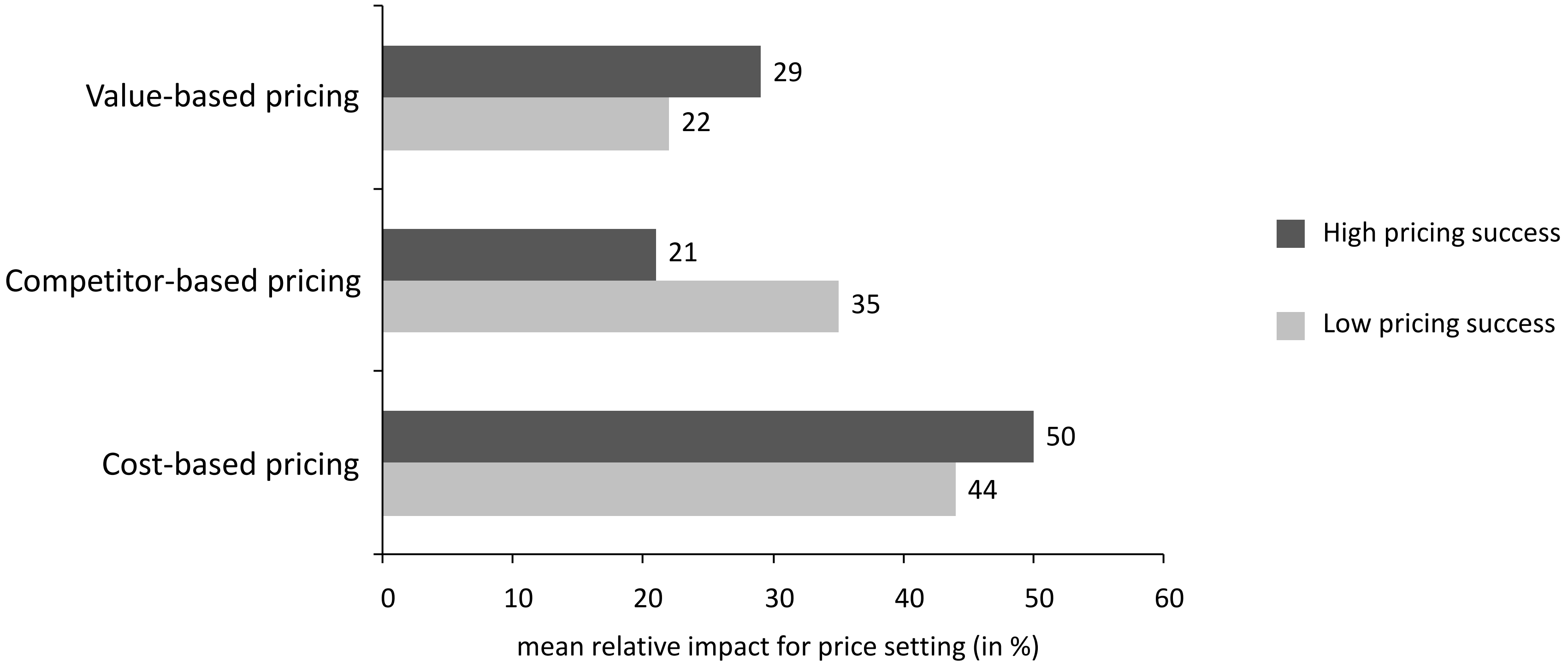
A systematic collection of **objective** information on prices and price trends in the market leads to a higher pricing success and profitability. However, the use of external and neutral sources for price information is still underdeveloped in practice.



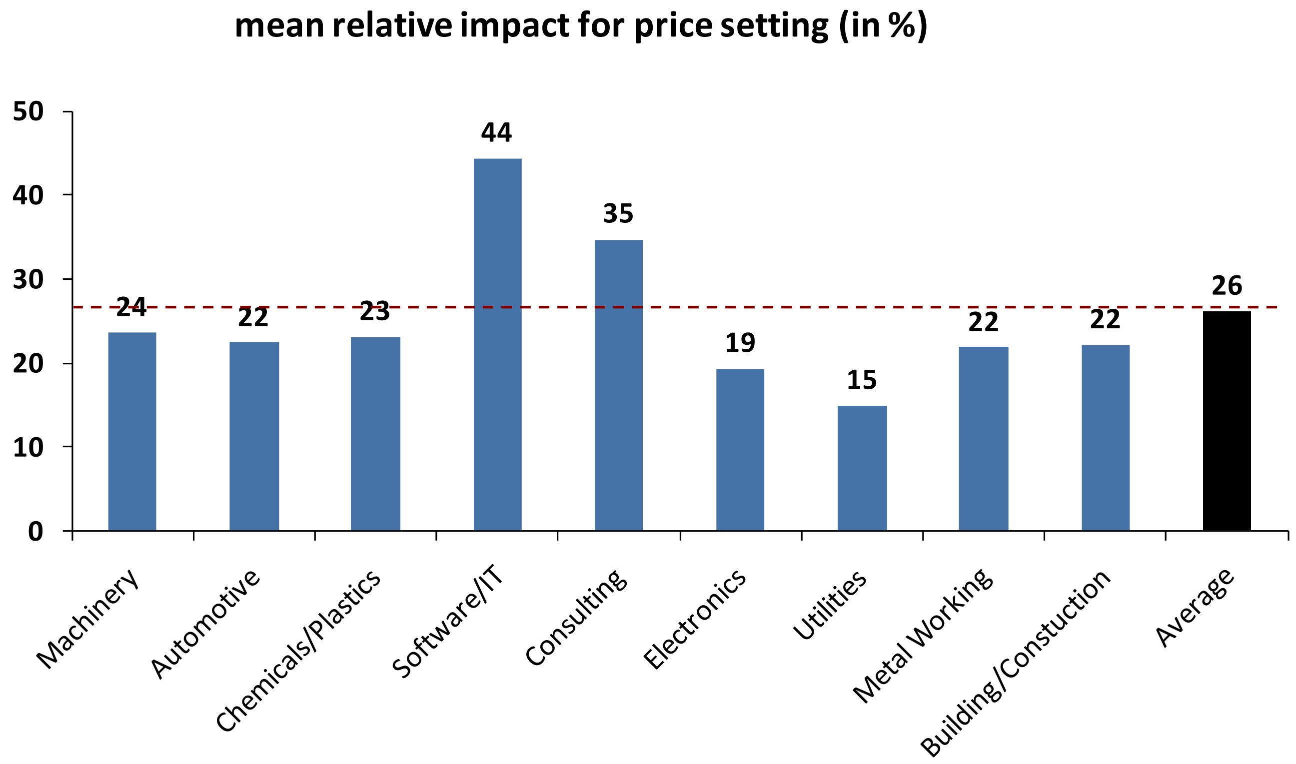
Firms with a **proactive** instead of reactive competitive pricing behavior have a higher pricing success and profitability.



Firms with a stronger focus on value-based pricing instead of competitor-based pricing have a higher pricing success and profitability.

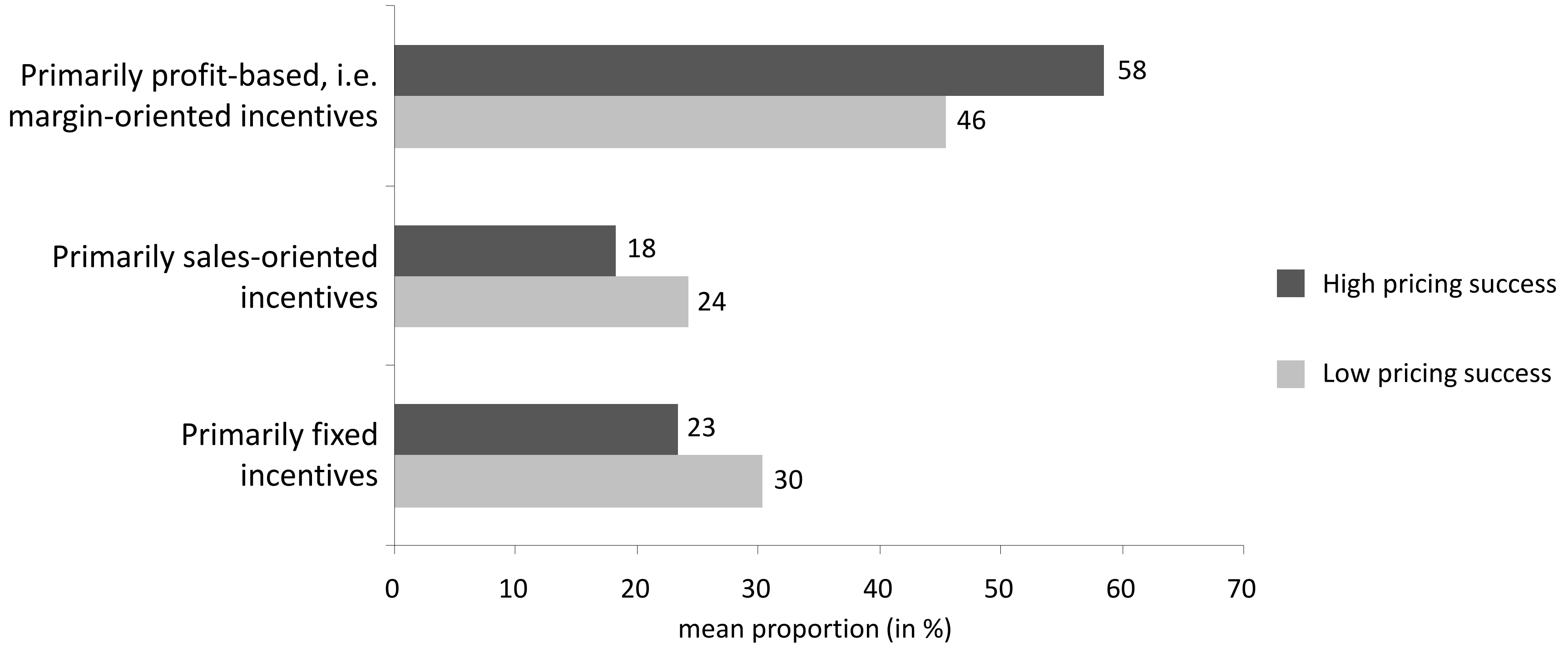


Value-based pricing is most common in the software/IT industry, and the least common in the utilities sector. All industries score very low, with a need for a stronger emphasis on value-based pricing in practice.

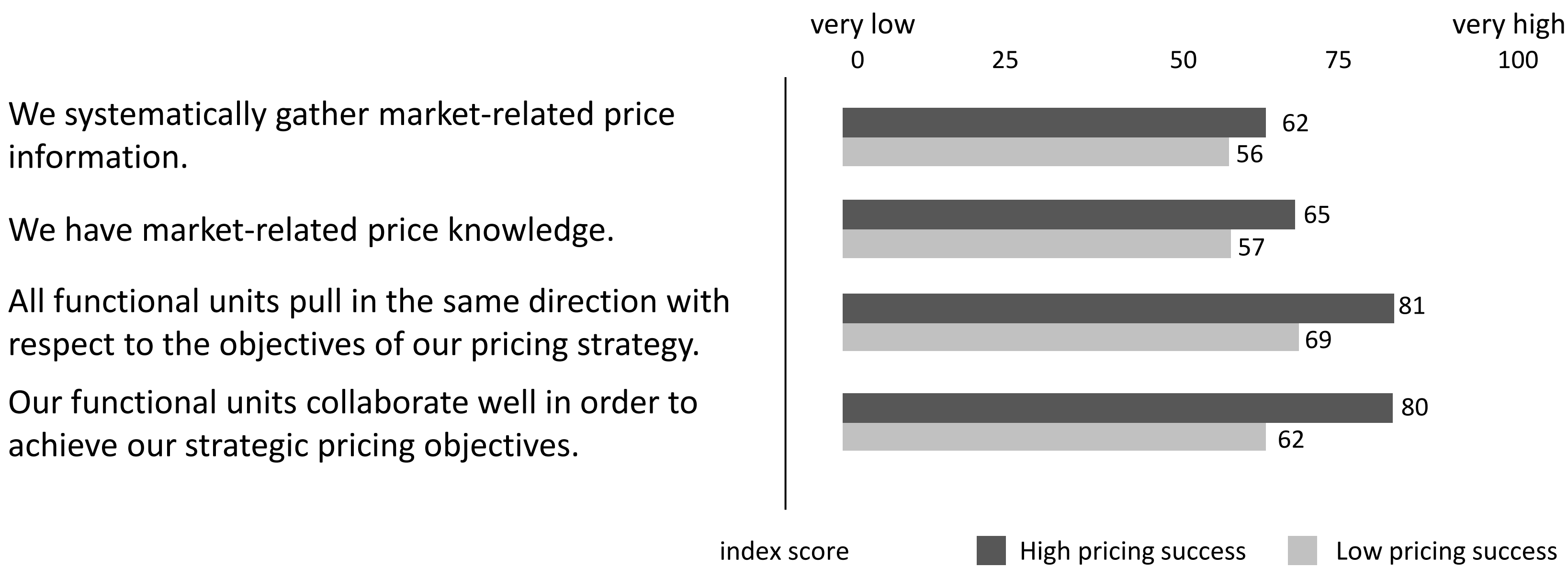


Study Results: Key Question 3

Successful competitive pricing is generally supported by rewarding price managers based on profits instead of fixed or sales-oriented rewards.



The systematic gathering and sharing of price information as well as shared objectives and a collaboration across functional units are major internal prerequisites for a successful competitive pricing behavior.



A competitor-oriented culture considering competition as an opportunity rather than a threat increases competitive pricing success.

Managerial Implications:
Nine Rules for a Successful Competitive Pricing Behavior

Rule 1	Examine carefully whether the perception of your price positioning in the market is really true. You might not be the premium supplier you thought to be!
Rule 2	Question the prevailing perceptions in the firm of your own aggressiveness and the price pressure by your competitions. Examine whether the price perceptions are incrusted and not challenged any more!
Rule 3	Set up margin-oriented, not volume-oriented incentives for your price managers!
Rule 4	Collect customer- and competitor-related price information systematically and rely on neutral / external sources of information!
Rule 5	Engage in proactive competitive pricing behaviors and avoid mere reactions to competitor moves! Use innovative pricing concepts!
Rule 6	Focus on value-based pricing and minimize competitor-oriented pricing!
Rule 7	Establish clear-cut pricing responsibilities!
Rule 8	Assure that all organizational functions pull in the same direction with respect to your pricing strategy and pricing objectives!
Rule 9	Establish an organizational culture considering competition as an opportunity, not as a threat!

Contact and Further Information: Institute for Market-Oriented Management at the University of Mannheim

The **Institute for Market-Oriented Management** (**IMU**) at the University of Mannheim (Germany) considers itself to be a forum for dialogue between scientific theory and practice. The high scientific and academic standard is guaranteed by the close networking of the IMU with the three Chairs of Marketing at the University of Mannheim, which are highly renowned on a national and international level. The Academic Directors of the IMU are Prof. Dr. Hans H. Bauer, Prof. Dr. Dr. h.c. mult. Christian Homburg and Prof. Dr. Sabine Kuester.

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Further Readings:

Homburg, Ch., Totzek, D. (2011), Preismanagement auf B2B-Märkten: Zentrale Entscheidungsfelder und Erfolgsfaktoren, in: Homburg, Ch., Totzek, D. (Hrsg.), Preismanagement auf Business-to-Business-Märkten: Preisstrategie – Preisbestimmung – Preisdurchsetzung, Wiesbaden, p. 13-69. (in German)

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