Wissen für Entscheider

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B2B pricing

It's often the case that purchase decisions within companies aren't as rational as you might think. Just like the purchase process undergone by a B2C customer, there are numerous factors – such as established corporate structures or people's personal approach to making decisions – that can influence how employees responsible for making the choice will act. This means that undreamt of potential margins can be exploited if one gains an understanding of price knowledge, price interest and price sensitivity.

B2B pricing – hot on the heels of behavioural pricing

Decision-makers within companies are just as irrational as private individuals when they make their choices. Provided this insight is acknowledged by people within the company, it will enable them to exploit undreamt of potential margins and develop specific approaches that will avoid the perils inherent in price wars.

In 2008, Vocatus conducted a GRand International Pricing Study ('GRIPS') in 10 sectors and 16 countries, thereby providing the baseline research for Vocatus' approach to psychological pricing which has in the meantime received a number of national and international awards. The fundamental results of this study mainly related to the B2C area, and are described in detail in the edition of our customer magazine entitled A Customer-centred Pricing Strategy (2/2008, download by going to www.vocatus.de).

Project-based experience over recent years has now demonstrated that the results of GRIPS not only apply to the B2C area, but can be used just as successfully in the B2B sector. The assumptions that underlie common psychological pricing procedures (conjoint, PSM, etc.) are based on the supposed existence of a „homo oeconomicus", a perfectly informed decider who is fully aware of the prices and features of all the competing products, and uses this as the basis for a rational decision.

In spite of every effort to the contrary, pricing decisions within companies are seldom rational.

As the international GRIPS study showed, this type of decision-making by private customers only applies to a minority of decisions. The following details will demonstrate that rational pricing decisions within companies are even less likely than they are in a private context.


SAMSUNG

The 5 'decider types'

Empirical research enables people to be divided into five easy-to-understand 'decider types'; these types can also be found among deciders within companies, albeit in a slightly altered form.

Figure 1:
GRIPS typology:
The 5 decider types.

Bargain Hunter prototype:
The purchaser for whom discounts are an incentive, and who is nonetheless willing to ignore the total cost of ownership.

Risk Avoider prototype:
The inexperienced decider who tells themselves that "no one ever got fired for buying IBM".

Price Accepter prototype:
The experienced decider who knows which quality-related dimension to watch out for: "The quality of specific components determines the quality of our overall product".

Loyal Buyer prototype:
Thrives in situations in which the decider and the person making the payment operate independently (e.g. Miles & More).

Indifferent Buyer prototype:
The user-chooser who uses their budget to buy unimportant items (e.g. office materials) spontaneously and without any in-depth research.

Source: Vocatus

Traditional pricing research methods rely on the model of the homo oeconomicus and the assumption of complete price knowledge. By contrast, the approach to psychological pricing that has been developed by Vocatus understands how people actually think and decide. This leads to specific recommendations concerning the avoidance of price wars and the optimal exploitation of potential margins.

B2B purchasers are also frequently unaware of how much products actually cost.

Empirical research yields five decider types which can be characterised within the B2B environment (as shown in Fig 1).

In order to differentiate the five types, empirical research is conducted to determine the level of price knowledge, price interest and price sensitivity possessed by a specific person within in a specific market. This goes well beyond the approaches that are normally used in market research (e.g. conjoint or PSM), and which assume a homo oeconomicus and thus an awareness of – and interest in – prices, thereby allowing one to look exclusively at this person's levels of price sensitivity.

By contrast, it makes sense to also ascertain price knowledge and price interest, as well as recording the reasons behind a decision and typical decision processes.

92% believe they know the price of a given product, but only 27% are actually correct.

The reality within the B2B area is that (as expected) price interest is relatively high but can vary greatly (depending on the sector and product life cycle): For example, price interest is much less pronounced and more budget-oriented when it comes to new products. Price knowledge increases if products are already familiar, yet it sometimes remains at an astonishingly low level (as the figure below makes clear).

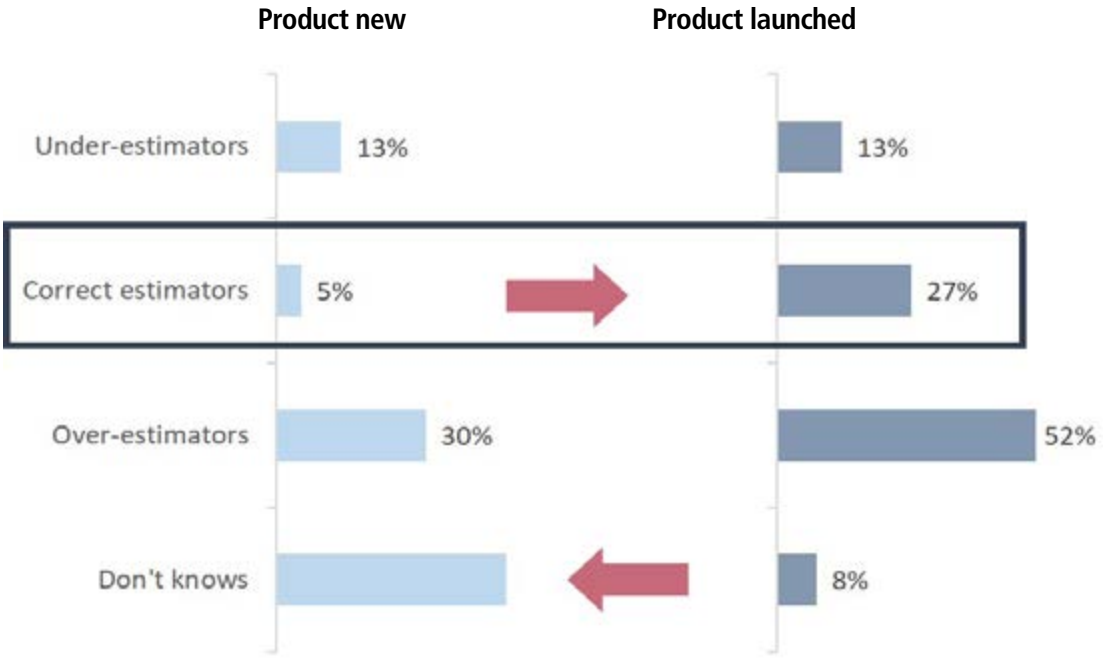
The example shows that a B2B purchaser is often totally uninterested in prices and is usually completely unaware of what things actually cost. In addition to price knowledge, price interest and price sensitivity, a B2B pricing project must therefore always include the organisational and market structures in the study and its subsequent recommendations.

With this example in the logistics market, price knowledge was (as expected) very limited when the product was new. When the same product had been on the market for a while, 92% nevertheless believed they knew its price; however, only 27% were actually correct. All the same, 52% considerably overestimated the actual price, which leads to obvious potential margins for suppliers.

Figure 2:

Example: Logistics

Actual price knowledge among B2B deciders: as expected, limited when the product was new.



Source: Vocatus

Structures in corporations and how they affect rational

Structures and processes that are customary within businesses (such as annual budgets, the allocation of decision-making authority to more than one individual, plus incentives to encourage savings) militate in favour of suboptimal price decisions for the company as a whole. On the other hand, suppliers can benefit from undreamt of potential margins if they understand these structures.

You would like to think that it's maybe only private individuals who reveal irrational purchase behaviour, but not deciders in companies who are paid to make optimal choices. Yet paradoxically, the rational behaviour of the homo oeconomicus tends to be encountered even more rarely in companies than it is among private individuals. This is firstly due to the fact that companies also rely on people – and not machines – to make decisions, and these people are subject to the same psychological phenomena as B2C consumers.

Yet it's above all down to the fact that companies have countless structures which render rational purchase decisions somewhat unlikely. For example, they include having to work with annual budgets, spreading the responsibility for making decisions among several people and/or decisions being made by groups, or incentives that encourage savings – these are just some of the structures that are used in most larger companies and corporations. This is then aggravated by the multiplicity of individual motivations (as described in the article about 'decider types').

All of these structures may be meaningful and necessary when it comes to leading people and managing a company, but they don't produce rational purchase decisions. The following examples ought to make this clear.

Budgets often lead to irrational pricing decisions.

Most large and medium-sized companies have budgets for various divisions and departments; a purchase number is generally assigned to these budgets, and any expenditure has to be authorised. The respective budget cannot be exceeded, and is forfeited if it isn't entirely used up. However, when responsibility

for a budget is combined with risk aversion it generally means that disadvantageous pricing models are actually preferred.

For example, it can often make sense to establish a 'pay as you order' pricing model. This entails a variable product/service-related invoice that is transparent because all the cost items are listed separately, and it's also fair because the commercial risks are clearly defined for both parties.

Faced with a choice, most purchasers in companies will nevertheless opt for a package model where the product/service is paid for via a lump sum, regardless of whether (and how much) it is used.

For those in the company who are responsible for such matters, the major advantage of such packages is that everything can be precisely calculated and there will be no surprises (such as going over-budget or under-budget) at the end of the year. However, in actual fact this involves choosing a pricing model that is unfavourable for the company.

One further problem with regard to budgetary responsibility becomes clear at the end of the respective financial year because the budget holder naturally wants to completely use up the remaining budget, often under pressure of time. Shortly before year-end, discussions with the supplier often no longer revolve around what the product/service costs or whether it's actually needed at all; at this juncture, the most important 'product feature' is whether the invoice can be issued with a 'date of services rendered' that falls within the current calendar year, thereby allowing it to be charged to the annual budget. These decisions have little to do with a rational approach to pricing, but they open up interesting potential margins for suppliers who have made preparations for such requirements.

From a structural perspective, it is of course necessary within companies to spread the authority to make decisions to a number of different people, but this doesn't always promote rational purchase decisions. For example, team leaders in one of the companies we investigated are allowed to decide themselves about any expenditure up to a level of 50 euros per item. Given these guidelines, hundreds of team leaders in a medium-sized corporation took out annual subscriptions to a specific magazine at a price of 49 euros.

The cheapest provider loses market shares because it's perceived as being more expensive.

When price sensitivity alone was measured, it revealed that the team leaders would very likely be willing to pay a higher price, such as 55 euros. Nevertheless, if one were to use this as the basis for increasing the price of the magazine, this would rapidly turn out to be an own goal. If the budget limit of 50 euros were exceeded, the decision would namely be delegated to the next level up, where it would quickly become obvious that the company was actually buying far too many copies of the same magazine. A higher price would therefore lead to a huge decline in sales when these excessive subscriptions were cancelled.

The fostering of irrational decisions becomes particularly obvious if one looks at incentivisation models in purchase departments. Purchasers in many companies receive a variable component of their salary which is based on the level of savings they've achieved in their respective negotiations. This means that purchasers are more or less

forced by their contract of employment to become classic Bargain Hunters who aren't interested in the absolute price, let alone worrying about the usage costs in subsequent years (total cost of ownership); instead, they chase after the highest discount in order to maximise their own benefit.

Figure 3, which shows a classic market in the processing industry, is a good example of this. List prices are available, but the high number of products means the lists are very dense and difficult to understand, and it's hard to get any kind of overview. Thanks to the high discounts, the list prices are systematically underestimated and hardly ever taken seriously: they no longer provide any kind of guidance.

Combined with a purchase department that primarily focusses on discounts, the market became a classic Bargain Hunter market where people lose sight of total prices and the crucial price signals emanate from discounts which are also much easier to recognise and understand than the 'dense' price list of numerous individual products. It can therefore transpire that Provider A appears to be 'expensive' because it doesn't woo potential buyers with lower prices, while Provider B is perceived as 'fair' as a result of its high discounts even though the end price is ultimately more expensive. By using a smart pricing structure, Provider B can enforce higher prices and at the same time win market shares while Provider A appears to be more expensive and has duly been losing market shares for a number of years already.

One can see that deciders in companies might very well behave rationally on an individual basis, but are constrained by the company's own rules and structures. Thus anyone in the B2B market who wants to avoid price wars and achieve optimal margins must not only be very aware of psychological factors, but above all the structural and organisational framework that influences the decision process too.

Figure3:
Example: processing industry
Loss of market shares due to price image.

	Provider A	Provider B
List prices of the 4 best-selling products (standardised)	100	115
Average discounts on list price	36%	42%
Level of effective prices (standardised)	64	67
Price image	Pricey	Fair

Provider A has consistently been losing market shares for quite a while

Source: Vocatus

Special aspects of B2B pricing research

B2B pricing research is often far more wide-ranging than B2C pricing research (which is nevertheless already complex) because the structures within companies and markets must also be included in the study design and subsequent results.

As ever, the basis for successful pricing research is to initially gain an understanding of real-life decision processes. In order to achieve this in the B2B world, one often requires a more complex study design than what is customary with end customer studies. This is because the particular challenge in the context of the study is not to survey 100 purchasers and 100 specialists/ departmental heads, but in each case to survey one purchaser and one specialist/ departmental head from the same company. It's often the case here that one single individual doesn't have the specialist expertise combined with a responsibility for decisions and budgets, which means any pricing study must also analyse formal rules, roles and budgets.

A pricing study isn't only about understanding the decider's price sensitivity. A more fundamental approach to the topic of pricing must be based on an analysis of the market structure, since price and value are also the result of specific power and market structures.

B2B pricing research is more complex than B2C pricing research.

The outcome of a pricing project in the B2B area is therefore far more than merely a defined price point. Not only the decision process, but also the sales and negotiation process must be understood in the context of the project. Price recommendations can then vary greatly, depending on whether (for example) the salesforce mainly sells on the basis of price, value, sales expertise or service quality.

Sales in the B2B area are generally much more individual and personal, so new pricing frequently also raises issues linked to organisations and organisational psychology.

A pricing strategy must also include implementation within the organisation.

Particularly when it comes to large organisations, the implementation of an optimal pricing strategy is inconceivable without a detailed integration into the organisational structure, with corresponding areas of responsibility and opportunities for monitoring and control. The important thing is to not only have an optimal pricing strategy, but meaningful price monitoring and company-wide enforcement of prices too. However good a pricing strategy might be, it cannot function if (for example) the commission system doesn't support it (or even undermines it).

These approaches demonstrate that particularly when it comes to the B2B environment, pricing research amounts to more than simply measuring willingness to pay, and that a pricing strategy entails much more than the definition of price points. This makes B2B research even more difficult than the already complex B2C pricing research, but at the same time it's also disproportionately exciting and rewarding for the company.

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Vocatus is an innovative and globally active consulting and market research company which specializes in decision analysis, price optimization, customer satisfaction and employee commitment. Each project attaches great importance to problem-oriented solutions, concrete recommendations, and the efficient implementation of results. Vocatus has received a number of international awards for its innovative studies and practice-based concepts.
Vocatus is an active member of the Professional Association of German Market and Social Researchers (BVM) and the European Society for Opinion and Marketing Research (ESOMAR).

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