

BUSINESS-TO-BUSINESS MARKETING

WEEK 7 PRICING STRATEGY IN BUSINESS MARKETS

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WEEK SEVEN

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7.1 Introduction

Welcome to week seven lecture! It is my joy to have you in this class! Last week we discussed the product which is the first element of marketing mix theory in the context of business-to-business marketing. We saw how the product strategy is developed, the product portfolio new product development as well as product lifecycle. This week we delve further into pricing strategy. Price is the only aspect of marketing mix that is easily adjusted to raise or lower revenue. The pricing aspect ensures sustainability of a business and must be done tactically to not only meet customer expectations but also generate enough revenue for the business. In this lesson we shall examine how business marketers set prices and how the pricing strategy impacts the firm's profitability.

7.2 Intended Learning Outcomes

At the end of this lecture, you will be able to:

1. Describe the characteristics of business markets pricing.
2. Discuss factors that influence pricing decisions in business markets.
3. Examine pricing strategies for business markets.
4. Evaluate pricing policies in business markets.
5. Evaluate pricing methods adopted in business markets.

7.3 Business Market Price Characteristics

Price is the value (usually measured in monetary terms) at which the seller agrees to sell a product and service to the buyer and the value to which the buyer agrees to pay (Ali, 2021). It is one of the most critical decisions that has a direct and substantial effect on the profitability of the firm. Fill and McKee (2011) note that price of one product can influence other products in the mix or line and is viewed by customers as shorthand for quality, value, and market position.

Ali (2021) perceives business market pricing as characterized by a variety of issues that make it different from business marketing. First, price is not an independent variable but is integrated with other marketing mix variables (product promotion and distribution strategies). Second, the real price a business customer pays is quite different from the list price due to other factors like delivery and installation cost, training cost, discounts, financing cost, trade in allowances etc. Third, prices can be changed by changing the quantity of goods & services provided, premiums and discounts offered, and time and place of payment among others. This implies that the decision regarding pricing is more flexible. Fourth, prices can be resolved through negotiation in many cases. Fifth, business buyers who are experienced and able to estimate the vendors' approximate production costs, expect the increasing price to be justifiable based on either increasing cost or improvement in product hence emphasis on fairness. Sixth, B2B prices are affected by several economic factors such as inflation, change in interest rates, fluctuation in exchange rates etc. This problem is particularly critical for the marketer locked in long term contract with no escalation clause.

7.4 Factors That Influence Pricing Strategies in Business Markets

Like any other marketing mix variables, the decision on pricing strategies and methods is influenced by a variety of factors. We will examine a number of these factors as discussed by Ali (2021) and Blythe and Zimmerman (2013).

1. **The firm pricing objectives:** The business marketer must develop pricing objectives that are in line with its overall business objectives. The pricing objectives could follow in either of the following categories (Blythe and Zimmerman, 2013):
 - a) Profit-oriented: Profit-oriented objectives include pricing to realize a target return on investment or to maximize profits. The objective is therefore to focus on current profit maximization rather than long-term performance or long-term relationships with B2B customers.
 - b) Sales-oriented: This objective is either based on increasing market share because this gives an organization more industry power, or on maximizing sales, through running promotions and doing excessive advertising.
 - c) Status quo-oriented: This includes meeting competition or choosing to compete on a non-price basis. For the survival of the firm, it reduces the prices to convert the inventory into sales. Survival is more important than prices. The prices are fixed in such a way that they cover variable costs and a part of the fixed cost so that the company continues in business.
 - d) Other aspects of the firm will include the overall marketing program and product assortment considerations.
2. **Demand analysis:** Business- to -business customers are generally not as price sensitive as other customers. B2B demand can be explained through four categories of demand:
 - a) Derived demand: the demand for B2B products is generally derived from B2C demand.
 - b) Inelastic demand: This refers to a situation where a significant increase or decrease in the price of a product does not significantly affect the demand for the product. This is common in situations where customer demand is urgent, products sold are highly differentiated, competition is low, the products are seen as complements to other products, the cost of switching is high and where it is seen as a quality indicator.
 - c) Joint demand: This occurs when two or more items are used together in a final product. The demand for the items is thus interdependent.
 - d) Fluctuating demand: The demand for B2B products can be less stable than the demand for B2C products. A small increase or decrease in consumer demand may have a large effect on B2B demand.
3. **Cost analysis:** This will include both fixed costs (costs that do not change with the production or sales, such as rent, interest charges and managerial salaries) and variable costs (costs that change on the units of production like material and labor costs) in production, marketing and distribution. In considering the cost, the business marketer must determine economies of scale (the total average cost per unit decreases when the production volume increases, and total fixed costs spread over more units). Experience curve (the

average unit total cost of products decreases over a period with the firm's experience of manufacturing and marketing) and activity-based costing (ABC).

4. **Competitor analysis:** The business marketer must consider market conditions and probable reactions in case of price changes. A business marketer competitor may react to price changes by ignoring the price change, match the price change or offer more for the same price.
5. **Government regulations:** The business marketer must be aware of rules and regulations passed by the government and their impact in the profitability and sustainability of his business.
6. **Customer:** The business marketer pricing strategy is also influenced by the type of customers it serves and its relationship with them. The marketer will have to consider perception of the product or company, value based on usage as well as the ability of the customers to pay.
7. **Distribution channel:** Distribution channels also have a large impact on the pricing strategy. The availability of capable and competent distributors is a key consideration. The distributors also come with a cost to the firm. The marketer must assess whether it is easier to do in-house distribution or use intermediaries. If the marketer is involved in international marketing, he must consider grey market possibilities and its impact on pricing strategy.
8. **Environment:** The business marketer needs to be aware of environmental factors that influence pricing strategy. Apart from government regulations, the marketer must examine economic conditions such as inflation, interest rates, economic cycles, and growth as they will all have a bearing on the pricing strategy adopted.

7.5 Developing a Business Market Pricing Strategy

Developing business markets pricing strategy may take two different approaches. First, there is inside-out approach and outside-inside approach. The inside-out approach to pricing assumes that price reflects the costs incurred in developing, manufacturing, and bringing the product to market. It is also referred to as cost-based pricing and is used a great deal in B2B marketing. The main challenge with this approach is the identification and accurate allocation of the real costs involved in this process and lack of market orientation (Fill and McKee, 2011). The outside-inside approach starts by considering the customer's perception of the price and the value they attribute to the product. This value is determined by the perceived benefits product ownership will bring. These benefits are assessed in terms of what the product will enable the customer to do, and/or how it will solve problems. This approach is considered more customer friendly and easier to implement depending on how well market segmentation has been done.

The various business market pricing strategies are outlined below as discussed by Ali (2021), Blythe & Zimmerman (2013), and Fill & McKee, (2011).

1. **Pricing across product life cycle:** Pricing strategies vary as the business product moves through its life cycle. In the introductory stage of the new product, skimming strategy is applied to recover new product development costs. The products that are distinctive with sophisticated technology and capital intensity are suitable to adopt this strategy. For low-technology markets, penetration strategy generates high relative market shares and can be effective in deterring competitors from entering the market. In the growth stage the industrial marketers lower the product price and focus on product differentiation, product line extension and building new market segments. In the maturity stage, the business marketer cuts his prices to increase his sales and match the competitors' prices. In the final stage the business marketer may do either of the following
 - a) If the company has a reputation for good product quality or dependable service, do not cut price but reduce costs to earn some profits.
 - b) Cutting prices to increase sales and using a product to help in selling other products.
 - c) Selective increases in prices in markets that are not price sensitive.
2. **Competitive bidding:** The second pricing strategy employed in business marketing is competitive bidding. This is particularly important when dealing with government institutions. Competitive bidding occurs when buyers ask suppliers to tender to supply goods or services. Competitive bidding may take two forms: closed and open. In closed bids only the customer knows the value of all the bids and normally selects the lowest offer, although on occasions the best overall value bid is selected. In open bids, suppliers can see each other's offers and adjust accordingly. The buyer uses this approach to drive up the value of the offers to maximize the potential of the work. The natural progression from closed and open bidding is an auction. New technology has given auctions a new dimension and enabled both buyers and suppliers to reduce their costs. Before making a bid, the B2B supplier should consider five aspects:
 - If the company wins the bid, can its manufacturing plant handle the capacity?
 - What is the potential for becoming a preferred supplier and what are the chances of securing future orders or contracts?
 - What is the quantity required?
 - What is the potential profit?
 - Does the supplier have the experience to handle the request?
3. **Leasing:** Leasing is an arrangement between the leasing firm or the lessor and the user or the lessee, the former arranging to purchase the capital equipment for the use of the latter. The lessee must pay the lessor in the form of rentals and the lessor remains owner of the equipment during the specified period. Leasing enables organizations to reduce their exposure to debt and to concentrate their use of debt on areas where it is strategically more imperative. It frees up resources to enter markets or acquire the latest technology or capital equipment. The main challenge with leasing is that it can tie an organization into equipment or a specific technology for a long period of time. This can prevent the organization from

making changes when the environment or internal conditions change. Three types of leases can be identified:

- a) **Sales/leaseback:** Assets are sold to a leasing company and then leased back to the original owners for a fee over a fixed period. The advantage of this approach is the cash receipt resulting from the initial sale.
 - b) **Operating leases:** Maintenance of the asset is often included in these financial arrangements. There is no transfer of ownership (of the asset) when the payment schedule is complete.
 - c) **Capital leases:** The financial lease is for a basic term during which the lease is non-cancellable. The length of this basic period is determined primarily by the economic life of the asset and is usually shorter than the expected life. This arrangement provides some means by which the company may continue to use the asset after the expiry of the basic lease period, or alternatively, a market purchase price is negotiated on the lease termination.
4. **Price skimming:** occurs when there are few competitors and customers are willing to pay higher prices to be associated with the values and benefits of the new product. Skimming also occurs as a positioning tool, to convey prestige and high status.
 5. **Penetration pricing is the opposite to skimming:** The goal is to sell at a low price during the introductory and growth stage of a new product. This approach, common in low-technology markets, can generate high relative market shares and can be effective in deterring competitors from entering the market.
 6. **Price leadership:** Opportunities arise when an organization has a high market share and there are many ways in the category to develop customer value.
 7. **Follow the leader:** The strategies are advisable when there are few ways to reduce costs, relative to competitors, and the product category has few ways to increase value. This strategy can often be seen in commodity markets.

7.6 Pricing Policies

Apart from developing an appropriate pricing strategy the business market must also develop pricing policies that guide the entire pricing strategy. These are the broad guidelines that inform not only pricing strategy but also pricing methods to be adopted for specific products and services. Ali (2021) outlines the following as the key pricing strategies.

- a) **List Price:** This is the base price of a product consisting of various sizes and specifications. It is a published statement of basic prices given to the customers. This statement implies the effective date of its applicability and shows the extra charges for optional product features, such as the excise duty, freight, sales tax, or transit insurance. In modern times catalogues are issued by businesses marketers specifying the various charges and how the final price is computed.

- b) Trade Discounts: Trade discounts are offered to marketing intermediaries, such as dealers and distributors. The amount of trade discount given depends upon the industry norms and the functions performed by those intermediaries.
- c) Quantity Discounts: A quantity or volume discount is given to customers who buy in large quantities. It could also be a price reduction given by deducting the quantity discount from the list price of the product. These discounts can be given either on individual orders (noncumulative basis) or on a series of orders over a longer period, usually one year (cumulative basis).
- d) Cash Discounts: Cash discounts are given to encourage customers for prompt payments.
- e) Geographical Pricing: Pricing the company's products based upon the different geographical locations of buyers. Mainly, this happens since the company must undergo different transportation costs and transit insurance when delivering products to various locations. There are two issues in geographical pricing. The business marketer must decide whether to absorb the transportation cost or make the customer pay for it.

7.7 Pricing Methods

The business marketer must also use appropriate pricing methods to maximize pricing in achieving his marketing objective. Many of the methods used by organizations to price business products are based on the inside-out costing approach. The commonly applied pricing method are discussed briefly below (Fill and McKee ,2011):

- a) Mark-up pricing involves applying a set percentage of the cost of production or purchase price.
- b) Break-even pricing is like mark-up pricing except that both direct and variable costs are incorporated. The method requires the calculation of the number of units that need to be sold to cover all costs associated with the production of those units.
- c) Peak-load pricing, unlike the previously mentioned methods, considers customer demand. By understanding levels of demand and system capacities, it is possible to use price to smooth demand to manageable levels.
- d) Marginal cost pricing is often used by organizations such as airlines and hotels, which have high fixed costs. By trying to cover just the variable costs, the organization, especially in times of recession and economic downturn, can generate a contribution rather than no revenue at all.
- e) Product line pricing is the method that considers the relationship between all the products in a particular line. The objective is to allow customers to choose lines according to their price (value) range and to allow the organization to maximize their profits across the lines. Although this method is preferred more by retailers than by manufacturers, there are instances of manufacturers selling the same line to different markets, taking advantage of the different levels of price elasticity, to maximize profits.
- f) Going rate pricing is where the company sets the price according to price levels that are already used in their market. These price levels might have come about through tacit

agreement, similar cost and profit needs, customer demands, or by competitive market interaction.

7.8 Other Important Issues in Business Markets Pricing

There are several other issues that arise in business marketing pricing strategy that may require special attention from the business marketer. Some of these include:

1. The effect of internet in business

The availability of internet has greatly increased access to information globally. The business marketer must be aware that any facts placed on the internet will quickly be obtained by buyers throughout the world. Further, the internet has allowed development of price-oriented search engines, enabling buyers to quickly compare prices of various products from various firms and make decisions on whom to qualify for bids. Where prices are posted, the internet makes comparisons quite easy and therefore would dictate a standardized pricing policy rather than a differentiated one. If differentiated prices must be used, the website should explain why there is a price difference in a particular market based on additional costs for freight or distribution (Blythe and Zimmerman, 2013).

2. Foreign trade issues

The business marketer will often find himself doing international business and therefore the need to understand how to set prices in that market. There are several considerations that will have to be made among the common most including:

- a) Legality of pricing policies: Many nations regulate pricing in various ways. The business marketer often does not know which law to apply in foreign markets trade disputes. The issues of anti-competitive actions and dumping. Dumping means that a product is sold in a particular market at a level less than its cost of production plus a reasonable profit margin.
- b) Transfer pricing: Transfer prices are those set for goods or services which are bought by one division of a firm from another division. These are inside or intra-corporate prices. The issues of taxing in these situations strongly affect the business marketer pricing strategy.
- c) Terms of sales and payment: The business marketer must be aware of Incoterms used in international pricing strategy. Incoterms are standard terms of sale set by the International Chamber of Commerce. Incoterms specifically define the responsibilities of the buyer and the seller in any transaction. A large percentage of international business is completed using letters of credit. With a documentary letter of credit, the importer's bank will pay for goods provided certain conditions are met, which in most cases are the presentation of a bill of lading or air waybill. There may be other requirements such as insurance certificate, pre-inspection certificate, dangerous goods notice, bank indemnities etc.

2. Prices sensitivity

This refers to the degree to which buyers are likely to notice and react to price changes. Customer price sensitivity is affected by factors such as customer economics, search and

usage, and competition. The business marketer requires a thorough understanding of these factors and how they may affect his pricing strategy.

Review questions

1. Identify the main characteristics of b2b pricing.
2. What are the main pricing methods in b2b markets?
3. Identify key pricing policies in b2b markets.
4. What are the three major types of pricing objectives firms may use?
5. In developing a pricing strategy, what factors should a manager consider?
6. What affects a customer's price sensitivity?
7. What are the most common pricing methods used by international exporters?
8. In developing pricing policies, what should an international firm consider?
9. When a firm enters a competitive bidding situation, how might they analyze the attractiveness of entering a particular bid?

References

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