

## Pricing Strategies – An Overview

The arrival at an appropriate price for a product is a lengthy, considered course that has a dominant effect on the entire future of an enterprise. For this reason it must be steeped in strategy and born of process. There are a number of valid strategies that can be pursued, each with its own advantages and deficits. This article reviews the strategic options so that the art of pricing is not only better understood, but better practiced.

Tudog would like to present 6 pricing strategy options for consideration. They are:

1. Skimming Pricing
2. Comparable Pricing
3. Variable (Marginal Cost) Pricing
- 4, Penetration Pricing
5. Expansionist Pricing
6. Full Cost Plus Pricing

### 1. Skimming Pricing

Skimming is the act of charging a relatively high price (generally for a limited time) when introducing new, improved, or niche products to market. The objective is to “skim” additional profits off the early adapters and those that feel compelled to have the new price early.

Seen often in the electronics sector, for example, the success of a skimming strategy often depends on consumer’s viewing the products as being significantly distinctive from other product options. This produces an inelastic demand, at least among certain sectors of the market. For this strategy to be completely successful there should also be elements of market segmentation, as the widespread availability of the products might lead to a diminishing of the skimming opportunity.

The benefit of skimming is a short term increase in profits. There are perception benefits as well, as secondary adapters experience a rise in demand based on the prestige and glamour bestowed on the new product (in part by the high pricing).

The downside with skimming is that it slows market penetration and can cause a reduction in consumer loyalty.

### 2. Comparable Pricing

In most marketplaces there exists a consumer expectation of price. This is often established by either the market leaders or the historical pricing path similar products have taken. The notion of a consumer expectation of price is also related to the notion of perceived value, in that the consumers have assigned a specific value level to the product and are expecting a price that reflects their view of the value.

In comparable pricing, the price of an object is a reflection of the prices existing for similar products. The advantage is that the product joins a group of goods that are already accepted by consumers, and is seen as similar to them in value. The downside to this strategy is that it is devoid of any competitive tactic and lumps the product in with, and not distinctive of, its competitors.

### 3. Variable or Marginal Cost Pricing

This strategy provides for the setting of a price in relation to the variable costs of production (excluding costs such as overhead and fixed costs). The advantage of this model is that it provides for good short term decision making and avoids having to make arbitrary allocations to fixed costs and overhead. This strategy also forces a company to focus on getting to the break-even point.

There are significant risks associated with this model, including that the price set will not recover the total fixed costs in the long term. Ultimately a business must recover loss and have prices set at levels that exceed their total costs. If the company experiences difficulty raising their prices (due to competitive considerations, market conditions, or other variables), the company could sink into debt and find it challenging to recover.

### 4. Penetration Pricing

Perhaps the reverse of skimming, penetration pricing calls for the setting of a lower than market price in order to capture a large market share. Seen often in the food industry, the strategy is an effective tool for introducing new products to a broad market. The requirement is that the demand be primarily elastic (price sensitive) so that both new buyers and existing customers are attracted.

An advantage to this strategy is that it allows for a rapid gaining of market share without the need to challenge competitors on issues beyond price. Also, the strategy can lead to significant marketing advantages as it could generate word of mouth enthusiasm that serves to further drive sales.

The disadvantage of this strategy is the risk of a price war with competitors. Also, by positioning the product at a low cost could lead to longer term consumer perception issues, such as questions on quality.

### 5. Expansionist Pricing

Expansionist pricing can be viewed as a more intensive version of penetration pricing insofar as it involves setting extremely low prices with the intent to target mass markets. The competitive reaction to this strategy is secondary, and in some instances, is even part of the intended fallout.

Companies using this strategy are attempting to enter new or international markets by offering lower-cost versions of products already established. The goal is to gain recognition and market acceptance, so that subsequent (more expensive) models can be introduced on the momentum created. An example might be a new musical release by an artist seeking to broaden his/her fan base. The lower price may draw new fans, who will then be willing to pay full price for the next release.

The disadvantage associated with this strategy centers on the risk of being labeled an inexpensive product, the result of which may be consumer resistance to any efforts to offer follow up products at higher price points.

### 6. Full Cost Plus Pricing

This strategy takes into account all relevant costs of production and then adds a determined percentage that serves as profit.

The advantage of this model is that it is easy to calculate and monitor, as price increases in production automatically are reflected in price hikes. This strategy might also encourage competitors to assume similar models, as they will fear risks that a company adhering to this strategy would not be exposed to.

The disadvantages of this model includes that it ignores all rules of consumer demand and seeks to impose a value not born from the market, but rather on the production side.

This article reviewed all the strategy options for establishing a pricing policy, demonstrating that each strategy has advantages and disadvantages. The pros and cons emphasize the need to create a policy as part of a broader strategic process, so that the pricing of the company products, and the objectives of the company's strategy are complimentary.