A MODEL FOR SHARED VALUE PRICING NEIATION

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Abstract

A Deal is an expected purchase transaction of a customer, comprising of aggregated products / services provided by a supplier. A Deal may be initiated by a customer or by the selling organization. Since much of the research has focused on the buying process that drives the creation of value for the seller, the importance of the value that the customer perceives in the Deal further consideration. It will be the purpose of this study to support the assumption that in approaching a Deal, the major factor influencing successful negotiations leading to a business transaction is NOT price, but the perceived value the Deal holds for the customer. To gain a better understanding of the influence that the Customer's Value (CV) has on negotiations during a Deal, one of the research opportunities of this study is to examine the success probabilities as a function of CV. The paper proposes a Shared Value Pricing Negotiation Model to represent and quantify the dynamic process that occurs during negotiations.

Keywords*: Deal, negotiations, customer value, transaction, buyer, pricing.*

I.   INTRODUCTION

Traditional pricing policies have been heavily dependent on the determination of prices according to the firm's internal cost structures and profit objectives. In these transactions, much of the focus has been placed on a single transaction, where the final price results from negotiation between seller and buyer, with the negotiation process strongly associated to the price. Pricing practices have adhered to a conservative approach, with limited consideration of the buyer in the pricing decision making process (Formentini & Romano, 2016). With ongoing changes in the business environment, greater importance is being placed on conducting business to create value. Initially, focus is placed on creating value for the customer, with the aim of extracting from the customers' value, business value in the form of profit (Kumar, & Reinartz, 2016). Increased customer value also contributes to greater success for the business in a competitive market. To achieve this goal, businesses are focusing on customer value-focused sales management (Töytäri, & Rajala, 2015).

Therefore, with the interest in including customer' valuation into the pricing process, I propose a Shared Value Pricing Negotiation Model which focuses on the influence of the customers' behavior in determining pricing in a Deal and the effect that the customers' valuation has on negotiating the Deal.

II.   CUSTOMER VALUATION

A.   Pricing Practices

Price, when used as a term, can relate to one of the two possibilities. The first possibility is what is considered the ticket price that is the price that ought to be paid for the product or service. The second is the realized price, which relates to the price that is actually paid when the transaction takes place. In this case, the interested

parties may enter into negotiations during which the final price is justified (Aspers, & Beckert, 2010).

Pricing practices have been shown to influence a firm's performance, yet it is not fully understood how the firm's organizational and behavioral factors for determining pricing practices can alter the effect that pricing has on performance. In a study that involved 507 professionals in B2B firms worldwide, five organizational factors that effect sales collective confidence were examined. Of these five factors, four were shown to influence sales collective confidence associated with pricing and relative firm performance. These four factors were pricing capabilities, incentive and goal systems, delegation of pricing authority, and knowledge before negotiation (Liozu, 2015).

B.   Value Theory

The determination of pricing decisions has been viewed as the influence of seeking an alignment between Customers' Perceived Value and the Firm's Value (Kumar, & Reinartz, 2016). In determining price, multiple approaches have been used to assess value. Although many factors may influence the pricing process, the perception of value has been expected to play a crucial role. It has been suggested that "value is best understood as a view of the price that something *ought* to exchange at" (Elder-Vass, 2019, p.1486).

Value can be related to as a perception of a fair and just price or the worth of a product or service. The focus on value often arises when issues are created around the price. Thus, it has been explained that value "serves as the justification for prices" (Boltanski, & Esquerre, 2016, p. 37). The determination of economic value further relates the perception of a fair price for a product or service to a monetary standard of

exchange (Elder-Vass, 2019). Yet, the identification, quantification, and verification of value has not been fully examined, and there remains a need for placing emphasis on determining shared value and investigating practices for value-based selling (Töytäri, & Rajala, 2015).

In 2011, Porter and Kramer published a theory for creating shared value with the goal of achieving economic success (Porter, & Kramer, 2011). Three strategies were introduced for achieving success. These strategies included redefining productivity in the value chain, reconceiving products and markets, and enabling local cluster development. When relating to redefining productivity in the value chain, Porter, & Kramer (2011) described the value chain as all the activities that a firm is involved in to conduct their business. The firm reconceives products and markets to meet unmet needs within the society. Redesigning products and changing distribution methods often enable the firm to enter underserved markets. Through local cluster development the firm creates a concentration of suppliers and service providers that add to the value of the firm (Moon, Parc, Yim, & Park, 2011).

C.   *Behavioral Economics*

In behavioral economics, transactions which involve the payment of money in exchange for a desired prospect have been studied. Research has examined human behavior within the decision-making process. This behavior can not always be expected to be rational. Thus, to explain economic behavior, Kahneman and Tversky (1979) developed the prospect theory, which presented an alternative model to the expected utility theory, which had been until then, the leading theory used to analyze decision making under risk. The prospect theory challenged the tenets of the expected utility theory, with its proposal that individuals apply greater weight to outcomes that

are certain as opposed to applying lesser weight to outcomes that appear only to be probable. As a result, it is possible that individuals' preferred choices may be inconsistent if the choices are presented in different ways. The prospect theory focused on the value function as it related to losses versus gains (Kahneman, & Tversky, 1979). In this paper, I shift the focus to the value function as it relates to price.

D. Customer Value

The customer-perceived value has been defined as the difference between what the customer perceives as the benefits received from conducting the transaction and their perception of sacrifices made to conclude the transaction. The customer perceives the elements and dimensions making up the scope of the Customer Value, as well as the outcomes the customer expects in terms of value (Töytäri, & Rajala, 2015).

Customer value has been defined as a four-dimensional construct. Töytäri, Rajala, & Brashear (2015) described the four multi-dimensional concepts relating to customer value as including operational, strategic, social, and symbolic dimensions of value. The first dimension of value, the operational dimension, relates to the operational performance of the company and the organizational processes that affect the organization and its customers. Thereafter, the strategic dimension of value encompasses the improvement of capabilities or the development of new capabilities to enable adaptation and innovation. Customers who form relationships or networks with suppliers may elevate their social status. The symbolic dimension of value is expected to manifest itself because of the goods involved or the business relationships or networks formed around the transactions (Töytäri, Rajala, & Brashear, 2015).

E.   Customer Value Based Pricing

Customers base their perceived value on their valuation of the expected benefits to be gained from the products or services, against the costs they are willing to incur to satisfy their needs. Perceived customer value includes the anticipated benefits that the customer expects, balanced with the undesired consequences, resulting from the purchase of the products or services. These benefits and consequences may be experienced immediately following the transaction or delayed to a later stage. Nevertheless, it is perceived that the customers' choices are dependent on the customers' desire to maximize the benefits and minimize the consequences of the transaction (Kumar, & Reinartz, 2016).

Changing pricing processes have resulted in a shift in the focus of pricing to an approach that is derived from a greater understanding of the value perception of the end customer. Thus, the Customer Value Based Pricing (CVP) approach uses an understanding of the value a product or service delivers to a specific customer segment as the main factor for determining prices (Hinterhuber, 2008). The focus on creating value for the customer and assisting the customer in increasing their profits is a time-consuming process for the seller. It requires a clear understanding of the creation of value for the customer, which may be challenging for the seller. In customer value management, the task of the seller is to demonstrate the superior value of the products and/or services, if possible, with quantified evidence (Classen, & Friedli, 2019).

Kumar, & Reinartz (2016) suggested that the measurement of the customers' perceptions of value requires three actions, which include the measurement of the overall perceived value, the measurement of the customers' attributes and benefits

and the determination of the relative weights of these attributes and benefits (Kumar, & Reinartz, 2016).

The importance of value-based offerings has driven businesses to collaborate with their customers to develop customer value. Adopting value-based pricing models has enabled the businesses to capture their share of the value, while addressing their market competition (Töytäri, Rajala, & Brashear, 2015).

F.   Sellers' Perspectives of Value

The sellers are expected to take an active role in creating the perceived value for their customers, since the seller can align their offerings to what is perceived as valuable for the customer. The seller may also promote their own capabilities and in addition, the seller may create a perceived differential advantage for their customers over their competitors (Kumar, & Reinartz, 2016).

When the seller leverages value for the customer while enabling a transaction, the chances of the seller realizing greater value are increased. Thus, the introduction of value-based business strategies has driven the strategies utilized for selling towards approaches increasingly focused on customer value management to increase the economic returns for the business (Töytäri, & Rajala, 2015). Value-based selling uses the implementation of the marketing of value at the level of the individual Salesperson (Classen, & Friedli, 2019).

From the seller's perspective, the objective of a deal is to create value for the customers, while creating an opportunity to appropriate part of the value for the seller (Jaakkola, Frösén, & Tikkanen, 2015). In the business-to-business environment, the salespeople who are involved in the deal have an opportunity to understand the customers' perceived value and to transfer these perceptions back to the firms

involved in the selling process. It would be expected that the salespeople of the seller would have the greatest understanding of the opportunities available for creating value for the customers, which would allow for appropriating value for the sellers. The value to the sellers could be expressed in their revenue or in other forms of benefits (Blocker, Cannon, Panagopoulos, & Sager, 2012).

When adopting a selling approach focused on adding value to the customer, in addition to being an adept salesperson with multiple selling abilities, the salesperson must develop their insights into the customers' operations so that this understanding can be used to promote the added value of the Deal to the customer (Haas, Snehota, & Corsaro, 2012).

Thus, during negotiations between seller and buyer, different approaches are employed to determine price. There is no single theory associated with price and value that can be consistently used during the pricing process (Elder-Vass, 2019). Nevertheless, it appears that determination of price is strongly associated with its value. In the next section, my proposed Shared Value Pricing Negotiation Model is presented.

III.   SHARED VALUE PRICING NEGOTIATION MODEL

When negotiating a purchase transaction between a customer and a supplier for the purchase of aggregated products or services, during the Deal, I argue that it is the responsibility of the Sales Team to create a viable strategy focusing on the client's perceived value of the Deal. Based on this assumption. I propose my Shared Value Pricing Negotiation Model. I suggest that the Shared Value Pricing Negotiation Model may provide a basis on which to further develop the empirical analysis of the

concepts and parameters influential on creating value in the negotiation process that are outlined below.

At the beginning of the process and during the initial introductory sales meeting in anticipation of establishing a purchase transaction, Sales staff will discuss the value parameters that are important to the client, to enable a better understanding of the parameters that may influence their client's value matrix. Developing a client value matrix, will provide an initial value measure to be the basis of the price negotiations. Furthermore, empirical analysis of both the Customer's Perspective and the Sales Team Perspective are of importance during the negotiation of a purchase transaction.

A.   Customer's Perspective

The customer has a sense (a feeling / a perception) of the *value* of the Deal, i.e., the perception of the Customer's Value (CV) is then translated to a monetary amount. In negotiating the deal, the customer will take into consideration the perceived value of the deal, allowing for a perceived realistic price for the deal.

The Customer's Value Pricing (CVP) is calculated as:

$CVP = Price\ list + CV$

B.   Sales Team Perspective

The Sales Team of a business often include experienced Salespeople who possess capabilities that are tacit. Thus, the Sales Team perspective is addressed in the model due to expectation of the influence that the Sales Team have on negotiating

the Deal. The Sales Team may estimate the customer's perceived value by using the value matrix.

The Value Selling Organization (VSO) definition of Sales Value (SV) is calculated independent of the client and is a reflection of the Sales Team perception of the client's value of the deal.

The Sales Value Price (SVP) is calculated as:

$$SVP = Price\ List + SV$$

C. *Negotiation Process*

In the negotiations process, it is assumed that the customer's willingness to pay more for the deal is dependent on the customer's perceived value received from acquiring the Deal. Thus, according to the proposed Shared Value Pricing Negotiation Model, the Sales Team's negotiations strategy should focus on the customer's perceived value, rather than focusing on price.

A graphic description of the Proposed Shared Value Pricing Negotiations process has been suggested along the Value / Price Scale as follows:
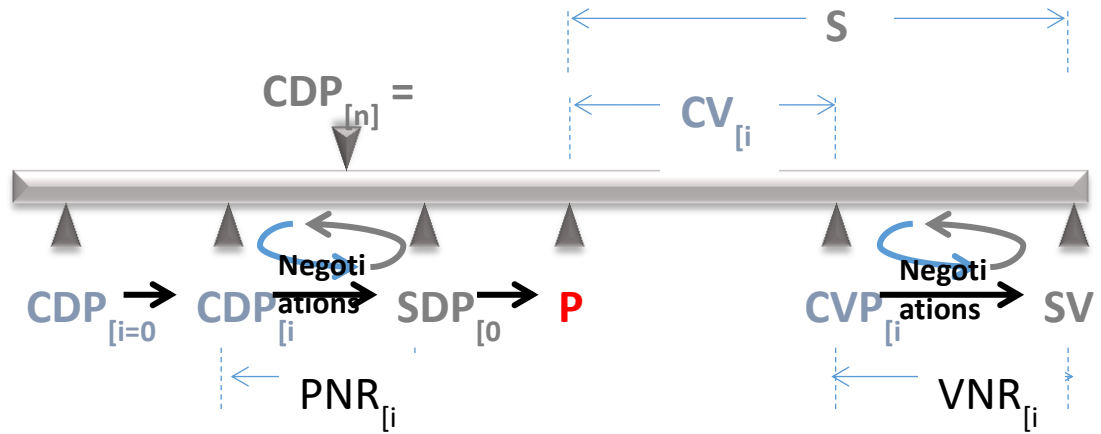
Diagram 1: The Proposed Shared Value Pricing Negotiations Process

The variables that influence the Proposed Shared Value Pricing Negotiations Process include variables associated with the Sales Team and variables associated with the Customer and are listed below.

1) ***Sales Team Variables***

i - where i represents indicator.

- i=0 represents the starting point of negotiations
- i=n represents the end point of negotiation

PL - where PL represents Price List.

- The suggested retail price for the product / service
- It is set by the company
- It is known to the client

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Price List is calculated as:

$$PL = TCM + Pr$$

TCM - where TCM represents the Total Cost of Manufacturing.

- Known cost of manufacturing the product or service

Pr - where Pr represents Profit.

- The profit is set by the organization for a specified product / service
- The profit is set as a business policy
- There are two types of Profits:

• Pr_d representing Desired profit – the profit that the organization would like to have

• Pr_m representing Minimal profit – the minimum amount of profit that the organization is willing to tolerate

SDP$_i$ - where SDP$_i$ represents Sales Deal Price.

- The price of a deal at any given negotiation's iteration.
- $SDP_{(i=0)}$ represents the Deal Price at the start of negotiations
- $SDP_{(i=n)}$ represents the Deal Price at the end of negotiation

Based on the Sales Team variables, the first hypothesis is posited.

Hypothesis 1 $SDP = f(SVP)$

The Sales Deal Price is positively associated with the Sales Value Price

SVP - where SVP represents Sales Value Price

- A fictitious number that represents the true value of the deal to the client as seen from the *sales team* perspective.

- This number serves to calculate the Deal Price (SDP_0) for negotiation purposes.

SVP is calculated as:

$SVP = PL + SV$

SV - where SV represents Sales Value.

- Calculated by the sales team according to the value parameters defined above

- Having calculated the SV for a Deal provides the sales team with a strategic advantage in determining the Price Negotiations Range

PNR_i - where PNR_i represents Price Negotiations Range.

- The degrees of freedom – price wise – that the sales team has

- $PNR_{[i=0]}$ value is maximum at the beginning of negotiations

- $PNR_{[i=n]} = 0$, when there is an agreement on the price of the deal ($SDP_{[i=n]} = CDP_{[i=n]}$)

2)   Customer Variables

CDP_i - where CDP_i represents Customer Deal Price.

- The initial price that the customer is willing to pay for the Deal

- $CDP_{[i=0]}$ represents the initial price that the customer is willing to pay, before negotiations begin

- $CDP_{[i=n]}$ represents the final and agreed upon price that the customer is willing to pay, before negotiations begin.

- It is the goal of the sales team to discover as early on as possible the initial customer deal price before initializing negotiations, i.e., $CDP_{[i=0]}$

Based on the Customer variables, the second hypothesis is posited.

Hypothesis 2 $CDP_i = f(CVP_i)$

The Customer Deal Price is positively associated with the Customer Value Price

CVP_i - where CVP_i represents Customer Value Price.

- A fictitious number that represents the true value of the deal to the client as seen from the ***client*** perspective.

- This number serves to calculate the Deal Price (CDP_0) for negotiation purposes

CVP is calculated as:

$CVP = PL + CV$

CV - where CV represents Customer Value.

- The value of the deal known only to the customer

- This number is of great importance as it helps in defining the $CDP_{(i=0)}$

VNR – where VNR represents Value Negotiations Range.

- The degrees of freedom – price wise – that the sales team has

D.   Value Matrix

The definition of Value can be derived from my proposed Value Matrix. The proposed Value Matrix is a two-dimensional matrix that is applied to the three entities that influence the negotiations process, the Value selling Organization (VSO), the Primary Client and the Secondary Client. In addition to the seller or VSO and the buyer or the Primary Client, the buyer's buyer or the Secondary Client also is expected to influence the negotiation process.

Parameters for a mathematical model that comprise Value originate in the proposed Value Matrix, shown in Table 1.

Table 1: Proposed Value Matrix

	Monetary Value	**Managerial Value**	**Image Value**
Business Benefits	Cell **A**	Cell **B**	Cell **C**
Personal Benefits	Cell **D**	Cell **E**	Cell **F**

Hereafter are descriptions given for the parameters from the proposed Value Matrix, shown in Table 1.

Cell A - Business Benefits / Monetary Value

The client's profits due to the savings / income resulting from the use of the products / services.

Cell B – Business Benefits / Managerial Value

The client's management efficiency due the use of the products /services.

Cell C – Business Benefits / Image Value

The client's increase in corporate image / reputation resulting from the use of the products / services.

Cell D - Personal Benefits / Monetary Value

The personal profit of employees resulting from the corporate savings / profits resulting from the use of the products / services.

Cell E – Personal Benefits / Managerial Value

The personal / departmental managerial production benefits that are created resulting from using the products / services.

Cell F – Personal Benefits / Image Value

The improved image / reputation to the individual / department resulting from using the products / services.

Each one of the cells in the Value Matrix contains a value, which may be calculated from value questionnaires which are developed for use with the clients. The value of each cell may be a transformation of quality data that will be collected by the Sales Team or a numerical value.

The following equation may be used to calculate a numerical value for the Customer Value (CV) or the Sales Team Value (SV).

Value = $\Sigma_j\Sigma_{ij}x_{ij}$

Where:

i = 1 – Monetary Value

i = 2 – Managerial Value

i = 3 – Image Value

j = 1 – Business Benefits

j = 2 – Personal Benefits

Example: $X_{1,3}$ = The benefits of the product contributing to the Business Image

Additional mathematical calculations are suggested for calculating other parameters that influence the Shared Value Pricing Negotiation Model.

1)   Sales Person Abilities

Soft skills, such as elocution, self-management, ability to provide consultation services to the client, chemistry, professionalism, personal skills and interpersonal skills are critical components in the communications process with the customer and greatly contribute to the negotiations process.

Salesperson Abilities are calculated as:

Salesperson Abilities = $\Sigma_{k=0}\gamma_kA_k$

Where:

A_k = the set of parameters defining the salesperson abilities

γ_k = the coefficients defining the contribution of the Salesperson Abilities

Note: the final set of parameters defining the Salesperson Abilities have not been identified.

2) *Reputation of the Product / Service*

The reputation of the product / service provided is critical to two processes:

✓ the negotiations process

✓ definition of the Client Value (calculation of the Client Value Price)

Product Reputation is calculated as:

$$\text{Product Reputation} = \Sigma_{p=0}\theta_p PR_p$$

Where:

PR_p = the set of parameters defining the Product Reputation

θ_p = the coefficients defining the contribution of the Product Reputation

Note: the final set of parameters defining the product reputation have not been identified

3) *Reputation of the Organization*

The reputation of an organization is believed to be one of the indicators contributing to a successful negotiation. When a client believes in the organization, this belief is transferred to the product / service being sold, e.g.: how long the company is in existence, prestige, etc…

Organization Reputation is calculated as:

$$\text{Organization Reputation} = \Sigma_{l=0}\delta_l OR_l$$

Where:

OR_l = the set of parameters defining the Organization Reputation

δ_l = the coefficients defining the contribution of the Organization Reputation

Note: the final set of parameters defining the organization's reputation have not been identified

4) Client Experience

It is believed that each encounter with the client should be a WOW. Although not definitive, this may be a reflection of the level of success of the Value Selling Organization.

Client Experience is calculated as:

$$\text{Client Experience} = \Sigma_{r=0}\delta_r X_r$$

Where:

X_r = the set of parameters defining the Client Experience

δ_r = the coefficients defining the contribution of the Client Experience

Note: the final set of parameters defining the client experience have not been identified

5) Success of the VSO

Success of the VSO is measured (in part) by the success of the Secondary Client, and not only the Primary Client.

Client Experience is calculated as:

$$\text{VSO Success} = \Sigma_{i=0}\alpha_i PC_i + \Sigma_{j=0}\beta_j SC_j$$

Where:

PC_i = the set of parameters defining the Primary Client success

SC_i = the set of parameters defining the Secondary Client success

α, β are coefficients defining the contribution of each success parameter

Note: the final set of parameters defining the success of the Primary Client and Secondary Client have not been identified

IV.   CONCLUSIONS

In the context of the Shared Value Pricing Negotiation Model, a successful negotiations process is a process that results in the execution of a Deal – the procurement

of a product /service. The initial value measure is utilized as the basis for the price negotiations. It is suggested that during the negotiation process between seller and buyer, the customer will be willing to pay more for the Deal depending on the customer's perception of the value to be received from acquiring the Deal. If the perceived value of the Deal is low, there will be a high probability that the Deal will fail.

Therefore, in the proposed Shared Value Pricing Negotiation Model, the Sales Team's negotiation strategy focuses on negotiation of value, and not price. As opposed to the Sales Value (SV) that is calculated and fixed, the Customer Value (CV) changes as negotiations progress. It is the goal of the Sales Team to maximize the Customer Value and to achieve a level for the Customer Deal Price that is as close to the Price List as is possible. Based on the proposed mathematical model for the Shared Value Pricing Negotiation Model, the Price Negotiation Range will equal zero (PNR $_{[i=n]}$ = 0) when there is an agreement on the price of the deal between Salesperson and Customer. Such an agreement is indicated as an alignment between the Sales Deal Price and Customer Deal Price, so that $SDP_{[i=n]} = CDP_{[i=n]}$. At this stage, the transaction can be fulfilled, and the Sales Team would have achieved their goal of creating Customer Value, while enabling the company to extract value for the business, usually in the form of profit.

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