Chapter 1
Strategic Pricing

ABSTRACT

Pricing is complex but has become manageable for firms with new tools and techniques in the marketplace. The ability to set the right price at the right time is also becoming increasingly important for firms to sustain market competition. Prices indicate perceptions of customer value and also delineate objectives of the firms. Pricing plays a key role in the marketing strategy. Strategic choices about market targets, products, and distribution set guidelines for both price and promotion strategies. Most firms use pricing as a demand detonator for a product, but few of them realize how it affects the consumption of a product. The firms that play with the price of products and services for influencing the demand need to understand that the relationship between pricing and consumption lies at the core of customer strategy. This chapter presents a methodical approach to strategic pricing analytics, based on a review of the literature and applying a set of best practices to maximize profit. The discussion guides both students and professionals on how to identify and exploit pricing opportunities in various business contexts and develop appropriate strategies.

INTRODUCTION

Pricing is complex but has become manageable for the firms with the growing new tools and techniques in the marketplace. The ability to set the right price at the right time is also becoming increasingly important for firms to sustain the market competition. Prices indicate perceptions of customer value and also delineate objectives of the firms. Hence, pricing has been one of the highly emphasized strategic issues in the business management. Historically, firms have taken price for granted, considering its main function to cover costs and support target sales with a predetermined rate of return. Contemporarily, firms lean on developing strategic pricing in order to gain competitive advantage in the market. The strategic perspective on pricing includes price objectives, price strategy, price structure, price levels, and price promotions. Globalization has driven various routes to market, and e-commerce as one of the convenient shopping options opens new opportunities for using differentiated pricing all the time optimizing pricing by creating

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customer switching barriers, and differentiating by stage. However, challenges to management include the development of technology that facilitates customer price searching (Schindehutte and Morris, 2001).

Low prices can be used as a weapon to build market share. Prices that undercut competitors attract new customers and allow for greater utilization of facilities. However, low prices squeeze margins and often reduce net profits. Thus an ideal pricing strategy should be the one that balances the need for sales growth against market demand for profits. The selection of pricing objectives is determined by the decisions of business positioning. Many organizations need profits to satisfy the stakeholders and allocate resources for product development. The other objectives of the pricing strategy for a growing company may be maximizing the revenue, maximizing the market share and achieving the quality leadership. Several factors influence management's decisions about how price will be used in marketing strategy. An important concern is estimating how buyers will respond to alternative prices for a product or service. The cost of producing and distributing a product sets lower boundaries on the pricing decision. Costs affect an organization's ability to compete. The existing and potential competition in the market segments targeted by a company constrains the flexibility in selecting prices. Finally, legal and ethical constraints also create pressures on decision makers. Pricing plays a key role in the marketing strategy. Strategic choices about market targets, products, and distribution set guidelines for both price and promotion strategies. Product quality and features, type of distribution channel, end-users served, and the functions of intermediaries all help to establish a feasible price range. When an organization forms a new distribution network, selection of the channel and intermediaries may be driven by price strategy.

Pricing does not require significant investments or resources as it is the key operational factor in marketing strategy. Pricing is considered to be the most accessible lever to manage profitability of a firm. Even minor fluctuations in pricing can have a significant impact on both revenues and profitability. Since consumers vary in their preferences, motivations, and propensity to spend, they assign varying degrees of emphasis regarding price upon their purchase decision and firms can reduce profit drains by appropriately monitoring prices at various levels of market (Kohli and Suri, 2011). The strategic pricing approaches are built around the v*alue-based, proactive, and profit-driven* platforms in most firms thriving to sustain the market competition.

The value-based pricing relates to the consumer perceptions towards buying the products and analyzing the convergence of its utilitarian value with the money spent on purchasing the product. Such consumer attribute may be defined as 'value for money' constituent for the firms in developing the pricing strategy. The common assumption that high prices and high market share are not compatible is simply incorrect. In a variety of industries, from consumer durables to pharmaceuticals, cosmetics to cars, and aircraft to fashion apparel, it is quite common for the premium price brand to also be a market share leader. However, commonly the 'value for money' attribute in pricing is considered as a pricing objective in pushing the products and services in a target market at an initial low price. Such pricing strategy is referred as penetration pricing to gain strategic advantage in the competitive marketplace. Penetration pricing by setting the low prices can be adopted by the firms if the objective is to build market share in a long-run, whereas 'price skimming' by setting the high prices in a target market can be followed by the firms if the objective is to increase profits in the short-term (Hinterhuber, 2004). The Figure 1 exhibits the pricing shell with different layers of strategic insights in developing a profitable pricing model.

In the context of value-based pricing approach, proactive pricing strategies may be determined that force customers to acknowledge and pay for