Price Penetration or Price Skimming?

The following is an excerpt from a manager's meeting for firm that produces entertainment/game consoles (like PlayStation, Xbox, Wii).

They are trying to decide whether to use a price penetration or price skimming strategy in the upcoming launch of their game console. Can you help them decide?

Excerpts from the Manager's Meeting

Ken: Thanks for coming everyone. This is our price setting meeting for the launch of the new K-J Game Box next year. By way of background, on average our competitors have a unit cost of around \$50. When they first launched, they sold the units to retailers at around \$350, hence a \$300 margin.

The retailers then sold the product to their customers at around \$700. And, as we know, those same competitive products are now sold into retailers at just \$100, and resold to consumers for \$200. Personally, I support adopting a similar pricing strategy – a market skimming approach at first, and then progressively lowering the price. What does everyone else think?

Jessica: Well, that approach makes sense for some of our competitors. They have strong brands and they heavily invested in pre-launch promotion, thereby creating a pool of 'innovators' who are virtually willing to buy the product at any price.

I'm not sure whether our product would have the same attraction – given our brand isn't as strong and our limited pre-launch promotion to date.

Kurt: But do we really need the brand equity? This product has a number of technological advantages over our competitors. Once we get the product out there, we should be able to generate some publicity, which will automatically attract the 'innovators'.

To these consumers, price is not an issue. They just want the latest and the best technology. So, I too favor a setting a skimming price.

Jane: I know that our competitors have typically gone down the price skimming track. But I think that there could be a greater opportunity for us by adopting a price penetration strategy. Look, we make profits in two ways – one from the sale of game consoles and two from the royalty fee for each game sold that operates on our system.

And we know that while consumers will only buy one game console, they will buy many games, which can add up to a significant and ongoing income stream for us. Therefore, my plan would be to minimize the price of the game console. This means that we will get many more consoles out there (as compared to market skimming). And more consoles, means more games will be sold, which means more ongoing revenue.

Kevin: I'd agree that your plan would probably lead to much greater income streams in the long-term.

But we've just invested tens of millions of dollars in developing this technology and you are talking about foregoing our profit margin on the game consoles. That's profit that we get in the short-term, which we can put back into developing our next opportunity.

Julie: That's a good point, which is why I would be nervous about relying upon any longer-term profits. We will probably introduce the K-J Game Box 2 in a few years' time, and the profits from the game sales from version one will quickly disappear.

Keith: That assumes that we keep updating the technology. I would imagine that constant upgrading would be a nuisance for many consumers. We could position our product as 'stable technology' – I'm sure that there would be a considerable market segment of families that would be very interested in that possibility.

Jenny: I really wouldn't think so. Most people want the latest and the greatest technology. Nobody wants to play computer games from ten years ago.

Kim: Actually, I think that Keith makes a good point. Sure, a lot of people do want the most up-to-date technology. But Keith's talking about a particular market segment, and as far as I know, none of our competitors have aggressively pursued them.

Therefore, this appears to be a major gap in the market and an opportunity for the K-J Game Box to be clearly differentiated as a late entrant in a cluttered and competitive market.

Ken: OK, thanks, we've now heard everyone's views and we have two distinct pricing, and indeed overall, strategies to consider.

Student Discussion Questions

1. What are the arguments for a price skimming approach, as outlined in the case?
2. What are the arguments for a price penetration approach, as outlined in the case?
3. Which pricing approach would you advise the firm to adopt? Why?