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# Industrial Pricing: Theory and Managerial Practice

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## Abstract

We organize the existing theoretical pricing research into a new two-level framework for industrial goods pricing. The first level consists of four pricing situations: New Product, Competitive, Product Line, and Cost-based. The second level consists of the pricing strategies appropriate for a given situation. For example, within the new product pricing situation, there are three alternative pricing strategies: Skim, Penetration, and Experience Curve pricing. There are a total of ten pricing strategies included in the framework.

We then identified a set of cost, product, market, and information conditions which determine what pricing situation(s) a firm is facing as well as which strategies are appropriate within a given situation. Some of these determinant conditions are common to many pricing strategies (e.g., highly elastic demand) while others are unique to a given strategy within a particular pricing situation. For example, within the product line situation, the profitability of supplementary sales is a unique determinant of the Complementary Product pricing strategy (razor-and-blade pricing). Using this framework as a basis for an empirical study, we examined how well current industrial pricing practice matches the prescriptions from the existing research.

Our sample consisted of 270 respondents (27% response rate). Of these, more than 50% indicated that they used more than one pricing strategy in formulating their most recent pricing decision for a high-value industrial product sold in the United States. As in previous research, Cost-Plus pricing was the most often cited pricing strategy (56% of the respondents).

Since the respondents were able to indicate their use of more than one pricing strategy, the data are of the "pick  $k$  from  $n$ " variety. In order to model the managers' pricing strategy choices, we constructed a "stacked" binary logit with a separate observation for each strategy within a given pricing situation. The signs of the determinant variables were estimated as interaction terms.

The new product pricing strategies (skim, penetration, experience curve) were used for new models in the market.

Skim pricing was used in markets with high levels of product differentiation by firms at a cost disadvantage due to scale. Penetration pricing was used by firms with a cost advantage due to scale in markets with high level of overall elasticity but low brand elasticity. Experience curve pricing was used for minor innovations by firms with low capacity utilization in markets with a high level of differentiation.

The competitive pricing strategies (Leader, Parity, and Low-price Supplier) were used in mature markets. Parity pricing was used by firms in a poor competitive situation, i.e., high costs, low market share, low product differentiation. These firms were also unable to take advantage of high levels of elasticity since their capacity utilization was high. In contrast, the low-price supplier strategy was used by firms with low costs due to scale advantages. Since they have low utilization, these firms can take advantage of elastic brand demand. None of the determinants were significantly related to the choice of leader pricing.

Product line pricing strategies (Bundling, Complementary Product, and Customer Value pricing) were more likely to be used by firms which sell substitute or complementary products. Bundle pricing was used for per-sale/contract pricing in markets with high levels of brand elasticity. Complementary product pricing (razor-and-blade) was used by firms that enjoyed high profitability on its supplementary sales. Using customer value pricing, a firm offers a stripped down version of its current products to appeal to more price sensitive segments or to leverage new distribution channels. This strategy was used to target a narrow segment in high growth markets where price changes are difficult to detect.

Cost-based pricing was more likely to be used in markets where demand is very difficult to estimate. In such a situation, cost-based pricing makes a great deal of sense.

In general, the results show that the managers' pricing strategy choices are consistent with normative pricing research. However, questions about how managers combine their strategies to arrive at a final price as well as the organizational influences on pricing strategies remain important areas for future research.

*(Pricing Research; Industrial Marketing)*