

Roine, Henna; Sainio, Liisa-Maija; Saarenketo, Sami

## Article

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jbm - Journal of Business Market Management

## Provided in Cooperation with:

jbm - Journal of Business Market Management

*Suggested Citation:* Roine, Henna; Sainio, Liisa-Maija; Saarenketo, Sami (2012) : Export channel pricing management for integrated solutions, jbm - Journal of Business Market Management, Freie Universität Berlin, Marketing-Department, Berlin, Vol. 5, Iss. 3, pp. 195-214, <https://nbn-resolving.de/urn:nbn:de:0114-jbm-v5i3.238>

This Version is available at:

<https://hdl.handle.net/10419/66010>

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## Export Channel Pricing Management For Integrated Solutions

Henna Roine · Liisa-Maija Sainio · Sami Saarenketo

**Abstract:** This article studies systems integrators' export channel pricing management for integrated solutions. We find support from our empirical case study for the notion that a systems integrator's export channel pricing strategy is multidimensional and dependent on international pricing environment and partner characteristics and that export partnerships have unique implications on a systems integrator's pricing process. The results show that giving up pricing control in export channel context may be suitable if the partnership is strategic. The findings also suggest that customer value-based pricing strategies instead of traditional cost-plus pricing methods should be adopted towards both end customers and channel members.

**Keywords:** Export channel pricing · Partnerships · Integrated solutions

### Introduction

*Systems integration* or *integrated solution provision* has emerged as a prominent business model in today's dynamic business environment, characterized by globalization, deregulation of markets, evolution of information technologies, and an increasing trend of outsourcing (Cova and Salle 2007). Business customers are increasingly demanding complex solutions that are based on components supplied by a variety of different companies (Davies, Brady, and Hobday 2007). According to Hobday, Davies, and Prencipe (2005), capabilities in systems integration have

Published online: 28.09.2012

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H. Roine · L.-M. Sainio · S. Saarenketo (C)  
Lappeenranta University of Technology, School of Business, Finland  
e-mail: sami.saarenketo@lut.fi

become a central, key asset to many large multinational corporations (MNCs) such as Nokia, ABB, Dell, Ford, IBM and Hewlett-Packard. These companies are utilizing wide networks of different suppliers to bundle and integrate a variety of different components into a comprehensive system or solution, complete with a service offering covering the whole lifecycle of the system (Doster and Roegner 2000, Davies, Brady, and Hobday 2006). Small and medium-sized systems integrators, on the other hand, can be expected to utilize business networks also in the downstream side of the value chain. Recent literature has identified export partnerships as an increasingly common way of internationalization for such companies (ie. Ruukonen, Hätönen, Lindqvist, Marjakoski, and Hurmelinna-Laukkanen 2008, Varis, Kuivalainen, and Saarenketo 2005).

Although many articles on systems integration and solutions provision are quite recent, the stream of literature may be traced back to the '60s, when the concept of *systems selling* was introduced (Yuong Buyn and Smith 1990, in Cova and Salle 2007). However, despite the long tradition, most of the research in the area is quite descriptive in nature (e.g. Brady, Davies, and Gann 2005, Davies, 2004, Hobday et al. 2005, Davies et al. 2007), providing little practical guidance to the marketing of such systems or management of international partnering in such a context. Pricing has traditionally received a limited amount of attention in the marketing literature despite its importance as the only revenue-generating element of the mix (Kotler and Armstrong 2004, Hollensen 2004). For example, a very limited amount of research addresses the question of how to manage export channel pricing – especially in a systems integration context. Given that a system typically comprises of software, hardware, and services components (Davies 2007), and that a system may be marketed to quite different organizational customers in both B2B and B2G side, the question of managing export pricing with partners in such a challenging environment is both complex and relevant.

The goal of this paper is to examine the strategic role of system integrators' export channel pricing. Firstly, through a literature review we aim to provide an integrated theoretical framework of the key decision-making issues of export channel pricing of a system integrator. Secondly, we examine how pricing should be controlled when selling integrated solutions through export channels. The issue of pricing control is twofold: the complex nature of the integrated solution itself makes it difficult to price so we need to examine the determinants of price formation connected to the question of who controls price setting. On the other hand, the role of the product in the channel exporters's own system may affect pricing control and partner incentives. The developed framework is applied to a descriptive single-case study, providing theoretical insights on the connections between pricing decisions and channel governance, and managerial recommendations for companies dealing with export channel pricing.

This paper is organized as follows: first, we discuss the conceptual background, synthesizing literature from the three different streams of systems business, export pricing, and export partnerships. These form the basis for the theoretical framework presented in Chapter 2.3. In Chapter 3 the research methodology and data collection will be clarified, followed by Chapter 4 which presents the findings from the case study. Chapter 5 concludes the paper with discussion and avenues for future research.

## Literature Review

### Challenges of pricing an integrated solution

The concept of systems selling, which was initially discussed in academic literature in the '60s (Yuong Buyn and Smith 1990, in Cova and Salle 2007), was used to refer to a vertically integrated organization that manufactured complex systems and offered the services necessary for the customers to operate the systems. Such systems can be observed in a wide range of industries, such as transportation, telecommunications and networks, flight simulation, and infrastructure (Davies 2004, Hobday 1998). Towards the end of the 80's, the dominance of a vertically integrated organization structure started to fade, with systems sellers realizing that focusing on a few core activities, and outsourcing the manufacture of components and other inputs to third parties can provide with competitive advantage (Davies 2004). Capabilities in *systems integration* – integrating components, skills, and knowledge from other companies to produce an even more complex combination of products and services (Hobday et al. 2005) – became of crucial importance to companies in the systems business. From the 90's, academics began to discuss the concept of *solution selling* in the capital goods sector (Cova and Salle 2007), highlighting a move from product-centric to customer-centric thinking (Brady et al. 2005) and increasingly intimate customer relationships in order to create a unique solution that delivers superior benefits to the customer (Doster and Roegner 2000).

Several characteristics of integrated solutions make the pricing task quite challenging when compared to more simple goods. Furthermore, when exporting such products to international markets, additional issues must be considered. Several authors have proposed frameworks of the international pricing environment (e.g. Stöttinger 2001, Hollensen 2004, Cavusgil and Zou 1994, Forman and Hunt 2005), which encompass many factors that have an impact on an exporter's channel price setting. For example, whereas factors of the internal pricing environment, such as positioning, distribution channels, product life cycle stage, and service/maintenance requirements have specific implications on the choice of a pricing strategy (Stöttinger 2001, Hollensen 2004, Cavusgil and Zou 1994), constraints imposed by the external environmental factors (ie. government influences and constraints, customers' perceptions and ability to pay, nature of competition) need to be also taken into account (Hollensen 2004).

Unfortunately, some studies have indicated that many times companies tend to adopt an ad-hoc approach to export pricing decisions, thus failing to analyze the international pricing environment and make strategic pricing decisions (Myers 1997, Cavusgil et al. 2003). Nagle and Cressman (2002) advocate in favour of a strategic approach to pricing decision making. The authors argue that companies can achieve greater profits by strategically managing the price structure, pricing process, and value-based market communications. Many alternative models of pricing process have been suggested by different authors (e.g. Cravens and Piercy 2006, Czinkota and Ronkainen 1995, Cavusgil 1988, Roberts 1988), and although the number, labeling and sequence of the steps varies between different models, most authors seem to agree that the pricing process should begin with the definition of pricing objectives and

analysis of the target market, after which a pricing strategy and specific prices can be determined.

The nature of the integrated solution suggests that the selection of a pricing strategy is not a straight-forward decision. To start with, such systems consist of multiple components such as hardware, software, subsystems, and embedded services (Hobday et al. 2005, Davies 2004). Many companies tend to resort to cost-based pricing strategies, such as rigid or flexible cost-plus, which involve calculation of absorption cost and then adding a profit margin to cover any overheads and capital costs (Stöttinger 2001). However, such pricing strategies are not feasible when pricing intellectual capital, such as software (Bontis and Chung 2000). According to Bontis and Chung, one is easily tempted to overemphasize the financial perspective—recovering the development costs—when pricing software; however, the authors advocate in favor of pricing strategy which aligns customer value realization with the vendor's business objectives.

A factor which further complicates the pricing of an integrated solution is the possible high-technology nature of the components or the system in general (Hobday 1998, Hobday et al. 2005). Several authors have argued that specific considerations are involved when pricing a high-technology product (ie. Grunenwald and Vernon 1988, Mohr, Sengupta, and Slater 2005, Dean 1969, Marn, Roegner, and Zawada 2003, Shanklin and Ryans 1984). The economic and competitive environments for such products are uncertain and volatile, which is why it has been argued that companies in high-tech industries should initially aim at fast recovery and early contribution to profit, whereas later on the pricing objectives should concentrate on keeping the established market position (Grunenwald and Vernon 1988).

Marketing literature generally identifies two optional pricing strategies for pricing a new product: skimming and penetration strategy (Shanklin and Ryans 1984, Noble and Gruca 1999). The skimming strategy implies setting a high initial price and then gradually lowering it, whereas the penetration pricing strategy involves setting an exceptionally low price for the new product in order to maximize market share rapidly, encourage adoption, or establish it as a *de facto* standard (Noble and Gruca 1999). Shanklin and Ryans (1984) suggest that skimming should be used when the product is state-of-the-art in nature and represents a remarkable improvement to ones currently available, whereas penetration pricing can be an appropriate strategy when the objective is to establish long-term customer relationships. If additional products and services can be sold later on during the relationship, low pricing for the basic product can be justified. In this sense, penetration pricing is potentially suited to pricing an integrated solution, since such systems typically require services and maintenance over the lifecycle of the product.

Doster and Roegner (2001) have argued that systems integrators or solutions providers should earn a relatively high premium when compared to suppliers of other goods, because they save the effort of dealing with a multitude of suppliers, recede customer's risk and responsibility and provide more value with the whole solution. The authors advocate in favour of a customer value –based pricing strategy for pricing integrated solutions.

## The role of pricing in export channel governance

Recent literature has suggested that export partnering can be a suitable mode of internationalization for smaller, resource-constrained companies (Varis et al. 2005; Ruokonen et al. 2008). This is not a surprising finding when considering the many benefits of such a mode of operation. When considering entry to the export markets, partnering reduces risk in international business and allows companies to focus on their core competences. A partner's added resources can also allow a company to internationalize faster, get products faster to the market and enter markets that would otherwise be closed for foreign firms. Operational flexibility is improved and the exporting company can adapt to changes in markets more easily. (Ruokonen et al. 2008, Cavusgil 1998, Stiles 1995, Koza and Lewin 2000)

Typically, an export partnership is formed with a local distributor or agent (Cavusgil 1998), and the nature of the relationships can range from operational short-term, as-needed relationships to strategic relationships, characterized by close cooperation, commitment, interdependence, and trust (Mentzer, Min, and Zacharia 2000). Such close, strategic relationships can be essential for the success of an exporting company in the systems business, since the marketing of integrated solutions is nothing like that of ie. simple consumer retail goods; thorough knowledge is needed on the system and its features as well as customer needs and requirements, which necessitates close collaboration between the systems integrator and the export partner.

Most literature on international partnering focuses on the partnering rationale, partner selection and characteristics (Aulakh, Kotabe, and Sahay 1996), governance aspects (e.g. Aulakh et al. 1996, Bello and Gilliland 1997, Gencturk and Aulakh 2007, Zhang, Cavusgil, and Roath 2003), and characteristics of successful international partnerships (Leonidou, Katsikeas, and Hadjimarcou 2002, Cavusgil 1998, Holm, Erikson, and Johanson 1996, Obadia 2008). Literature on the successful management of marketing variables in an international partnership seems to be extremely scarce and links to pricing literature limited. Specifically, it is in our interest to find out how the integrated solution should be priced to the international partner so that it remains committed to selling the system, and how export channel pricing can be managed in general in such a collaborative mode of partnership.

Theories of channel governance have identified two different forms of managing manufacturer-distributor export relationships: *bilateral* and *unilateral* controls (Bello and Gilliland 1997, Gencturk and Aulakh 2007). This kind of a distinction allows distinguishing between partner relationships that are more based on the socialization of the parties into an intimate relationship characterized by close collaboration (Gencturk and Aulakh 2007), and partnerships that are more based on the exporting company's efforts to directly coordinate and control a partner's actions ie. by regular monitoring and influencing the partner's day-to-day marketing actions (Bello and Gilliland 1997). One important decision, which relates to channel governance forms and pricing, is whether the exporter wishes to use *pricing control* or not. Pricing control can be understood as a unilateral process control, defined as exporter influences on distributor behaviour in order to set desirable prices in the overseas markets or direct setting of those prices by the exporter (Myers and Harvey 2001).

Myers and Harvey (2001) argue that pricing control reduces the distributors' ability to match prices with market conditions, and thus the strategic performance of the focal

firm suffers. However, when it comes to economic performance (that is, profitability in terms of price/cost margins), pricing control is found to have a positive influence. In contrast, the authors argue that while the deferral of pricing control improves strategic performance, it can result in the distributors setting a price lower than the exporters' costs or too low to maintain a strategic positioning of a high quality product. Nevertheless, firms interested in maintaining distributor relationships and a long-term presence in export markets are likely to be more willing to defer control of prices to other channel members than are companies that have a profit or differentiated strategic orientation. (Myers and Harvey 2001)

The viewpoint of incentives is also relevant in channel governance and pricing control: how can the exporting systems integrator use price as a means of motivating the partner? A fair margin should be allowed to the partners, because inadequate margins may discourage intermediaries from active promotion of the manufacturer's products (Cravens and Piercy 2006). However, pricing is only one type of a partner incentive. Gilliland (2004) identifies four different categories of incentives: output, activity, capability, and pledge incentives. A mix of different types of incentives and a motivating partner scheme should be used to maintain the partner's commitment to selling the exporter's solution.

Ruokonen, Nummela, Puumalainen, and Saarenketo (2006) summarize the key partnership challenges when extensive product- and market-specific knowledge and an ability to both sell and install or implement the focal firm's product are required. According to the authors, the critical success factors relate to network formation and management. That is, the company is challenged to find a suitable partner, maintain partner commitment by means of mutually rewarding revenue, and create a well-functioning division of labour between the organizations, which can change over time.

The following Table 1 summarizes the most relevant previous research related to pricing in export markets and channel pricing and governance discussed above.

**Table 1:** Literature on pricing in export markets and channel governance

<i>I. Pricing in export markets</i>			<i>II. Channel governance</i>		
<b>Author</b>	<b>Focus of the study</b>	<b>Key findings</b>	<b>Author</b>	<b>Focus of the study</b>	<b>Key findings</b>
Noble and Gruca 1999	Industrial pricing: theory and managerial practice	Identifies a set of industrial pricing strategies and determinants. Provides insight into what pricing strategies managers use under different situations.	Bello and Gilliland 1997	Effect of output controls, process controls, and flexibility on export channel performance	Shows that output control enhances export channel performance, but process control has no performance effect.
Stöttinger 2001	Strategic export pricing	Sheds light on the process of industrial exporters' international pricing practices. Describes common "best practices".	Zhang et al 2003	Manufacturer governance and relational norms in foreign distributor relationships.	Provides evidence on effects between the manufacturer's use of governance via relational norms and its competitiveness in the export market.

Myers and Harvey 2001	Value of pricing control in export channels	Provides evidence on the organizational and environmental influences driving pricing control decisions and the impact of pricing control on both the economic and strategic performance of the firm.	Gilliland 2004	Designing channel incentives to overcome reseller rejection	Prescribes a four-step, theory-based process to help suppliers craft attractive incentive programs. The process involves identifying resellers' performance needs, recognizing how each need suggests a different basis for incentive rejection, and designing an incentive package such that the incentives support specific reseller needs.
Forman and Hunt 2005	Managing the influence of international and external determinants on international industrial pricing strategies	Indicates that international experience, product technology, degree of internationalization, market share, and certain external factors influence weightings managers give to internal and external factors in the process of making international pricing decisions.	Ruokonen et al 2006	Network management as the key to the successful rapid internationalization	Identifies the key challenges in governing the channel partnerships when extensive product- and market-specific knowledge and ability to both sell and implement the focal firm's product are required. The critical factors relate to network formation and management.
Argouslidis and Indounas 2009	Relationship pricing in industrial export settings	Provides evidence that by adopting the principals of a relationship-based export pricing, firms can overcome their inward-looking export pricing behavior. A RP philosophy will manifest itself in a more market-based, and consequently, more well-informed export pricing process. Stated differently, RP can drive industrial exporting firms to a more outward-looking export pricing process.	Gencturk and Aulakh 2007	Norms- and control-based governance of international manufacturer-distributor relational exchanges	Shows a differential effect of relationship structures on the use of control-based and norms-based governance. Furthermore, the results show that these governance forms have distinct performance implications.

## Theoretical framework

Figure 1 depicts the export pricing process and environment of a systems integrator in a partnership with a local distributor. The pricing process encircles the systems integrator's offering, which is composed of hardware, software and service elements. Integration of the three different kinds of components creates customer value that is higher than the sum of the individual values of the components, and customer value lies at the heart of the pricing process, thus it is situated in the very centre.

The large circle, which encompasses the integrated solution and the pricing process, is situated in the pricing environment, which is divided into external and internal environments. These can be further categorized into market factors, industry/environmental factors, firm-level factors, product factors, and management orientation (Hollensen 2004, Stöttinger 2001). Specifically, an exporting systems integrator needs to be able to balance its pricing somewhere between the market price level (price ceiling) and absorption cost (price floor). Costs are a subset of product factors whereas the market price level is determined through market (demand,



customers' ability to pay) and industry/environmental factors (competitors' prices). Other important factors of the pricing environment include product life cycle stage and product technology.

The arrows leading from the circle to the export partner(s) depict the systems integrator's pricing-related actions directed at the partner. First of all, the systems integrator needs to decide on the most appropriate form of channel governance, which often represents a combination of both bilateral and unilateral governance forms. Most companies are likely to have their own preferences as to how much they wish to influence the partners' day-to-day marketing actions (process controls), and as to how much they wish to monitor the partner's commercial performance (output controls). When it comes to pricing considerations, process controls are especially relevant; that is, whether the systems integrator prefers to influence the partner's price setting, set those prices directly, or allow the partner to price the products freely in the target market. These considerations are depicted as a dotted arrow leading from the circle representing the systems integrator to the partner's final price at the bottom. Finally, the systems integrator also needs to consider channel pricing issues— that is, how to price the product to the partner and how large a margin should be allowed to it. This framework forms the backbone of the following case study analysis.

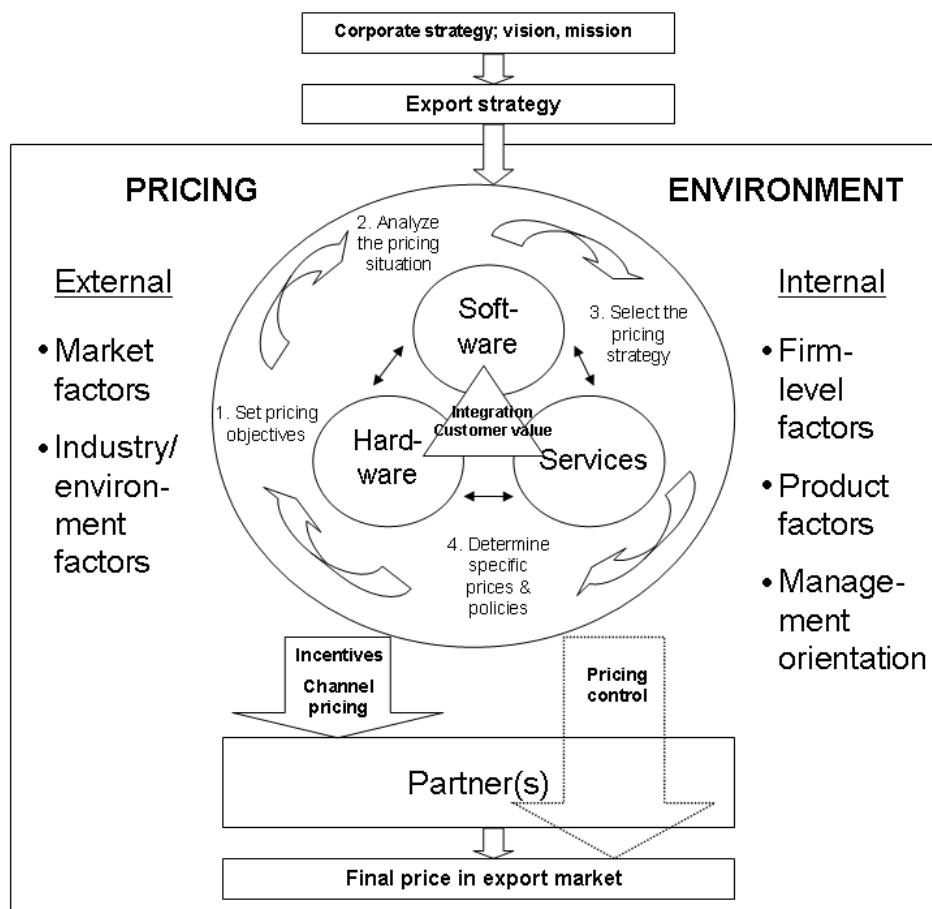


Fig. 1: Systems integrator's export pricing in an international partnership

## Research Design and Data Collection

The literature review revealed that very little is known about pricing in the systems business, especially in the context of export partnerships. Because of the paucity of research in the area and the exploratory intent of this thesis, qualitative methods were chosen.

A case study approach has been argued to be an appropriate research strategy when studying complex managerial issues, which are considered to be difficult to study with quantitative methodologies (Ghuri and Gronhaug 2005, in Eriksson and Kovalainen 2008). In this study, a single case was used in order to obtain a comprehensive understanding of the company's business and product. Indeed, since integrated solutions represent highly complex and multidimensional product and service offerings, and since providers of such offerings may exist in a variety of different industries (Hobday 1998), it would be quite difficult to obtain a solid understanding of several such companies' export channel pricing within the limits of a single study. Furthermore, Dyer and Wilkins (1991) have identified several merits of conducting single case studies. They argue that single case studies result in more coherent, credible, and memorable stories when compared to multiple case study reports.

The selected case company is Syscon Ltd, a Finnish provider of complex ICT systems. Syscon was perceived as a suitable case company for the purposes of this study due to its recent expansion into export markets and use of partnerships as an entry mode. The main sources of data collection were personal in-depth interviews and group interview with the key managers / informants in the company. Hirsjärvi and Hurme (2001) have argued that the interview is a suitable data collection method when the topic of the study is little explored and previously rather unknown, as a result of which the researcher may not be able to predict the nature of the answers; conditions which apply to this study. Group interviews, in turn, have been argued to result in richer, cumulative, and elaborative set of data and possibly provide a gratifying and stimulating experience for the participants (Morgan 1988, in Madriz 2000).

This study derives data from personal in-depth interviews with five key managers (managing director, two export managers – one responsible for Eastern European countries and the other for Western European countries, sales manager, and head of projects). In addition, a group interview was held with the managing director and sales manager. All the interviews were recorded with permission and transcribed to facilitate analysis, yielding 136 pages of data. Some preliminary conclusions could be confirmed at the group interview session, and it also allowed the case company an opportunity to review the pricing process with the help of an outsider. The interviewees are treated anonymously and the name of the company has been changed due to the strategic nature of the information. In addition to the primary data, the study also uses some supplementary data made available by the company representatives (company documentations, slideshows, charts and maps). The primary interviews together with other data sources enabled us to obtain a richer set of data (triangulation) and provide us with a holistic view of the complex phenomenon of export channel pricing management.

## Case Study: Export Channel Pricing Management of Syscon

### International pricing environment of Syscon

Syscon strives to be innovative, which becomes particularly manifested in its newest product that is at the moment the only IP-based system in its segment. Syscon positions itself as a quality producer, which has important implications on its pricing strategy. One of Syscon's key bases for its innovativeness is a strong focus on R&D. More than 20 % of Syscon's revenue is reserved for R&D. In the export markets Syscon has chosen to use local partners that are responsible for sales and marketing actions as well as services, such as installations, maintenance, and repair. A heavy strategic emphasis has been placed on the export operations, since the domestic market has saturated and Syscon currently seeks aggressive growth in the export markets.

Syscon's strategic role in its value chain is to integrate different components from several sources into a working system and provide the necessary operational services to its customers either by itself or in cooperation with a partnering company. Thus, systems integration, software upgrades, and domestic sales and marketing processes are retained in-house, whereas rest of the value chain activities are outsourced at least to some extent. However, in the export markets Syscon has chosen to use local partners that are responsible for sales and marketing actions as well as operational/after-sales services, such as installations, maintenance, and repair. A heavy strategic emphasis has been placed on the export operations, since the domestic market has saturated and Syscon currently seeks aggressive growth in the export markets.

The IP-based system can be serviced and customized remotely through the Internet, and there is no need for additional cabling since the system uses general cabling. This saves costs and improves scalability and ease of integration. Syscon wishes to target those segments and countries that understand the benefits of the new technology and are willing to pay for the efficiency it brings. The system is thus positioned as a superior solution, which reflects in pricing and requires an aligned marketing communications plan. Syscon's partners are systems integrators of various sizes whose main business is to build Local Area Networks (LAN) in different facilities, and integrate as many different IP-based systems as possible in the network. The external pricing environments vary countrywise, with regard to price levels and the sophistication of public sector infrastructures. In the export markets, Syscon has many competitors, both large multinational and small local players. According to one of the export managers, the competitors' systems represent "*hopelessly outdated technologies*". Nevertheless, the most price sensitive customers may still easily opt for a competitor's solution.

## Pricing process of Syscon

The short-term pricing objective of Syscon is to maximize market share; that is, enter markets fast and gain a strong foothold in the target countries, which requires it to price at relatively low levels. Because the solution is of pioneering nature, Syscon wishes to act swiftly in order to capitalize on first-mover advantages. In the long-term, however, the company wishes to obtain a higher price level and position in the high-end, more demanding segment of the market.

“[...] we have to start at a profitable, yet moderate level– not rob it all but make sure that the target country is showing positive results. And once it has gone on for a while, once there is some sort of a customer base and the partner is hooked and selling a lot, we can raise it [price level] slightly, once the things have started rolling.” (Managing director)

The target market analysis is conducted by a consulting agency, but it only contains general descriptive information. The export manager found it extremely difficult to find a price benchmark because of the pioneering nature of the solution. With a lack of a better benchmark, a target price is often formed using the prices of competitors' most sophisticated solutions, and in some target countries a premium is added to those prices, whose size depends “very much on how active the partner is in promoting Syscon's system”. Thus, partners' commitment and ability to communicate the benefits of the system can be critical factors in enabling Syscon to charge a superiority differential. The channel partners also have an important role in determining the market price levels. According to Export manager B, Syscon representatives try to “probe” the price level during the first partner meetings of the partner selection process. Once a partner is selected, Syscon managers figure out the market prices in cooperation with the partners' representatives.

“First we have to ask the partner's opinion, and ask him what the price level is in general. And after the partner has left his first bid to the first customer and an answer is received, we can see what the price level is like. In this way, we figure out the prices together with the partner, and try to find out at which price they can manage to close sales.” (Export manager A)

In the domestic markets, the market conditions allow Syscon to use a flexible cost-plus pricing strategy, which has remained as a “legacy” from the larger company that Syscon used to be a part of. In the export markets Syscon needs to keep a closer eye on market prices; however, the basis for price calculation is domestic prices, which are discounted with a certain percentage depending on the general level of prices in the target country, leaving the partner with a margin of around 25-40 % when considering estimated market price levels. Thus, a combination of cost- and market-based pricing strategies is used. Nevertheless, Syscon is often required to complete the first project at absorption cost or even loss, because customers consider these solutions extremely risky investments and refuse to pay a high price for an untried solution. Interestingly, however, the necessity of penetration pricing seems to also depend on the channel partner's qualities, since Export manager A considered that partners with

an exceptionally well-established reputation can possibly sell the system at normal pricing even to the very first customer.

“And because we haven’t been operating actively in the new target country, we don’t have any reputation in that market and nobody knows about us. So we are often forced to take the first reference case through low pricing. That’s one way to do it, the other way is that the partner already has a great reputation and then they trust that... because they kind of market our system as their own product [...]” (Export manager A)

The final price of the total solution is always unique to each customer depending on the number of customer units, system configurations, and possible integrations to the customer’s other systems. According to the sales and export managers, Syscon does not exercise any pricing control on its partners. It often does not– or even cannot– verify the partner’s pricing, because Syscon’s system may represent only a small fraction of the partner’s sale, which may include not just general cabling but also other systems that are integrated in the Local Area Network. According to Interviewee D, Syscon’s fraction of the total sale can be as small as 5 % of the total value. This brings up an interesting question: if Syscon’s systems contribute so little to the partners’ sales, why should a partner be interested in selling Syscon’s systems in the first place? Interviewee C explained that the partners seek to boost their image and gain competitive advantage by offering pioneering products that are not available from their competitors.

“When we find the right type of partner, it can conceal our high price level in the total bid. And his competitive advantage comes from being able to offer a product that others don’t have. [...] So actually it doesn’t really matter what the price of our product is, because it represents such a small fraction of the partner’s total offering. Pricing of the cabling or something like that has a much bigger impact. So, this whole pricing thing is really about finding the right partner.” (Interviewee C)

Furthermore, Interviewee C also pointed out that some partners seek profits from operational services (such as maintenance) rather than hardware sales, and thus they needn’t put a high price on the actual system.

### **Pricing an integrated solution**

The solution of Syscon represents a complex system consisting of not just hardware components, such as customer interfaces, hallway monitors and monitoring PCs, but also software components such as customer management software and services, since the system requires regular updates and occasional maintenance. Setting a price for such a solution is not straightforward, but requires simultaneous consideration of the pricing of each individual component as well as that of the system as a whole.

The hardware part of the solution is priced using a cost-plus method. Despite still relying on this pricing strategy, the managing director and the sales manager did not find it an optimal pricing method and were actually willing to change the pricing

practices in Syscon. The issue with the cost-plus pricing strategy is that it ignores customer value. Some components, which the customers value high and whose prices cannot be compared across competitors, can be priced too low when using the cost-plus method. The managers found the issue to be particularly vexing when considering the pricing of integrations, for example to other systems used by the customers. Such integrations can be of very high value to the customer and create significant improvements in efficiency; nevertheless, currently the integrations have been priced based on a low hourly charge -basis, or even free in some cases, despite their high value to the customers. The customer value-ignoring pricing practices are, according to the sales manager, “remains from the past”, and they represent, as such, organizational routines that can be difficult to change. Furthermore, the managing director felt that Syscon might not have enough know-how to be able to price completely based on customer value.

[...] Unfortunately, we have pretty much been using some standard pricing practices or then the sales representative just figures out that, ok now we're putting a couple of bits here and there, and that makes it 3000 euros, whereas the customer might value it at 30 000 euros. So the pricing is in a very poor state indeed. [...] The issue is that we should be able to clearly demonstrate, or understand the benefits ourselves, and that's where we come to the customer's processes and at that point we simply lack the know-how.” (Managing director)

The software of the system consists of a number of different programs with different functionalities. Because the software is multidimensional and complex, Syscon does not wish to sell a separate license for each program. Instead, it has packaged the software components into three separate licenses: server license, client-specific management software license, and customer unit-specific license. The server license involves a fixed one-time fee which is set at a relatively high level, with the purpose of inducing customers to install the system to multiple units instead of just one. The other licenses are tied to the number of units and number of customers, and are priced relatively low. In addition, Syscon has introduced an “expansion fee” in export markets alone, which is a fixed fee that is charged whenever the system is installed in additional units. The objective of the export license structure is to lower the customer's initial investment and obtain revenues from future expansions.

According to the managing director, Syscon has considered both the product development costs, sales potential and market prices when pricing its software. However, in general it is forced to price at market level, which is rather low, because customers have deeply rooted pricing perceptions. Traditionally, the systems have relied much on hardware and the intelligence they used to embody was very limited. However, sophisticated and improved production methods have constantly pushed the prices of the hardware components down. Still, the software currently represents only 20-25 % of the final price, whereas hardware represents 75-80 %. This kind of a pricing practice unfortunately undermines the value of the software, since it clearly has outpaced that of the hardware.

“In the domestic markets, the customer has quite a lot of these... pricing perceptions, and it's very difficult to change them, because we have traditionally been an old hardware producer, that has slowly started making more and more software, so... and it's hard to argue the price change to our customers. [...] On one hand we would like to set a high price for the software, but on the other hand the domestic markets just don't allow it, or else we'll lose sales. [...] And now when we're entering the international markets... we can't do anything funny there either. So we're kind of in a situation where we just have to price as high as we dare.” (Sales manager)

Syscon's software licenses are one-time licenses; that is, the customer pays a fixed amount and there are no recurring payments except for the software maintenance fee, which is a yearly fee. According to the managing director, licenses paid on a monthly fee –basis would seem desirable for Syscon, especially because many of its customers are currently using very old systems but have little money to invest in a new system. A monthly fee would imply a smaller initial investment. However, the buying processes of the public sector limit the altering of Syscon's revenue model to some extent. Tenders must be submitted exactly according to what has been specified in the call, and thus monthly pricing schemes may be challenging to implement if the public sector in a target country is used to making one-time investments.

### **Partner relationships and channel governance**

Syscon managers have placed a particular emphasis on the channel partner selection process, which is sophisticated in nature and ensures that the right types of partners are chosen. Specifically, Syscon seeks partners who understand the potential of its product, see beyond the price, and have the right type of portfolio– that is, a portfolio characterized by high-quality products and systems. Choosing the right type of channel partner for each target country is critical in order for Syscon to reach its intended niche in the markets.

“[...] according to the market analysis, there is a very low price level in Poland for our kind of a player, because they have some of their own production there and they don't value this kind of a high-end product, they want something affordable. On the other hand, that may not hold true if we find a partner who wants to sell something else. For example, in Turkey we are most likely selecting this particular company, where they told us that they're looking for products that others don't have, so that they don't need to compete with price. All of their current products and services are of high quality. So when we find this type of a partner, it doesn't matter if the general price level in the country is unfavourable for us, because the partner will seek and find the customers who are willing to pay more.” (Export manager A)

Syscon provides heavy marketing support for each of its partners. A marketing plan is prepared together, and marketing materials and portable demo kits are provided to the partners. Furthermore, specific sales arguments have been prepared for each member of the buying organization, and they are shared with the partners,

who are expected to use them in order to successfully communicate the benefits of the solution to the customers. Many different types of partner incentives are used; for example, Syscon has founded a “Syscon certified partner” –program, which allows partners to reach certain levels according to their sales activity.

The partner relationships of Syscon seem to be governed through bilateral mechanisms and relational norms: the relationships rely very much on close cooperation, mutual trust, and mutual interest, and partner pricing is flexible and adjusted according to market conditions. The relationships are nurtured by frequent visits (6 visits per partner every year), open communications and Annual partner meetings, which are held every year to discuss business issues in a relaxed atmosphere.

“[...] the pricing should be based on a relationship of trust, so that they can tell us that they get this much, and then they can also tell us if the market circumstances leave them with no margin, in the case of which we can price more flexibly. Certainly, it [the relationship] needs to be based on trust, and that’s why we don’t talk about retailers or distributors, we talk about partners.” (Sales manager)

Despite the bilateral mechanisms in use, Syscon also utilizes output control in channel governance: it requires each partner to report certain monthly data on customer visits, potential orders and the volume of potential customers etc. These data are gone through in a monthly meeting, where the export managers recount the situation in each target country.

## Conclusions

The current case study illustrates how the nature of the systems integration business can result in a multidimensional pricing strategy in export environment. Our developed framework for the key decision-making issues provides a starting point for examining these complex issues. The specific characteristics of the target market and the partner determine how much the systems integrator’s prices can deviate from the market price levels. The export channel partnership also creates a unique context to the integrated solutions lifecycle (see Brady et al. 2005), because the partner is carrying out many of the stages in integrated solutions provision. How well the partner is able to handle the phases is likely to have a large strategic impact on the exporting systems integrator’s success. It seems that an intimate relationship characterized by close cooperation and high partner support from the exporter’s side– that is, a partner relationship much governed through bilateral mechanisms or relational norms– would be ideally suited to successful operation over the whole integrated solutions life cycle.

## Theoretical implications

From the point-of-view of marketing theory, this study shows that pricing deserves more attention in the channel governance literature. Customer value -based pricing



strategies instead of traditional cost-plus pricing methods should be adopted towards both end customers and channel members. The current study is a comprehensive example of a situation when traditional cost-plus pricing method is ineffective: from customer point-of-view, the software brings more value than its relative part in the cost structure of the end product, and from channel partner point-of-view, the Syscon solution gives extra marketing value to the channel partner's end product that their customers appreciate. Regarding price control issues, the findings of the current study seem to support Myers and Harvey's (2001) notion that firms interested in maintaining distributor relationships and a long-term presence in export markets would be willing to allow control of prices to other channel members. However, in the light of the findings of the current study, the disadvantages of given up pricing control mentioned by Myers and Harvey may not always apply. The export partner may want to have the systems integrator's solution in its portfolio because of strategic, rather than economic advantages. Furthermore, if the partner selection process follows a rigid procedure, the partner's product portfolio should align well with that of the exporting systems integrator, eliminating some of the possibility of disadvantageous strategic positioning. In addition, when the partner is also a systems integrator (as in the Syscon case), the price of the solution may not even be visible to the end customer, since it may represent only a small fraction of a larger project/order but offer considerable marketing value. Based on this case study, the deferral of pricing control appears more desirable than the use of pricing control in a *strategic* partnership of two systems integrators, because it allows the exporter to realize the benefits of improved strategic performance. Since the strategic partnership and the use of bilateral channel controls implies that the goals and general business ambitions of the parties are well-aligned, strategically disadvantageous product positioning is not likely to be realized. Furthermore, when the partner is also a systems integrator, the deferral of pricing control is desirable also in the sense that many systems integrators are nowadays obtaining more and more revenue from services; thus, letting the partnering systems integrator price the actual solution freely allows it to alter its revenue logic according to its own strategic ambitions and thus probably increases partner satisfaction and performance.

### **Managerial implications**

From managerial point-of-view, the current case study demonstrates that output controls can be used simultaneously to monitor performance, ensure that strategic goals are achieved, and also to ensure that the focal company stays on track of its end customers, since the importance of customer relationships over the lifecycle of the solution becomes particularly highlighted in systems integration. Furthermore, comprehensive use of different types of partner incentives (output, activity, capability, and pledge incentives) will reinforce the partner's commitment to selling the exporter's product, and activity incentives will ensure that the benefits of the solution are successfully communicated to the customers, which is critical especially for the success of customer value –based pricing strategies.

The current study also illustrates the high potential of customer value -based pricing strategies in the sales of integrated solutions, and thus supports the views of

Roegner et al. (2001). In the current study, the case company recognized the importance of using such pricing strategies, but nevertheless resorted to easier cost-plus strategies because of a lack of intimate know-how of the customers' processes. In order to remedy this, the company would be required to engage in closer and closer customer relationships, which would involve systematic collection of information on the customer's processes and also information on how those processes will change in the future. The development of such intimate customer relationships implies, in essence, movement from *systems integration* towards *solutions provision*. Recent research suggests that adoption of such a change in modes of operation may be essential to remain competitive in today's business environment (Davies et al. 2006, Brady et al. 2005, Doster and Roegner 2000).

The current study also illustrates how advances in manufacturing technologies and increased efficiency push the prices of integrated solutions' hardware components down, and at the same time, the value of the intelligence embodied in the solution—typically represented by the software component—increases and outpaces that of the hardware part. This creates a new pricing challenge for the systems integrator. Software pricing requires specific considerations and capabilities in crafting an appropriate license structure. However, especially those systems integrators whose systems have traditionally been hardware-based might not have the capabilities required in software pricing. Furthermore, customers might have deeply rooted pricing perceptions, as in the Syscon case, which further complicates software pricing. Customer education and the successful communication of customer benefits become of central importance to the success of the pricing- and marketing strategy in general, and when export partnerships are involved, the exporting systems integrator needs to make sure that the partner has the necessary capabilities. This can be ensured by careful partner selection, marketing support activities, and partner training.

### **Directions for future research**

Many opportunities remain for further research. The current study focused on a single company operating in a specific industry. The case company was in a quite early stage of export operations, and the solution was of pioneering, high-tech nature. These factors have naturally influenced the case company's pricing process and strategies, and thus it is important that future research observes systems integrators operating in various, different industries and solutions of varying technological and market novelty. Furthermore, future studies that involve the partner aspect could examine both ends of the dyad to obtain a more comprehensive view of "relationship pricing" practices (Argouslidis and Indounas 2009). Managerially, an important contribution would be to know the performance implications of systems integrators' different pricing strategies and processes in different international pricing environments. The performance effects of a customer value –based pricing strategy is a research topic of particular interest, since the current and previous studies have hypothesized that such a pricing strategy could be particularly suited for pricing integrated solutions.

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