

To Delegate Or Not To Delegate? That Is The Question Of Pricing Authority

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ABSTRACT

The burning issue of delegating pricing authority to the sales force is of interest to marketing academics as well as practitioners in a wide variety of consumer, industrial and institutional marketing situations. There are many studies which examine the decision to delegate ultimate pricing authority (PA) to the sales force. Additionally the marketing literature encompasses many theoretical rationales for giving sales personnel authority to set prices. Conversely there are also empirical research outcomes that debate the opposite scenario, asserting that giving salespeople the highest degree of pricing authority engendered the lowest sales and profit results. It is difficult to find any study which has investigated or explored this issue from the salesperson's point of view. In this study, we examine the perception of the sales force on the price authority they have been given. Supported by the sales motivation theory, we, specifically, examine the sales force perception of the decentralized (delegated) price authority to them and perceived firm performance.

INTRODUCTION

It is of interest to marketing academics as well as practitioners in a variety of consumer, industrial and institutional marketing situations to explore in-depth the topic of delegating pricing authority to the sales force. There are a number of studies which examine the decision to delegate ultimate pricing authority to the sales force (Bhardwaj 2001; Greene, Walls, Sechrest 1996; Joseph 2001; Lal 1986; Stephenson, Cron, and Frazier 1979). The marketing literature also encompasses many theoretical rationales defending giving sales personnel authority to set prices (Lal 1986; Weinberg 1975) as long as the incentives are properly based on gross margins and not on sales volumes. On the other hand, there are also empirical research outcomes that debate the opposite scenario (Joseph 2001; Mishra and Prasad 2004; Stephenson, Cron, and Frazier 1979), asserting that giving sales people the highest degree of pricing authority engendered the lowest sales and profit results, generating less sales effort, and more aggressive price reductions on the salesperson part (Stephenson, Cron, and Frazier 1979).

“Agency theory describes relationships in which one party delegates work to another and focuses on determining the most efficient contract to govern a particular relationships given the characteristics of the parties involved. Agency theory also declares that one party (the principal) depends on another party (agency) to undertake some action on the principal's behalf. It is clear, that most agency models define efficiency from the principal's point of view.” (Bergen, Dutta, Walker 1992) No scholarly journals, and very few studies (in fact none to our knowledge except for the survey done by Associated Equipment Distributors, Inc. magazine), have looked into this issue from the agent's, which is in our case the salesperson's, point of view. In this study, we examine the perception of sales force on the price authority they have been given. Supported by the sales motivation theory, we, specifically, examine the sales force perception of the decentralized (delegated) price authority to them and perceived firm performance.

An argument for price delegation (decentralized pricing) is that the salesperson is the only one who is able to judge and decide the best circumstances in terms of the customer's willingness and readiness to pay the price. Providing pricing authority (PA) to individual salespeople permits them to use their superior information about customer readiness to pay and in that way closes a greater number of transactions which in turn increases sales volume (Joseph 2001). On the other hand providing salespeople with PA leads to the possibility of “suboptimal tradeoffs

between price and effort” that means price latitude causes sales people to take the path of least resistance, that is, discounting rather than spending a greater effort on selling (Joseph 2001; Stephenson, Cron, and Frazier 1979).

Within this paper we firstly provide the background to this research, then, we outline the research design and methodology. This overview is followed by our hypotheses in relation to agency theory and the salesperson’s point of view based on this existing literature review, and the essential features of our research setting. We then give our explicit results for each of the hypotheses. Before presenting our views and conclusions, we indicate our study’s limitations and finally we present the managerial implications of our findings to assist managers charged with the price delegation decisions, and to guide academics by indicating further research areas.

BACKGROUND

Stephenson, Cron, and Frazier’s study (1979) identified five factors, in terms of the optimality of delegating pricing authority to the sales force, which they believed needed further research. These factors were;

1. Sales behaviour - what types of selling behaviour evolve when salespeople have pricing authority.
2. Market knowledge - the amount of superior knowledge they have about customer’s willingness to pay.
3. Competitive behaviour – what kind of competitive behaviour develops when the sales force has price setting authority.
4. Purchase environment – how does the knowledge that the salesperson has pricing authority effect bargaining and negotiation situations.
5. Control of commission systems – existing sales compensation systems basing sales commission on gross margins may not provide adequate control over the use of pricing authority by the sales force.

Joseph (2001) examines the net effects of two of the factors of Stephenson, Cron, and Frazier’s study (1979), namely behaviour of the salespeople when given price autonomy, specifically “whether PA would lead to suboptimal tradeoffs between price and effort”, and whether this PA would “enable them to use their superior information about customers’ willingness to pay”. The third factor concerned with competition, and competitor’s reactions to PA and the fifth factor with regard to the control value of gross-margin commission systems on salesperson compensation have been investigated by Bhardwaj (2001). His findings add weight to previous discussions in the area of PA most especially with regard to tradeoffs.

While some research has been undertaken on the above mentioned factors some areas have still been ignored. Trust is a very important aspect of salesperson-sales manager relationships which causes job satisfaction among salespeople which in turn leads to high sales performance (Flaherthy and Pappas 2000). High sales performance clearly has a flow-on effect to higher overall firm profit and performance. Trust is the perceived credibility, reliability, and benevolence of a target (Doney and Canon 1997; Ganesan, Weitz and John 1993; Kumar, Sheer and Steenkamp 1995). In addition to trust, one of the important facets of the sales manager’s role is his influence on the salesperson’s motivation (Flaherthy and Pappas 2000; Yammarino 1997). The simplest model of performance posited is ability x motivation (Gallagher and Einhorn 1976). Where trust is considered a sub-element of motivation, and delegating authority a sub-element of trust, in turn leads us to the conclusion that salespeople motivation is highly dependent on their level of given authority. Specifically, in this paper we examine the price authority delegated to salespeople and how the salespeople perceive such an authority, as well as its indirect effects on salespeople’s motivation.

METHODOLOGY AND RESEARCH DESIGN

This research aims to gain insights into the salesperson’s perceptions of delegated price authority. By looking at available literature we have seen the gaps which need to be filled in the field of PA. Hypotheses that evaluate the effects of the variables have been collected from the existing literature, and these are developed in light of the existing gaps. Accordingly the questionnaire has been formed, and tested via a survey method within the field work. Since this research is exploratory in nature, and also being the first of its kind (to our knowledge) with an agency perspective, non-probability sampling techniques have been used. Among them, the most appropriate was a convenience sampling approach. The chosen sample was salespeople within the construction industry who were together at the same time,

under the same roof; i.e. in a single place, a trade fair. The basic limitation for this sampling method is that the resulting sample may not be representative of the entire industrial population.

The questionnaire was handed out at a trade fair/exposition, called “Construction Days”, where sales representatives of several construction companies were present. It was therefore one specific industry where the majority of the salespeople were men, in this particular case 93%. Of the 115 questionnaires which were distributed, only 62 were collected or handed back which is response rate of 54 %. Of the 62 questionnaires collected, only 50 were completed correctly giving us an effective response rate of 43%. This is an interesting finding in its’ own right since it was assumed that we had a somewhat captive audience and would have expected a higher return percentage. In hindsight the chosen respondents and trade fair may have caused the lack of interest, attention and concentration on the survey, since many respondents were rather more focused on their customers at this time.

The questionnaire used consists of twenty questions. The first two open-ended questions were asked in order to evaluate the perception of salespeople about their own and the firm’s success. These questions were set because it was believed that having the same future goals would be a significant criterion in allocating PA. The third question was asked to ascertain whether the salesperson in question had PA. Questions four to six were designed as indicators of the salesperson’s conformity levels. These questions were in statement form and using a 5 point Likert scale measure, the respondents were asked to indicate how strongly they agree with these statements on PA levels. The fifth, seventh, and ninth questions were asked in order to determine the level of importance of pricing authority’s affect on motivation level, prestige in customer’s eyes (opinion), and efforts spent to close the sale, respectively, from a salesperson’s perspective. The remaining questions were related to the compensation system, and socio-demographic facts such as age, gender, marital status, education degree, and monthly income level etc.

HYPOTHESES AND RESULTS

Match Of Objectives

A mutually beneficial working relationship with the salespeople is necessary if a firm is to accomplish its objective. A profitable operational link based on mutual trust and respect must be built between the company and the salesperson. To do so, the company must respect the employee’s goals and objectives, while the employee must show deference to and follow the company's objectives. Hence, specific objectives which have been set based on company criteria and resources should be clearly communicated to the salesperson. Besides, in order to attain the goal of a sound firm performance, company objectives should match salesperson’s objectives.

As per agency theory, the firm hires the salesperson to maximize its expected profit in return for compensation (Bergen, Shantanu, and Orville 1992; Coughlan and Sen 1989) while the salesperson will expend effort on selling that maximizes his/her own expected financial benefit (Basu, Lal, Srinivasan, and Staelin 1985). Equitable and shared objectives would allow a company to increase its firm performance. Based on this theory, we speculate whether delegating PA to the salesperson would affect shared objectives of salesperson and the firm. Hence, our first hypothesis:

H1: Match of the objectives of the salesperson and the firm is related to the ownership of price authority.

Price Authority, Sales Volume And Firm’s Profit

Theory also supports the view that decentralized pricing (i.e. delegating price authority to the sales force) will have a positive affect on the sales volume, and a negative effect on the firm’s profit and gross margin which is net sales minus cost of goods sold expressed as a percentage of net sales (Stephenson, Cron, and Frazier 1979). “It is expected that salespeople with price latitude will tend to discount prices in order to overcome sales resistance. Price latitude will seldom be used, to sell at prices above list.” (Stephenson, Cron, and Frazier 1979) The conjecture therefore is whether this view about the relationship of PA’s effect on sales volume and PA’s effect on firm’s profit is also been shared by the sales force when asked about their perceptions on this issue. Hence our second hypothesis:

H2: As per sales force perceptions, PA’s effect on sales volume is related to PA’s effect on firm’s profit.

Table 1: Match Of Objectives, And Having PA Cross-Tabulation

<u>Count Having PA</u>	<u>Yes, I have PA</u>	<u>No, I don't have PA</u>	<u>TOTAL</u>	<u>CHI-SQUARE TEST</u>	<u>Value</u>	<u>df</u>	<u>Asymp.Sig. (2-sided)</u>	<u>Exact Sig. (2-sided)</u>	<u>Exact Sig. (1-sided)</u>
<u>Match of objectives:</u>				Pearson Chi-Square	,0009(b)	1	,925		
Match	13	3	16	Continuity correction(a)	,000	1	1,000		
Don't match	28	6	34	Likelihood ratio	,009	1	,925	1,000	,605
Total	41	9	50	Fisher's Exact Test	,009	1	,925		
				Linear-by-linear assoc.	50				
				N of valid cases					

(a) Computed only for a 2x2 table (b) 1 cells (25,0%) have expected count less than 5. The min. expected count is 2,88.

Our first hypothesis is not supported. Grouping limited authority and full authority (Joseph 2001) responses in having PA make the outcome worse. Thus, we conclude that ownership of PA does not affect the match of the salesperson’s and firms’ objectives.

Table 2: PA On Sales Volume*, And PA’s Effect On Profit Of The Firm Cross-Tabulation

<u>Count PA effect on firm's profit</u>	<u>Strongly disagree</u>	<u>Disagree</u>	<u>Neutral</u>	<u>Agree</u>	<u>Strongly Agree</u>	<u>Total</u>	<u>CHI-SQUARE TEST</u>	<u>Value</u>	<u>df</u>	<u>Asymp. Sig. (2-sided)</u>
<u>PA on sales volume:</u>							Pearson Chi-Square	3,899	8	,867
Neutral	5	4	6	2	1	18	Likelihood ratio	4,436	8	,816
Agree	6	4	5	3	2	20	Linear-by-linear assoc.	,257	1	,612
Strongly agree	13	13	15	6	3	50	N of valid cases	50		
Total										

(a) 11 cells (73.3%) have expected count less than 5. (b) The min. expected count is ,72.

We expected to see a correlation between perceived PA effect on sales volume and perceived firm’s performance. Since it is obvious to expect that with discounted prices the salesperson would increase her/his sales volume at a cheaper unit price, which then will result in a cut or decrease of the sales revenue and the firm’s profit. Unpredictably, salespeople did not see any association or relation. Thus, our second hypothesis is not supported.

Price Authority, Sales Volume, And Compensation

As mentioned earlier, theory supports the view that when the sales force has price authority they will tend to give discounts easily (Joseph 2001; Stephenson, Cron, and Frazier 1979) to increase their volume of sales. Price authority would be an incentive on discounting for the salesperson if his performance is measured by his sales volume, and a discouragement on discounting for the salesperson if his performance is measured by the sales revenue, gross margin, or firm’s profit. Since the performance measurement in these cases becomes a proxy for the compensation (or bonus) method in the field of sales, we investigated the salespeople’s view on these topics with the following hypothesis:

H3: PA’s effect on sales volume is related to its effect on salesperson’s salary (compensation).

Table 3: PA Effect On Sales Volume, And PA’s Effect On Salesperson’s Compensation/Income Cross-Tabulation

Count <u>PA effect on compensation</u>	Strongly disagree	Disagree	Neutral	Agree	Strongly Agree	Total	CHI-SQUARE TEST	Value	df	Asym. Sig. (2-sided)
<u>PA on sales volume:</u>							Pearson Chi-Square Likelihood ratio Linear-by-linear assoc. N of valid cases	9,170	8	,328
Neutral	3	4	2	3		12		a	8	,277
Agree	8	6	1	2	1	18				
Strongly agree	4	7	2	2	5	20			1	,265
Total	15	17	5	7	6	50			1,242	50

(a) 11 cells (73.3%) have expected count less than 5. The min. expected count is 1,20.

As the chi square test indicates, salespeople see no association of the price authority’s (discounts) effect on sales volume and its’ influence on their salary or compensation. This is a surprising result and proves to us as indicated in the theory that the salespeople are more interested in the sales action itself and do not think so much about its consequences. Salespeople sometimes look more for the sale vs. the best interest of the dealership overall (Reilly 2003). In fact, the quite complex salesperson’s behaviour is shown in “motivational responses toward quota achievement versus maximization of sales or income” (Stephenson, Cron, and Frazier 1979; Winer 1973). H3 is not supported from salesperson’s point of view. This result forced us to probe this outcome further with the following hypothesis:

H3a: PA’s effect on sales volume is related to the effect of price on sales volume.

PA’s Effect On Sales Volume, And Price Effect On Sales Volume

Table 4: Effect On Sales Volume And Price Effect On Sales Volume Cross-Tabulation

Count <u>PA effect on sales volume.</u>	Neutral	Agree	Strongly Agree	TOTAL	CHI-SQUARE TEST	Value	df	Asymp. Sig. (2-sided)
<u>Effect of price on sales volume:</u>					Pearson Chi-Square Likelihood ratio Linear-by-linear assoc. N of valid cases	8,045a	8	,429
Strongly disagree		2	2	4		9,039	8	,339
Disagree	7	4	7	18				
Neutral	2	1	4	7		,015	1	,901
Agree	2	8	5	15		50		
Strongly agree	1	3	2	6				
Total	12	18	20	50				

(a) 11 cells (73.3%) have expected count less than 5. The min. expected count is ,96.

As expected this outcome does support the result of the previous hypothesis (H3) that means that H3a is also not supported. Salespeople do not even see an association between price effect of sales volume and PA effect on sales volume.

All these striking results show and support the view of theory that salespeople do focus on sales action itself (Reilly, 2003) and do not make further associations about the effects of any discounts from the list price to sales volume, sales revenues, firm’s profit, and compensation.

Given these results we decided to dig deeper into the area of motivation. This decision was based on the strong link between power, authority and performance, and motivation in the theory. Hence our next hypothesis:

H4: PA’s effect on motivation is related to its effect on salesperson’s performance.

PA’s Effect On Motivation And Performance

Table 5: PA’s Effect On Sales Person’s Performance, And PA’s Effect On Sales Person’s Motivation Cross-Tabulation

Count <u>PA effect on sales person’s motivation</u>	Disagree	Neutral	Agree	Strongly Agree	Total	CHI-SQUARE TEST	Value	df	Asymp. Sig. (2-sided)
<u>PA effect on sales person’s performance:</u>						Pearson Chi-Square Likelihood ratio Linear-by-linear assoc. N of valid cases	58,259	9	,000
Disagree	1	1	1		3		a	9	,000
Neutral		4	4		8		51,346	1	,000
Agree			8	4	12		34,006		
Strongly agree			2	25	27				
Total	1	5	15	29	50			50	

(a) 13 cells (81.3%) have expected count less than The min. expected count is ,06.

At last, salespeople see a significant and strong association between PA’s effect on salesperson’s motivation and performance. H4 is supported.

PA’s Effect On Effort To Close The Sale And On The Easiness Of Sale

Theory supports the view that a negative feature of PA to practitioners would be that PA will cause a suboptimal substitution of selling effort by price discounting (Joseph 2001). Providing PA to salespeople may make them too compliant in the negotiation situation (Dolan and Simon 1996, p. 313). Giving price discounts would generally be expected to result in easier sales, and thus make it trouble-free and demand less effort from the salesperson in closing the sale. This finding leads to the next hypothesis.

H5: PA’s effect on the effort to close the sale is related to its effect on the easiness of sales.

Table 6: PA’s Effect On The Effort To Close The Sales*, And PA’s Effect On The Easiness Of Sales Cross-Tabulation

Count <u>PA effect on the easiness of sales.</u>	Neutral	Agree	Strongly Agree	Total	Chi-Square Test	Value	df	Asymp.Sig. (2-sided)
<u>PA effect on the effort to close the sales:</u>					Pearson Chi-Square Likelihood ratio Linear-by-linear assoc. N of valid cases	4,012a	8	,856
Strongly disagree	1	3	3	7		4,134	8	,845
Disagree	2	12	7	21		,455	1	,500
Neutral	2	4	3	9				
Agree	1	5	3	9				
Strongly agree		1	3	4				
Total	6	25	19	50				

(a) 13 cells (86,7 %) have expected count less than 5. The min. expected count is ,48.

Another nonconforming and unexpected result is that salespeople do not perceive any correlation between PA effect on the effort to close the sale and PA effect on the easiness of sale. Consequently our H5 hypothesis is also not supported. This outcome made us curious and subsequently we investigated further to understand what the underlying issue here was.

PA’s Effect on the Easiness of Sale and Price Effect on Sales Volume

H5a: PA’s effect on the easiness of sales is related to the effect of price on sales volume.

Table 7: PA’s Effect On The Easiness Of Sales*, And Effect Of Price On Sales Volume Cross-Tabulation

Count Effect of price on sales volume	Strongly disagree	Disagree	Neutral	Agree	Strongly Agree	Total	CHI- SQUARE TEST	Value	df	Asymp.Sig. (2-sided)
PA effect on the easiness of sales:							Pearson	3,597a	8	,892
Neutral	1	2	1	2		6	Chi- Square	4,286	8	,830
Agree	1	8	3	9	4	25	Likelihood ratio	,159	1	,690
Strongly agree	2	8	3	4	2	19	Linear-by- linear assoc.	50		
Total	4	18	7	15	6	50	N of valid cases			

(a) 11 cells (73.3%) have expected count less than 5. The min. expected count is ,48.

PA’s Effect on the Easiness of Sales, and its Effect on Sales Volume

H5b: PA’s effect on the easiness of sales is related to its effect on sales volume.

Table 8: PA’s Effect On Easiness Of Sales *, And PA’s Effect On Sales Volume Cross-Tabulation

Count	Neutral	Agree	Strongly Agree	Total	CHI-SQUARE TEST	Value	df	Asymp. Sig. (2-sided)
PA effect on easiness of sales:					Pearson Chi-Square	3,131a	4	,536
Neutral	1	3	2	6	Likelihood ratio	3,252	4	,517
Agree	5	11	9	25	Linear-by-linear assoc.	,000	1	,983
Strongly agree	6	4	9	19	N of valid cases	50		
Total	12	18	20	50				

(a) 4 cells (44,4 %) have expected count less than 5. The min. expected count is 1,44.

The fact that our previous hypothesis (H5), was not supported, is confirmed with these outcomes. Surprisingly again, salespeople did not perceive any association between PA’s effect on the easiness of sale and the effect of price on sales volume, nor do they associate PA’s effect on the easiness of sales with its effect on sales volume. H5a and H5b are not supported.

Discussions, Limitations, and Further Research

In theory many academics and practitioners believe that PA significantly increases the salesperson's chances of making a sale, and as a result favour giving salespeople PA. In other words they support decentralized pricing authority, which is delegating pricing decisions to the sales force. This view is further supported by the idea that responsibility, power, control, autonomy, authority, and job satisfaction are associated. Moreover, salespeople have more complex behaviour and perceptions of incentives than just a simple pay check or bonus. Salespeople, some of whom, may be in the progress of moving towards a sales manager position and as such should be facing circumstances where they have to make more independent decisions. Often in these circumstances pricing is the most important decision they have to make and is most relevant to their field. Ultimately, a salesperson is the one who decides the relative importance and size of the prospects, since they are the ones calling, and visiting on both potential prospects and current customers, influencing them, and hopefully closing the sale. Therefore a salesperson's role should not be limited to just being a messenger boy delivering information to and from the firm. Clearly his customers and prospects would value him more when they perceive that he is powerful in decision making, since most customers prefer to do business with credible and decisive partners. And as every salesperson is no doubt aware, there is no better time than present to close a sale with a willing customer. Taking PA out of the hands of the salesperson would slow down the process of the transaction and additionally make the salesperson look less important and authoritative to the customer. By the time the sales person checks the price with the management, the customer may be exposed to competitor's offers, or just simply change his mind by being distracted from that unique and magic selling atmosphere.

On the other hand, researchers who took the opposing view basically believe the practice of giving PA to the salesperson causes lower gross margins and there are several empirical research study results which prove this. Our study in a way also supports this view, since salespeople see no associations between their PA and sales or profit of the firm, this would lead to the conclusion that they would use their pricing authority to just close the sale.

This study has its limitations, mainly in how it was administered. As previously pointed out the questionnaire was handed out at a trade fair/exposition, called "Construction Days, where sales representatives of several construction companies were present. It was therefore one specific industry where the majority of the salespeople were men, in this particular case 93%. The basic limitation of this convenience sampling method is that the resulting sample may not be representative of the entire industrial population. However the 43% response is promising and allows a contribution to be made to the existing literature and also paves the way for future research.

For the marketing and sales management, delegating PA to sales force is a very significant matter. This subject deserves further investigation in industrial and services marketing situations, as well as international marketing conditions since the results may differ given the education level and circumstances of the sales force working for those industries. As we pointed out other researchers have examined in detail four of the five factors identified by Stephenson, Cron, and Frazier's study (1979) as needing further research but one still remains untouched, namely negotiation circumstances, that is buyer's negotiating skills and abilities in light of the delegation of pricing authority.

CONCLUSION

By testing our hypotheses and analysing the frequency tables, we were faced with some contradictory results. Even though sales people see having PA as an appealing incentive tool, they do not associate its effect with sales volume, and firm's performance. They do, however, perceive that the length of time spent working at the same corporation affects their loyalty to the firm, and that their motivation is undoubtedly related with performance of salespeople. The fundamental effects of having PA on the salespeople are that they perceive PA as an enhancing tool to increase motivation, performance, and their respect and dignity from their customer's point of view. This was found despite the existence of a minority of the salespeople who perceive authority as a burden on their shoulders. Results show that having price authority and its different effects on sales volume, and firm profit has not been understood clearly and completely by the sales force. Almost half of the group has the view that having PA would increase the sales volume and subsequently the firm's profit, whereas the other half claim the opposite. Different arrangements of

questions in our questionnaire using Joseph's (2001) scale, and research setting, regarding salespeople having limited, and full authority, did not change our result.

To the extent that one can generalize from this sample of 50 salespeople from the construction industry, one can conclude that the strategy of delegating price authority to the sales force is likely dysfunctional except if its function is motivating the salespeople. Considering that motivation can be achieved through other circumstances and through other more powerful and influential tools (Joseph and Thevaranjan 1998) giving sales people PA does not make a lot of sense from a managerial viewpoint. One may even deduce that given the negative outcomes of delegating PA, in that from the salesperson's point of view, it is neither associated with their income and the firms' profit nor it is appreciated by the sales force, pursuing a decentralized pricing strategy is not necessary and in fact wasted. Literature has even speculated that since firms that give their salespeople a high degree of PA had consistently poor performance, providing high PA to sales force may be symptomatic of a pattern of relatively weak marketing and sales management (Stephenson, Cron, and Frazier 1979).

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NOTES