Lesson From Experience: Penetration and Skimming Pricing Strategies

Introduction

The story that you are about to read is from actual events that occurred in the field. Its purpose is to provide you with a real-world example from a seasoned professional in the business world.

Penetration and Skimming Pricing Strategies

Pricing strategy is one of the 4 *P*s of the marketing mix. Setting prices is no small matter because it will have long-lasting impacts on marketplace penetration rates and of course, profits. Two common choices for pricing strategies are referred to as *penetration pricing* and *skimming strategy*.

A brand-new company in the commercial fitness equipment industry began doing business in 2005. It was competing as a new start-up against established competitors who had sales levels of $40, $60, and $300 million. From the beginning, its strategic plan recognized that it could not compete in the marketplace based on price, as was the norm among other companies, because it lacked the economies of scale of its well-established competitors.

Instead, it chose a product differentiation strategy, coupled with a premium price and skimming strategy, in its marketing plan. The company had a sales force who were well-experienced in negotiating the sales of every customer order and who were excited about having a patented, revolutionary product to sell in the marketplace. When introduced to the pricing and product strategy, the sales force was shocked. The strategy included the following two parts:

- Salespeople would no longer be allowed to negotiate every sale. Instead, the published price was set, allowing only for normal volume-based discounts.
- Price points would be set 10 percent above the competition's similar equipment, keeping in mind that the firm's product line was a unique, patented technology.

The sales force was provided with the new pricing strategy and began the long selling cycle, which typically lasted from 9–12 months. Within days of going into the field with this premium pricing, or skimming strategy, the salespeople started requesting permission to discount and negotiate with customers who were saying they could get similar equipment from competitors for 10 percent less. The salesmen were told, “No, our product is not identical, but revolutionary and unique. Tell the customers if they wish to have the latest technology available, we are the only firm from which they can get it.” Despite this high price skimming strategy, first-year sales approached $10 million.

It is important to take the following away from this scenario:

- The pricing strategy must be well-thought out and must take into account the degree of competition, the degree of uniqueness of the product or service, and the firm's own cost structure.
- The pricing strategy must be accompanied by other tactics that are harmonious with the strategy, such as advertising messages, product quality, and product development strategies.
- Revolutionary, innovative, and patented products may create barriers to entry and lead to sales growth for a new company. It is just as important that the marketplace perceive the innovation or differentiation as meaningful to them as opposed to simply being different.