Ecommerce Pricing Strategy

Ecommerce empowers retailers to attract customers from virtually anywhere in the world while offering fast shipping, customization, and other perks. It also has some challenges.

No longer limited to their local haunts, customers can go online to comparison-shop and find the best value for their money. This pushes online retailers to compete on price — with the exception of well-known or innovative brands.

Consequently, an ecommerce pricing strategy is one of the key determinants of business success.

Effective pricing strategies have the power to influence brand perception, drive sales, and maximize profitability. On the other hand, poor pricing decisions can lead to eroded profit margins, loss of customers, and even business failure.

Price determines the brand's position in the market, including its target audience, marketing strategy, brand perception, and market share.

Ecommerce businesses should carefully study market conditions to determine price points that are fair, competitive, and profitable to the business.

Types of ecommerce pricing strategies

Businesses use different pricing strategies based on industry conventions, customer expectations, and product positioning.

Competitor pricing.

Competition-based pricing is a low-risk strategy where businesses set product prices based on the average price points of rival firms in their industry. The goal is to set a competitive price while maintaining profitability and meeting customer expectations.

This type of pricing takes two forms:

- **Price matching:**A business sets prices at the same level as its competitors to avoid losing customers on the basis of price. This is common in industries with high price sensitivity and intense competition (eg: apparel or consumer electronics).
- **Price leadership**: A business positions itself as the industry leader by undercutting competitors' prices.

Pros

- **Market competitiveness**: Businesses can attract price-conscious customers and avoid losing customers based on price alone.
- **Customer perception**: Setting prices equivalent to or slightly below competitors creates the perception of good value for customers.
- **Profitability**: Businesses can make data-driven decisions about pricing that balance customer demand, market share, and profitability.

Cons

- **Margin erosion**: Businesses may engage in a race to the bottom by undercutting competitors with the lowest price.
- **Loss of differentiation**: By fixating on price alone, businesses miss opportunities to emphasize unique value propositions, quality, or product features that could justify higher prices.
- **Lack of control:**This dependency on competitors' actions restricts price flexibility and hinders the business from adapting to market fluctuations.

Price skimming.

Typically used for novelty products, such as video games, price skimming is where a business sets an initially high price for a product and gradually lowers it. This strategy targets early adopters and customers willing to pay a premium for exclusive access or superior features.

Pros

- **Profit maximization**: Businesses maximize profits in the early stages of a product's life cycle, taking advantage of the price insensitivity of early adopters.
- **Investment recoupment**: Novelty products typically carry high research and development (R&D) and/or production costs. Price skimming recoups these costs quickly.
- **Product positioning**: Innovative products are marketed to generate buzz and perceived exclusivity. High pricing reinforces this image.

Cons

- **Lack of sustainability**: As the product matures and competition increases, high prices may become less attractive to price-sensitive customers.
- **Susceptibility to competition**: Competitors may enter the market with similar offerings at lower prices, eroding the price advantage of the skimming strategy.

Dynamic pricing.

Also known as surge pricing or demand-based pricing, dynamic pricing is a real-time pricing strategy based on market conditions.

Influencing factors include supply and demand, competitor pricing, time of day and/or seasonality, customer demographics, and external factors such as weather conditions or special events.

Surge pricing capitalizes on consumers' price insensitivity during peak demand. For example, travelers voluntarily pay higher airfares during the summer. Conversely, prices plunge during low seasons to stimulate sales.

Dynamic pricing is the de facto pricing model for industries like transportation (airline tickets, ride-sharing services), hospitality (hotels and vacation rentals), and entertainment (concerts and sporting events).

Pros

- **Profit maximization**: Businesses can capitalize on customers' willingness to pay. Excess profits notched during peak season may offset slumps during low season.
- **Flexibility**: Dynamic prices are responsive to competition, inventory, and other factors, making businesses more nimble.

Cons

- **Negative customer perceptions**: Customers may view surge pricing as price gouging if overused. Businesses also risk alienating price-sensitive shoppers.
- **Requires capital and labor**: Dynamic pricing requires sophisticated data analysis software and pricing algorithms.

Penetration pricing.

Unlike price skimming, penetration pricing introduces a product at low prices. This strategy aims to stimulate demand, encourage trial purchases, and establish a foothold in the market. The rationale is that trading short-term profitability builds long-term market presence.

Pros

- **Market share**: By offering products at a lower price point, businesses can lure price-sensitive customers away from competitors.
- **Barriers to competition**: As customers become accustomed to low prices, they may hesitate to buy expensive alternatives.

Cons

- **Negative brand image**: Low prices may be perceived as indicators of low quality.
- **Lack of customer loyalty**: Shoppers may switch to other brands once prices increase.

Value-based pricing.

While certain pricing models are based on production costs, value-based pricing quantifies the value of your product.

For example, a B2B software product may help enterprises avoid costly mistakes, and its pricing reflects the cost savings businesses achieve by using the product, rather than the cost of producing the software.

Businesses require a deep understanding of their target customers to position themselves as a trusted partner.

Pros

- **Differentiation:** Businesses can position themselves as trusted providers with a unique value proposition.
- **Customer centricity**: To justify value-based pricing, businesses must offer an exceptional customer experience.

Cons

- **Complexity**: Value-based pricing often requires custom quote generation or tiered pricing catered to customer needs. Businesses need an unmatched understanding of the market to offer an unmissable value proposition.

Psychological pricing.

Psychological pricing leverages consumer behavior to create a perception of value, affordability or exclusivity. Some common techniques include: odd-even pricing, prestige pricing, and anchoring effect.

Pros

- **Perceived value**: Customers who think they're getting a good deal will view the retailer more favorably.
- **Increased sales**: Perceived affordability spurs impulse purchase decisions.
- **Competitive advantage**: Businesses can differentiate from competitors based solely on price perceptions.

Cons

- **Perceived deception**: Some customers may view psychological pricing as deceptive or manipulative. Shoppers may prefer transparent, straightforward pricing.
- **Unsuitability**: Complex products with few substitutes rely more on quality, features, and uniqueness than pricing.

Bundle pricing.

Products are combined into a bundle with a lower total price than purchasing items à la carte. This drives customers toward higher-priced options due to perceived value. Common types of bundle pricing strategies include: pure bundling, mixed bundle, and leader-follower bundle.

Pros

- **Increased perceived value**: Customers think they're getting more bang for their buck.
- **Higher sales volume**: Product bundling increases average order value as customers are enticed to purchase more items than intended.
- **Inventory management:**Stock moves faster, lowering warehousing costs and making inventory movement more predictable.

Cons

- **Lower profit margins**: Bundles slash the retail prices of individual items, dropping their margins.
- **Customer preferences:**Customers may not wish to purchase items in a bundle, particularly if they only desire a specific item.
- **Complexity**: Managing pricing and inventory for bundles requires more planning and coordination than selling piecemeal items.

Loss leader pricing.

Businesses may intentionally set prices below costs to acquire new customers and drive sales of other profitable items. The loss leader product acts as a magnet to lure shoppers, who are then expected to make additional purchases of complementary, higher-margin items.

The chosen product should have broad appeal and high demand. The point is not to achieve immediate profits but to generate website traffic and stimulate sales.

Pros

- **Increased traffic:** Businesses can showcase their offerings and potentially convert customers into long-term buyers.
- **Higher sales of other products**: Businesses have a higher chance of cross-selling or upselling similar products, resulting in increased revenue.

Cons

- **Decreased profits:**Selling products at a loss sacrifices immediate profits without a guarantee that the losses will be offset by future sales.
- **Perceived value**: Customers may expect consistently low prices and refuse to transition to regular-priced items.
- **Risk of margin erosions:**Overreliance on loss leader pricing without capturing additional sales of profitable items jeopardizes overall profitability.

The cause and effect of an ecommerce pricing strategy

Pricing strategy hinges on both internal and external factors. For example, production costs, whether the business is a startup or an established company, and the relative uniqueness of its value proposition.

Total costs.

Pricing should account for fixed and variable costs associated with production and delivery. Businesses must cover expenses and maintain a profit margin.

High production costs or shipping costs must be passed onto the consumer or absorbed by the business. Cost control is integral to an effective pricing strategy. The cost-plus pricing strategy involves adding a markup (typically a fixed percentage) on top of production costs.

New businesses attempting to gain market share may seek to simply break even.

Defining a fair price.

Fairness is subjective, influenced by individual viewpoints and market dynamics. However, here are a few considerations when determining a fair price:

- **Cost-value relationship**: Fair pricing covers production costs while providing a reasonable profit margin.
- **Market competition**: Fair pricing is competitive in the market while considering the value provided to customers.
- **Transparency:**Customers appreciate clear and upfront pricing without hidden fees or misleading tactics.
- **Customer perception**: Fair pricing considers the customer's willingness to pay. Understanding customer demographics and psychographics helps set prices customers perceive as reasonable.

Relative pricing.

Businesses often default to using competitor-based pricing or industry standards as a yardstick for their own pricing strategy. However, ecommerce stores should decide whether to position their offerings as high-end, mid-range, or budget-friendly to make the right comparisons.

Relative pricing enables businesses to differentiate their offering based on price. By setting prices higher or lower compared to competitors, ecommerce companies can establish themselves as premium providers or cost leaders.

Other differentiators.

In addition to surveying the market, businesses can use other differentiators to justify pricing. Examples include:

- **Product quality**: Superior product quality justifies higher prices. Businesses that invest in R&D, use premium materials, or offer advanced features and functionalities can raise the selling price.
- **Brand reputation**: Reputable brands, including on social media, may get away with a higher price tag based on established brand loyalty.
- **Customization:**Tailoring products to individual customer preferences justifies higher prices as customers will pay more for a product that meets their specific requirements.
- **Customer support**: Exceptional customer support is a powerful differentiator that increases a brand's price elasticity. Providing a simplified returns process, personalized support, and ongoing assistance adds value to the customer.
- **Sustainability**: Customers are increasingly willing to pay a premium for products that promote eco-friendly practices, fair trade, and sustainability.

How combining pricing strategies helps boost business

Businesses can combine pricing tactics to boost sales and conversions. Differentiating pricing strategies between products or varying the strategy over time helps online stores appeal to a broader range of customers.

- **Segmentation and targeting**: Value-based pricing will appeal to cost-conscious shoppers, while premium pricing targets customer personas seeking high-quality, exclusive offerings.
- **Promotions and discounts**: Promotional pricing such as discounts, flash sales, or buy-one-get-one (BOGO) build urgency and drive impulse purchases.
- **Loss leader and cross-selling**: A loss-leader pricing strategy can be combined with cross-selling techniques. Once customers are drawn in by the discounted item, businesses can promote higher-margin products.
- **Loyalty programs**: Offering special discounts or exclusive benefits to loyal customers incentivizes repeat purchases.

The final word

A strong ecommerce pricing strategy is suited to business needs, market conditions, and customers' willingness to pay.

Ecommerce businesses must do comprehensive market research to determine the right pricing strategy that balances fair pricing and customer expectations with profit margins that guarantee a healthy bottom line.

By understanding how pricing works, businesses can avoid defaulting to cost-based pricing and gain a competitive advantage.

FAQs about ecommerce pricing strategy

What is the best pricing strategy for ecommerce?

The ideal pricing strategy depends on market positioning. For example, a premium brand targets a vastly different market than a company posturing itself as an affordable provider. Online businesses entering new markets may favor pricing that helps quickly grow market share (eg: penetration pricing), while a marquee brand can exploit its perceived exclusivity and trustworthiness to charge higher prices. Pricing conventions also vary by industry. For example, hotels and airline companies raise prices during peak seasons to recoup their costs during low seasons. Meanwhile, these fluctuations could be considered unethical and/or impracticable in industries like healthcare or education.

What are the benefits of two-sided pricing?

Two-sided pricing is the practice of offering segmented pricing based on customers' willingness to pay, purchasing power and other factors. For example, some companies offer discounts for students and seniors living on a fixed income. Benefits of two-sided pricing include: Increased revenue: Businesses can charge higher prices to those willing to pay more and/or target price-sensitive shoppers with discounts. **Higher profits:**By charging more to customers who derive the most value from the product, businesses can lift their profit margins. Enhanced customer satisfaction: Aligning pricing options with customer preferences offers a win-win for both. Competitive advantage: Two-sided pricing targets a broader swath of the market, potentially winning market share from competitors. Product innovation: By offering premium pricing tiers or add-on features, businesses justify the cost of R&D and continuous improvement.

What is the difference between price anchoring and price skimming?

Anchor pricing is a psychological pricing technique. Businesses set a high original price for a product as a reference point to anchor customer expectations. When the price drops, the product appears more enticing to customers. For example, a retailer launches a new smartphone with an initial price of $1,000. During a promotional sale, the price is slashed to $800. Customers will perceive the discounted price as a significant saving. On the other hand, price skimming involves introducing a new product at a high initial price. This strategy takes advantage of early adopters' willingness to pay a premium for exclusive access. Over time, the price is lowered to attract price-sensitive customers as the product's novelty wears off or competition intensifies.