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[Essentials of Software-as-a-Service \(SaaS\) Business.](#)

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## 3.3 Pricing Strategies

In this lecture, we will explore 4 widely adopted pricing strategies that can help shape product's market entry and growth, namely: Penetration, Skimming, Value-based and Competitive strategy. Each of them has its unique advantages and challenges and is tailored to different market conditions and business objectives.

Let's start with **Penetration Pricing Strategy**.

### Penetration Pricing Strategy

A strategy where a company enters the market with **a lower price than its competitors**.

#### ADVANTAGES:

- helps quickly attract a large customer base in competitive markets
- challenges established players and deters new competitors by setting lower entry prices

#### DISADVANTAGES:

- low prices can lead customers to associate the product with poor quality
- customers may resist when prices rise after the initial promotional period, leading to churn

It is a strategy where a company enters the market at a price point lower than that of its competitors. For instance, a new project management SaaS platform might set its subscription fees below those of well-known competitors like Asana or Monday.com. The goal is to quickly attract customers, build a market share, and establish a firm presence in a market crowded with established brands.

However, starting with low prices might lead customers to expect continued low costs, potentially creating an association with lower quality. Additionally, after the initial promotional period ends and the company needs to raise its prices to maintain financial health, it may encounter resistance from customers who have become accustomed to the lower pricing.

This issue is more pronounced in B2B markets, where long-term contracts and established relationships are common, making future price increases particularly challenging. Therefore, penetration pricing is generally more suitable for B2C markets, where price sensitivity is high and the primary goal is to quickly build a large user base. For example, a new

streaming service might use penetration pricing to attract subscribers away from competitors like Netflix.

## ***Skimming Pricing Strategy***

### Skimming Pricing Strategy

A strategy where a company enters the market with a **higher price point before gradually lowering it over time**.

#### ADVANTAGES:

- quickly recovers development costs by targeting customers willing to pay a premium
- maximizes short-term revenue from segments less sensitive to price

#### DISADVANTAGES:

- initially limits the market to high-end customers, potentially missing out on broader market segments
- high prices may attract competitive entries, increasing market pressure

Next we have skimming pricing where a company enters the market with a higher price point before gradually lowering it over time. This approach is often employed when launching innovative or highly differentiated SaaS products that offer unique benefits over existing solutions. For example, a SaaS company introducing cutting-edge AI-driven analytics might initially set premium prices targeting enterprise clients who value and can afford the latest technology.

The high initial prices help the company quickly recoup the investment made in developing the technology. This strategy leverages the willingness of early adopters to pay a premium for new and advanced features. Over time, as the novelty wanes or market competition increases, the company can lower prices to attract a broader customer base.

However, skimming pricing can limit the initial user base to only those who can afford the high cost, and potentially exclude a significant segment of the market. Additionally, maintaining high prices might encourage competitors to enter the market with lower-priced alternatives.

When considering market suitability, skimming pricing is particularly effective in the B2C market for new, innovative products that appeal to early adopters willing to pay a premium. For instance, a cutting-edge app with unique features might employ this strategy to capitalize on the initial hype and high demand among tech enthusiasts. As the product matures and more competitors enter the market, the price can be gradually reduced to attract a wider audience.

## Value-based Pricing Strategy

### Value-based Pricing Strategy

A strategy where a company sets its prices primarily **based on the perceived value of the product** to the customer rather than solely on the cost to produce or market rates.

#### ADVANTAGES:

- allows for higher prices and margins where customers perceive high value
- enhances customer satisfaction by aligning prices with the value delivered

#### DISADVANTAGES:

- requires intensive understanding and research to determine the correct value perceived by customers
- risk of mispricing if the customer's value perception is misjudged or shifts over time

Another strategy is called Value-based pricing. This is a strategy where a company sets its prices primarily based on the perceived value of the product to the customer rather than solely on the cost to produce or market rates. This approach is ideal for SaaS products that deliver significant benefits tailored to specific customer needs or solve particular problems effectively. For instance, a SaaS healthcare analytics platform might charge premium prices because it offers specialized data insights that significantly improve patient outcomes and operational efficiencies for healthcare providers.

The strength of this pricing strategy lies in its focus on customer satisfaction — it aligns the price with the customers' perceived value, which can justify higher prices if the customers recognize the superior benefits. This strategy encourages ongoing innovation and enhancements, as the more value a product provides, the higher the price it can command in the market.

However, this pricing strategy requires a deep understanding of the customer's business and substantial upfront research to effectively evaluate the value provided by a product. Companies typically employ a combination of quantitative and qualitative research methods such as Customer Interviews and Feedback, Market Surveys, Competitor Analysis or offer pilot programs for a selected group of users. All of these methods provide invaluable data on product usage and help gauge its value. This enables companies to set a price that accurately reflects this value and informs their pricing strategy effectively. On the other hand, value perceptions can change due to new competitors, changes in the business environment, or technological advancements. This necessitates a dynamic pricing strategy that is regularly reassessed and adjusted. For example, if a competitor introduces a new tool with more features at a similar price, the company might need to lower its prices or improve its product to maintain its value proposition.

Value-based pricing works well in B2C markets where it's easier to understand and

measure what customers value. They often have similar needs and ways of using products, making it simpler to determine what they are willing to pay. For example, applications like the Calm meditation app or specialized fitness services like Peloton can charge higher prices because customers clearly recognize the unique benefits these products offer, such as high-quality content, personalized experiences, and positive impacts on their well-being. This perceived value justifies the higher cost to consumers.

## **Competitive Pricing Strategy**

### Competitive Pricing Strategy

A strategy where a company sets its prices **based on what competitors are charging for similar services**.

#### ADVANTAGES:

- keeps pricing in line with industry standards, which helps attract price-sensitive customers
- easier to implement as it largely follows market trends rather than requiring extensive original pricing research

#### DISADVANTAGES:

- can lead to thinner profit margins as prices may need to be continuously lowered to match or undercut competitors
- may divert focus from innovating on product features towards competing solely on price, potentially devaluing the product

The last is competitive pricing where a SaaS company sets its prices based on what competitors are charging for similar services. This approach is particularly common in markets where several companies offer comparable features and capabilities, making price a significant differentiator for customers. By aligning pricing closely with the market average, a SaaS company ensures it remains an attractive option without undercutting its own potential revenue significantly.

However, competitive pricing can also lead to reduced profit margins. Companies might be forced to continually lower prices to stay competitive. Additionally, competitive pricing can potentially stifle innovation in some companies, particularly smaller ones or startups that might prioritize cost-cutting to remain competitive.

This type of pricing is common in the B2C market where products are similar and consumers are price-sensitive. Examples include streaming services like Netflix and Disney+, or cloud storage solutions like Google Drive and Dropbox. In these segments, consumers look for the best deal among comparable options, and even small differences in pricing can influence their choice. Competitive pricing helps companies attract price-conscious customers and stay relevant in a crowded market.

This strategy is also effective in the B2B market with many similar solutions. This includes sectors such as cloud storage, communication tools, and project management software. For

instance, companies like Dropbox Business and Microsoft Office 365 use competitive pricing to align their offerings with market standards. This strategy allows businesses to remain competitive without needing extensive market research. By setting prices in line with competitors, companies can appeal to cost-sensitive businesses looking for reliable and affordable solutions.