New Product Pricing Strategy: Skimming Vs. Penetration

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Abstract: Adopting a pricing strategy becomes crucial in the current high-competitive environment. Many pricing strategies were developed as a response to the market's needs. Skimming pricing strategy and penetration pricing strategy are the most popular pricing strategy followed by companies for pricing a new product. Some circumstances and factors affect which one of these strategies should be adopted. Each type of these strategies has its merits and demerits. Gaining high profit in a short time and excellent customer's perception of the product quality is the most advantage of skimming pricing. On the other hand, avoiding the threat of competitors and leading the market through the high diffusion of the product are the main pros of penetration pricing. The right decision taken to determine the suitable price means the success of the product, which in turn, the success of the company through achieving its objective. This study demonstrates the difference between the mentioned above (skimming and penetration) from different aspects. The theoretical literature review methodology was employed in this research to answer the following question: what is the optimal pricing strategy should the marketer/decision-maker follow to achieve the firm goals?

Keywords: Pricing strategy, Skimming, penetration, new product, marketing

Introduction

The ways of pricing have been changed over time. In primitive society, they were exchanging commodities for other goods, which almost they are equal in value. For instance, one sheep equals a bag of wheat. While in the new community, the exchange of goods and services becomes with money. The value of the goods and services determined if there is someone who has the willingness to pay for it.

Although it is not a daily basis mission, Pricing is one of the most critical managerial decisions. Due to the lack of the history of the new product, marketing, and pricing of the new product need deep thinking and force the company to follow a specific approach. Spann et al. (2015) mentioned that the pace of launch a new product in the base of high-technology, the pricing of such product becomes a critical mission, where the success of this mission means the success of the company (Spann, et al., 2015).

The second part of the marketing mix is the pricing process of the products or services after the finalization. Therefore, in the current era, choosing the optimal price needs a specific strategy depending on different factors (Kienzler & Kowalkowski, 2017). There are many pricing strategies presented in the literature such as cost-plus pricing, psychological and odd pricing, promotional pricing, nevertheless, Skimming pricing strategy and penetration pricing strategy are the most presented and recommended in the literature for pricing new product and service (e.g., (Rekettye & LIU, 2018) (Kotler & Armstrong, 2012) (Spann, et al., 2015)). For the reasons above the researcher shed light onto these two types of pricing strategy (penetration pricing and skimming pricing); moreover, the relationship between the market and the price, and pricing objective took place in this paper

1 Pricing and marketing

In the marketing mix, there are multiple variables. However, pricing is considered the most elastic one due to the pricing ability to affect the profitability of the firm in a short time frame (Darden, 1968). Through the pricing strategy, many factors studied before setting the price for the product or service (Kienzler & Kowalkowski, 2017). (Udell, 1964) Stated that factors are affecting the implementation of the pricing strategy include: concerning the need and demand for such product or service, the level of competition, and conditions related to the markets and economics. In other words, to reach the optimal price for product or service, the company should balance between the three Cs (Customers, company, and competitors) (Rekettye & LIU, 2018).

Souza et al. (2004) demonstrated that understanding the market through the acquisition of sufficient knowledge about the different variables, besides knowing the internal company component, will reduce the complexity of the pricing strategy (Souza, et al., 2004). Where price considered one of the essential factors in the success of the product and, therefore, achieving the corporate objectives (figure1).

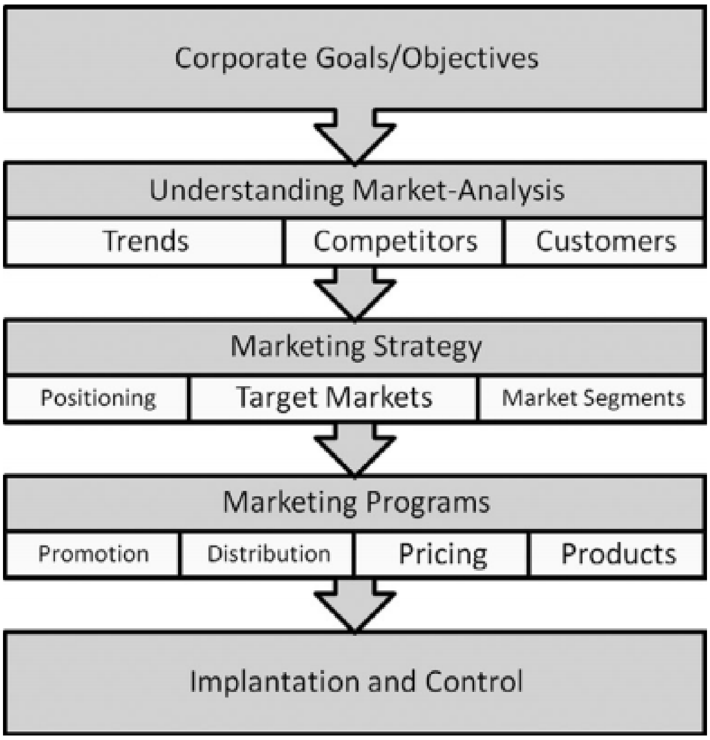

Figure (1) marketing steps. Source: (Simkin, 2000)

The company focuses more on the customers either present customers or prospective customers in the term of price, not only the rivals (Davcik & Sharma , 2015). Therefore, the Company should concern about the pricing strategy, particularly in case the competitors launch a new brand with keeping the same price. Also, the pricing strategy should be altered in case any competitors change in the price of the product or the service. Many companies depend on the manager's insight and experience. Therefore they consider pricing strategy the most straightforward strategy within marketing processes (Kotler & Armstrong, 2012).

2 Pricing Objectives

Pricing objectives mean the goals that the organization seeks from the pricing. Pricing decisions and objectives relate to and significantly affect other functional areas such as financial accounting and production. It is necessary to harmonize and align these goals with the goals of the Organization (Avlonitis & Indounas, 2005). The following are a set of goals that the organization seeks to achieve:

A. Long-term survival:

Organizations generally seek to reach the goal of survival through success in the market and persistence in work, especially organizations that have distinct brands. Moreover, organizations should know that the lack of value-added to their products means that they fail (Oxenfeldt, 1973).

B. Maximizing profits:

Through this goal, organizations seek to maximize and increase profits by estimating demand Cost and different prices. Therefore that they choose the price that earns a high profit or a high cash flow (Avlonitis & Indounas, 2005). However, this objective is not easy to achieve because it is difficult to estimate demand accurately (Oxenfeldt, 1973). The administration in these organizations largely ignores the effects of the rest other marketing mix elements as well as competitors' reactions and limitations on the prices.

C. Market share leadership:

Some organizations seek to be the market leader by adopting the strategy of Low costs to achieve good long-term profitability or by linking its price policy with the quality of the product. Therefore, organizations should pay more attention to the other marketing mix. The penetration strategy helps to achieve the firm goal depending on two points: to avoid the potential of entering new competitors and Reduce prices and increase sales and thus lead to cost per unit coverage (Avlonitis & Indounas, 2005).

3 New product and Pricing strategy

New products and services coming in different shapes include the product and services developed for the first time or improvement on the current services or product. Krishnan et al. (1999) Mentioned that it is not easy to arrive at an appropriate pricing strategy for the new product. He referred that to the diffusion of the product in the market as well as the product encompass the complex dynamics (Krishnan, et al., 1999).

New product prices should meet the company strategy by increasing profit and satisfying customers. Product quality and price are the prime factors that affect the success of the product once it is launched in the target market (Smith, 1986). Therefore, the company Decision maker responsible for the product's success.

The pricing policy is a philosophical guide or a specific event designed to influence and determine pricing decisions. Pricing policy gives approaches to reaching pricing targets as an essential consideration in developing a strategy (Kotler & Armstrong, 2012). The pricing policy as a set of rules, methods, procedures, and measures that determine the appropriate price of the company's products, which ensures the achievement of the objectives of the company within a limited period (Rekettye & LIU, 2018). There are two pricing policies:

1- Skimming Pricing

2- Penetration Pricing

Pricing policies are the general framework through which the management can find its price decisions. Pricing strategy helps the decision-maker to determine the right price to achieve the pricing goals. It also reduces its effort to find such decisions. Price policy helps to coordinate the pricing decisions and the image that the consumer carries to his marketing component (Kotler & Armstrong, 2012).

3.1 The Skimming pricing

A skimming strategy is known as charging a high price once the product is launched in the target market and then lowered over time (Dean , 1976). (Rekettye & LIU, 2018) Demonstrate that the promotion budget plays a primary role in the skimming strategy. Two types of skimming strategies have emerged, either fast skimming or slow skimming, depending on the amount of the promotion budget.

The amount will pay on Creating and developing an innovative product that is very high. Therefore, the pricing of skimming is the best strategy a company should follow to gain a high position in the market and cover the product developing expenses (Toptal & Çetinkaya, 2014). The results of Hanif (2014) study showed that the quality of the Product, Product brand name, Technology, and Innovation used affected the skimming pricing positively. Therefore, Skimming pricing usually used with innovative technology products (Hanif, 2014).

“learning curve effect” is one of several factors that play a significant role in declining the product price over time. This factor means that the cost of the production decrease as the experience increase, customer demand, and the activities which are practiced by the rivals (Smith, 1986). An excellent example of declining the price by the time is the prices of the T.Vs and electronics equipment. The initial price for such devices was very high, and it was affordable for a small segment of customers, then the price decline yearly (Bayus, 1992). Figure (2) shows the three potential causes of the pricing in skimming pricing after a while of launch the product or service.

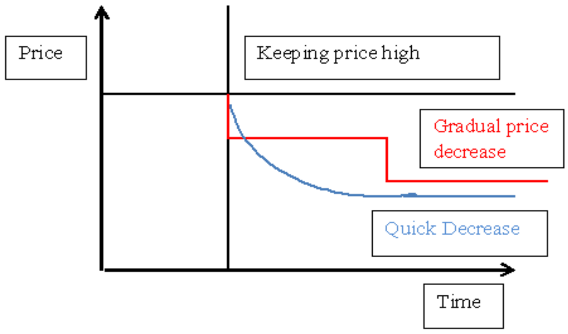

Figure (2) skimming strategy. Source (Rekettye & LIU, 2018) P. 124

The customers' common belief that the high price indicates high product quality. Therefore, applying skimming pricing reinforce a prestigious position of the product. Moreover, the company can allocate a substantial amount for promoting, marketing, and distribution product through the high profit that they can gain at an early stage (Rekettye & LIU, 2018). On the other hand, setting an initial high price probably an obstacle to accepting the product by customers as fast as possible. Therefore the market becomes a fertile environment for competitors to show up (Deshpande, 2018). There are appropriate conditions that indicate the success of launching a new product at a high price. Elastic of the demand on the early stage should be very low beside the market should be segmented consider as the critical condition to apply pricing skimming (Rekettye & LIU, 2018).

3.2 Penetration pricing

On the contrary of skimming pricing, the initial price in the penetration pricing strategy is set at a lower price compared to similar products. The additional cost for the marketing and promotion sets the pricing of penetration into two groups; quick penetration and slow penetration, wherein marketing cost is higher in quick penetration (Rekettye & LIU, 2018). However, overall, reaching fast sales and keeping the rivals away are the main penetration pricing strategy objectives.

In a contract of skimming pricing, penetration pricing applicable if the elastic of high price of demand. As well as the absence of patent protection, or there is a potential threat by competitors is an encouraging reason to adopt the penetration pricing strategy.

Selling a large number of products in a short time, therefore increasing the profit through accumulating the small amount contribution of each product, is one of the penetration strategy advantages. Moreover, the low price increases the possibility of fast diffusion of the new product and decreases the probability of the rivals or competitors to enter the market. In turn, increase the market share of the company and increase the promotion and marketing portion for the product (Rekettye & LIU, 2018).

The general customers believe that the low price means low quality is the main drawback of adopting the pricing of penetration. Moreover, the ROI for the firm will be very low due to the small profit contribution. Penetration pricing is a long-term strategy. Therefore, companies should be more careful in case they adopt this strategy. Nevertheless, penetration pricing is suitable in case the price elasticity of the new product or service very high — moreover, the penetration strategy the right choice in case no elite market.

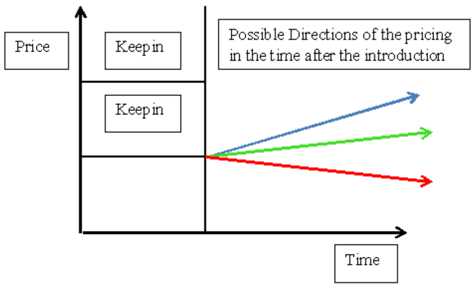

Figure (3) a penetration pricing strategy. Source (Rekettye & LIU, 2018) P. 128

Discussion and conclusion

The new product's optimal pricing strategy should the company followed depends on different factors and circumstances. Indeed, the high price in the skimming pricing can be preserved for an extended period only if the firms incessant a monopolistic product. Moreover, brand loyalty keeps the firm from the competition or imitation threat; for instance, the majority of Ray-Ban customers keep loyal to the brand and return to buy the same brand. Customer's sensitivity for price considers as main factors which guide the company to follow the skimming pricing or penetration pricing, for example, customers of cosmetic. Where penetration pricing applied in case price sensitivity very high and competition on the market very high (Kotler & Armstrong, 2012).

The firms usually plan to adopt the skimming pricing strategy, where keeping high prices once the product launched, then by the time, the price becomes lower than the initial price (Dean , 1976). The Promotion and marketing of the product are essential processes. The number of expenditures spends on marketing in skimming pricing very high, while the amount of penetration pricing very low. Nevertheless, skimming pricing is appropriate when capital returns expected in over a short period (Rekettye & LIU, 2018). Usually, the company with extraordinary reputable adopt the skimming pricing for its innovated product or service. Therefore, customers respect the effort made by the company by accepting the high price for the innovated product or service (Hanif ،2014). On the other hand, some circumstances force the company to set a low price. Even though the expected profit very low and ROI take a long time, in addition to the bad image quality taken by the customer for product or service, make an increase in price on the future impossible (Marn, et al., 2013).

Many researchers recommend skimming strategy for pricing new products regarding the high profits which the company can achieve (Kotler & Armstrong, 2012). Particularly in high-technology and innovated products where the life cycle of such products very short, for instance, digital camera (Spann, et al., 2015).

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