Firms don't use controversial skimming/penetration strategies to price products

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A new study in *Marketing Science*, a journal of the Institute for Operations Research and the Management Sciences (INFORMS), finds that most firms do not use the skimming or penetration strategies that deliberately overprice or underprice new products.

Skimming or Penetration? Strategic Dynamic Pricing for New Products appears in the Articles in Advance Section of Marketing Science. The research was conducted by Martin Spann, Ludwig-Maximilians-University Munich; Marc Fischer, University of Cologne and University of Technology, Sydney; and Gerard J. Tellis, Marshall School of Business, University of Southern California.

Strategists have long recommended that marketers use either a skimming or a penetration strategy for pricing new products. A skimming strategy involves charging a price much above costs in order to exploit demand for the new product that offers improvements in quality or features.

"This strategy basically attempts to skim consumer surplus," says Professor Spann.

On the other hand, penetration strategy involves selling at a low price, even below costs, in order to gain a large chunk of the market and achieve economies of scale.

"This strategy sells low on the hope of driving down costs and reaping a profit in the future," says Professor Fischer.

Marketers had long assumed that firms adopted either one of these two strategies for pricing new products.

In contrast, the authors find that manufacturers in one sector, digital cameras, adopt penetration and skimming strategies, for just 20% of new products. However, for 60% of new products, firms use a straightforward competitive or market pricing strategy. The authors obtained these results from an analysis of dynamic pricing strategies in a highly complex branded market, consisting of 663 products sold under 79 brand names of digital cameras in a large European country. They developed a method to classify dynamic pricing strategies and analyze the choice and correlates of observed pricing paths in the introduction and early growth phase of this market.

Professor Tellis explains, "Market conditions are so restrictive that they limit strategic pricing. Some competitors would undercut the skimming price limiting margins while others would match the penetration price preventing economies of scale."

Thus despite experts' recommendations, skimming or penetration are only practiced by a minority of manufacturers.

The authors find that firms exhibit various dynamic pricing strategies simultaneously over a portfolio of products. The choice of strategy is associated with market, firm, and brand characteristics.

"Market-pricing and penetration strategies occur more often after the takeoff of the market and under increased competitive intensity," says author Marc Fischer.

"Market pricing is also more likely to be adopted by late entrants, whereas firms that have established a reputation in the market prefer adopting a skimming strategy. Penetration strategies occur more often if firms have larger cumulative sales," says Tellis.

The authors conclude that firms seem to follow a portfolio approach in their choice of pricing strategy, with various products in their product line launched at various times and probably targeted at various consumer segments.

"In this case, the application of penetration pricing for some products can exploit economies of scale and experience that may subsidize costs for skimming other products," adds Martin Spann. "Related, price skimming for some products exploits margins that can complement the low margin from price penetration for other products."

Marketing managers in other markets can apply the method developed in this study to analyze the prevalence and use of pricing strategies in their respective market. They only need to adapt variables such as product features to the specific characteristics of their market.

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