9 Pricing Strategies Every PM Should Know

Note that some of them can be combined:

Cost-Plus

Competitive

Penetration

Dynamic

Price Discrimination

Economy

Premium

Loss Leader

Value-Based

> Before we dive in, it's important to remember that for digital products, costs tend to grow slower than revenue due to low marginal costs.
>
> It's virtually free to copy a digital product. They are also easier to scale, distribute, and maintain.

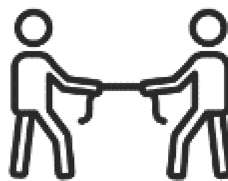
1. Cost-Plus Pricing

This is a method of setting prices where the selling price is determined by adding a specific amount or percentage to your total cost.

This strategy is commonly used in physical products with tangible costs, retail, and manufacturing industries.

Many consulting companies like **McKinsey**, **Delloite**, and **Accenture** use the same approach charging their customers based on the hourly rates of their consultants (aka “time & material”).

> The low marginal cost of digital products makes cost-plus pricing less relevant.



2. Competitive Pricing

It’s a strategy considering what competitors charge for similar products.

For digital products, given their lower marginal cost, there might be more flexibility to adjust prices based on competition.

At the same time, competing with price in a digital space is often a terrible idea. It ultimately causes all the competitors to operate on extremely low margins, which is often referred to as the "red ocean."

> A better approach is competing to be unique, for example, by solving specific customers' problems way better than anyone else, providing superior user experience, or ensuring frictionless onboarding.

3. Penetration Pricing

Penetration pricing is a strategy businesses use to attract customers when they enter a market with a new product.

The company initially sets a low price to attract customers away from competitors and to gain market share quickly.

Once the product is established in the market and customer loyalty is built, the price typically gradually increases.

Good examples are:

- **Netflix**: When Netflix initially launched its streaming service, it offered a low price to attract new subscribers. Once they had established a substantial user base, they gradually increased their prices.
- **Uber**: When Uber first entered various markets worldwide, it offered significant discounts to attract users away from competitors like taxi corporations. Over time, the promotional offers were reduced.

4. Dynamic Pricing

Also known as surge pricing or demand pricing, it’s a strategy where businesses set flexible prices for products or services based on current market demands.

It’s commonly used, for example, in the travel, entertainment, and conferencing industries due to the limited “inventory” that companies want to sell at the highest possible price.

Most people experience it when booking flights or hotels. For example, **Booking.com** and **American Airlines.**

> Digital products typically don’t have similar constraints, so the Dynamic Pricing strategy is less relevant.

5. Price Discrimination

This involves charging customers different prices for the same product or service, often based on the maximum they're willing to pay. One of the Price Discrimination types is Location-Based Pricing.

A good example is **Justin Welsh**'s location-based discounts for his Content Operating System. Discount 50% for Poland:

It looks like you're from **Poland** PL . Use code **"PD"** for relief pricing of **50%** off your purchase at checkout.

Justin Welsh
Testimonials
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Build a better, faster content production system.

The Content

If you are curious, Justin used ParityDeals. Interestingly, the solution can't be tricked by popular VPNs (I tested it with AtlasVPN; I'm not an affiliate).

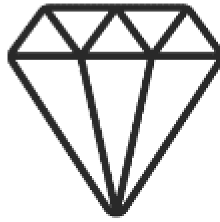
6. Economy Pricing

Economy pricing involves setting a low price for products with minimal marketing or promotional expenses to keep the price as low as possible. This strategy often targets a large market segment that is very price sensitive.

Examples:

- **Walmart**: Known for its "Everyday Low Prices" mantra, uses this strategy to attract a wide customer base. They do it through efficient supply chain management and economies of scale.
- **IKEA**: They achieve this through efficient production and logistics, flat packing of products, and customer self-service.
- **Southwest Airlines:** It has effectively used an economy pricing strategy to become one of the most successful low-cost carriers in the world. They use a single aircraft type (Boeing 737). They don't offer assigned seating, free meals, or first-class cabins. Southwest Airlines focus on efficient operations and sell most tickets directly from its website to avoid travel agents’ commissions.

> Economy Pricing might not be the best strategy for digital products, as it’s easier to achieve product differentiation.



7. Premium Pricing

This is the opposite of Economy Pricing. It's used when a company deliberately sets the price of its product higher than the competition to cultivate a perception of superior quality.

Luxury brands like **Apple**, **Rolex**, and **Gucci** often use this approach.

> While premium pricing can improve profitability, it must be justified by delivering exceptional value, quality, customer service, and brand prestige.

8. Loss Leader Strategy

This strategy involves selling a product at a price that is not profitable, but it can help attract new customers or sell additional products and services.

Examples:

- **Amazon**: It has been known to sell Kindle devices at a loss, with the expectation that it will make up for the loss through digital sales (like eBooks, movies, and music) and prime memberships.

- **Gillette**: They sell razors at a low price but set high prices for replacement blades, which customers must repeatedly purchase to continue using the razor.

9. Value-Based Pricing

Value-Based Pricing is a strategy where prices are based on the **perceived value** of a product.

It has several advantages:

- **Focuses on Customer Value**: Value-Based Pricing is all about charging what customers are willing to pay. It shifts the focus from the cost of production or market to the actual benefits your product provides.
- **Maximizes Profitability:** In this model, companies can capture a larger portion of the value they create. This can lead to higher profitability, especially for software products where the marginal cost (cost of producing an additional unit) is virtually zero.
- **Flexibility:** Value-Based Pricing allows for a lot of flexibility. Prices can be set differently for different market segments based on the value they perceive. A good example is Microsofts' offering for education.
- **Customer-Centricity**: Value-Based Pricing requires a deep understanding of the customer, their needs, and how they perceive value. This encourages companies to be customer-centric, which leads to better products, better customer experience, and higher intrinsic motivation of your employees.

Examples:

- **Apple**: It combines Premium Pricing and Value-Based Pricing. Apple has successfully created a strong brand and a perceived value around the quality, design, and user experience of its products.
- **Tesla**: Tesla's electric vehicles are priced based on their perceived value. Customers who buy a Tesla are not just buying a vehicle; they're buying a high-end, environmentally friendly lifestyle and a future vision. There are some nuances, as the brand is perceived as premium and, at the same time, uses Penetration Pricing to expand the EV market and make electric vehicles more affordable.
- **Diamonds**: Value in the diamond industry rests almost exclusively on perceived value and scarcity. Diamonds have value primarily because we believe they have value.

> Implementing Value-Based Pricing requires in-depth market research to understand how customers perceive value. You also need to develop a specific strategy to capture it.
>
> That's why Value-Based Pricing is often seen as the "holy grail" – highly desirable but challenging to achieve.

Conclusions

Choosing the right pricing strategy for your product involves many factors.

You need to:

- Understand your cost structure and how it might change as you grow.
- Understand what customers value (market research, surveys, interviews).
- Understand what customers try to achieve (jobs).
- Select your primary pricing strategy (cost leader vs. differentiator).
- Be clear about your value proposition and what's unique about it.
- Analyze your competitors offering, including substitute products.

Pricing isn't a set-it-and-forget-it decision. Test different approaches, regularly analyze how customers respond, and be ready to adjust if necessary.

Pricing is a strategic decision that can greatly affect your business.

It's worth investing the time to get it right.

You can learn more about Product Pricing Strategies from my new post in The Product Compass: https://huryn.substack.com