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The Price is Right: Effective Pricing Strategies

The following report is set to explore how to determine the best price for a product, some of the pricing strategies firms can use, and how it can affect their bottom line. As a business, one of the most important decisions you can make is pricing your product or services in a way that will help you thrive in a market. (Marn and Rosiello 1992) It is very important to understand various pricing strategies to stay informed and make the correct choice for success.

To determine the best pricing strategy of a business, one need to consider several factors, to ensure profitability and competitiveness. Please see table below:

Exhibit 1. Pricing factors to consider (Not an exhaustive list)

Factor	Explanation
Cost Calculation	Determine cost of product, materials, labor, and overhead
Market Research	Understand your target customers, competition, and the industry trends
Price Model Consideration	Choose a model that aligns with your business and customer expectations → No model fits all
Desired Profit Margin	Determine the profit margin you want to achieve
Evaluating Customer Perception	The customers perception of value, and their Willingness to Pay for product or service
Monitor and adjust accordingly	Review your pricing strategy, and its impact → adjust accordingly

Sources: www.uschamber.com/co/start/strategy/how-to-price-your-product

One pricing model to consider is **Cost-Based Pricing**. This strategy involves setting prices based on the cost of production and distribution. The advantage is that all costs are covered, and potential losses can be prevented. (Keenan 2022) This model works well if competitors are using the same pricing strategy. However, a setback is that external factors such as competition and demand are not taken into account. For example, if a watch costs $300 to manufacture and you want to make a $600 profit on each watch, you would set the price of the watch at $900, which is a markup of 300%.

Value-Based Pricing is a strategy that determines the price of a product or service based on the perceived value by customers. This approach allows firms to charge a price that customers are willing to pay without discouraging them, resulting in higher profit margins (Dholakia 2016). However, it is important to note that value-based pricing may not be suitable for every customer, as perceptions of value can change over time (Decker 2023). Additionally, implementing this strategy requires significant resources for data analysis. To illustrate, let's consider two customers who are interested in purchasing a BMW X3. Customer 1 is willing to pay $49,000 and chooses the 2024 X3, xDrive20i. On the other hand, Customer 2 is willing to pay more and selects the Hybrid edition of the 2024 X3, M40i for $61,900. It is evident that Customer 2 has a higher willingness to pay and belongs to a different market segment than Customer 1.

Competitive-Based Pricing is a strategy that determines the price of a firm's product or service based on the existing market rate and competition. By using this strategy, a firm can benchmark their prices against their competitors (The Investopedia Team 2020). This approach can give your product or service an advantage if you are able to differentiate it in a way that your competitors cannot, such as through exceptional customer service or unique benefits. For example, if a competitor’s watch cost $300, you can price it through necessary adjustments as seen below:

Exhibit 2. Competitive-Based samples

Scenario 1	Competitor Price $300	Your Price $300
Scenario 2	Competitor increases Price to $320	You keep the price at $300
Scenario 3	Competitor decreases price to $280	You keep price at $300
Scenario 4	Competitor decreases price to $290	You decrease it to $280

Market Penetration Pricing is a strategy where a company enters a competitive market by setting a low price to attract customers and gain market share. As the product establishes itself, the price is gradually increased over time (Decker 2023). However, it is important to note that this tactic is not sustainable in the long-term as it may initially result in losses. For example, firms may offer a discounted rate of 15% off the first purchase or a buy 2 get 1 free offer to entice customers with a lower price.

Skimming Pricing, the opposite of market penetration, refers to a strategy where a firm initially sets a high price for its product and then gradually lowers it over time as its popularity wanes. By doing so, the firm aims to capture the maximum revenue from customers willing to pay a premium price (Decker

2023). This approach allows the firm to recover its initial costs and sell a substantial number of units at each price point before eventually lowering the price again. For example, companies like Apple adopt this strategy when launching new smartphones and other tech products. They capitalize on consumers' willingness to pay a higher price during the initial product release, and as time passes, they lower the price to attract a wider range of consumers with different willingness to pay.

Bundle Pricing refers to the offering of discounts when customers purchase multiple products or services together instead of individually. This strategy aims to create a perception of value by allowing customers to pay a lower upfront cost for a combination of products (Liberto 2021). Additionally, bundle pricing enables firms to sell less attractive products as part of a package deal. For instance, customers can purchase or subscribe to Microsoft Office as a bundle, which includes all programs, at a single fixed price instead of paying a higher total price for individual programs.

Freemium Pricing refers to the offering a free or basic version of product or service, and then charge a premium for upgraded features. Firms usually offer free trials to give customers a taste of the functionality in hopes to build trust before purchase (Kannan, Gu and Li 2023). It gives access to the customers information. For example, Spotify offers free services, and has premium services that can only be accessed through purchasing.

Premium Pricing refers to a high price that conveys a sense of high-value or exclusivity. This strategy focuses on the perceived value rather than the actual value or cost of products (Decker 2023). Firms can influence the perception of exclusivity by using influencers, supply control, and drive-up demand. This exercise is common within brands such as Chanel, Patek Phillipe, and Bentley.

In conclusion, pricing strategies play a vital role in the success of any business. They assist companies in determining the optimal price for their goods or services by assessing various factors such as the cost of production, product characteristics, market conditions, target customer base, positioning strategy, revenue objectives, and competitor offerings. Moreover, the nature of the product and the industry in which it operates significantly influence the pricing strategy.

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