Pricing Decisions

Chapter 11

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Introduction to Pricing Issues

- Law of one price
- Price floors, ceilings
- Optimum prices
- Target costing
- Price escalation
- Environmental issues
- Gray market goods
- Dumping
- Price fixing
- Transfer pricing
- Countertrade

Basic Pricing Concepts

- International trade results in lower prices for goods
- Lower prices, in turn, help keep a country's rate of inflation in check. In a true global market, the **law of one price** would prevail: All customers in the market could get the best product available for the best price.
- Because of differences in national markets, the global marketer must develop pricing systems and pricing policies that take into account **price floors, price ceilings, and optimum prices**
- Within the typical corporation, there are many interest groups and conflicting price objectives. A firm's pricing system and policies must also be consistent with other uniquely global opportunities and constraints

Basic Pricing Concepts

- ***Law of One Price***

  international trade results in lower prices for goods
  - All customers in the market get the best product for the best price
- Global markets
  - Diamonds
  - Crude oil
  - Commercial aircraft
  - Integrated circuits

Pricing decisions are a critical element of the marketing mix that must reflect
- Costs
- Competitive factors
- Customer perception regarding Value of the product
- Regulation

Heineken's price in Japan is a function of competition with other imports and the national producers.

Global Pricing Objectives and Strategies

- Whether dealing with a single home country market or multiple country markets, marketing manages must develop pricing objectives as well as strategies for achieving those objectives.
- The pricing strategy for a particular product may vary from country to country; a product may be positioned as a low-priced, mass-market product in some countries and a premium-priced, niche product in others.
- Pricing objectives may also vary depending on a product's life-cycle stage and the country-specific competitive situation.
- It is necessary to factor in external considerations such as the added cost associated with shipping goods long distances across national boundaries. The issue of global pricing can also be fully integrated in the product-design process, an approach widely used by Japanese companies.

Market Skimming and Financial Objectives

- The **market skimming** pricing strategy is often part of a deliberate attempt to reach a market segment that is willing to pay a premium price for a particular brand or for a specialized or unique product.
- Companies that seek competitive advantage by pursuing differentiation strategies or positioning their products in the premium segment frequently use market skimming.
- The skimming pricing strategy is appropriate in the **introductory** phase of the product life cycle when both production capacity and competition are limited. By setting a deliberately high price, demand is limited to innovators and early adopters who are willing and able to pay the price. This strategy has been used consistently in the consumer electronics industry

Global Pricing Objectives and Strategies

- 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

1979 Sony Walkman

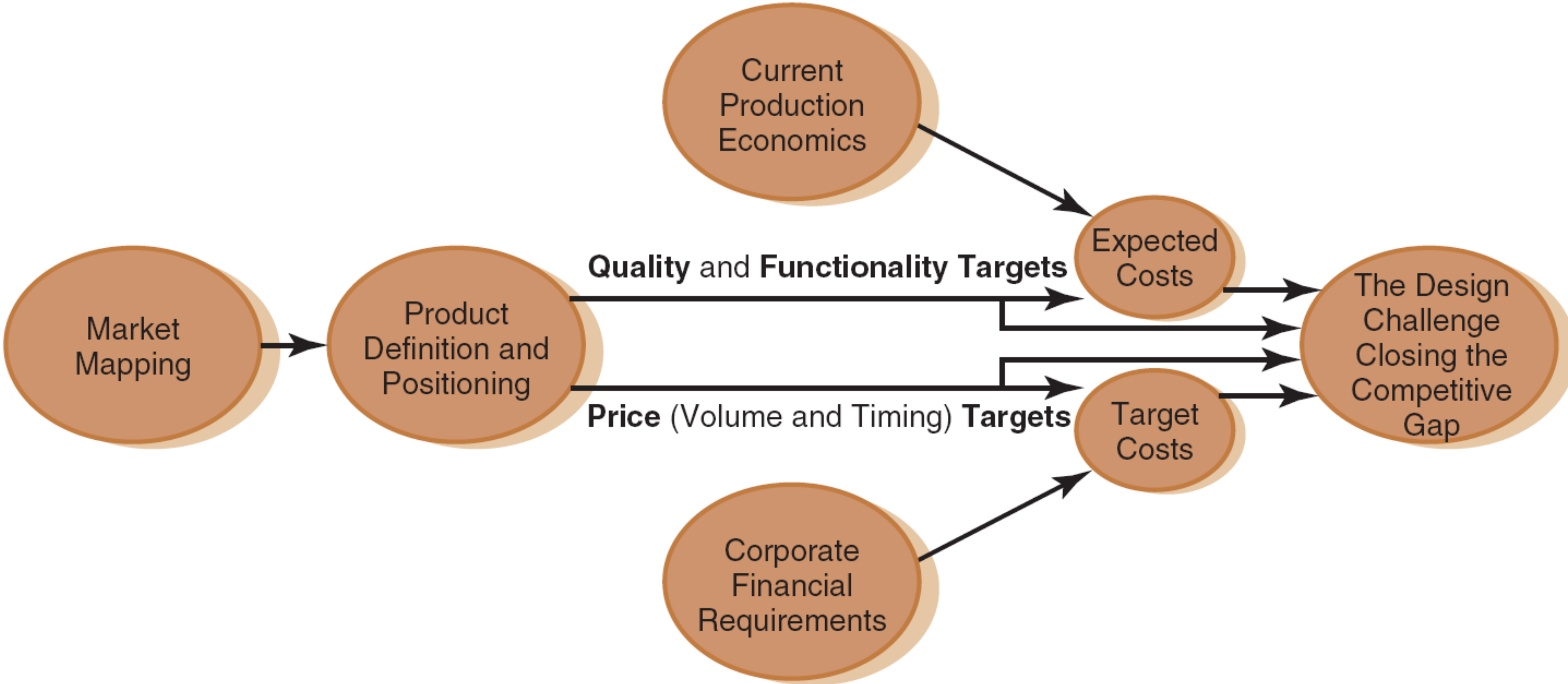
- Penetration Pricing
  - Charging a low price in order to penetrate market quickly
  - Appropriate to saturate market prior to imitation by competitors
- Packaged food product makers, with products that do not merit patents, may use this strategy to get market saturation before competitors copy the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

X-Box Game System and Sports Game

The Target-Costing Process



Export Price Escalation

TABLE 11-3 An American-Built Jeep Grand Cherokee Goes to Japan (estimates)

Item	Amount of Price Escalation	Total
Ex-works price	0	$30,000
Exchange rate adj.	$2,100	$32,100
Shipping	$ 300	$32,400
Customs fees	$1,000	$33,400
Distributor margin	$3,700	$37,100
Inspection, accessories	$1,700	$38,800
Added options, prep	$3,000	$41,800
Final sticker price	$8,200	$50,000

Pricing Goods for Cross Border Shipment

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?

Target Costing

- 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

Target Costing

- *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

Terms of the Sale

- 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

Chilean Customs House

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

- 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

U.S. Dollar vs. Japanese Yen

January 2000	January 2002	January 2007	January 2010
\$1=¥101	\$1=¥130	\$1=¥113	\$1=¥91

Currency Fluctuations

TABLE 11-4 Global Pricing Strategies

When Domestic Currency Is Weak	When Domestic Currency Is Strong
1. Stress price benefits.	1. Engage in nonprice competition by improving quality, delivery, and after-sale service.
2. Expand product line and add more costly features.	2. Improve productivity and engage in cost reduction.
3. Shift sourcing to domestic market.	3. Shift sourcing outside home country.
4. Exploit market opportunities in all markets.	4. Give priority to exports to countries with stronger currencies.
5. Use full-costing approach, but employ marginal-cost pricing to penetrate new or competitive markets.	5. Trim profit margins and use marginal-cost pricing.
6. Speed repatriation of foreign-earned income and collections.	6. Keep the foreign-earned income in host country; slow down collections.
7. Minimize expenditures in local (host-country) currency.	7. Maximize expenditures in local (host-country) currency.
8. Buy advertising, insurance, transportation, and other services in domestic market.	8. Buy needed services abroad and pay for them in local currencies.
9. Bill foreign customers in their own currency.	9. Bill foreign customers in the domestic currency.

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

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

Mercedes moved beyond ethnocentric pricing when Toyota began offering Lexus—Mercedes value at $20k less. In 1993, Mercedes boosted employee productivity, increased low-cost suppliers and invested in production facilities in the U.S. to move to better pricing.

Extension

- 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 Vice President for Global Sales, Marketing, and Service

Adaptation or Polycentric

- Permits affiliate managers or independent distributors to establish price as they feel is most desirable in their circumstances

AIDS drugs meant for Africa are smuggled into Europe

- Sensitive to market conditions but creates potential for gray marketing

Geocentric

- 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

Selling drugs out of date leads to lawsuits.

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
- To prove, both price discrimination and injury must be shown

Dumping

- In 2003, the Southern Shrimp Alliance protested that six countries were dumping shrimp in the U.S.
- The International Trade Commission agreed and allowed the U.S. Dept. of Commerce to raise duty rates on shrimp from India, China, Brazil, Vietnam, Ecuador, and Thailand.

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 competitor within an industry that make and market the same product conspire to keep prices high
- Vertical price fixing occurs when a manufacture 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

Barter

- The least complex and oldest form of bilateral, non-monetary countertrade
- A direct exchange of goods or services between two parties