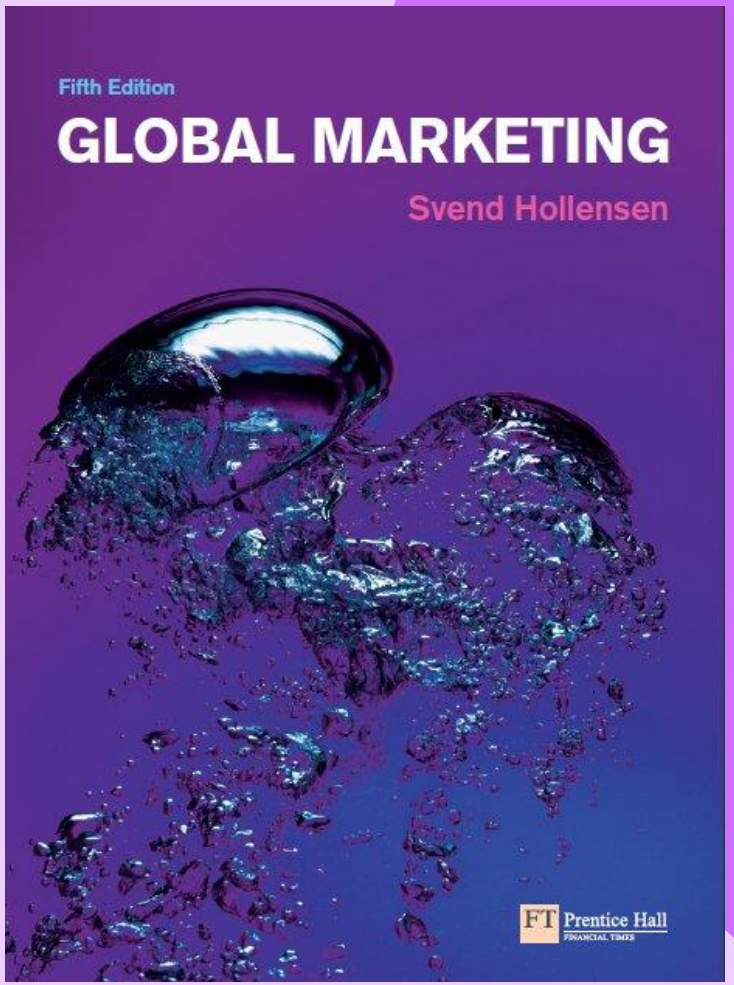


Svend Hollensen

GLOBAL MARKETING

5th Edition

Chapter 15 Pricing decisions and terms of doing business

Learning objectives (1)

- Explain how internal and external variables influence international pricing decisions
- Explain why and how prices escalate in export selling
- Discuss the strategic options in determining the price level for a new product
- Explain the necessary sales volume increase as a consequence of a price decrease

Learning objectives (2)

- Explain what is meant by experience curve pricing
- Explore the special roles and problems of transfer pricing in global marketing
- Discuss how varying currency conditions challenge the international marketer

Learning objectives (3)

- Identify and explain the different terms of sale (price quotations)
- Discuss the conditions that affect terms of payment
- Discuss the role of expert credit and financing for successful export marketing

Pricing

- Only area of global marketing mix where policy can be changed rapidly without large direct cost implications
- Decisions in global markets are affected by complexity of influential factors

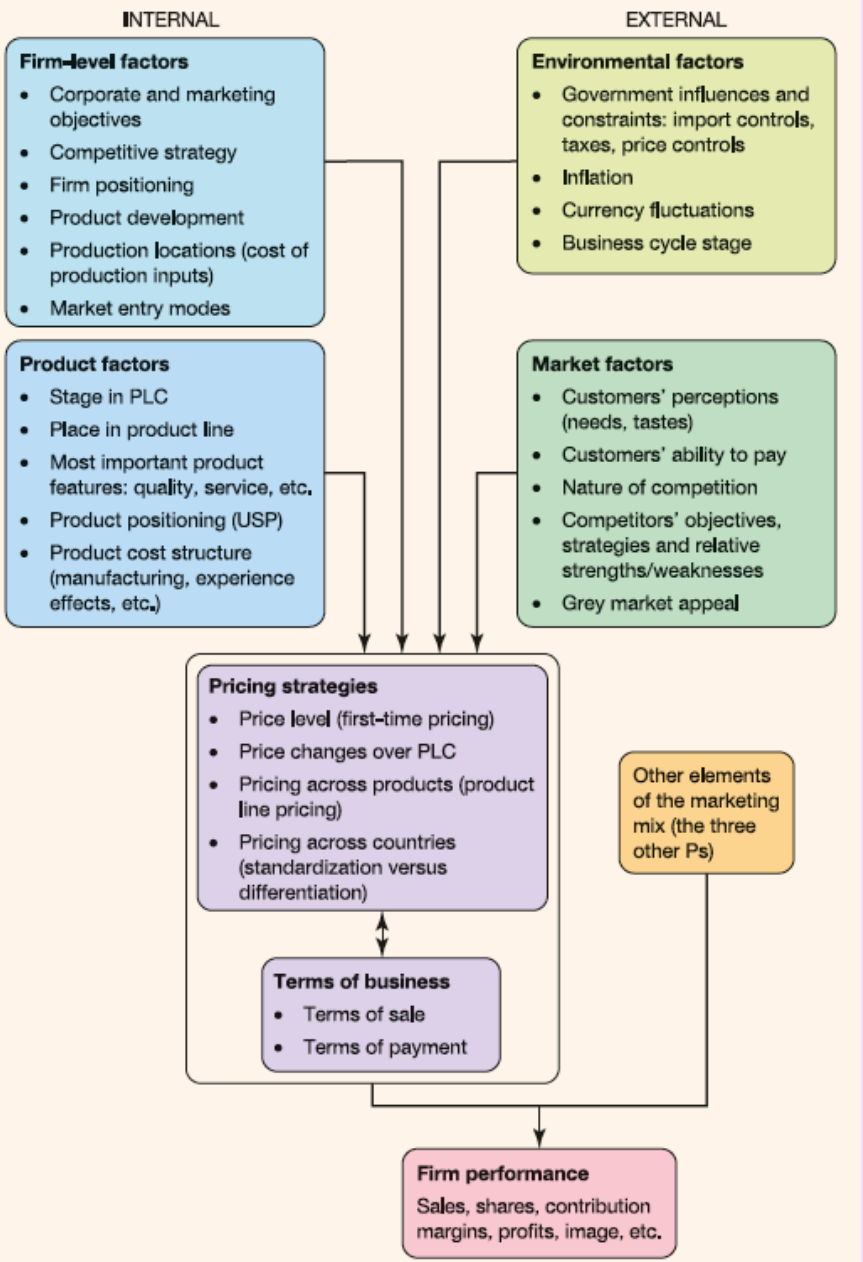


Figure 15.1 International pricing framework

Internal factors affecting international pricing decisions

Firm-level factors

- Corporate and marketing objectives
- Competitive strategy
- Firm positioning
- Product development
- Production location
- Market entry modes

Product factors

- Stage in PLC
- Place in product line
- Most important product features
- Product positioning
- Product cost structure

External factors affecting international pricing decisions

Environmental factors

- Government influences and constraints
- Inflation
- Currency fluctuations
- Business cycle stage

Market factors

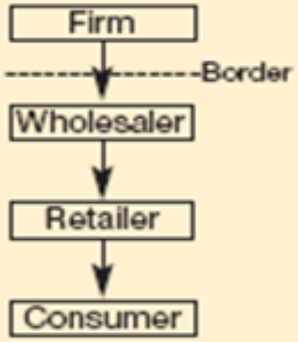
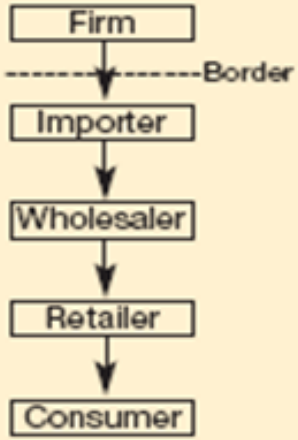
- Customers' perceptions
- Customers' ability to pay
- Nature of competition
- Competitors' objectives, strategies, strengths and weaknesses
- Grey market appeal

What is this?

What price-related phenomenon is caused by the summation of all cost factors in the distribution channel including ex-works price, shipping costs, tariffs and distributor mark-up?

Price escalation

Table 15.1 Examples of price escalation

	Domestic channel	Foreign marketing channel	
	(a)	(b)	(c)
			
	£	£	£
Firm's net price	100	100	100
Insurance and shipping costs	—	10	10
Landed cost	—	110	110
Tariff (10% of landed cost)	—	11	11
Importer pays (cost)	—	—	121
Importer's margin/mark-up (15% of cost)	—	—	18
Wholesaler pays (cost)	100	121	139
Wholesaler'/mark-up (20% of cost)	20	24	28
Retailer pays (cost)	120	145	167
Retail margin/mark-up (40% of cost)	48	58	67
Consumer pays (price) (exclusive of VAT)	168	203	234
% price escalation over domestic channel	—	21	39

Tactics for countering price escalation

- Rationalizing the distribution process
- Lowering the export price from the factory
- Establishing local production of the product
- Pressurizing channel members to accept lower profit margins

Figure 15.2 Strategies for pricing a new product

Factors influencing customer sensitivity to price (1)

- More distinctive product
- Greater perceived quality of products
- Consumers less aware of substitutes in the market
- Difficulty in making comparisons
- Proportion price represents of total expenditure of the customer

Factors influencing customer sensitivity to price (2)

- Perceived benefit for customer increases
- Product is used in association with a product bought previously, such that components and replacements are highly priced
- Costs are shared with other parties
- Product or service cannot be stored

What is this?

What price strategy involves charging a high price at the top end of the market with the objective of achieving the highest possible contribution in a short time?

Skimming

Problems with skimming

- Having a small market share makes the firm vulnerable to aggressive local competition
- Maintenance of a high-quality product requires a lot of resources
- If product is sold more cheaply at home or in another country grey marketing is likely

What is this?

What price strategy involves charging a final price based on competitive prices?

Market pricing

What is this?

What price strategy involves charging a low price with the objective of achieving the highest possible sales?

Penetration pricing

Motives for penetration pricing

- Intensive local competition
- Lower income levels of locals
- View of exporting as marginal activity

Price changes

Before price reduction

Per product	sales price	£100
	variable cost per unit	£80
	contribution margin	£20
Total contribution margin: 100 units @ £20 =		£2,000

After price reduction (5 per cent)

Per product	sales price	£95
	variable cost per unit	£80
	contribution margin	£15
Total contribution margin: 133 units @ £15 =		£1,995

As a consequence of a price reduction of 5 per cent, a 33 per cent increase in sales is required.

Table 15.2 Sales volume increase or decrease (%) required to maintain total profit contribution

Price reduction (%)	Profit contribution margin (price – variable cost per unit as % of the price)								
	5	10	15	20	25	30	35	40	50
	Sales volume increase (%) required to maintain total profit contribution								
2.0	67	25	15	11	9	7	7	5	4
3.0	150	43	25	18	14	11	9	8	6
4.0	400	67	36	25	19	15	13	11	9
5.0		100	50	**33**	25	20	17	14	11
7.5		300	100	60	43	33	27	23	18
10.0			200	100	67	50	40	33	25
15.0				300	150	100	75	60	43

Price increase (%)	Profit contribution margin (price – variable cost per unit as % of the price)								
	5	10	15	20	25	30	35	40	50
	Maximum sales volume reduction (%) required to maintain total profit contribution								
2.0	29	17	12	9	7	6	5	5	4
3.0	37	23	17	13	11	9	8	7	6
4.0	44	29	21	17	14	12	10	9	7
5.0	50	33	25	20	17	14	12	11	9
7.5	60	43	33	27	23	20	18	16	13
10.0	67	50	40	33	29	25	22	20	17
15.0	75	60	50	43	37	33	30	27	23

What is this?

What price changes are based on the idea that total unit costs of a product in real terms can be reduced by a certain percentage with each doubling of cumulative production?

Experience curve pricing

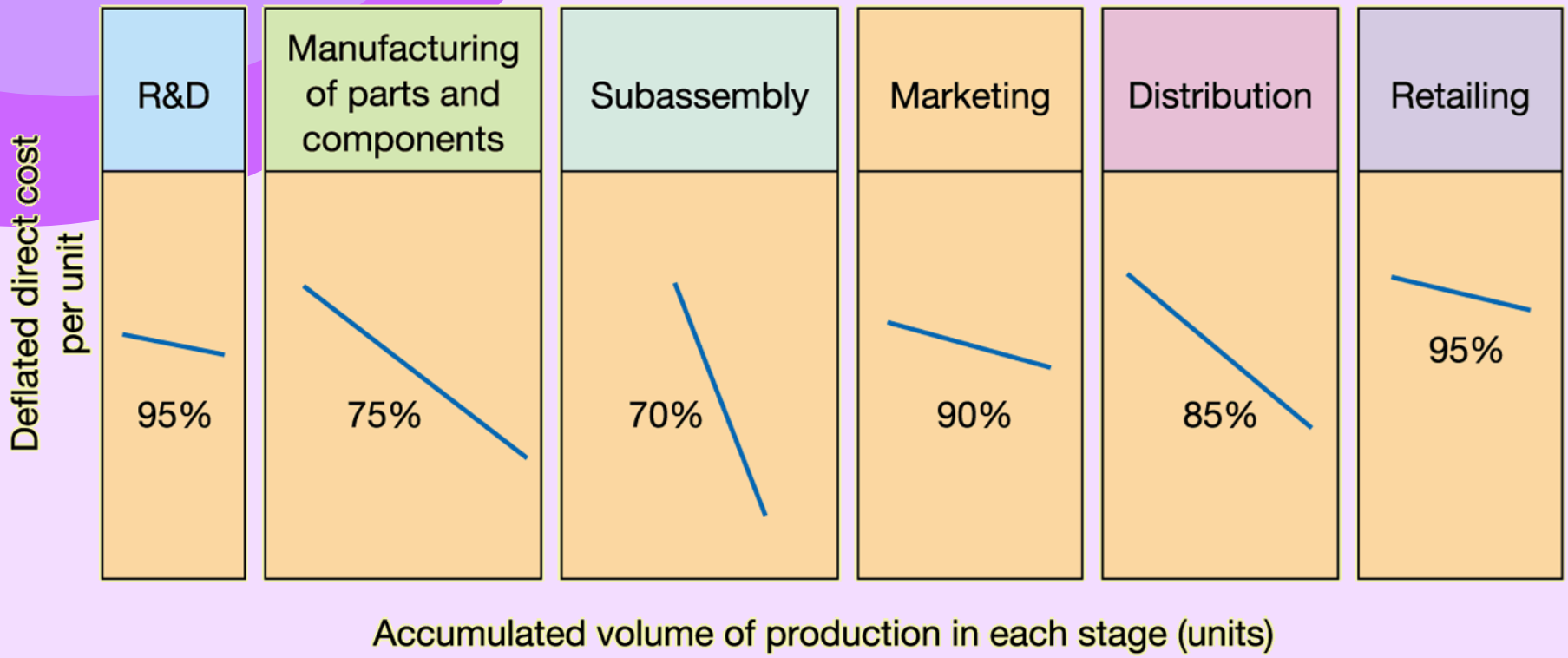


Figure 15.3 Experience curves of value chain activities

Source: Hax, Arnoldo C.; Majluf, Nicholas S., *Strategic Management: An Integrative Perspective, 1st*, © 1984. Electronically reproduced by permission of Pearson Education, Inc., Upper Saddle River, New Jersey

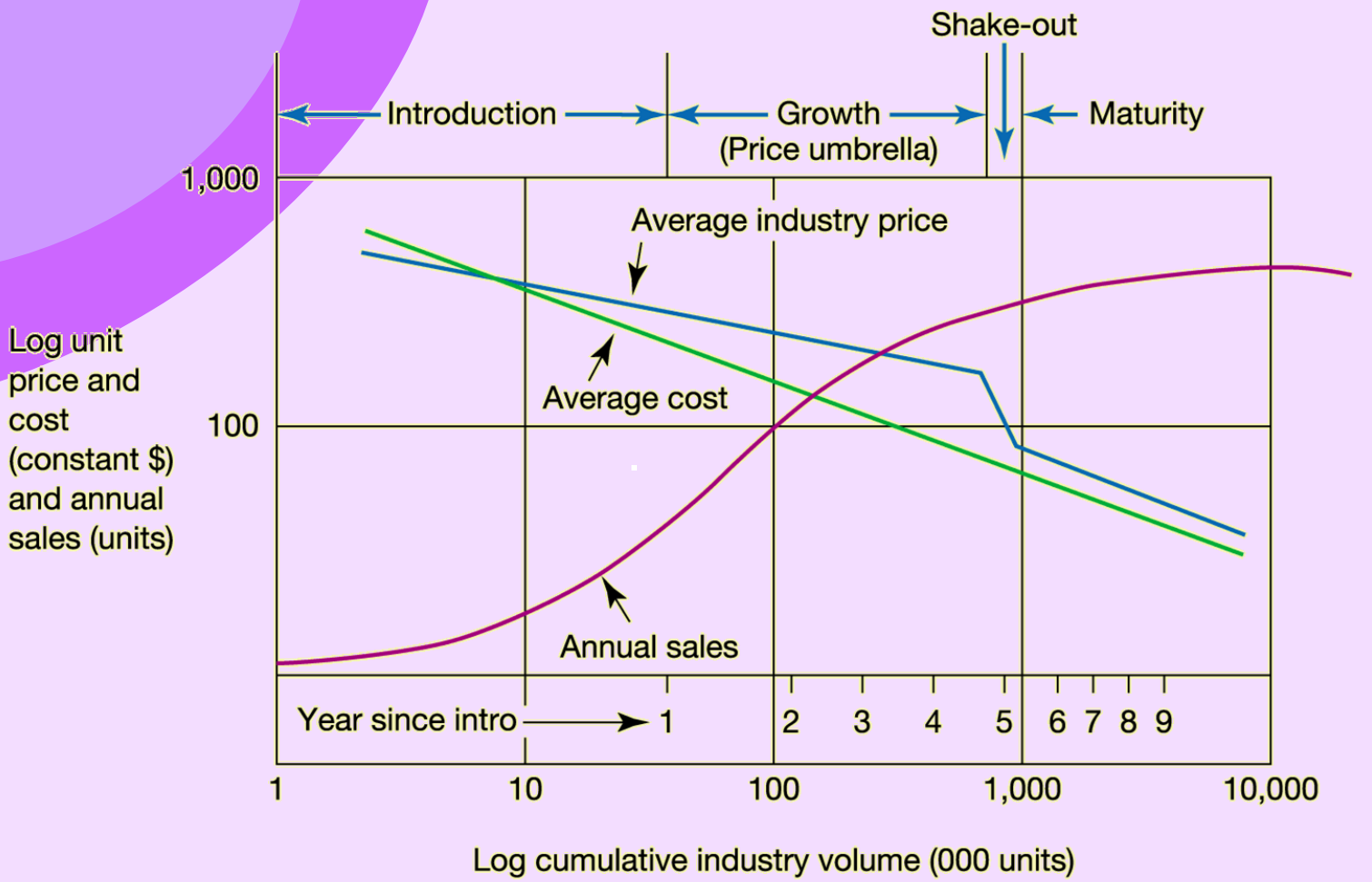


Figure 15.4 Product life cycle stages and the industry price experience curve

Source: Kotler, Philip, *Marketing Management: Analysis, Planning, Implementation and Control, 7th*, © 1991. Electronically reproduced by permission of Pearson Education, Inc., Upper Saddle River, New Jersey

EXHIBIT 15.1 The Gillette price premium strategy

An incrementally innovative new product can enable a firm to command a higher price as well as realize higher margins than the product it replaces in the marketplace. For example, in 1971 the Gillette Safety Razor Company (acquired by Procter & Gamble in 2005) introduced the Gillette Trac II brand, a razor with two blades fitted in a shaving cartridge. In 2006, it introduced the Gillette Fusion brand, fitted with five blades in a cartridge for shaving plus a sixth blade for trimming. The history of the price per replacement cartridge for Gillette brand razors, spanning the 35-year period from 1971 to 2006, summarized in Table 1, is instructive in this regard.

Table 1 Gillette's price per replacement cartridge (2006 prices, adjusted for inflation)

Gillette product version	Price per replacement cartridge (2006 prices)
Gillette II (1971, two-bladed cartridge) 'Two blades are better than one'	$1.00
Gillette Sensor (1990, spring-mounted blades), 'Can sense and adjust to the contours of your face'	$1.22
Gillette Mach3 (1998, three blades), 'You take one stroke, it takes three'	$2.02
Gillette Fusion (2006, five blades plus a trimmer), 'The comfort of five blades, the precision of one'	$3.00

The price per replacement cartridge adjusted for inflation has increased by 200 per cent.

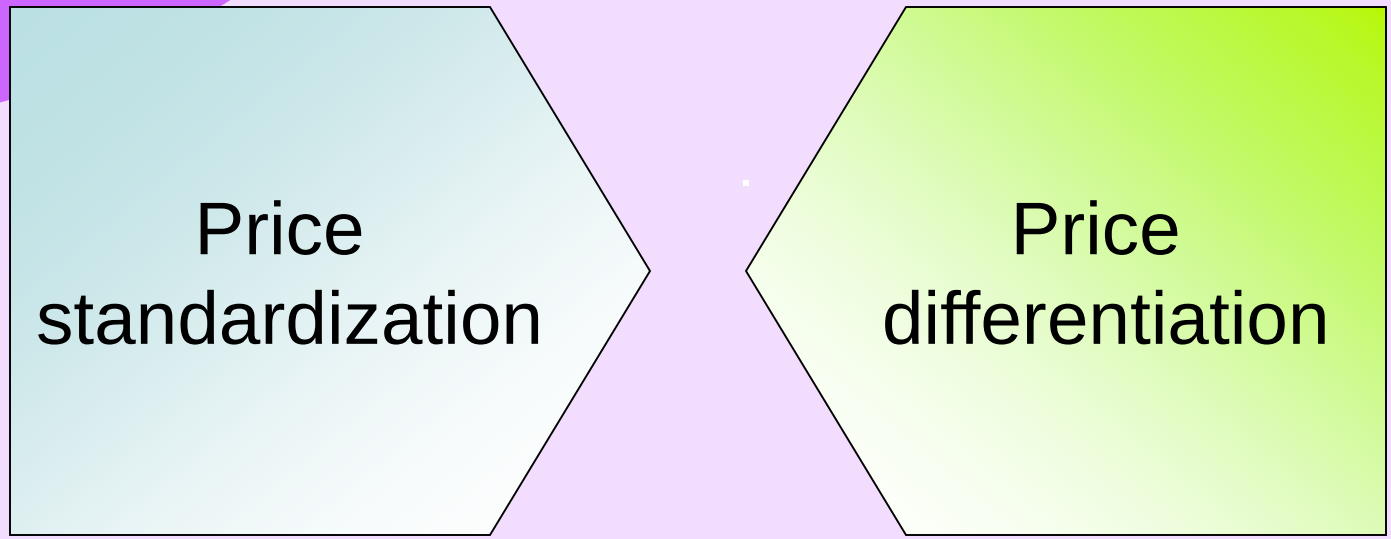
Source: based on Varadarajan (2009).

What is this?

What price strategy is based on grouping products and services in a system-solution product in order to overcome possible customer price concerns?

Bundle pricing

Basic approaches to pricing across countries



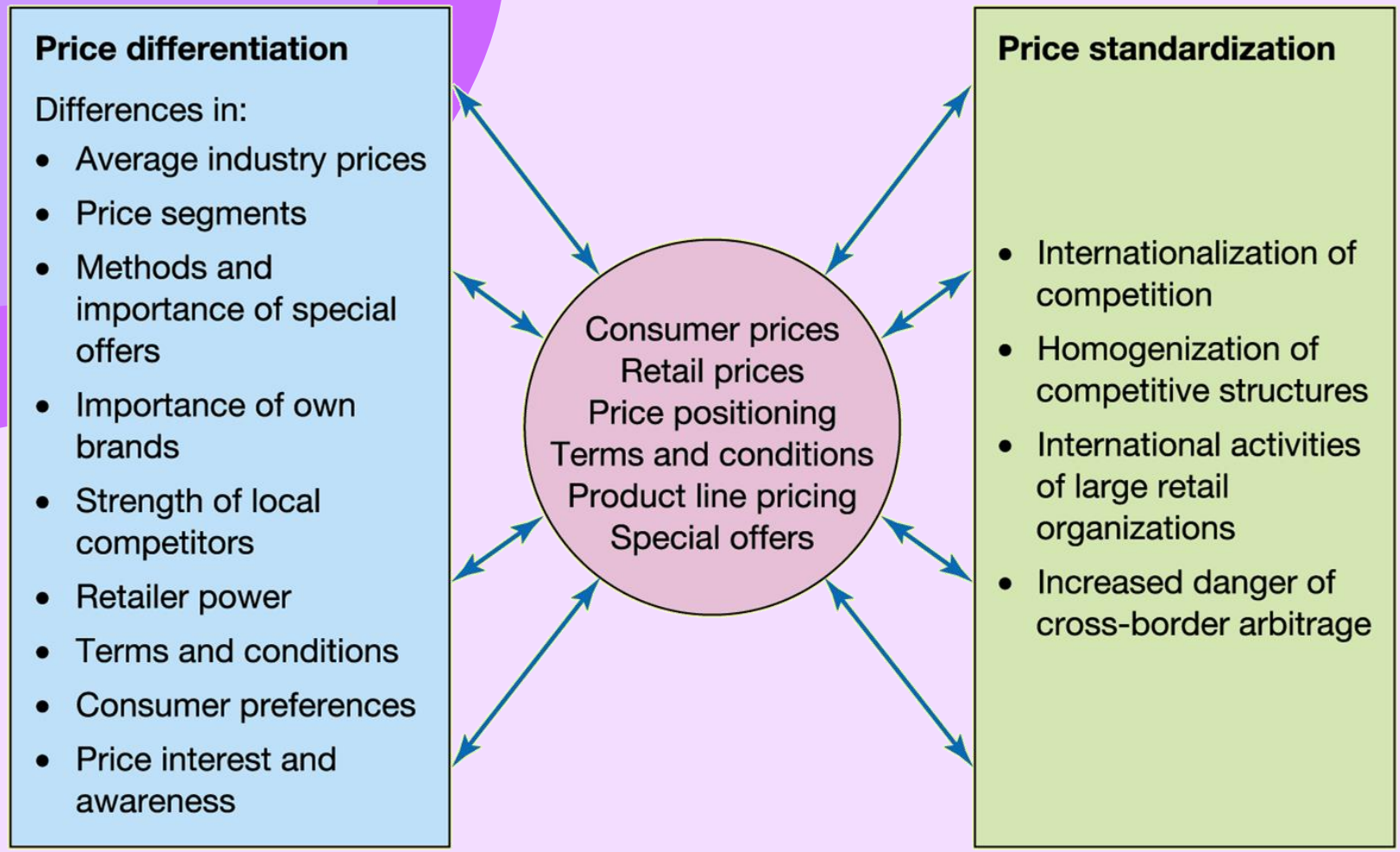


Figure 15.5 Structural factors of standardized versus differentiated pricing in European consumer goods markets

Source: reprinted from *European Management Journal*, vol. 12, no. 2, Diller, H. and Bukhari, I. (1994) 'Pricing conditions in the European Common Market', p. 168, Copyright 1994, with permission from Elsevier

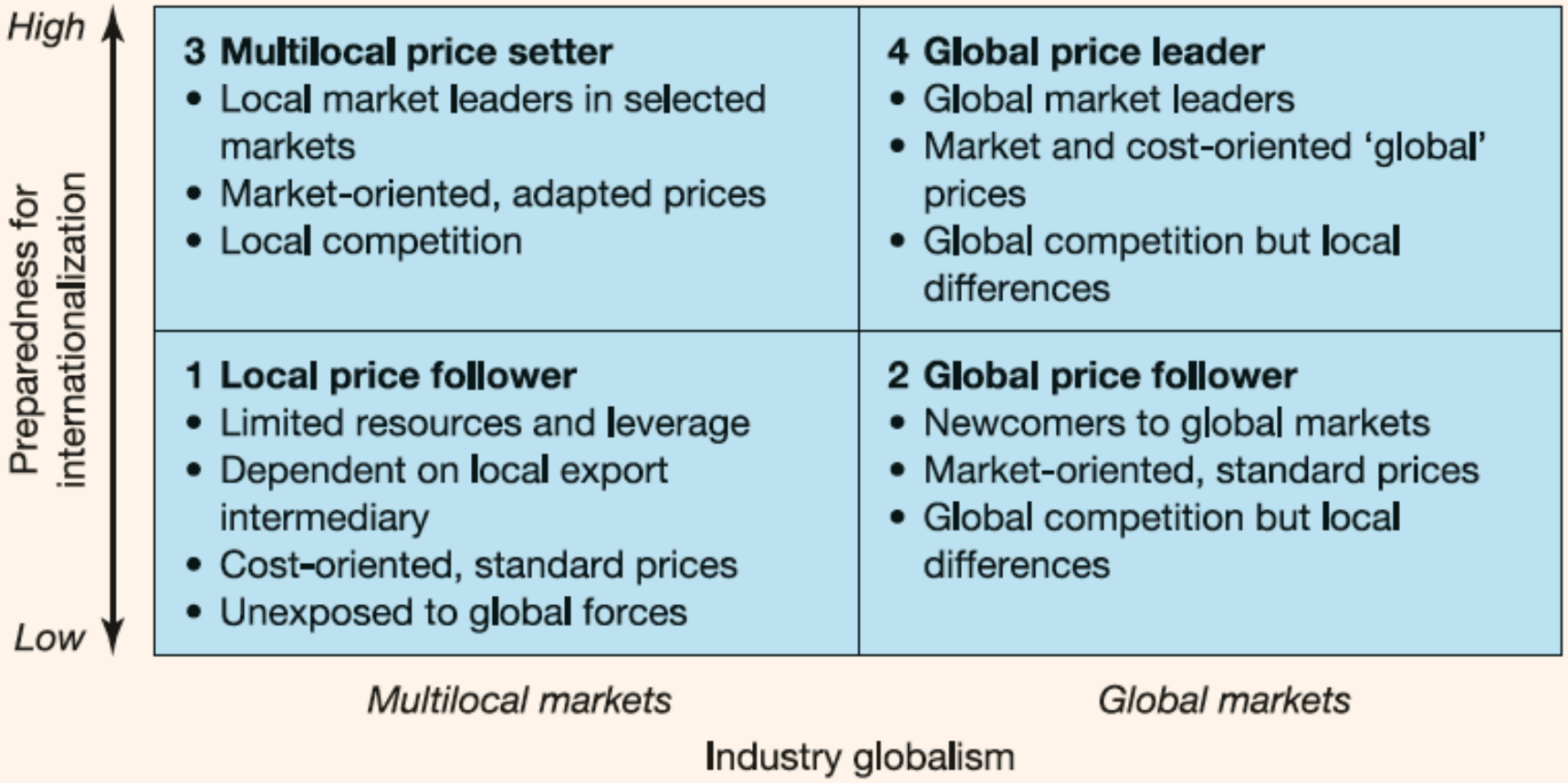


Figure 15.6 A taxonomy of international pricing practices

Source: adapted from Solberg *et al.* (2006, p. 31). In the original article Solberg has used the concept 'globality' rather than 'globalism'

What is this?

When a customer requires one global price per product from the supplier for all its foreign SBUs and subsidiaries, a _____ has been requested.

Global pricing contract

Customer advantages and disadvantages of GPCs

Advantages

- Lower prices worldwide
- Higher levels of service
- Standardization of products
- Efficiency of processes
- Faster diffusion of innovations

Disadvantages

- Less adaptability to market changes
- Potential for quality inconsistencies
- Dependence upon supplier could result in higher prices
- Resistance to GPCs among local managers
- Monitoring costs

Source: adapted from Narayandas, Quelch and Swartz, 2000, pp. 61–70.

Supplier advantages and disadvantages of GPCs

Advantages

- Access to new markets
- Economies of scale
- Influence over market development through association with industry leaders
- Strong relationships developed
- Solve price and service anomalies across countries

Disadvantages

- Resistance to change
- Loss of customers
- Risk of failing to deliver on promises
- Inappropriate use of cost information
- Over dependence on one customer
- Conflict in distribution channels

Source: adapted from Narayandas, Quelch and Swartz, 2000, pp. 61–70.

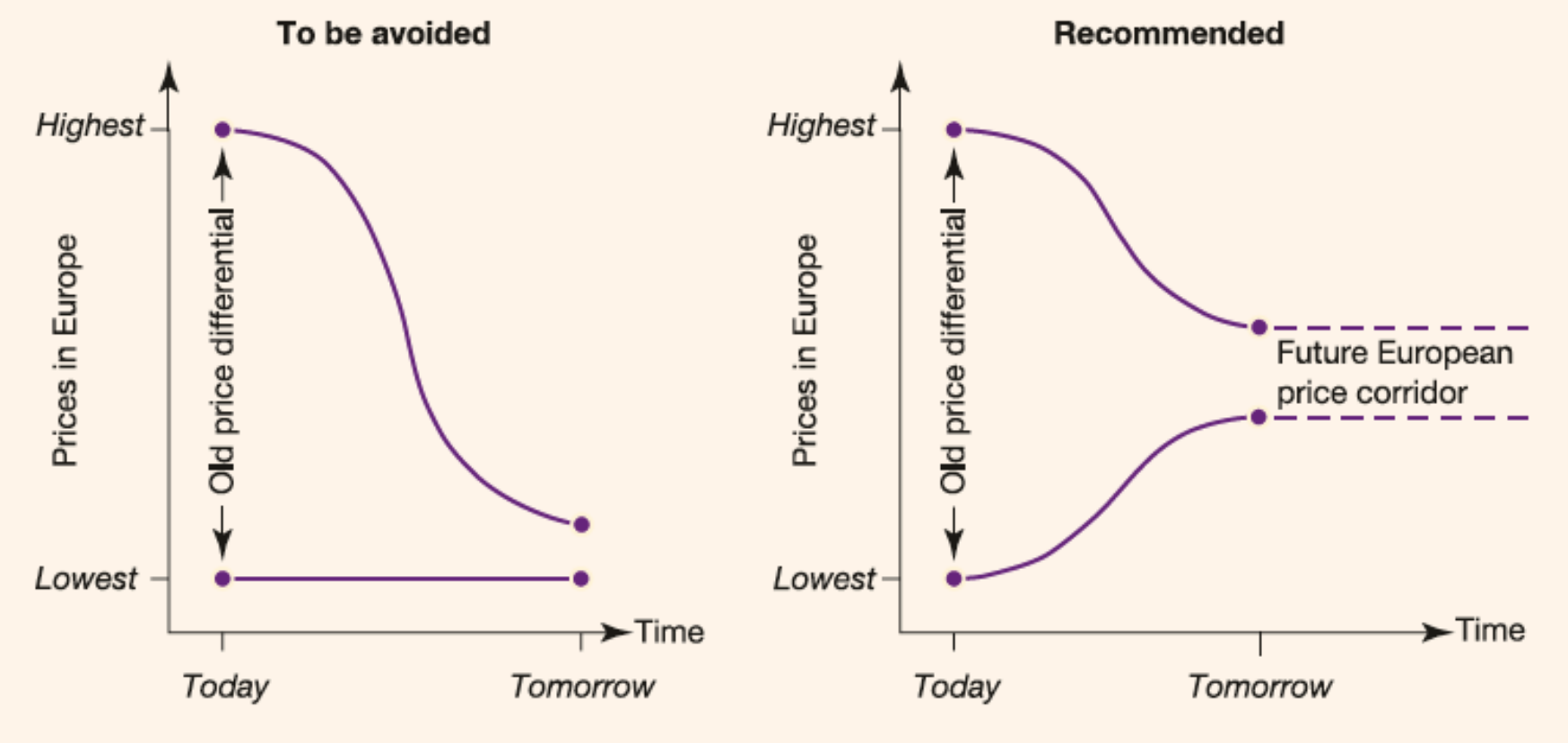


Figure 15.7 Development of prices in Europe

Source: Simon and Kucher (1993, p. 26). Copyright ESOMAR

What is this?

What term is used to describe the prices charged for intracompany movement of goods and services?

Transfer pricing

Table 15.4 Tax effect of low versus high transfer price on net income (US$)

	Manufacturing affiliate (division)	Distribution/selling affiliate (subsidiary)	Consolidated company total
Low mark-up policy			
Sales	1,400	2,000	2,000
Less cost of goods sold	1,000	1,400	1,000
Gross profit	400	600	1,000
Less operating expenses	100	100	200
Taxable income	300	500	800
Less income taxes (25%/50%)	75	250	325
Net income	225	250	475
High mark-up policy			
Sales	1,700	2,000	2,000
Less cost of goods sold	1,000	1,700	1,000
Gross profit	700	300	1,000
Less operating expenses	100	100	200
Taxable income	600	200	800
Less income taxes (25%/50%)	150	100	250
Net income	450	100	550

Note: Manufacturing affiliate pays income taxes at 25%. Distribution affiliate pays income taxes at 50%.
Source: based on Eiteman and Stonehill (1986).

Approaches to transfer pricing

- Transfer at cost
- Transfer at arm's length
- Transfer at cost plus

Currency decisions in export pricing

- Quote price in foreign currency of buyer's country
- Quote price in currency of exporter's country
- Quote price in currency of a third country
- Quote price in currency unit (euro)

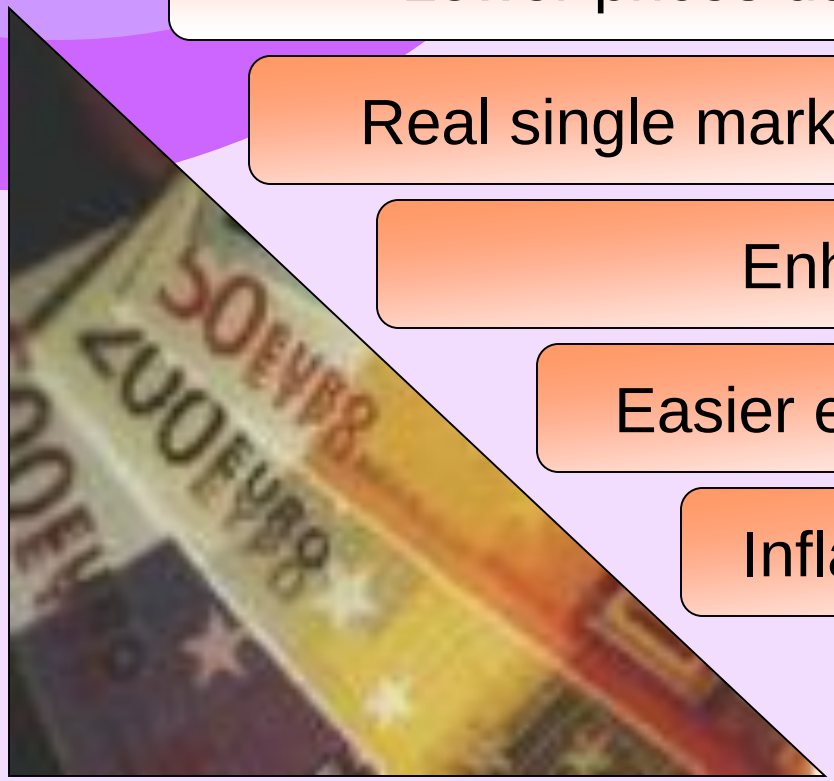
Benefits to quoting price in buyer's country currency

- Quoting in foreign currency could be a condition of the contract
- Access to finance abroad at lower interest rates
- Good currency management may be a means of gaining additional profits
- Customer preference for quotes in their currency

The ‘Eurozone’

The euro is the currency of 16 European Union member states: Belgium, Germany, Greece, Spain, France, Ireland, Italy, Luxembourg, the Netherlands, Austria, Portugal, Finland, Slovenia, Cyprus, Malta and Slovakia. These countries comprise the ‘Eurozone’, with some 326 million people.

Euro (€) implications



- Lower prices due to price transparency
- Real single market without transaction costs
- Enhanced competition
- Easier entry to foreign markets in EU
- Inflation and interest rate stability
- Lower costs of doing business

Incoterms 2000

The 13 terms contained in *Incoterms 2000* are:

EXW	*Ex-works* (. . . named place)
FCA	*Free carrier* (. . . named place)
FAS	*Free alongside ship* (. . . named port of shipment)
FOB	*Free on board* (. . . named port of shipment)
CFR	*Cost and freight* (. . . named port of destination)
CIF	*Cost, insurance and freight* (. . . named port of destination)
CPT	*Carriage paid to* (. . . named place of destination)
CIP	*Carriage and insurance paid to* (. . . named place of destination)
DAF	*Delivered at frontier* (. . . named place)
DES	*Delivered ex-ship* (. . . named port of destination)
DEQ	*Delivered ex-quay* (. . . named port of destination)
DDU	*Delivered duty unpaid* (. . . named place of destination)
DDP	*Delivered duty paid* (. . . named place of destination)

Table 15.5 Point of delivery and where risk shifts from seller to buyer

	EXW	FAS	FOB	CFR	CIF	DEQ	DDP
Supplier's factory/warehouse	×						
Dock at port of shipment (export dock)		×					
Port of shipment (on board vessel)			×	×	×		
Port of destination (import dock)					×*	×	
Buyer's warehouse (destination)							×
Main transit risk on	Buyer	Buyer	Buyer	Buyer	Seller	Seller	Seller

* The seller transfers the risk to its insurance company.

Source: adapted from Onkvisit and Shaw (1993, p. 799). Courtesy of Sak Onkvisit.

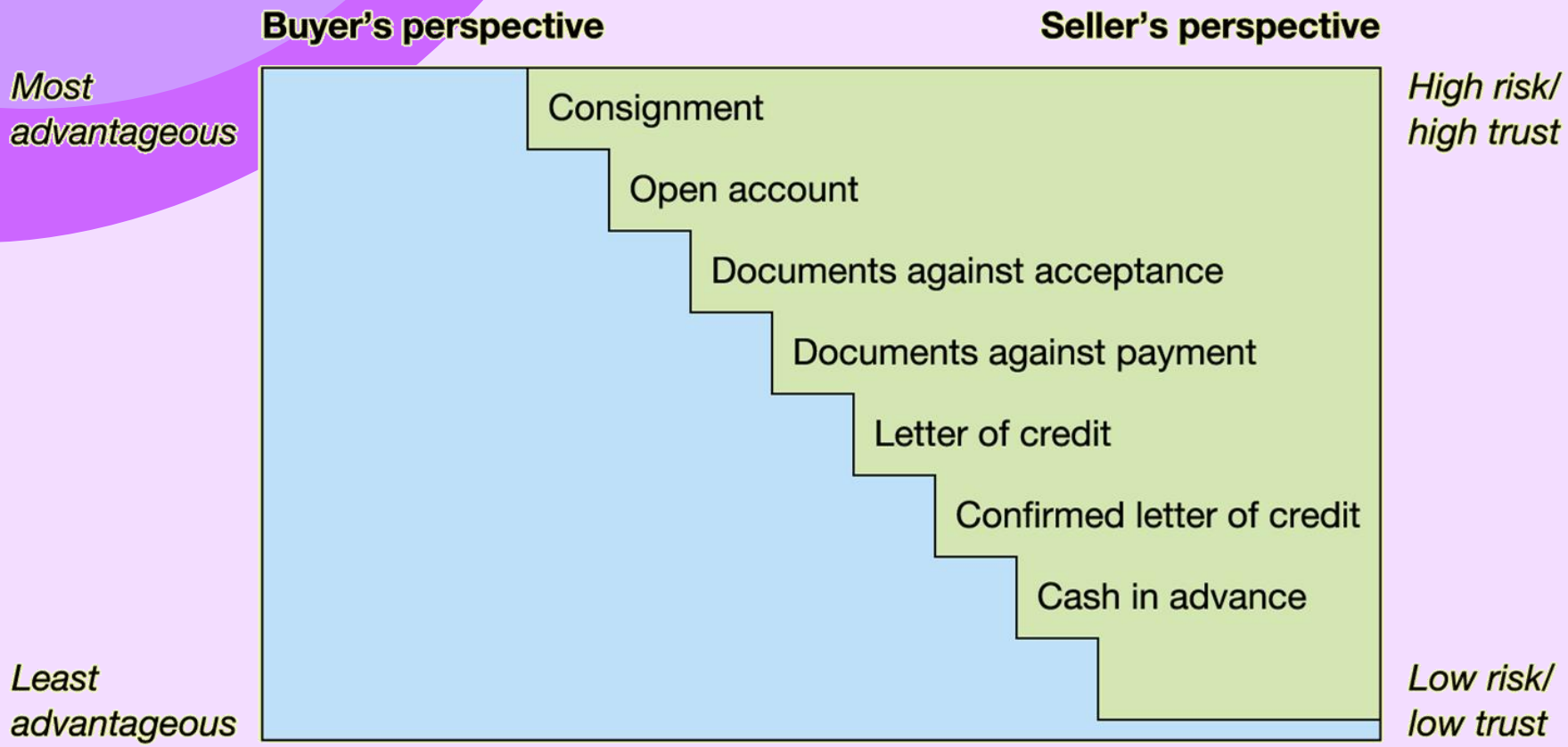


Figure 15.8 Different terms of payment

Source: Chase Manhattan Bank (1984, p. 5)

Characteristics of letters of credit

- An arrangement by banks for settling international commercial transactions
- Provide a form of security for parties involved
- Ensure payment, provided that terms and conditions of credit have been fulfilled
- Payment based on documents only and not on merchandize or services involved

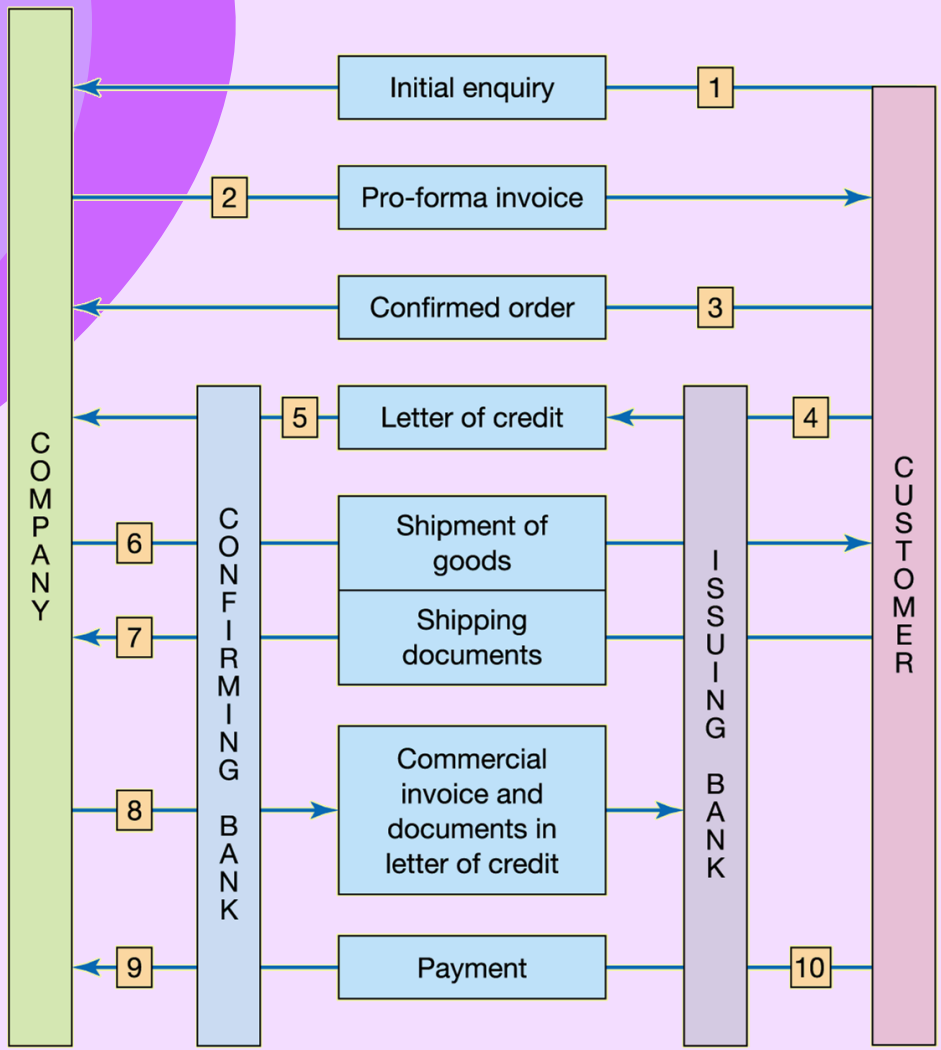


Figure 15.9 The process for handling letters of credit

Source: Phillips *et al.* (1994, p. 454). With permission from Cengage Learning

Letter of credit forms

- Revocable L/C
- Irrevocable but unconfirmed L/C
- Confirmed irrevocable L/C

Export financing

- Commercial banks
- Export credit insurance
- Factoring
- Forfeiting
- Bonding

- Leasing
- Counter-trade
  - Barter
  - Compensation deal
  - Buy-back agreement

CASE STUDY 15.1

Harley-Davidson: does the image justify the price level?

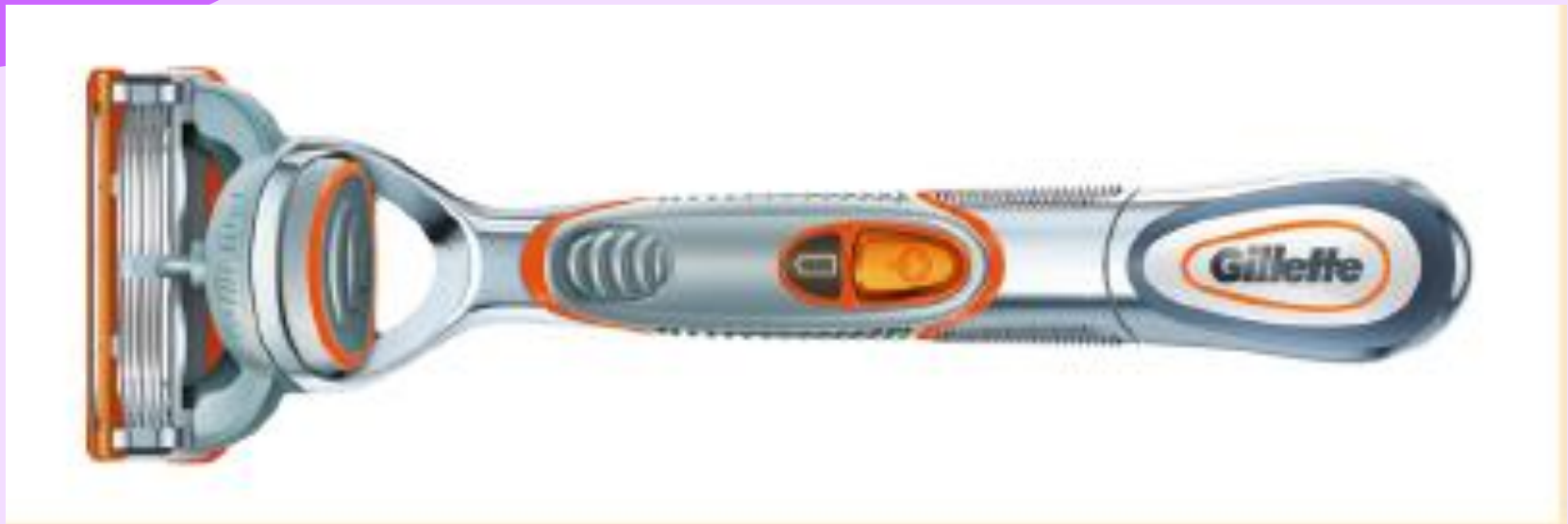
Ann Heisenfelt/AP/EMPICS.

QUESTIONS

1. Describe HD's general pricing strategy. What does the company's positioning have to do with its pricing strategy?
2. Should Harley alter its price, given strong price pressures from rivals?
3. What should HD do to improve its market share in Europe?

CASE STUDY 15.2

Gillette Co.: is price standardization possible for razor blades?



Gillette: courtesy of Procter & Gamble UK.

QUESTIONS

1. Evaluate the price level of Gillette's Fusion.
2. Discuss whether it is possible for Gillette to standardize pricing across borders for its new five-blade, Fusion. Which factors would favour price standardization and which factors would favour price differentiation?

VIDEO CASE STUDY 15.3 Vaseline pricing strategy

download from www.pearsoned.co.uk/hollensen

Courtesy of Unilever Danmark A/S

Table 1 Vaseline pricing: pure petroleum jelly versus Lip Therapy

Vaseline product	List price in United States (US$)	Price per ounce of jelly (US$)
Vaseline Pure Petroleum Jelly (13 ounces in a plastic jar)	2.99	0.23 per ounce of jelly
Vaseline Lip Therapy (0.35-ounce in a tube)	1.99	5.69 per ounce of jelly

Source: based on various sources

Questions

Watch the following YouTube videos:

http://www.youtube.com/watch?v=yptlLH36Mkw&feature=related (old commercial – all-purpose Vaseline)
http://www.youtube.com/watch?v=_V9hDR8XDDw&feature=related (Corporate Vaseline commercial)
http://www.youtube.com/watch?v=B4bqv1eVHXs&feature=related (Vaseline Intensive Care Lotion – the Phillippines)

1. If you were a representative of the Vaseline (Unilever) management, how would you justify the price difference? What extra customer value do you create by selling the jelly as Lip Therapy in small tubes?
2. How would you price the Vaseline Intensive care lotion in the Phillippines compared to UK?

Questions for discussion (1)

- What are the major causes of international price escalation? Suggest possible courses of action to deal with this problem
- Explain how exchange rate and inflation affect the way you price your product
- In order to protect themselves, how should marketers price their product in a country with high inflation?

Questions for discussion (2)

- International buyers and sellers of technology frequently disagree on the appropriate price for knowledge. Why?
- What methods can be used to compute a transfer price (for transactions between affiliated companies)?
- What relevance has the international product life cycle theory for pricing strategy in international firms?

Questions for discussion (3)

- Why is it often difficult to compute fair arm's-length transfer prices?
- Explain these terms of sale: EXW, FAS, FOB, CFR, CIF, DEQ and DDP. Which factors will determine the terms of sale?
- Explain these types of letter of credit: revocable/ irrevocable, confirmed/unconfirmed. Under what sets of circumstances would exporters use the following methods of payment:
  (a) revocable letter of credit;
  (b) confirmed letter of credit;
  (c) confirmed irrevocable letter of credit;
  (d) time draft (i.e. bill of exchange)?

Questions for discussion (4)

- Name some of the financing sources for exporters.
- How does inflation affect a country's currency value? Is it a good idea to borrow or obtain finance in a country with high inflation?
- How and why are export credit financing terms and conditions relevant to international pricing?
- What is counter-trade? Why should firms be willing to consider counter-trade arrangements in their global marketing efforts?