

# Global Marketing

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**Pricing Decisions**

**Chapter 11**

# Learning Objectives

- Review basic pricing concepts that underlie a successful global marketing pricing strategy.
- Identify the different pricing strategies and objectives that influence decisions about pricing products in global markets.
- Summarize the various Incoterms that affect the final price of a product.
- List some of the environmental influencers that impact prices.
- Apply ethnocentric/polycentric/geocentric framework to decisions regarding price.
- Explain some of the tactics global companies can use to combat the problems with gray market goods.
- Assess the impact of dumping on prices in global markets.
- Compare and contrast the different types of price fixing.
  - Explain the concept of transfer pricing.
- Define *countertrade* and explain the various forms it can take.

# Basic Pricing Concepts

- ***Law of One Price***
  - All customers in the market get the best product for the best price
- **Global markets**
  - Diamonds
  - Crude oil
  - Commercial aircraft
  - Integrated circuits
- **National markets**
  - Costs
  - Competition
  - Regulation

# Basic Pricing Concepts

- The Global Manager must develop systems and policies that address
  - Price Floor: minimum price
  - Price Ceiling: maximum price
  - Optimum Prices: function of demand
- Must be consistent with global opportunities and constraints
- Be aware of price transparency created by Euro zone, Internet

# Global Pricing Objectives and Strategies

- Managers must determine the objectives for the pricing objectives
  - Unit Sales
  - Market Share
  - Return on investment
- They must then develop strategies to achieve those objectives
  - Penetration Pricing
  - Market Skimming

# Market Skimming and Financial Objectives

- **Market Skimming**
  - Charging a premium price
  - May occur at the introduction stage of product life cycle
  - Luxury goods marketers use price to differentiate products
    - LVMH, Mercedes-Benz

# Penetration Pricing and Non-Financial Objectives

- **Penetration Pricing**
  - Charging a low price in order to penetrate market quickly
  - Appropriate to saturate market prior to imitation by competitors
  - Packaged food product makers, with products that do not merit patents, may use this strategy to get market saturation before competitors copy the product

# Companion Products or “Razors and Blades” Pricing

- Products whose sale is dependent upon the sale of primary product
  - Video games are dependent upon the sale of the game console
- “If you make money on the blades, you can give away the razors.”
- Cellular service providers subsidize the phone and make money on calling plans

# Target Costing

- Use by Japanese companies to control costs, save on production expense, & create competitively priced global products
- Also called **Design to Cost**

# The Target-Costing Process

- Determine the segment(s) to be targeted, as well as the prices that customers in the segment will be willing to pay.
- Compute overall target costs with the aim of ensuring the company's future profitability.
- Allocate the target costs to the product's various functions. Calculate the gap between the target cost and the estimated actual production cost.
- Obey the cardinal rule: If the design team can't meet the targets, the product should not be launched.

# Export Price Escalation

- **Export price escalation** is the increase in the final selling price of goods traded across borders.

# Export Price Escalation

Item			Percentage of Ex-Works Price
Ex-works Des Moines		\$45,000	100%
Inland and ocean freight from DSM to CY Yokohama	\$1,475.00		4.44%
Bunker adjustment fee	300.00		0.67%
Destination charges	240.00		0.53%
Freight forwarding fee	150.00		0.33%
AES filing fee	25.00		0.06%
Total shipping charges	\$2,715.00	\$ 2,715.00	6.03%
Insurance (110% of CIF value)—\$0.20 per \$100		104.97	0.23%
Total CIF Yokohama value		\$47,819.97	106.27%
VAT (3% of CIF value)		<u>1,434.60</u>	3.19%
Landed cost		49,254.57	109.45%
Distributor markup (10%)		<u>4,925.46</u>	10.95%
Dealer markup (25%)		<u>12,313.64</u>	<u>27.36%</u>
Total retail price		\$66,493.67	147.76%

\* This was loaded at the manufacturer's door, shipped by stack train to Seattle, and then transferred via ocean freight to Yokohama. Total transit time from factory door to foreign port was about 30 days.

# Pricing Factors for Goods That Cross Borders

1. Does the price reflect the product's quality?
2. Is the price competitive given local market conditions?
3. Should the firm pursue market penetration, market skimming, or some other pricing objective?
4. What type of discount (trade, cash, quantity) and allowance (advertising, trade-off) should the firm offer its international customers?
5. Should prices differ with market segment?
6. What pricing options are available if the firm's costs increase or decrease? Is demand in the international market elastic or inelastic?
7. Are the firm's prices likely to be viewed by the host-country government as reasonable or exploitative?
8. Do the foreign country's dumping laws pose a problem?

# Cost-Based Pricing

- **Cost-based pricing** is based on an analysis of internal and external cost
- Firms using western cost accounting principles use the **Full absorption cost method**
  - Per-unit product costs are the sum of all past or current direct and indirect manufacturing and overhead costs
  - Must include additional costs & expense when goods cross national borders

# Cost-Plus Pricing

- **Rigid cost-plus pricing** means that companies set prices without regard to the eight pricing considerations
- **Flexible cost-plus pricing** ensures that prices are competitive in the contest of the particular market environment

# Crossing International Borders

- Obtain export license if required
- Obtain currency permit
- Pack goods for export
- Transport goods to place of departure
- Prepare a land bill of lading
- Complete necessary customs export papers
- Prepare customs or consular invoices
- Arrange for ocean freight and preparation
- Obtain marine insurance and certificate of the policy

# Terms of the Sale

- **Incoterms**
  - **Ex-works** – seller places goods at the disposal of the buyer at the time specified in the contract; buyer takes delivery at the premises of the seller and bears all risks and expenses from that point on.
  - **Delivery duty paid** – seller agrees to deliver the goods to the buyer at the place he or she names in the country of import with all costs, including duties, paid

# Incoterms

- **FCA (free carrier)** sale occurs when goods are delivered to the carrier
- **FAS (free alongside ship)** named port of destination – seller places goods alongside the vessel or other mode of transport and pays all charges up to that point
- **FOB (free on board)** – seller’s responsibility does not end until goods have actually been placed aboard ship
- **CIF (cost, insurance, freight)** named port of destination – risk of loss or damage of goods is transferred to buyer once goods have passed the ship’s rail
- **CFR (cost and freight)** – seller is not responsible at any point outside of factory

# Inflationary Environment

- Defined as a persistent upward change in price levels
  - Can be caused by an increase in the money supply
  - Can be caused by currency devaluation
- Essential requirement for pricing is the maintenance of operating margins

# Low Inflation Environment

- Should make it possible to raise prices but consider the global competitive environment
- U.S. inflation rate in the 1990s was low and strong demand had factories at capacity
- However, mid-1990s Europe had high unemployment, Asia was in recession
- By the end of the decade, globalization, the Internet, low-cost products from China, and cost-conscious consumers became other constraining factors

# Government Controls, Subsidies, and Regulations

- The types of policies and regulations that affect pricing decisions are:
  - Dumping legislation
  - Resale price maintenance legislation
  - Price ceilings
  - General reviews of price levels
- Foreign governments may:
  - require funds to be noninterest-bearing accounts for a long time
  - restrict profits taken out of the country and limit funds paid for imported material
  - Restrict price competition

# Competitive Behavior

- If competitors do not adjust their prices in response to rising costs it is difficult to adjust your pricing to maintain operating margins
- If competitors are manufacturing or sourcing in a lower-cost country, it may be necessary to cut prices to stay competitive

# Using Sourcing as a Strategic Pricing Tool

- Marketers of domestically manufactured finished products may move to offshore sourcing of certain components to keep costs down and prices competitive
- China is “the world’s workshop”
- Rationalize the distribution system—Toys ‘R’ Us bypasses layers of intermediaries in Japan to operate U.S. style warehouse stores

# Global Pricing: Three Policy Alternatives

- Extension or Ethnocentric
- Adaptation or Polycentric
- Geocentric

# Extension Pricing

- Ethnocentric
- Per-unit price of an item is the same no matter where in the world the buyer is located
- Importer must absorb freight and import duties
- Fails to respond to each national market

# Extension Pricing

***"In the past, Mercedes vehicles would be priced for the European market, and that price was translated into U.S. dollars. Surprise, surprise: You're 20 percent more expensive than the Lexus LS 400, and you don't sell too many cars."***

-Joe Eberhardt, Chrysler Group Executive VP for Global Sales, Marketing, and Service

# Adaptation or Polycentric Pricing

- Permits affiliate managers or independent distributors to establish price as they feel is most desirable in their circumstances
- Sensitive to market conditions but creates potential for gray marketing

# Geocentric Pricing

- Intermediate course of action
- Recognizes that several factors are relevant to pricing decision
  - Local costs
  - Income levels
  - Competition
  - Local marketing strategy

# Gray Market Goods

- Trademarked products are exported from one country to another where they are sold by unauthorized persons or organizations
- Occurs when product is in short supply, when producers use skimming strategies in some markets, and when goods are subject to substantial mark-ups

# Gray Market Issues

- Dilution of exclusivity
- Free riding
- Damage to channel relationships
- Undermining segmented pricing schemes
- Reputation and legal liability

# Dumping

- Sale of an imported product at a price lower than that normally charged in a domestic market or country of origin
- Occurs when imports sold in the U.S. market are priced at either levels that represent less than the cost of production plus an 8% profit margin or at levels below those prevailing in the producing countries
- U.S. law, *the Byrd Amendment*, provides for payment to companies harmed by dumping
- To prove, both price discrimination and injury must be shown

# Price Fixing

- Representatives of two or more companies secretly set similar prices for their products
  - Illegal act because it is anticompetitive
- **Horizontal price fixing** occurs when competitors within an industry that make and market the same product conspire to keep prices high
- **Vertical price fixing** occurs when a manufacturer conspires with wholesalers/retailers to ensure certain retail prices are maintained

# Transfer Pricing

- Pricing of goods, services, and intangible property bought and sold by operating units or divisions of a company doing business with an affiliate in another jurisdiction
- Intra-corporate exchanges
  - Cost-based transfer pricing
  - Market-based transfer pricing
  - Negotiated transfer pricing

# Countertrade

- Countertrade occurs when payment is made in some form other than money
- Options
  - Barter
  - Counterpurchase or parallel trading
  - Offset
  - Compensation trading or buyback
  - Switch trading