Pricing for a Global Market

8 Models to Convert Customers & Maximize Revenue

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Introduction

Pricing Model Breakdown: What types, Where to find them, & Why they work

As many e-commerce firms have discovered, pricing can make or break a company, product, or brand. It shouldn't be surprising that pricing models, or the strategy a firm uses to assign monetary value to its offerings, range from practical to radical. Interestingly enough, this vast range of methodology actually mimics the human psyche, which plays a substantial role in how merchants like yourselves price your products for the growing e-consumer segment.

Unfortunately, consumers are creatures of unpredictable habit and taste. Your buyers purchase for many different reasons, some tangible and others psychological. Dan Ariely, consumer psychology guru and author of *Predictably Irrational*, found that if you offer a consumer more options, both good and bad, the consumer tends to purchase a higher-priced product, based on the perception that it is more valuable in comparison to the new offerings in the product line. This equation becomes even more complex when more middle-priced options are introduced, further causing the consumer to evaluate products based on subjective value instead of price point.

So in order to better understand the various pricing strategy models an expanding, international online merchant should be using, we'll touch on each model and the basic psychological factors each model employs.

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$$\frac{\text{What you get}}{\text{What you give up}} = \text{Value}$$

type

Market Value Pricing

Let's start with the easiest pricing strategy to understand. In this model, the cost of production, shipping, tariffs, and other expenditures dictate not only how you price your product, but also how your competitors price their product. In essence, market value pricing is the basis for all pricing models. This model provides the foundation price that you start with, and then alter for more complex or specialized pricing strategies. At its most basic definition, market value pricing is the price at which supply and demand intersect, or how much the consumer is willing to pay for your product. In general, market pricing does not yield a high profit margin.

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As far as international scope is concerned, Market Value Pricing is not popular in Asian markets. These consumers prefer to buy from established luxury brands, or whenever there's a juicy deal: the discount reigns supreme. This pricing model sticks to the status quo. If your service or product doesn't stand out, you will need to rely on a few psychological tricks to win a buyer's attention:

- American markets prefer prices that end in a "9."
- Conversely, in Cantonese- and Mandarin-speaking areas, prices should end in an "8," because the pronunciation of the number sounds like the word "wealth" in those languages.
- Also in these markets, consecutive "8"s are considered a status symbol. According to John Yunker at Pitney Bowes, this is why the Beijing Olympics kicked off on August 8, 2008.
- Asian markets see the number 4 as unlucky; its pronunciation resembles the word for 'death.'
- In Japan, colors, not numbers, significantly influence the buyer. Yellow is a highly-favorable color, but in the US it often means cowardice or caution. It is important to remember that Japanese-speaking markets take color symbols more seriously than other countries.
- Across all markets, prices that only use two digits ($48 or $49) look more appealing than prices that use four digits ($49.00). Keep the numbers in your price visually 'small,' with as few digits as possible.
- Finally, a consumer will always appreciate the sensation of obtaining something for nothing. Think of infomercials that propose a price of $69.99; by the end of the 5-minute segment, said item "could be yours for only $29." Maybe the commercial even throws in a "FREE" gift. This concept is known as anchoring: one price point is presented, and then further adjustments to that price either induce gains or losses in perceived value.

Is market value pricing right for you?

- Can you afford to stay afloat with a small profit margin?
- Do you primarily sell in Asian markets?
- Are you in a saturated market?

If you answered **NO** to one or more of the above, then this model might not be right for you.

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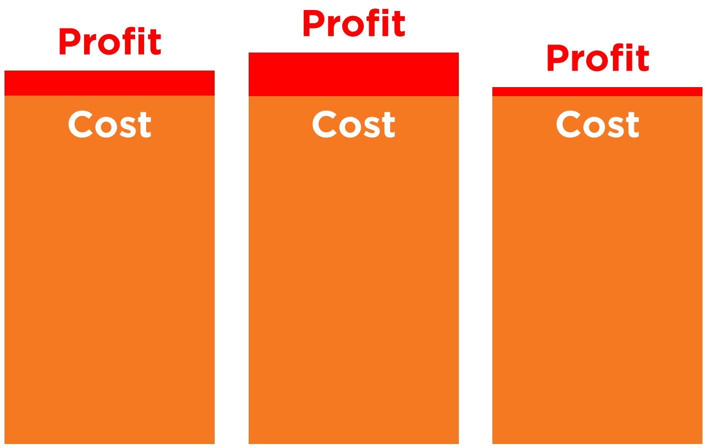

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Competitive Pricing

Professor Richard Gilbert, the Chair of the Competition Policy Center at the University of California at Berkeley, defines competitive pricing as the gap between cost and profit for an entire industry. "The closer together these are, the greater the competition." Competitive pricing is commonly used in cut-throat markets where players attempt to "starve" out competitors by providing products at the lowest price possible; sometimes these prices aren't even profitable. In this situation, bigger companies with a larger portfolio of products will use this tactic to force out smaller companies that can't afford unprofitable margins.

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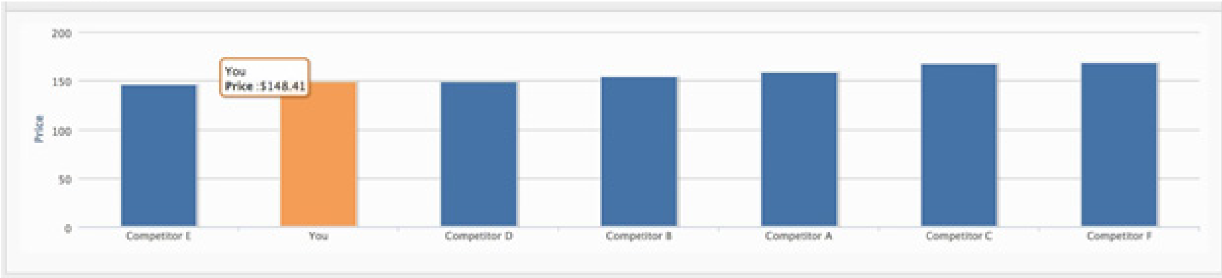
In 2009, online coupon sites like Groupon and LivingSocial began popping up across the globe. These discounters offered cuts as high as 50% for everything from spa treatments to lavish dinners. In no time, the electronic discount industry had over 50 competitors. These online giants expanded all over the world to various countries: Korea, Australia, Malaysia, Thailand, and many more. However, in 2014 the future of these companies isn't looking quite so profitable and, in some cases, downright grim. Why?

Discounts can initially entice a buyer to try a new product or service he or she may have never experienced before. However, a PwC 2012 Global Multichannel Consumer survey found that discounts don't entice consumers to pay more on a long-term basis. Discounts are more profitable as a one-time offer, not as an actual model for your e-commerce site.



Competitive pricing requires a company to be extremely aware of its competition and its competition's pricing. Get used to graphs like the one above in a competitive environment: profits aren't always high, so this pricing model is best used when a consumer will repeatedly need or want your product: think groceries and laundry detergent, not vacuums, washers and dryers. High-volume products also tend to use competitive pricing more. Countries like the United States and Canada are obsessed with scoring a deal, and are best suited for this model.

Is competitive pricing right for you?

- Do you have a lot of competition?
- Do you enjoy analyzing your competition?
- Do you sell high volumes of your product?
- Are there ways you can diversify what you offer?
- Do you only use discounts for marketing campaigns and not a business plan?

If you answered **YES** to one or more, this may be the right model for you.

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Value-Based Pricing

Throw everything that you know about pricing out the window with this model. Taxes, shipping, tariffs, and competitor pricing are all secondary priorities in the world of value-based pricing, because this strategy bases pricing solely on the perceived value. What's that mean? This method works best with products or services that have a highly-emotional component (art, fashion, entertainment) or products that exist in controlled environments (meals in an airport, popcorn in a movie theater). It's not about how much the product costs to make; it's about how much the customer will pay for it, and how much your product differs from that of your competition.

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For example: Kevin Plank, the CEO of Under Armour, started his company out of a garage. What changed? The product is still the same, and it still costs the same to make sweat-wicking shirts.

The real difference? Under Armour established itself as one of the upset leaders in the sports apparel industry, snagging $1.4 billion in sales for 2012. Not surprisingly, many American Olympians got into Under Armour during the 2014 Winter Olympics. People could buy a jacket anywhere, but the consumer wants what the Olympians wore. They want the brand: price now applies to the value, not the cost. For this reason, marketing plays a huge role in value-based pricing.

Popular brands will sell universally, but Retail Week states that the UK is the world's leading exporter of online goods, with records of trade surplus over $1 billion. Fashion leads the way here. The UK and China excel in value-based pricing because their consumers gravitate toward items that have a higher perceived value.

Is value-based pricing right for you?

- Do you have a cult-like following?
- Are you an established brand, or would like to become one?
- Do you do most of your business in the UK or Asian markets?
- Do your customers tend to want quality, not quantity?
- Are you prepared to host many, many focus groups?

If you answered **YES** to one or more of these questions, this might be the model for you.

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$$x + x(y\%)$$

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Cost-Plus Pricing

Just like the name suggests, this pricing model entails adding a set profit margin to the cost of a product before confirming a final price. In this case, the profit margin is a static percentage of the overall cost to produce and distribute the product or service sold. If the cost of production goes up or down, these fluctuations will effect the bottom line. Savings in production are passed directly onto the consumer.

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Pricing experts Jagmohan Raju and Z. John Zhang state that this pricing model dates back to "medieval times, when churches were involved in regulating commerce and allowed merchants to make only a fair living, not a killing."

Companies that distribute a wide line of products commonly use this method. For example, a line of hair products or a skin care regimen might use this strategy to establish continuity within the brand. Determining the percent by which the product is marked up is usually evaluated by demand and competition. If demand is high, the percentage added to the cost is higher. If demand is low, the percentage added to the cost would be in the single digits to entice more customers to buy. The Financial Times Press states that this model is widely used in the United States, while gaining traction in China and India.

Is cost-plus pricing right for you?

- Do you offer a line of products that you can mark up across all verticals?
- Do you operate in the United States, China and India?

If you answered **YES** to one or more of these questions, this might be the model for you.

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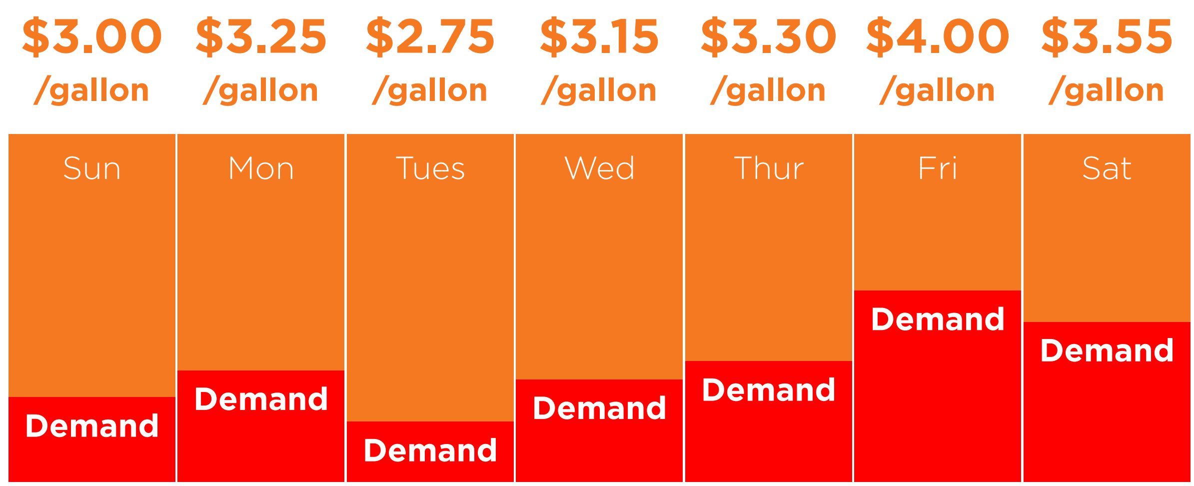

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Dynamic Pricing

With a few exceptions, the previous pricing models operate with a fixed price, meaning the price stays (relatively) the same until the product runs out of stock, or the agreed period of the offer expires. Dynamic pricing operates solely on demand and can change second-to-second.

According to Future Agenda, dynamic pricing is often used in Europe to control "off-peak and peak-time ticketing on public transport [in order] to balance out consumer use of trains, trams, and buses . . . so that those who are able to might decide to save money by travelling outside of rush hour periods."

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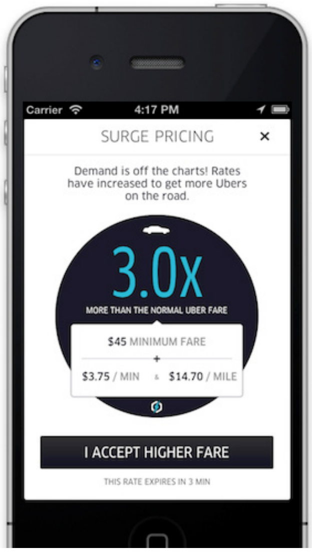
Uber, a company that offers a luxury taxi service booked through an online mobile application, uses dynamic pricing that leads to higher fares at peak demand times for drivers. This disruptive model led to a reported gross of 1 billion in 2013. Initially, the practice of selectively increasing pricing was met with criticism; however, those willing to pay the premium prefer the model. You get what you pay for! Uber is rapidly expanding and just launched operations in China.



To succeed, dynamic pricing needs to be clearly communicated up front. In a best-case scenario, dynamic pricing can leave a customer feeling like he or she received a great price for a service or product. Conversely, this approach can leave a bad taste in the customer's mouth if he or she paid a higher rate then a friend, colleague, or family member. People talk.

Is dynamic pricing right for you?

- Do you offer a good or service that can handle fluctuations in price?
- Do you operate in European countries where the majority of people use public transportation?
- Do you employ a strong marketing team that can accurately communicate pricing?

If you answered **YES** to one or more of these questions, this might be the model for you.

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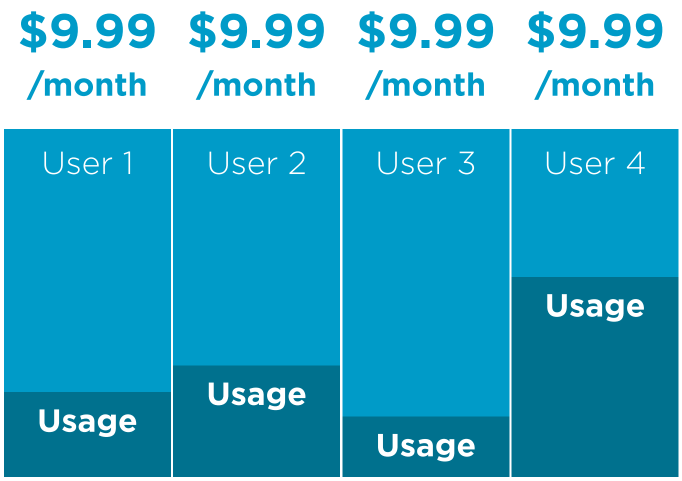

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Flat Fee Pricing

This model is exactly what it sounds like: the consumer pays the same amount no matter how much (or little) he or she uses the product or service. This model is very popular for service industries, as well as shipping and legal.

Most recently, however, this model has been used to entice consumers who have specialty interests. The subcom market is one industry that uses flat fee pricing. In these cases, variety is key. Consumers pay a monthly fee to try a sample of the latest and greatest trends. It doesn't matter if the product contains accessories, nail polish, or face cream. Even canines are getting in on the action: Bark Box, a site that sends a package of canine-themed toys and treats to its customers each month, is just one example.

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Smallbusiness.chron.com notes one major drawback to this type of pricing model: "any obstacle that gets in the way of productivity reduces income." It seems logical, maybe even common sense. But for many small businesses, trial and error are natural, and an essential part of the growing process. When it comes to the flat fee pricing model, these "growing pains" can eventually end in financial disaster

The key to avoiding any loss in this model is to master all costs, mainly production and shipping. In the case of subcoms, subscribers may receive all of their treats and toys free of shipping. Companies whose goods are featured by a subcom want exposure, and are willing to give away the product for free during a given month. It's a form of advertising to a very specialized audience. After these companies secure their products on a continual basis, they can then scrutinize their shipping costs to maximize profit.

Because shipping plays such a major part in this model, subcom companies exist in many countries, but usually stay domestic. Otherwise, the cost of business is too high and customers unsubscribe at a rapid rate.

Is flat fee pricing right for you?

- Is the product cost consistent?
- Is your company established?
- Are your shipping costs stabilized?
- Do you only want to operate domestically?

If you answered **YES** to one or more of these questions, this might be the model for you.

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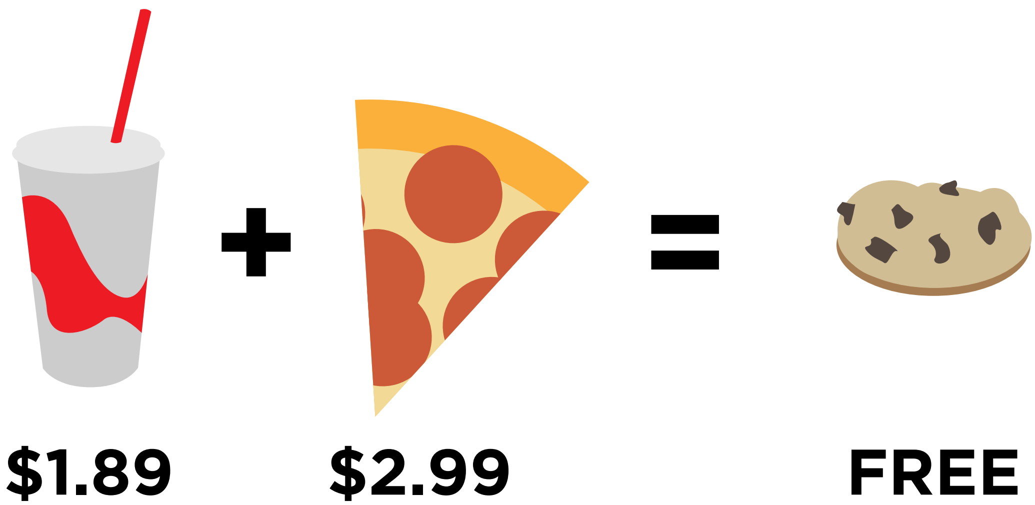

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Free Pricing

FREE two-topping pizza with any combo meal. FREE shipping on orders over $50. FREE gift with every order. The name says it all. Dan Ariely addressed the free phenomenon when he looked into a case in which Amazon's sales were faltering in France. The reason? Amazon was offering FREE shipping, but still assessed a $.20 surcharge during the checkout process. Buyers left their carts abandoned because of that small fee alone. The moral: when a company states that something is free, even a few cents can deter a potential customer. They'll feel cheated.

Typically, the technology sector favors this model. A study done by Blue Mine Group notes that, "this 'free pricing' trend has been enabled by the fact that the marginal cost of the Internet's underlying technologies — storage, bandwidth, and processing power — have been converging to zero."

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But we all know nothing is free. So how does this pricing model prove lucrative? How exactly does this work? Here are some examples:

- ***Subsidy:*** The customer receives a free service, but then pays for another related service from the same provider. The paid service subsidizes the free service. Example: any magazine that you can buy in print, you'll also receive online for free.
- ***Upgrade:*** Customers are lured in with a free service, but end up paying for a premium product. Example: Linkedin.com. Linkedin has always offered free profile registration for a basic account. However, since the San Francisco-based networking site introduced Linkedin Premium, which offers extended features like increased inmail (messages to professionals outside of a network) and search listings, sales have grown 89%. This model is also referred to as freemium.
- ***Advertising Model:*** In this case, advertising vendors fund the service. Example: Influenster.com. Advertisers donate large amounts of product that will be given to notable subscribers in the hopes that these highly-social members will review, tweet, and spread the word.

In rare instances, like Influenster, this model can be used for retail. Practical Ecommerce notes that Gillette often offers free razors to customers, knowing that they will have to buy their blades to actually use the razor. The grooming giant is giving away something for free, but also ensuring a future attachment purchase.

Is free pricing right for you?

- Can you afford to offer something for absolutely free?
- Are any of these ways applicable ways for your company to make money?
    - Subsidize the free service/good
    - Be able to upsell the customer
    - Use advertisers to absorb costs

If you answered **YES** to one or more of these questions, this might be the model for you.

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Volume Pricing

Who can resist a good deal to buy 100 rolls of toilet paper when it's so much cheaper per unit than the more manageable 5-roll package? This is volume pricing. Stores like Costco have made a mint capitalizing on this motto: bigger is better, and clearly, so is more.

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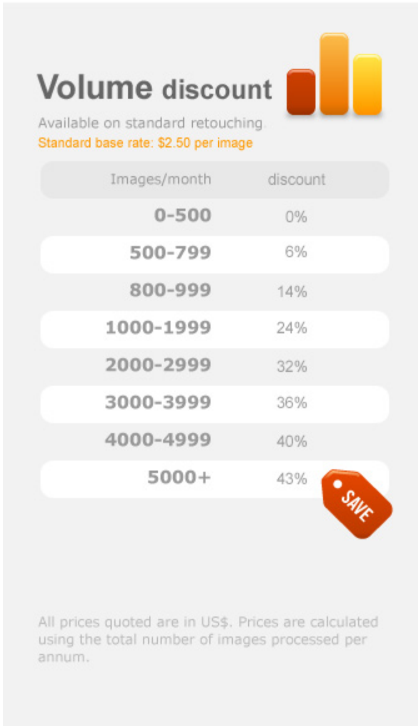
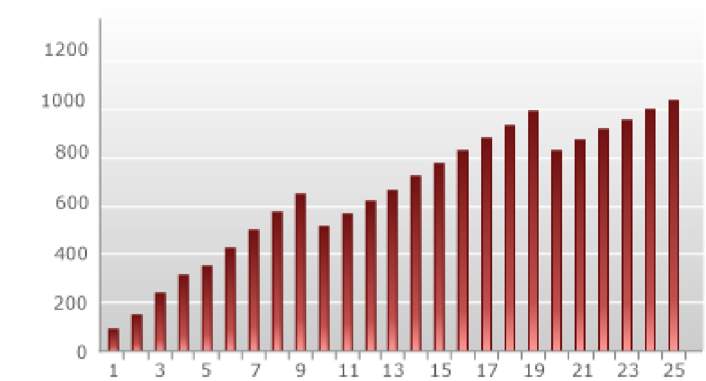
There are a few ways to implement Volume Pricing. The first is by tiers.



In the example to the left, you'll notice that there are incremental savings as you reach each new tier. This seems fairly logical, however Cleverbridge points out some obvious flaws upon a closer look.



All-Units Volume Pricing – Total Price by Volume

As you can see in this graph, the manufacturer actually reduces its profit when it sells 10 units instead of 9. 9 units; this is what we call the sweet spot for this company. Imagine a company that sells roof shingles. It can cut 1,000 shingles from a single sheet. However, it will cost more if it has to buy a whole new sheet to fulfill an order of 1,050 shingles. The sweet spot for this company would be to cut increments of 1,000. Discounts would be most beneficial to the consumer if he or she ordered in thousands.

Another variation on this model is to offer the consumer full price for one unit, and then a slight discount for the second, a deeper discount for the third, and so forth. For instance, imagine you sit down at your favorite pancake house. Your first order of hotcakes is $10. Your second $8, and your third costs $6. Hopefully you are stuffed by now and you saved on this pricing model variation.

Volume Pricing is most successful in the digital goods sphere, because packaging and shipping is a non-issue. However, when dealing with goods that need to be shipped, countries with large production plants such as China provide the most lucrative outcome.

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Is volume pricing right for you?

- Is it cheap to produce your good or service?
- Is your industry in the digital sphere?
- Do customers need many units of what you offer?

If you answered **YES** to one or more of these questions, this might be the model for you.

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Conclusion

Industry expert Mark Stiving notes in Entrepreneur that a consumer will ask him or herself two questions before buying: ‘will I?’ and ‘which one?’ Pricing has little influence over whether or not a consumer will buy. Do I need this car? Do I look good in green? Is this cleaning service necessary? Pricing isn’t a factor at this pivotal junction, but when it comes to deciding between two similar products or services, companies are in the proverbial driver’s seat.

Choosing which pricing model is right for you and your company is a very personal, important decision. There’s no cut-and-dry approach to finding what strategy will work most efficiently and profitably. Sometimes companies even employ more than one of these strategies. Each one of these pricing models will dramatically effect your bottom line. Start conservative. Think about what you are selling and where you will be selling it. Every country, state, and area favors a different pricing strategy, pending product or service. Do your research. In the end, it really is up to the consumer.

Have questions about these principles and tips or want to share your experience with applying them?
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about the author

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2Checkout Marketing & Sales Specialist Faith Albert sees tech as a way to make everyday life easier and less mundane, and is constantly looking for ways to enhance the e-commerce experience. Faith currently resides in Baltimore, Maryland with her husband and Pit Bull, Kaya.

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