

Market Skimming Pricing: An Examination of Elements Supporting High Price for New Products in Pakistan

Muzammil Hanif

Army Public College of Management and Sciences (APCOMS), UET Taxila, Rawalpindi, Pakistan

E-mail: muzammilhanif@hotmail.com

Abstract

Market skimming is a very important pricing strategy for the companies making innovative and technology based products. Market skimming pricing can be best practiced when the company is highly reputable, providing great quality and innovative products and the customers give a great value to the introduced technology and readily adopt it. The objective of this paper is to find out the factors responsible for market skimming pricing. In this research, the individuals using personal computers are taken as the population whereas Product quality, Brand image, Innovation and Technology adoption are taken as the variables responsible for practicing Market Skimming Pricing. A questionnaire is designed and the survey is conducted. The results showed that all the four variables significantly and positively influence market skimming pricing. The practice of market skimming pricing is explained up to 27% by the independent variables considered.

Keywords: market skimming pricing, product quality, brand image, innovation, technology adoption.

Introduction

The origin of computers and electronics industry can be traced back to the early 20th century. The computer and electronic product manufacturing industry produces computers, computer peripherals, communications equipment, and similar electronic products. Over the time advancements have been made in these products for better customization and easy use. The pricing strategy for such new and advance products is a very important decision to take in order to obtain a competitive and superior position in the market. Market skimming pricing strategy is actually setting a high initial price for a newly introduced product with a motive of “skimming the cream off the market”.

This study has a purpose to figure out the factors which are responsible to encourage customers to purchase the new products from their preferred brand even at high initial prices. The computers and electronics industry has been studied in this study and the users of world’s popular companies like; Apple, Hewlet Packard, Sony Vaio, Dell, and Epson are taken as the population of the study. Market skimming pricing is especially important for this industry because it is technology based industry. The life of an introduced technology is very short and soon one technology is surpassed by the next one. So in this case the only option for the companies offering these technology based products is to rely on the market skimming pricing.

The best strategy for pricing new products is market skimming pricing which involves charging a high price in the introductory stage of the product to grab the high profits from the market (Kotler and Armstrong, 2009). A company should use skimming strategy, when the demand of the new products is unsure, the company has spent much on the research and development for making that product, and when it wants to position its products strategically among the competitor’s similar products or when its product is so much innovative that the market is expected to mature very slowly. The high prices of the new markets will also help the company to segment the market. The fact behind this is that only those customers will buy the company’s new products at high prices in its initial phase that are not price conscious. This would tell the company that whom to focus for their new expensive products. The skimming strategy is best suited to a company having a weak financial status because this accounts for selling enough units at a higher price in order to cover the R&D and promotion costs.

There are five variables used in this research. Market skimming pricing is the main dependent variable. Four independent variables are proposed to be responsible for the practice of market skimming pricing which are; Product’s quality, Brand’s image, Innovation and Technology adoption. This research’s focus is on these four variables that how they individually and collectively encourage the market skimming pricing being practiced by the companies engaged in the computers and related products. The idea here is that the four independent will enable a computers company to use market skimming pricing.

Literature Review

Market skimming pricing:

The most important issue concerning the launch of a new product is its pricing. This decision is very important for a first mover company because it not only affects the profits and customer acceptance but also influences the competitive entrance. A pricing strategy is made while keeping in mind the goal of setting up the best possible price giving rise to a high profit. A useful pricing strategy is the one which is harmonious with the overall strategy of the firm. The pricing strategies which do not go with the goals of a company can surely damage its

performance results (Mathew, 2004).

Market skimming pricing strategy is about setting a high price first and then after the passage of time lowering it. It is quite similar to differentiation but also involves the time factor. This strategy works when the customers are less price sensitive e.g. for cosmetic industry, or when the customers are attracted toward some innovative products like electronic items e.g. personal computers. Market skimming pricing is used to divest from the heavy and expensive investments made for the research and development. A company can enjoy this high introductory price just for the initial period as compensation for being the first mover in any technology (Redmond, 1989). By offering high prices first for a new product, a company skims the market and then lowers it with the passage of time (Khouja and Smith, 2007).

Why the sellers decrease the price of the new products after some time? The reason for that is that the productions costs decrease as the product matures. The price skimming strategy calls the selling companies having a market control and a strong product to decrease the prices with the passage of time in order to take benefit from the difference in the customer's valuations of products so that they can get customers' surplus. The research on the prices of the cellular handsets revealed that their price decrease from \$2,000 to \$500 in the years from 1985 to 1992. This shows the use of market skimming pricing strategy used by the companies selling cellular handsets. This decrease in the prices is due to the fact that customers stop purchasing a newly introduced product after sometime. There are two reasons for this, first is that the customers usage decreases over time and the second one is that the new customer base is formed who do not use the products as the old customers (Jain et, al. 1999).

The companies which create and lead the market by introducing new products gain large benefits. The new products are a great means of support for many companies. If the new products fail they can lead to the bankruptcy of the company because it takes much time to reach a mass market. On the contrary if they get successful, they can take the companies to the heights of success (Haji and Assedi, 2009). A high price is significant for a new product because it gives an idea that the customers place it as a value product by paying high price to buy it. In this way company can get high profits out of it (Bernard and Julie, 1995).

Innovation:

Innovation means technological complexities and making a new product in the company (Danneels & Kleinschmidt, 2001). The pricing for a pioneer and innovative new product is a significant and complex decision to take. A pioneer product is the one which has a major innovation. Therefore its market is uncertain and turbulent and cannot be forecasted. While pricing these products there should be given enough room for the possible errors in the demand, cost and competitors' capabilities. The issue is about the competitive position of the new products which gets deteriorated due to the high rate of innovation in today's world. The new products should be distinct otherwise they can soon be substituted by the competitor's products. If this happens a company's new product would not enjoy high price independence (Dean, 1969).

The study of Liu et al. (2011) has proposed that the pricing decision of a company is significantly influenced by the customers demanding innovative products. So if the innovators' demand is high the best strategy to use is market skimming pricing and in other cases the market penetration pricing is recommended. On the contrary it has been found that the technological advancements in the products make the market skimming pricing less attractive for the companies. It is due to the reason that the need for further upgrading of technology will eat away the profits of the skimming strategy (Khouja et al. 2008.)

A great focus has been placed on the relationship between product quality, innovativeness and the new product performance. The innovation oriented strategy calls for exploring new possibilities through research, experiments and risks, a high quality emphasizes exploiting the existing sureness via efficiency, standardization and controlling (Castillo and Aleman, 2009). The innovation is the prime focus of most of the firms and it requires a large R&D. New product development is very important for the long term success of a company (Hooley et al., 2005).

Product quality

Quality means objective quality and the performance of the product according to the expectations (Calantone & Knight, 2000). Consumers see the price as a signal in examining the products and have shown that there exists a positive relationship between the price and the product's quality (Monroe and Dodds, 1988). The customers psyche is that they think the high prices mean high quality. A manufacturer can enjoy premium prices for its new products if it is perceived as a superior product (Mitra, 1995). The researches have shown that the increase in the quality durability gives rise to an increase in the price of the product. The durability of the products influences the demand of the new products. Keeping other things constant the shorter the life of a new product the larger would be the number of the customers who will buy it (Besanko and Wayne, 2006).

A new product has got some features which reveal its progression. The new and high quality versions of the product appear quickly and they are called the new models or new generations of the products. The other

thing is the quality adjusted price which is the price paid by the customers divided by the quality of the product and it decreases over time. So when the customers buy the quality units rather than the products which contain these quality units it is said to be taken as customers buying a better value when they go for a new generation or model rather than the old one. This concept can be taken in to account for mainframe computers and minicomputers (Chow, 1967).

Brand image:

The buying behavior of the customers depends too much on the image of the company from which they are buying (Ming H. H., et al, 2004). When a brand extends its business and offers new products, the image feedback gets very significant. This feedback to the brand's image can be negative when the new product of the parent brand fails to meet the desired levels of quality. The brands with a high reputation and image are more subject to negative feedback because they are perceived to be best brands by the consumers (Völckner et al. 2008). The sub brands of a brand have a great impact on its image and reputation and on the inclination of its customers toward it (Rajan V. et al, 2006).

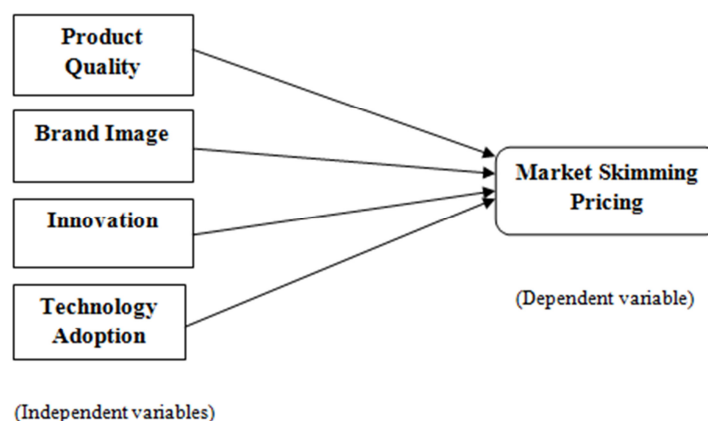
Brand image of Apple Inc. has helped it to grab its loyal customers' attention against competitors. This is the reason it adopted market skimming pricing for its Ipad in 2010 and achieved success out of it (Huimin and Hernandez, 2011). The studies have revealed that a company can charge a high price for its offerings in the uninformed dealings on the basis of its past relationships with its customers (Desgranges and Foucault, 2005).

Technology adoption:

It has been found that the ease to adopt and use the technology depends mainly on the interactivity of that technological product (Qimei C. et. al., 2007). A company has to make investments if it wants to lead in the technology. It will make investments in the technology according to the technology adoption barriers influencing the people who will adopt its technology. In the past there was a great focus on the strategies on launching the new, innovative, high technology products (Lee and O'Connor, 2003). The customers evaluate the benefits of buying a product today against the benefits of buying it in the future. This is the reason that most of the people buy the innovative products in the introductory stage of that product and do not consider its high price (Besanko and Winston, 1990).

In today's world the adoption and flow of new ITs and technological innovations has become critical for the survival of our information based society which benefits the people and organizations. These technological advancements have changed the way organizations work and exist in the competitive environment (Kauffman et al., 2010). When a company wants to launch a new and innovative product in the market, the suitable pricing strategy is market skimming. It is about offering the product at a high price in the initial phase. This works well when the company enjoys a customer base who desires to buy the product as early as possible and when the demand of these early adopters goes down, the company then lowers the price to target another market segment (Huimin and Hernandez, 2011.)

Theoretical framework



Hypotheses

In order to check the relationship between the independent and dependent variables, four hypotheses are developed.

H1: Product quality positively and significantly influences market skimming pricing.

H2: Brand image positively and significantly influences market skimming pricing.

H3: Innovation positively and significantly influences market skimming pricing.

H4: Technology adoption positively and significantly influences market skimming pricing.

Research design and Methodology

Population

Computer users within Rawalpindi, Pakistan focusing on the users of personal computers of the renowned computers companies such as Apple, Hewlet Packard, Sony Vaio, Dell, and Epson were considered as the population of this study.

Procedure

A sample of 200 was chosen and questionnaire survey technique was adopted using non-probability convenience sampling method. Out of 200, 145 were returned by the respondents. The respondents were requested to impart about how they felt about a particular computer brand which they use. Self administered approach was used to ensure that the questionnaires be filled properly. The data gathered from the respondents through questionnaires was analyzed with the help of SPSS 18 software.

Measures

The instrument used for getting data for this study was a Questionnaire which started with an introduction explaining the main purpose and the significance of this study. For getting the demography of the respondents the first part of the instrument had six items inquiring age, gender, highest level of education, occupation, income level and the computer brand they use. This section had a nominal scale like check boxes and dichotomous scale. Second part had 16 items in total. Market skimming pricing was measured with 4 items, Product quality with 3 items, Brand image with 4 items, Innovation with 2 items, and Technology adoption with 3 items. All the items were measured with 5 point Likert scale ranging from 1 Strongly Disagree to 5 strongly Agree. The questionnaire is self-developed and also some items are taken from the study of (Yee and Sidek, 2008).

Reliability analysis

In order to check the reliability of the data from the tool Reliability Analysis is performed. Cronbach's Alpha values for all the variables are shown in table-1. All the values are above 0.6 and 0.7 and one value is even above 0.8, showing that the tool is reliable.

Table 1: Cronbach's Alpha Reliability Coefficient

| Reliability statistics | | |
|-------------------------|------------------|------------|
| Constructs | Cronbach's Alpha | N of items |
| Market skimming pricing | .828 | 4 |
| Product's quality | .700 | 3 |
| Brand image | .631 | 4 |
| Innovation | .735 | 2 |
| Technology adoption | .701 | 3 |

Exploratory factor analysis

Exploratory factor analysis is used to check the validity of the tool used for the first time in a research study. The **correlation matrix** done here tells the inter item correlation. The results show that for all the five variables, the items have correlation coefficients between 0.3 and 0.8 showing a positive and significant relationship. The determinant of correlation is greater than 0.001 for all the variables. The anti-image correlations for all variables' items are greater than 0.5. Kaiser Meyer Olkin's (KMO) value is greater than 0.5. The significance level for Bartlett's test is less than 0.5. Extraction method used is principal component analysis. Extraction value is greater than 0.5 and one component is extracted for all items. The Total variance explained tells that to what extent the items measure a particular variable. The analysis shows that items for all the variables have value of total variance explained greater than 60%. The values for component matrix are all above 0.5. No item is removed from the tool as all the values came according to the benchmarks in the very first attempt. Overall, the results show that the tool is valid.

Table 2: Exploratory factor analysis

| Variable | Item | KMO | Bartlett's test | | Anti-image correlation | Extraction Value | Total variance explained % | Component matrix |
|------------|------|------|-----------------|-------|------------------------|------------------|----------------------------|------------------|
| | | | Chi sq. | Sig. | | | | |
| MSP | 1 | 0.78 | 42.45 | 0.000 | 0.85 | 0.50 | 0.70 | 66.3 |
| | 2 | | | | 0.81 | 0.69 | 0.83 | 82.3 |
| | 3 | | | | 0.74 | 0.75 | 0.87 | 92.6 |
| | 4 | | | | 0.75 | 0.70 | 0.84 | 100 |
| PQ | 1 | 0.67 | 15.73 | 0.001 | 0.68 | 0.62 | 0.79 | 63.7 |
| | 2 | | | | 0.69 | 0.60 | 0.77 | 83.5 |
| | 3 | | | | 0.64 | 0.68 | 0.82 | 100 |
| BI | 1 | 0.55 | 24.47 | 0.000 | 0.51 | 0.76 | 0.74 | 61 |
| | 2 | | | | 0.54 | 0.82 | 0.90 | 75.7 |
| | 3 | | | | 0.56 | 0.73 | 0.85 | 93 |
| | 4 | | | | 0.69 | 0.70 | 0.50 | 100 |
| INN | 1 | 0.50 | 12.25 | 0.000 | 0.50 | 0.65 | 0.70 | 80 |
| | 2 | | | | 0.50 | 0.80 | 0.89 | 100 |
| TA | 1 | 0.65 | 15.94 | 0.001 | 0.63 | 0.66 | 0.81 | 63.6 |
| | 2 | | | | 0.62 | 0.69 | 0.83 | 84.9 |
| | 3 | | | | 0.73 | 0.53 | 0.73 | 100 |

Normality of data

The normality of data is checked. It showed that the histogram of the data has a normal bell shaped curve with a little more peak than normal. This shows that the data has a little bit kurtosis. The Normal Probability Plot of the data showed that most of the data lies on the straight line with a few values lying outside it. This shows that the data is normally distributed.

5. Data Analysis

Demographical analysis

After collecting the data, it was analyzed to check the sample's responses against the variables taken in this study. The methods like descriptive statistics, correlation and regression were considered for this purpose. First the demographical analysis was done which showed that out of sample of 115, 57 were women and 58 were men and majority of them were young people and students using the products of Dell. Out of 115, almost 35 respondents were regular users of this Brand. 29 respondents used Apple, 23 used Sony Vaio, 16 used HP.

Descriptive and Correlation analysis

Descriptive statistics is used to analyze the collected data quantitatively. It describes the data in terms of central tendency i.e. mean and in terms of dispersion i.e. standard deviation. The instrument (questionnaire) measured all the items against a 5-point Likert scale so; the values of mean greater than 3.00 for all the variables (market skimming pricing, product's quality, brand's image, innovation and technology adoption) show a significant positive trend. Standard deviation indicates the deviation of the values from the mean value. The values of standard deviation vary from 0.55 to 0.81 showing that majority of the observations for the entire variables lie near the mean value.

The correlation analysis tells the strength of the relationship between variables taken. Correlation analysis of this study depicts that all the independent variables are positively correlated with the Market skimming pricing. Product quality and market skimming pricing have a correlation value of 0.282 which shows a positive relationship. Brand's image and market skimming pricing have a correlation value of 0.359 showing a significant and positive relationship between these two variables. The correlation value between innovation and market skimming pricing is found to be 0.437 which shows a high significant and positive relationship. Whereas the correlation value calculated between technology adoption and market skimming pricing is 0.447 which is also showing a very high positive and significant relationship.

Table 3: Descriptive and Correlation Results

| | Mean | Std. deviation | MSP | PQ | BI | INN | TA |
|------------|--------|----------------|---------|---------|---------|---------|----|
| MSP | 3.5496 | .55189 | 1 | | | | |
| PQ | 3.6434 | .59947 | 0.282** | 1 | | | |
| BI | 3.7953 | .66152 | 0.359** | 0.497** | 1 | | |
| INN | 3.8707 | .81058 | 0.437** | 0.343** | 0.631** | 1 | |
| TA | 3.7476 | .66912 | 0.447** | 0.32** | 0.439** | 0.504** | 1 |

** Correlation is significant at the 0.01 level (2-tailed).

Linear Regression analysis

The regression analysis determines the dependence of the dependent variable on the independent variables. The unstandardized coefficients' values were found to be as 1.624, 0.084, 0.317, 0.164 and 0.230 for MSP, PQ, BI, INN, and TA respectively. The t - values for these coefficients are significant. This means that the independent variables have an individual significant impact on the dependent variable MSP.

Table 4: Regression results

| Model | | Coefficients ^a | | | | |
|-------|------------|-----------------------------|------------|---------------------------|-------|------|
| | | Unstandardized Coefficients | | Standardized Coefficients | | t |
| | | B | Std. Error | Beta | | |
| 1 | (Constant) | 1.624 | .337 | | 4.817 | .000 |
| | PQ | .084 | .087 | .091 | .963 | .338 |
| | BI | .317 | .054 | .304 | 5.801 | .000 |
| | Inn | .164 | .075 | .241 | 2.179 | .031 |
| | TA | .230 | .079 | .279 | 2.905 | .004 |

a. Dependent Variable: MSP

The results have shown that up to 27% variation in Market skimming pricing is due to product's quality, brand's image, innovation and technology adoption while rest of the 73% depends on factors or variables other than considered in this research study. The Durbin Watson value of 1.981 shows that the value lies in the no autocorrelation zone.

Model summary

| R | R Square | Adjusted R Square | Std. Error of the Estimate | Durbin-Watson |
|-------------------|----------|-------------------|----------------------------|---------------|
| .519 ^a | .270 | .243 | .48008 | 1.981 |

In ANOVA table, F shows that the independent variables have a significant joint impact on MSP as F - calculated is greater than F - tabulated.

ANOVA^b

| Model | Sum of Squares | df | Mean Square | F | Sig. |
|--------------|----------------|-----|-------------|--------|-------------------|
| 1 Regression | 9.445 | 4 | 2.361 | 10.245 | .000 ^a |
| Residual | 25.583 | 112 | .230 | | |
| Total | 35.027 | 116 | | | |

a. Predictors: (Constant), TA, PQ, Inn, BI

b. Dependent Variable: MSP

6. Discussion and findings

Market skimming pricing is a very important pricing strategy for the new products and especially those products which are highly innovative and technologically advanced. Market skimming pricing is “setting high initial prices for new high end products and highly differentiated and technology based products”. The core objective of this strategy is to skim the market and to obtain high revenues from the market in the initial stages of the new products. The main objective of this study was to determine that how product's quality, brand's image,

innovation and technology adoption add value for practicing market skimming pricing. The results show that all the factors taken in this study have a great impact on market skimming pricing. Among all the factors taken in to account, Technology adoption is the most powerful stimulant of Market skimming pricing.

This study has focused on the companies dealing in computers that can use market skimming pricing for their new technological and highly innovative products. The idea here is that the technologically leading companies like Apple, HP, Sony vaio, Epson and Acer can adopt market skimming pricing for their new products and can enjoy high initial profits. Product's quality is the product's degree of conformance to predetermined specifications and expectations. If the quality of a computer is good and it has a good functional quality and the materials used in its manufacturing are good then the customers can buy it even at a high price. Some customers purchase the computers just due to the fact that a particular brand is world famous and they are brand conscious and they do not bother the prices. Brand's image is the picture of a brand in the customer's minds consisting of all the information and expectations related to that brand. Innovation is a process by which an invention is converted in to a product. An innovative product is created at a high economical cost and incorporates high imagination, information and creativity. Innovation also plays a significant role as people have a greater tendency to buy and experience every innovative product introduced. Technology adoption is a means through which the people are enabled to participate in the increasingly varying and dynamic environment in which technology has become a must. Those people who are unable to adopt the changing technologies will be left behind because technology has become a very important part of our everyday's life. Technology gives us financial as well as convenience benefits. Technology adoption drives the technology oriented people to buy the new computers at high prices just for the sake of adopting the new technology.

Descriptive results show a positive and significant relationship between all the factors taken. This means that if a computers company provides a high quality, is highly reputed, produces an innovative product and the customers readily adapt to this advanced technology product, then it can surely practice market skimming pricing. The results showed that the customers of a particular company are ready to buy the computers from their preferred brand and are satisfied by the performance of its products. Among all the factors considered in this study, technology adoption and innovation are the greatest driving forces for the people to purchase the expensive new products from their preferred brands at market skimming prices.

The results have highlighted that the high prices of the computers get compensated by its excellent performance. Furthermore, the brand's name and its reputation force a customer to purchase its expensive new products, Liu (2010). Moreover, the study has found that people purchase the new expensive computers so that they can quickly adopt the new introduced technology, can keep themselves up to date and make their lives easy going.

7. Conclusion

This research study has revealed that product's quality, brand's image, innovation and technology adoption play a very significant role in practicing market skimming pricing. All the independent variables influence the dependent variable and also complement each other. Market skimming pricing is a beneficial pricing strategy for the companies which bring technology based products to the market. The technology has a very short life cycle as it is soon surpassed by a next one. The companies which want to make high profits in the initial years of the product introduction phase should go for market skimming pricing. Product's quality supports the market skimming pricing. If the functional quality of the product is good and is durable then people buy new expensive products from their favorite computer companies. The brand's image can attract the customer to buy an expensive computer even at a high price. Innovation in the new computers and technologies motivate customers to purchase them at high market prices. Also the urge to adopt the new technology also play a significant role for motivating the people to make the purchases at market skimming prices. It can be concluded that if a company wants to enjoy high profits for its new technology based products and wants to recover research and development costs then it should adopt market skimming pricing. This would be made possible when the company is providing good quality and innovative products, is highly reputable and people are ready to adopt the introduced technology.

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