

Global Marketing

Contemporary theory, practice and cases

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Chapter 11

Setting Global Prices

Learning objectives

After reading this chapter you should be able to:

- Understand the centrality of pricing in the international marketing mix.
- Identify the main competitive, consumer, product, distribution and country factors influencing pricing decisions.
- Understand how to define objectives, strategies, and pricing policies.
- Distinguish between cost versus market-based pricing approaches.
- Learn how to manage new product pricing.
- Discuss the standardization versus adaptation alternatives.
- Recognize pricing strategies prototypes.
- Understand how to manage transfer pricing.
- Describe terms and methods of payment.
- Understand the concept of countertrade.

Why is Global Pricing Important?

- Price is a **key driver of consumer purchase behavior**
- Its hard to set a price which has to be **coherent with brand equity** and meanwhile **consistent across different countries**
- **Many internal** (corporate strategy and / or product cost) **and external factors** (competitors, a country's economic and legislative structure, etc.) can influence price decisions
- **Relative pricing power of intermediaries**
- It has to **satisfy the requests of big international retailers**
- The price must **reflect the value that the consumer is willing to pay** for the company's product
- On the other side, **consumers are increasingly looking for high quality - low price goods**, and companies gain a key advantage if they have the ability to build high quality inexpensively.
- Price is a **tangible value of an offer** created through product, distribution, and communication decisions.
- In **low-income countries**, price must be in line with purchasing power

Factors Influencing Pricing Decisions

- There are several factors influencing international pricing decisions that can be categorized into **five groups**:
 - Competitive factors
 - Consumer and cultural factors
 - Product factors
 - Distribution channel factors
 - Country factors
- Also, **company factors are important elements to consider**, especially at a strategic level. Their role will therefore be underlined when considering international pricing strategies and objectives.

Competitive Factors

- The **structure and intensity of competition varies significantly** from country to country (international vs local companies)
- They **need to maintain competitive and favorable price** to allow market penetration.
- Some markets have **high intensity of competition** which make it hard to price products within that market.
- Companies that have been able to create **differentiation relative to competition** are the ones that are **less subjected to price pressures**.



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Bike department in a Chinese supermarket in Shanghai

Consumer and Cultural Factors

- It is important to analyze consumers in relation to:
 - the **perception of price**: monetary, non monetary price and retail price ending;
 - **price and perception of quality**;
 - the **use of internet on price evaluation**.

Perception of Price

- **Monetary price** represents the idea that a consumer has regarding a product's price (expensive vs cheap). This correlates with past experience.
- **Non-monetary price** represents the sacrifice that a consumer must face when purchasing a product (consequences/fulfillments after purchasing a product). This varies greatly between countries.
- The final price perception depends on a careful **evaluation of costs** (monetary and non-monetary) **and benefits** (linked with the purchase of a product or service).
- Consumer and cultural factors can also influence **price-ending practices**.

Price and the perception of quality

- **Cultural factors influence the relationship between price and the perception of quality.**
- The relation has to be considered for **different product categories and brand strategies**. For example, for **luxury products**, characterized by factors such as uniqueness, high quality and rarity, it is frequent to find a **Veblen effect**: a higher rather than a lower price can determine an increase in demand for a product.
- For some products, the relation between price and quality is influenced by the **perception of local and global brands**.
- The consumer culture should also be considered in terms of **buying behavior distinguishing consumers of one country or region from those ones of other countries**. For example, in western markets, for many products consumers expect a good quality even if the product price is low.
- It is also important to consider that **the relation between low income consumers and affordable prices should not be generalized**.

Internet and price evaluation

- The **use of the Internet** has definitely given a **push toward consumer rationality**.
- On a global scale, the Internet is helping shoppers throughout the world to **compare prices of similar products**.
- Examples of:
 - NexTag.com, which has German, French, Italian, Spanish, Japanese and British versions as well as its United States site,;
 - Tencent, the largest and most used Chinese Internet service portal.
- In more and more industries all over the world **the use of internet is expected to intensify** in the next years.
- Internet will allow not only **price comparison between brands but also between retail prices for the same brand**, allowing the consumers to compare whenever they want the price of the desired products.

Product Factors

- **Product life cycle (PLC)**, usually prices are higher during the introduction phase of products.
- The ability to convey to consumers the **real quality of the product**, companies have to show consumers why their product's true value through attributes and leverage.
- **Product Costs**
 - Variable costs (raw materials, labor, energy, etc.)
 - Marketing expenses (marketing research, communication, etc.)
 - Finance and bank charges
 - Export-related charges (translation, labeling, country-of-origin marking, packaging adaptation, documentation, insurance, tariffs, shipping costs, etc.)

Distribution Channel Factors

- **The company set a sell in price** (to the first intermediary), then all the intermediaries (distributors, importers, retailers, etc) involved in the export channel charge a margin, **resulting in a sell out** (the final price paid by the final clients).
- The **length of the distribution channel** (i.e. the number of intermediaries), together with export charges such as insurance, shipping, export documentation and tariffs, can determine a relevant increase of the final export price if compared to the domestic price also known as **price escalation**. Alternatives to limit price escalation are:
 - to **reduce the length of the distribution channel**.
 - to **lower the producer's net price eliminating, for example, expensive features or shifting production of the product or of some of its components to low-cost countries**.
 - the possibility of limiting price escalation will strongly depend on the **company's power to control final prices**, also imposing lower margins on channel members of each target country.

Export Price Escalation: an example for coffee in the retail channel

	<u>Italy</u> Domestic channel with retailer (<i>Manufacturer margin: +70%</i>)	<u>USA</u> Foreign channel with importer and retailer (<i>Manufacturer margin: +50%</i>)	<u>Russia</u> Foreign channel with importer, wholesaler and retailer (<i>Manufacturer margin: +50%</i>)
Manufacturer's cost	5.00	5.00	5.00
Manufacturer's margin (%)	+70%	+50%	+50%
Manufacturer's margin (\$)	3.5	2.5	2.5
= Manufacturer's price	8.50	7.50	7.50
+ Insurance, shipping cost, export documentation (2%)	---	0.15	0.15
= Landed Cost	---	7.65	7.65
+ Tariff (20%)	---	1.53	1.53
= Importer's Cost	---	9.18	9.18
+ Importer's margin (30% on cost)	---	2.75	2.75
= Wholesaler's cost	---	---	11.93
+ Wholesaler's margin (30% on cost)	---	---	3.58
= Retailer's cost	8.50	11.93	15.51
+ Retailer's margin (40% on cost)	3.40	4.77	6.20
= Consumer's cost (=retailer's price)	11.90	16.70	21.70
Price Escalation over Domestic		+40.34%	+82.35%

Country Factors

- **Socio and economic factors and political country characteristics** play a large role in pricing decisions within different countries.
- These factors are not controllable by the company, so it must **adapt to them** when selling its products to a specific country.
- Some companies opt for a **low price strategy**.
- Many premium brand owners adopted the strategy of introducing **second brands or product lines** to access the low-priced markets of Eastern Europe, Middle East Africa, and Asia
- The main country factors which have to be considered in pricing decisions are:
 - Currency
 - Inflation
 - Government regulations, tariffs and taxes

Considering Currencies

- Currency is used for **invoicing**
- Some markets have **set currencies** (Oil is done in USD\$)
- **Changes in exchange rates** alter the firm's ability to compete, therefore affecting international pricing strategies.
- **Purchasing power parity theory** states that the very same good or basket of tradable goods should sell for the same price in different countries when measured in a common currency, taking into account transaction costs as well.

The Economist's Big Mac Index

	Big Mac prices		Implied PPP of the dollar	Actual exchange rate	Under (-) / over (+) valuation against dollar (%)
	In local currency	In \$			
USA	\$4.80	4.80			
India	Rupee 105.00	1.75	21.90	60.09	-63.6
Norway	Kroner 48.0	7.76	10.01	6.19	+61.8

Note: **PPP = Purchasing Power Parity**

Source: Adapted from "The Big Mac Index", The Economist, Jul 24th 2014, <http://www.economist.com/content/big-mac-index>.

- **Indian producers enjoy a comparative advantage**, as they can sell the Big Mac for 105.00 Rupee or \$1.75, according to the actual exchange rate of 60.09 ($105.00 / 60.09 = 1.75$), while the price in America is \$4.80.
- **In case of PPP** (i.e., same price of Big Mac in the United States), **the Rupee should have been changed at 21.90** ($105.00 / 4.80$); **that is, 63.6 percent less** when compared to the actual exchange rate ($(21.90 - 60.09) / 60.09$).
- Indian exports to the United States would change both local prices, via demand, supply and forex, appreciating the Rupee versus the U.S. dollar. **Actually, the local price in India entails an undervaluation of the Rupee by 63.6 percent and equivalently an overvaluation of the U.S. dollar.**

Inflation

- The key of good business is to **manage different inflation rates in multiple countries** while maintaining a price position.
- **If inflation is high in the production country**, a company may be unable to meet production costs and **decrease their margins**.
- There are **two options when there is high inflation**:
 - Abandon market/hope for economic recovery
 - Raise prices of products and face future backlash from consumers
- **In price negotiations**, the company must also cover the risk of payment delay if the customer is located in an inflationary market, because the real price paid would be lower.

Government regulations, tariffs and taxes

- Normal to have to deal with government intervention introduced to **maintain trade balances, develop domestic industries, and defend local employment and national security.**
- Some countries put **regulations and tariffs on products to protect local goods.**
- Government regulations are frequent **in many industries to help protect their products.**
- The government can also influence pricing positions introducing **subsidies to reduce local prices to increase domestic companies' local or global competitiveness.**
- **Tariffs and Taxes are other instruments of local protection,** used to increase the domestic price of an imported product (example of Mercedes).



Objectives, Strategies, & Pricing Policies

- Price decisions are influenced by variables as **short- versus long-term internationalization objectives, entry modes, competitive strategies,** and **profit and cost factors.**
- The export pricing control level is **correlated with internal organizational factors,** such as:
 - the degree of centralization
 - company size and experience
 - channel dependence
 - manufacturer asset specificity
- It is important to have a **rational and consistent strategy that fits the company's goals** as it expands in foreign markets.
 - the proliferation of prices and pricing strategies across channels, geographies, and brands, can cause problems.
 - In some cases, consumer packaged goods companies are forced to deal with million price points every year.

Strategic Alternatives to Setting International Prices

- Cost versus market-based approach
- New product pricing: skimming versus penetration pricing
- Standardization versus adaptation approach
- Centralized versus decentralized approach
- Preparedness for internationalization and industry globalization: pricing strategy prototypes

Cost Based Methods

- Based on the equation: *cost + margin = price*
- **Full-cost pricing**: the sum of total unit costs attributed to a product plus a profit margin
- **Incremental-cost pricing**: takes into consideration production and marketing costs that the company must face when exporting. Incremental production and marketing costs plus a profit margin will determine the final price.
- **Profit-contribution pricing** depends on the demand elasticity. Profit contribution represents the difference between incremental revenues and incremental cost of exporting in a foreign target market.

Profit contribution pricing: an example

Price (€/liter)	Estimated sales volume (liters)	Incremental revenue (000 €)	Incremental cost (000 €)	Profit contribution (000 €)
8,00	0	0	0	0
7,50	220.000	1650,00	990,00	660,00
6,60	380.000	2508,00	1635,00	873,00
6,25	400.000	2500,00	1700,00	800,00

Example for a French company exporting wine in the German market

Market-Based Methods

- Must take into consideration **not only costs but also competitors' prices and how much consumers are willing to pay**
- *affordable unit price – margin = target cost.*

New Product Pricing: skimming strategy

- The skimming strategy is based on the concept that a company can charge some consumer segments **higher prices for a product**.
- The **price is successively lowered** to reach all other segments, achieving maximum profitability from different target consumers.
- Can result in high margins, but there are **numerous risks**:
 - High prices should be justified by distinctive product features, while competitors should not be aggressive.
 - The company has to take the risk of creating a market easily conquered by other competitive products.
 - If price is lower in the domestic market, there is always the possibility of favoring parallel imports.

New Product Pricing: Penetration Pricing

- A company sets a **low price for the new product** in order to enter a foreign market, and often tends to base its communication campaign on this same strategy.
- It allows the company to **quickly penetrate the market and obtain a significant market share**.
- This strategy is **efficient when consumers are price sensitive**, enabling the company to gain a competitive advantage against competition.

Standardization vs Adaptation of Pricing Policies

- **Price standardization** implies the **same price positioning strategy across different markets**. Main factors to be considered are: economic and legal environment, distribution infrastructure, customer characteristics and behavior, and product life cycle stage. Price standardization is frequent when the company operates in **global sectors** and / or sells to **global retailers**.
- **Price adaptation** occurs when a company is compelled to adopt a **different price positioning strategy**. Managing transaction pricing means determining which discounts, allowances, payment terms, bonuses, etc. can apply in different countries. Some companies opt for:
 - **one fixed discount scale based on the overall quantity ordered by the client /distributor**. The main problem is the difference between countries with high potential and countries where the market potential is still small
 - **a pay per performance approach**. With this method, whose main goal is to improve the performance of clients/distributors, the discount depends on different variables. For example, it can vary from 0 to 4 percent in relation to:
 - 0.5% - Total sales in the country /geographical area
 - 1.0% - Sales growth
 - 0.5% - Market share
 - 0.5% - Number of clients
 - 0.5% - % of Key clients
 - 0.5% - In-store activities developed by the client/distributor
 - 0.5% - Assortment growthThe transaction price will be different (adaptation) not only country by country but also among clients/distributors operating in different geographical areas within the same country.

Price dumping

- Defined as **selling products in a foreign country (importing country) below the price of that product in the domestic market (exporting country)**, with the objective of obtaining relevant market shares in the foreign country.
- Can be used **to get rid of excess of inventory**, but can also cause the same result of **undermining competition**.
- However, dumping is **controlled by many laws** developed both at national (to hedge local companies against dumping) and international levels. This legislation is designed to counter unfair price competition but it can also be used as a barrier to trade (non tariff barrier).
- Since the creation of the **WTO in 1995**, anti-dumping activities have been reduced.

Parallel Imports (gray or grey market goods)

- Happens **when products, purchased in low price markets, are diverted to other markets without the authorization of the manufacturer or the brand owner**. These products are priced lower than goods sold by authorized distributors in the target market.
- The goods have been **manufactured by or for or under license from the brand owner** (they are not counterfeit goods), but they may have been **formulated or packaged for a particular geographical area where**, for example:
 - the competitive situation requires a lower price;
 - the target consumers have a limited purchasing power, which is typical of low income countries;
 - the exchange rate makes the product cheaper
 - the taxes are lower
 - the wholesalers had been able to benefit of big discounts buying higher quantities.
- If a company wants to **minimize the risk of parallel imports**, some guidelines can be followed:
 1. a **standardized pricing strategy**, reducing price disparities across markets, is actually preferable. If the price differential is low, opportunities for opportunistic behaviors are less.
 2. **clearly communicate that the product is different** and for this reason it fits with one market but it can be less attractive or it doesn't work for another market.
 3. **after sales services** can be planned and managed in order to avoid parallel imports.

Centralization vs decentralization of pricing decisions

- **Reasons that favor centralization** can be summarized as follows
 - Increasing **globalization**
 - **Internationalization of competition** and **homogenization** of competitive strategies
 - Price decisions are often closely related to **production volume planning, production capacity, economies of scale**. Hence, centrally directed prices facilitate the forecast of worldwide annual revenues.
 - Price positioning is a relevant component of **brand image**: global positioning requires price homogeneity
- **Reasons that can lead a company to prefer a decentralization** strategy:
 - if in different countries the company has to **target different price segments** or if the competitive structure is different
 - is necessary when there are **significant differences in end-user characteristics** (typically a lower income) **and in price sensitivity**, as well as **consumer preferences**
 - **added taxes, product adaptation costs, differences in transportation costs, and local economic and financial conditions** (e.g., interest rates and inflation)
 - different **retail power**, which forces local managers to reduce selling prices.
 - **Terms and conditions** diverging across different countries

Pricing Strategy Prototypes

- Four general pricing prototypes:
 - Local price follower
 - Global price follower
 - Multi-local price setter
 - Global price leader

Transfer Pricing

- It's the price set and paid for products shipped between units of the same organization (for example, from the head quarters to the subsidiaries). Different methods can be used to determine transfer price:
 - The **cost-plus pricing** method uses product costs as a base for determining final price.
 - The **market-based transfer price** is based on the market price of goods internally transferred. Hence it would be the local market price minus the margin to be obtained by the subsidiary to cover its costs.
 - The **negotiated transfer price** applies when market prices frequently change. In these cases a constant internal price becomes a necessity between subsidiaries.
 - The **arm's-length price** is based on the results of a hypothetical negotiation with an independent business partner. Main limitations are:
 - data are hard to obtain.
 - difficulties in identifying the right market price in the open market (no substitutes or the quality of similar products and services is different).
 - suppliers' cost structures can be significantly different
- Actually, **transfer prices are determined at a higher level than arm's-length prices** when the company finds it beneficial to maximize profit in the domestic market. Reasons can include the following:
 - Corporate income tax is higher in the foreign country than in the parent country;
 - A significant political risk of nationalization exists or expropriation of high profit foreign firms;
 - The foreign country is characterized by political instability and/or a high inflation rate;
 - The desire of the parent company to mask foreign profitability, keeping competitors out of the market.

Terms and Methods of Payment

- **Advance Payment**—The payment, which can be done with a bank transfer, is cleared before the goods are shipped.
- **Letters of Credit**—This method can be considered a guarantee more than a method of payment.
- **Documentary Collection**—This is a process developed to facilitate import and export operations.
- **Open Account**—This method of payment is highly risky because the goods are shipped before payment

Counter Trade

- Is a broad term that encompasses the **trading or exchange of goods or services without using currency**
- Practices can vary according to **local regulations and requirements**, to the **nature of the goods to be exported**, and to the **current priorities of the parties involved in the deal**.
- The **main advantages** given by counter trade are:
 - The potential to **capitalize excess capacity and transforming unproductive assets in profitable deals**, helping domestic industries to find new foreign markets.
 - The capacity to **stimulate trade between markets that are unable to pay for imports**; for example, because of lack of commercial credit or having a nonconvertible currency.

Discussion Questions

1. What are the factors influencing international pricing decisions? Take the example of a foreign brand that is marketed in your country: what local factors have to be taken into consideration when defining pricing decisions?
2. When you compare prices using the Internet, in what way do you use this information in your buying process?
3. Compare two similar products with a different price positioning (for example, two brands of jeans or motorcycles): what are the factors that affect value creation?
4. What are the advantages and disadvantages of using a cost- versus a market based approach?
5. When a company launches a new product abroad, what are the opportunities and risks of a skimming versus a penetration pricing policy?
6. In which sectors is gray marketing more frequent? Why? Give some examples.