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Various Pricing Strategies: A Review

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Abstract: *The current paper reviews various pricing strategies adopted by the modern businesses. It further states various merits and demerits of each of the pricing strategies. The main objective of the paper is to compile some of the popular pricing strategies and their pros and cons at one place. The topic not only relates to marketing management but also extends to managerial economics. The paper has been classified into six parts. The first section introduces the purpose of the paper. The second section examines the importance of the pricing strategies. The third section describes the main objectives behind pricing strategies. The fourth section explains various pricing strategies whereas the next section discusses advantages and disadvantages of various pricing strategies. The paper ends with a conclusion about how the businesses should select the most suitable pricing strategy for themselves.*

Key Words: *Pricing Strategies, Marketing Mix, Cost Plus Pricing, Demand Oriented Pricing.*

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I. Introduction:

It's a well-known fact that the success of the product in the market depends on the four factors popularly known as the marketing mix. This involves the price, the product, the promotion and the place. The price should be competitive and reasonable, the product should be of good quality, the promotion should be impressive and appealing whereas the place should be pleasant and easily accessible. The current paper focuses on one of the Ps of marketing i.e. Price**.** The paper reviews some of the popular pricing strategies adopted by the modern businesses.

II. Importance of Pricing Strategy

- If the pricing strategy of the product goes wrong, the demand for the product in the market will be very less. Product will fail.
- If the price is less than what it should be- then the company is unnecessarily sacrificing profit.
- If the price is more than what it should be- then the company will lose some of its customers.
- That's why an accurate price strategy is necessary.

III. Objectives of Pricing Strategy:

Different companies will have different objectives while deciding on the price strategy:

- To increase market-share within a market
- To defend an existing market from new entrants
- To enter a new market etc.

IV. Types of Pricing Strategy

Following is the list of some popular pricing strategies adopted by the modern businesses.

1. Cost-Plus Pricing
2. Incremental Cost Pricing
3. Auction Pricing
4. Price Skimming
5. Loss Leader Pricing
6. Predatory Pricing
7. Limit pricing
8. Psychological and odd pricing
9. Prestige Pricing
10. Demand Oriented Pricing
11. Delivered Pricing
12. Promotional Pricing
13. Cyclical Pricing

1. Cost Plus Pricing

Cost plus pricing is a cost-based method for setting the price of goods and services.

Under this approach, the direct material cost, direct labor cost, and overhead costs for a product are added up and added to a markup percentage (to create a profit margin) in order to derive the price of the product.

2. Incremental Cost Pricing

It is the method of pricing a product based on incremental cost.

In this type of pricing, the selling price of a product is determined by the variable cost, and not according to the overall cost of creating the product. Incremental cost is the cost of creating additional units of the same product from the same setup (i.e. machines and land etc) i.e. the fixed cost remains same, and the selling price of the product thus generated is based mainly on the variable cost. For example, a company that has been making packets of bread with 8 breads per packet launches a new product that is a 15-bread packet. So the fixed cost like the rent of the land, the initial cost of setting up the machinery and cost that was incurred in R&D of the bread remain same. The variable cost changes. This includes the cost of the extra volume of ingredients, bigger packets, extra oil/electricity used to run the machinery.

3. Auction Pricing

The seller allows the buyers to compete for the product by asking them to quote the highest price they would like to pay for it. The one who shows the willingness to pay the highest price gets to buy the product.

4. Price Skimming

Price skimming is a pricing strategy in which a company sets a relatively high initial price for a product or service at first, then lowers the price over time.

There are two reasons behind doing so:

a. As the product is generally a status-symbol product, the rich are willing to pay a higher price for the latest product when it is first launched.
b. A higher price allows the company to recover the heavy expenses it has made on research and development. The typical characteristic of price skimming is that the seller gradually reduces the price.
a. Because the most wealthy and desperate have already bought the product and now the company wants to target the second layer of customers.
b. Attracted by the super-normal profits, gradually the competition is created. To stay in the competition, a slight reduction in price is must.

5. Loss Leader Pricing

Loss leader pricing is an aggressive pricing strategy in which a store sells selected goods below cost in order to attract customers who will, according to the loss leader philosophy, make up for the losses on highlighted products with additional purchases of profitable goods.

Loss leader pricing is, in essence, a bid to lure customer traffic away from the businesses of retail competitors.

Retail stores employing this pricing strategy know that they will not make a profit on those goods that are earmarked as loss leaders.

But such businesses reason that the use of such pricing mechanisms can sometimes attract large numbers of consumers who would otherwise make their purchases elsewhere.

6. Predatory Pricing

The company deliberately sets an extremely low price of its product (sometimes below the AC) with an intention to drive competitors out of the market or create barriers to entry for potential new competitors.

The predator hopes to generate revenues and profits in the future that will more than offset the losses it incurred during the predatory pricing period.

The predator undergoes short-term pain for long-term gain.

Therefore, for the predator to succeed, it must have sufficient strength (financial reserves or other sources of offsetting revenue) to endure the initial lean period.

Loss Leader v/s Predatory

In Loss Leader pricing strategy, the other products are expected to generate profits to compensate the loss at the same time

In Predatory Pricing, the same product is expected to earn profits to compensate the loss in future, once the monopoly is established.

7. Limit Pricing

A limit Price (or limit pricing) is a price, or pricing strategy where products are sold by a supplier at a price low enough to make it unprofitable for other players to enter the market.

It is used by monopolists to discourage entry into a market.

As it limits the number of companies in the market, it is known as limit pricing.

Unlike the previous two methods, price is low but does-not necessarily results into a loss.

8. Psychological and Odd Pricing

Psychological pricing is a pricing strategy based on the theory that certain prices have a psychological impact.

Retail prices are often expressed as "odd prices": A little less than a round number, e.g. Rs.99

There's evidence that consumers tend to perceive “odd prices” as being significantly lower than they actually are.

9. Prestige Pricing

The practice of pricing goods at a high level in order to give the appearance of quality is known as prestige pricing.

It’s a pricing strategy where prices are set higher than normal because lower prices will hurt instead of helping sales, such as for high-end perfumes, jewelry, clothing, cars, etc. This is also called image pricing. There are certain products where the perception is that higher the price better is the quality of the product and thus higher the prestige associated with being the owner of that product.

In case of these products, lower price leads to lower sales. Higher price serves as the motivation to the customers to buy that product. Selling at a high price creates an aura of superior quality and social status.

10. Demand Oriented Pricing

Demand Oriented Pricing, as the name suggests, uses the customer demand to set up the price in the market.

The producer first determines the customer’s willingness to pay for any good or service and then decides the price.

A high price is charged when the demand is high and a low price is charged when the demand is low. In case of service, high price is maintained during the peak hours and vice-versa. Some of the sectors practicing demand oriented pricing are restaurants, cinemas, airlines etc

11 Delivered Pricing

A price for which a seller agrees to deliver merchandise to a purchaser at a designated place and which usually includes the lawful transportation charges actually incurred in delivery. It’s a price for a product that includes the cost of transporting the product from the manufacturer to the customer. The customers often prefer to buy the product from such companies due to the incentive of free-home delivery.

12. Promotional Pricing

When the prices are reduced by a percentage amount for a limited duration, it is known as promotional pricing. This helps to increase the demand for the product from price sensitive consumers.

13. Cyclical Pricing

The price which depends on the stage of business cycle is known as cyclical pricing.

During the recessionary phase of the business cycle, incomes of the consumers are declining and so the demand is likely to be less. Seller charges low price at this time.

During the boom period, incomes of the consumers are increasing and so the demand is likely to be high. Seller charges high price at this time.

V. Advantages and Disadvantages of Various Pricing Strategies

1. Cost Plus Pricing:

Advantages of Cost-Plus Pricing: It is easy to determine the price using this method. Secondly, it provides assured profits to the company. Further, it’s easy to justify the price hike when required.

Disadvantages of Cost-Plus Pricing: The cost-plus pricing ignores competition (Demand). It’s possible that the competitors may be charging higher or lower price. Another disadvantage is that the contract cost over-runs. From the perspective of any government entity that hires a supplier under a cost plus pricing arrangement, the supplier has no incentive to curtail its expenditures - on the contrary, he will likely include as many costs as possible in the contract so that it can be reimbursed.

2. Auction Pricing:

Advantages of Auction Pricing: The biggest advantage of the auction pricing is that the seller secures the best price for his product. Secondly, only the seriously interested customers will enter the market. Finally, the buyers do the job of price determination for the seller.

Disadvantages of Auction Pricing

Selling at auction can deter some buyers because of the competitive nature of the bidding process – not everyone enjoys that scenario.

3. Price Skimming:

Advantages of Price Skimming: Price skimming helps the company in recovering the research and development costs which are associated with the development of new product. Secondly, if the company caters to consumers who are quality conscious rather than price conscious than this type of strategy can work in a great way for the company.

Disadvantages of Price Skimming: This strategy can backfire if there are close competitors and they also introduce same products at lower price than consumers will think that company always sells the products at higher prices which will result in consumers abandoning other products of the company also. Secondly, price skimming is not viable option when there are strict legal and government regulations regarding consumer rights. Thirdly, if the company has history of price skimming then consumers will never buy a product when it is newly launched, they would rather wait few months and buy the product at lower price. Sometimes, it's not possible to get the economies of large scale production due to limited initial demand.

4. Loss-leader Pricing:

Advantages of Loss-Leader Pricing: When done correctly, loss leaders not only bring in new customers but also bring back former customers.

These carrots are often impossible to resist, even for people who have sworn brand loyalty to another store.

Disadvantages of Loss Leader Pricing: There's a big downside to loss leaders, and it's all due to lack of preparation. First, one needs to ensure that there is enough of the product in stock to keep people happy. *When KFC ran a coupon promotion and ran out of chicken there were people ready to start riots. Secondly,* the widespread network of deal-hunters that have appeared via the internet means people are targeting loss leaders with no intention of buying anything else in the store. Companies may find that their loss leaders don't lead to big sales due to this network, and they have basically just given away their product for almost nothing**.**

5. Predatory Pricing:

Advantages of Predatory Pricing: The low price may really help in eliminating the competition and gaining monopoly. Secondly, the loss due to low prices can be compensated later by charging higher prices once the monopoly is accomplished.

Disadvantages of Predatory Pricing: This price policy is illegal in most countries as it is considered anti-competitive. Secondly, small firms can not adopt this strategy as they won't be able to absorb the losses till all the competitors leave the market.

6. Limit Pricing:

Advantages of Limiting Price: The greatest advantage of limit pricing strategy is that it helps in restricting the competition and maintain monopoly.

Disadvantages of Limiting Price: Limit pricing will result into lower profits and again the small companies cannot adopt this strategy.

7. Psychological Pricing:

Advantages of Psychological (Odd) Pricing: It makes the product look cheaper than what it actually is. It keeps the product in lower price bands. Besides, the customers don't get a chance to bargain

Disadvantages of Psychological Pricing: The product is perceived as an ordinary product as such pricing is not associated with high quality products. Further, there will be difficulties for the cashier in counting the cash. It doesn't work in case of rational consumers.

8. Prestige Pricing:

Advantages of Prestige Pricing: The prestige pricing creates higher brand image for the product and results in to higher sales.

Disadvantage of Prestige Pricing: The premium price should be backed by extremely high quality product. Secondly, the companies have to spend a lot of money on creating a brand image

9. Demand Oriented Pricing:

Advantages of Demand Oriented Pricing: This pricing strategy allows higher profits during peak seasons when demand is high.

Disadvantages of Demand Oriented Pricing: It may result into loss during periods of less demand as it does-not take into account the cost of production. Besides, the consumers may carry a negative image of the company for taking disadvantage of the situation

10. Delivered Pricing:

*Advantages of Delivered Pricing***:** The company is not required to bear the transportation cost. The company can justify a higher price by informing the customers that the actual price was less.

Disadvantages of Delivered Pricing: Customers may find the company's product expensive compared to the other companies.

11. Promotional Pricing:

Advantages of Promotional Pricing: Promotional pricing may provide short-term boost to sales and might encourage more people to continue buying afterwards as well. Secondly, it's a good way to sell off unwanted or out dated stock.

Disadvantages of Promotional Pricing: As the price is low, it will result into lower prices. Besides, if your promotions occur in a predictable pattern, potential customers might wait for a sale rather than buy the product or service at full price now.

12. Cyclical Pricing:

Advantages of Cyclical Pricing: Under cyclical pricing, there is demand for the product even during recessionary phase. Further, the company can capitalize the boom by increasing its price.

Disadvantages of Cyclical Pricing: The necessities and habit forming goods can be sold at a high price even during recession due to their low price elasticity. Charging low price for such essentials during downturn is uncalled for. Similarly, the poor quality products will not fetch a high price even during the boom.

VI. Conclusion

As seen in the above discussion, every pricing strategy has certain advantages and disadvantages. Before selecting the pricing strategy, the businesses should look into both, the pros as well as cons of each price strategy. The determination of pricing strategy should be in accordance to the objectives of the business. A careful cost-benefit analysis should help the company determine the best pricing strategy for itself. Once the pricing strategy has been implemented, it should be allowed to continue for a while so that it can deliver the desired results.

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