CHAPTER 11

PRICING DECISIONS

SUMMARY

A. Pricing decisions are a critical element of the marketing mix that must reflect costs, competitive factors, and customer perceptions regarding value of the product. In a true global market, the **law of one price** would prevail. Pricing strategies include **market skimming**, **market penetration**, and **market holding**. Novice exporters frequently use **cost-plus pricing**. International terms of a sale such as **ex-works**, **DDP, FCA**, **FAS**, **CFR, FOB**, and **CIF** are known as **Incoterms** and specify which party to a transaction is responsible for covering various costs. These and other costs lead to **export price escalation**, the accumulation of costs that occurs when products are shipped from one country to another.

B. Expectations regarding currency fluctuations, inflation, government controls, and the competitive situation must also be factored into pricing decisions. The introduction of the euro has impacted price strategies in the European Union because of the improved **price transparency** it supports**.** Global companies can maintain competitive prices in world markets by shifting production sources as business conditions change. Overall, a company's pricing policies can be categorized as **ethnocentric**, **polycentric**, or **geocentric**.

C. Several other pricing issues must be taken into account in global marketing. The possibility of **gray market goods** arises because price variations between different countries lead to **parallel imports. Dumping** is another contentious issue that can result in strained relations between trading partners. **Price fixing** among companies is anticompetitive and illegal.

D. **Transfer pricing** is an issue because of the sheer monetary volume of intracorporate sales and because country governments are anxious to generate as much tax revenue as possible. Various forms of **countertrade** play an important role in today's global environment. **Barter**, **counterpurchase**, **offset**, **compensation trading**, and **switch trading** are the main countertrade options.

LEARNING OBJECTIVES

11-1 Review the basic pricing concepts that underlie a successful global marketing pricing strategy.

11-2 Identify the different pricing strategies and objectives that influence decisions about pricing products in global markets.

11-3 Summarize the various Incoterms that affect the final price of a product.

11-4 List some of the environmental influences that impact prices.

11-5 Apply the ethnocentric/polycentric/geocentric framework to decisions regarding price.

11-6 Explain some of the tactics global companies can use to combat the problem of gray market goods.

11-7 Assess the impact of dumping on prices in global markets.

11-8 Compare and contrast the different types of price fixing.

11-9 Explain the concept of transfer pricing.

11-10 Define countertrade and explain the various forms it can take.

DISCUSSION QUESTIONS

11-1. What are the basic factors that affect price in any market? Which considerations enter into the pricing decision?

One factor is the *price floor*, which can be linked to product cost or some other consideration. For example, in the fall of 1996, Florida tomato growers concerned about cheap tomatoes from Mexico persuaded the U.S. government to impose a price floor of 21 cents per pound on Mexican tomatoes.

A second basic factor is the *price ceiling*, an upper limit created when comparable products are available. As industries globalize, consumers should enjoy lower prices unless national or regional protective barriers are erected to imports. The U.S. market for entry-level luxury cars is crowded with imported nameplates, and price competition in the entry-level category is fierce among Lexus, Infiniti, Mercedes-Benz, and BMW. In the Mercosur countries, on the other hand, external tariffs on motor vehicles are still as high as 70 percent. Thus, many consumers in Brazil, Argentina, Uruguay, and Paraguay must buy locally produced vehicles at high prices.

Finally, between these two extremes there is an *optimum price*. Many Japanese companies have struggled to find the optimum price in view of a strong and fluctuating yen.

Some pricing considerations include:

- Whether or not a product's quality is reflected in the price
- How to price to different segments.
- Determining the latitude to adjust prices if costs change.
- Enforcement of dumping laws.

11-2. Define the various types of pricing strategies and objectives available to global marketers.

The three strategies discussed in the chapter are market skimming, penetration pricing, and market holding or status quo pricing. Market skimming is appropriate in the introductory phase of the product life cycle if there is little competition or few acceptable substitutes. Skimming can be the quickest way for a company to recoup product development and marketing costs. When Thomson SA's RCA unit launched its 18-inch Direct Satellite system in 1994, the basic unit sold for $699. By 1996, the price had fallen by several hundred dollars as competing DSS brands came onto the market. However, by that time RCA had already sold one million units at the higher price.

With a penetration pricing strategy, a relatively low price is established in an effort to gain market share. This strategy has historically been favored by Japanese companies that take a longer-term view of profitability. RCA has clearly switched form skimming to penetration as DSS enters the growth phase of the product life cycle.

Status quo pricing is particularly important in global marketing because currency fluctuations can drive up product prices in export markets. To avoid a sales decline, a company should be prepared to adjust prices. Another option is to try to cut fixed or variable costs.

11-3. Identify some of the environmental constraints on global pricing decisions.

Currency fluctuations are an important consideration in global marketing. Inflation is another factor in the economic environment that may force a company to make frequent price changes. Government regulations can hinder or prohibit a company's efforts to adjust costs. Finally, the presence or absence of competitors directly affects a company's flexibility with prices. In the absence of competitive restraints, a company can charge whatever the market will bear. In Switzerland, for example, there is little competition for imported Chevy S pickup trucks, so the price per vehicle is nearly double the typical price paid in the U.S.

11-4. Why do price differences in world markets often lead to gray marketing?

Price differentials mean opportunity to engage in arbitrage. "Buy low, sell high" is the operative phase, and many entrepreneurs are quick to capitalize on the chance to make some quick money. On the consumption side, many buyers jump at the chance to save money. They are willing to ignore issues such as buying from "authorized dealers."

11-5. What is a transfer price? Why is it an important issue for companies with foreign affiliates? Why did transfer pricing in Europe take on increased importance in 1999?

A transfer price if the price one unit of a company charges to another company unit for goods and services. Transfer prices can be determined on the basis of the market, or by negotiation between the company's various units. Companies under the jurisdiction of

U.S. tax laws must comply with Section 482, the portion of the Internal Revenue Code that deals with controlled intra-corporate transfers.

11-6. How do the ethnocentric, polycentric, and global pricing strategies differ? Which one would you recommend to a company that has global market aspirations?

An ethnocentric pricing policy calls for the price of a particular product to be the same in every part of the world. When management uses this approach it foregoes opportunities to set prices higher in countries where a lower price is required.

A polycentric approach relies on adaptation of country managers who attempt to be as responsive as possible to local market conditions. One problem with the polycentric approach is that it creates conditions in which gray marketing can flourish.

A geocentric pricing approach balances the desire for long-term returns on investment with shorter-term considerations such as market share. The geocentric approach is most appropriate for a company with a global strategy and global aspirations.

11-7. If you were responsible for marketing computed tomography (CT) scanners worldwide (average price, $1.2 million) and your country of manufacture had a strong currency that was appreciating in value against almost all other currencies, which options would be available to you to maintain your competitive advantage in world markets?

The real issue here is not just options for adjusting prices, but options that will allow the marketer to maintain competitive advantage. One option is to shift manufacture to one or more weak-currency countries. If that is not feasible, another medical-products company could become license under license. Another is to keep manufacturing in the strong currency country, focusing on cost-cutting efficiencies and/or product innovation and improvements that will differentiate the scanners. A lower cost, “no frills” model can be developed for some markets.

11-8. Compare and contrast the different forms of countertrade.

Companies barter when buyers are unable to pay in cash, or when a country’s currency is not freely convertible in foreign exchange markets. Barter is a category of countertrade in which goods, but no money, is exchanged. Other forms of countertrade, including countertrade, offset, and compensation trading, may also involve exchanging money or credit.

OVERVIEW

In general, two basic factors determine the boundaries within which prices should be set.

The first is product cost, which establishes a *price floor*, or minimum price.

Second, prices for comparable substitute products create a *price ceiling*, or maximum price. In many instances, global competition puts pressure on the pricing policies and related cost structures of domestic companies. The imperative to cut costs – especially fixed costs - is one of the reasons for the growth of outsourcing. In some cases, local market conditions such as low incomes force companies to innovate by creating new products that can be profitably sold at low prices.

Between the lower and upper boundary for every product there is an *optimum price*, which is a function of the demand for the product as determined by the willingness and ability of customers to buy it.

In this chapter, we will first review basic pricing concepts, and then discuss several pricing topics that pertain to global marketing. In the second half of the chapter, we will discuss gray market goods, dumping, price fixing, transfer pricing, and countertrade.

ANNOTATED LECTURE/OUTLINE

BASIC PRICING CONCEPTS

√ **(Learning Objective #1)**

Generally speaking, international trade results in lower prices for goods.

Lower prices, in turn, help keep a country's rate of inflation in check. In a truly 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.

A firm's pricing system and policies must also be consistent with other uniquely global opportunities and constraints.

Another important internal organizational consideration also exists besides cost. Within the typical corporation, there are many interest groups and, frequently, conflicting price objectives. Divisional vice presidents, regional executives, and country managers are each concerned about profitability at their respective organizational levels. Similarly, the director of global marketing seeks competitive prices in world markets. The controller and the financial vice president are concerned about profits. The manufacturing vice president seeks long production runs for maximum manufacturing efficiency. The tax manager is concerned about compliance with government transfer pricing legislation. Finally, company counsel is concerned about the antitrust implications of global pricing practices.

Ultimately, the prices for a company's products generally reflect the goals set by members or the sales staff, product managers, corporate division chiefs, and/or the company's chief executive.

GLOBAL PRICING OBJECTIVES AND STRATEGIES
√ (Learning Objective #2)

Whether dealing with a single home-country market or multiple country markets, marketing managers 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 as 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 also necessary to factor in external considerations such as the added cost associated with shipping goods over long distances across national boundaries. Moreover, 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

Price can be used as a strategic variable to achieve specific financial goals, including return on investment, profit, and rapid recovery of product development costs. When meeting financial criteria such as profit and maintained of margins is the objective, the product must be part of a superior value proposition for buyers; in such a case, price is integral to the total positioning strategy.

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. (See Exhibits 11-2 and 11-3)

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 high price, demand is limited to innovators and early adopters who are willing and able to buy and who want to among the first to own and use the product. This strategy has been used consistently in the consumer electronics industry.

Penetration Pricing and Nonfinancial Objectives

Some companies are pursuing nonfinancial objectives with their pricing strategy. In particular, price can be used as a competitive weapon to gain or maintain market position. Market share or other sales based objectives are frequently pursued by companies that enjoy cost-leadership positions in their industry.

A **market penetration pricing policy strategy** calls for setting price levels that are low enough to quickly build market share. Historically, many companies that used this type of pricing were located in the Pacific Rim.

Companion Products: "Razors and Blades" Pricing

When formulating pricing strategies for products such as video game consoles, DVD players, and smartphones, it is necessary to view these products in a broader context. The biggest profits in the video industry come from sales of game software. In fact, Sony and Microsoft may actually lose money on each console, but the sales of hit video titles generate substantial revenues and profits that more than make up for the losses.

These examples illustrate the concept of *companion products*: A video game console has no value without video game software, and a DVD player has no value without movies available on DVD. Likewise, a razor handle has no value without blade. Thus Gillette can sell a single Mach3 razor for less than $5—or even give the razor away for free. Over a period of years, the company will make significant profits from selling packages of replacement blades. As the saying goes, "If you make money on the blades, you can give away the razors."

Target Costing

Japanese companies have traditionally approached cost issues in a way that results in substantial production savings and products that are competitively priced in the global marketplace.

Many well-known Japanese companies use **target costing**. The process, sometimes known as *design to cost*, can be described as follows:
Target costing ensures that development teams will bring profitable products to market not only with the right level of quality and functionality but also with appropriate prices for the target customer segments. It is a discipline that harmonizes the labor of disparate participants in the development effort, from designers and manufacturing engineers to market researchers and suppliers. In effect, the company reasons backward from customers' needs and willingness to pay instead of following the flawed but common practice of cost-plus pricing.

Western companies are beginning to adopt some of these money-saving ideas.

The target costing process begins with market mapping and product definition and positioning; this requires using concepts and techniques discussed in Chapters 6 and 7. The marketing team must do the following:

- 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 target costs to the products 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.

Calculating Prices: Cost-Plus Pricing and Export Price Escalation

In global marketing, the total cost depends on the ultimate market destination, the mode of transport, tariffs, and various fees, handling charges, and documentations costs.

Export price escalation is the increase in the final selling price of goods traded across borders that reflects these factors.

The following is a list of eight basic considerations for setting prices on goods that cross borders:

1. Does the price reflect the product's quality?
2. Is the price competitive, given the local market conditions?
3. Should the firm pursue market penetration, market skimming, or another pricing objective?
4. Which 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. Which 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?

Companies frequently use a method known as cost-plus or cost-based pricing when selling goods outside their home-country markets. **Cost-based pricing** is based on an analysis of internal (e.g. materials, labor, testing) and external costs.

Firms that comply with Western cost accounting principles typically use *full absorption cost method;* this defines per-unit product cost as the sum of all past or current direct and indirect manufacturing and overhead costs.

Beyond this per-unit cost, when goods cross national borders, additional costs and expenses such as transportation, duties, and insurance are incurred. If the manufacturer is responsible for them, they too must be included. By adding the desired profit margin to the cost-plus figure, managers can arrive at a final selling price.

Companies using ***rigid cost-plus pricing*** set prices without regard to the eight considerations listed previously. They make no adjustments to reflect market conditions outside the home country. The obvious advantage of rigid cost-based pricing is its simplicity: Assuming that both internal and external cost figures are readily available, it is relatively easy to arrive at a quote.

The disadvantage is that this approach ignores demand and competitive conditions in target markets; the risk is that prices will either be set too high or too low.

Flexible cost-plus pricing is used to ensure that prices are competitive in the context of the particular market environment.

Managers who utilize flexible cost-plus pricing are acknowledging the importance of the eight criteria listed earlier. Flexible cost-plus pricing sometimes incorporates the *estimated future cost method* to establish the future cost for all component elements.

INNOVATION, ENTREPRENEURSHIP AND THE GLOBAL STARTUP
Dr. Dre and Jimmy Iovine - Beats Electronics and Beats Music

Dr. Dre and Jimmy Ivoine are entrepreneurs. Working as a team, they started a company, created a brand, developed an innovative product, and began to manufacture and market it.
By applying the basic tools and principles of modern marketing, Dre and Ivoine have achieved remarkable success.

As is true with many entrepreneurs, their breakthrough idea was based on their recognition of a problem that needed to be solved. Both were music industry veterans who identified an opportunity to develop high quality consumer headphones that would enhance the music playback experience while also serving as a fashion accessory.

By 2013, Beats by Dre had grown into a $1 billion-plus global business. Beats had quickly become the top-selling brand in dozens of countries. Meanwhile, Dre and Iovine were turning their attention to streaming music. They acquired online music service Mog in 2012. In 2014, in conjunction with Nine Inch Nails frontman Trent Reznor, they launched Beats Music, a subscription streaming service. Beats Music is a $10-per-month subscription service that offers users access to millions of songs.

Incoterms
√ **(Learning Objective #3)**

Every commercial transaction is based on a contract of sale, and the trade terms in that contract specify the exact point at which ownership of merchandise is transferred from the seller to the buyer and which party in the transaction pays which costs.

The following activities must be performed when goods cross international boundaries:

1. Obtaining an export license, if required
2. Obtaining a currency permit, if required
3. Packing the goods for export
4. Transporting the goods to the place of departure
5. Preparing a land bill of lading
6. Completing necessary customs export papers
7. Preparing customs or consular invoices as required by the country of destination
8. Arranging for ocean freight and preparation
9. Obtaining marine insurance and certificate of the policy

Who is responsible for performing these tasks? The answer is "It depends on the terms of the sale."

The internationally accepted terms of trade are known as **Incoterms** (short for International Commercial Terms).

Incoterms are classified into four categories:

1. **Ex-works** (EXW), the sole "E-Term" or "origin" term among Incoterms, refers to a transaction in which the buyer takes delivery at the premises of the seller; the buyer bears all risks and expenses from that point on.
2. **Delivered duty paid** (DDP). The seller has agreed to deliver the goods to the buyer at the place the buyer names in the country of import, with all costs, including duties, paid.
3. **Free carrier** (FCA) delivery. Also known as "F-Terms" or "pre-main-carriage terms". FCA is widely used in global sales. Under FCA, transfer from seller to buyer is affected when the goods are delivered to a specified carrier at a specified destination.
    a. **FAS (free alongside ship) named port** is the Incoterm for a transaction in which the seller places the shipment alongside, or available to, the vessel upon which the goods will be transported out of the country.
    b. **FOB (free on board) named port**. The responsibility and liability of the seller do not end until the goods have cleared the ship's rail.
4. Several Incoterms are known as "C-Terms" or "main-carriage" terms.
    a. **CIF (cost, insurance, freight) named port** is the risk of loss or damage to goods is transferred to the buyer once the goods have passed the ship's rail. The seller pays transportation and insurance.
    b. If the terms of the sale are **CFR (cost and freight)**, the seller is not responsible for risk or loss at any point outside the factory.

Table 11-1 is a typical example of the kind of export price escalation that can occur when some of the costs are added to the per-unit cost of the product itself.

ENVIRONMENTAL INFLUENCES ON PRICING DECISIONS
√ (Learning Objective #4)

Global marketers must deal with a number of environmental considerations when making pricing decisions. Among them are currency fluctuations, inflation, government controls and subsidies, and competitive behavior.

Currency Fluctuations

Currency fluctuations can create significant challenges and opportunities for any company that exports. A weakening of the home-country currency swings exchange rates in a favorable direction: a producer in a weak-currency country can choose to cut export prices to increase market share or maintain its prices and reap healthier profit margins.

It is a different situation when a company's home currency strengthens; this is an unfavorable turn of events for the typical exporter because overseas revenues are reduced when translated into the home country currency.

In responding to currency fluctuations, global marketers can utilize other elements of the marketing mix besides price.

EMERGING MARKETS BRIEFING BOOK
Demand in Asia Drives Fine Wine Prices

As every student of microeconomics knows, when demand exceeds supply, prices tend to rise. The market for fine wine is a textbook example. Each year connoisseurs seek out wines from top estates such as France's Chateau Rothschild.

Today, a set of new customers has joined the global win culture: affluent collectors in China and other Asian countries (see Exhibit 11-6). Several factors have contributed to this trend. In 2008, the Hong Kong government reduced tariffs on wine imports from 40 percent to zero. Although China still imposes ad valorem taxes on wine, hand-carried bottles crossing the border from Hong Kong are not taxed. This has created a business opportunity for entrepreneurial individuals to hire "mules" to transport wine to the mainland.

Chinese wine drinkers do their homework; they have been known to check out the tasting scores and prices of wines they have been served. This, of course, reflects the importance of status in Asian cultures.

The use of the flexible cost-plus method to reduce prices in response to unfavorable currency swings is an example of a **market holding strategy** and is adopted by companies that do not want to lose market share.

Price transparency means that buyers will be able to comparison shop easily because goods will be priced in a single currency (Euros) as opposed to multiple currencies (marks, francs, or lira).

Inflationary Environment

Inflation, or a persistent upward change in price levels, is a problem in many countries markets and can be caused by an increase in the money supply.

An essential requirement for pricing during inflation is the maintenance of operating profit margins. Inflation may require price adjustments for a simple reason: Increased selling prices must be covered by higher selling prices. Regardless of cost accounting practices, if a company maintains its margins, it has effectively protected itself for the effects of inflation.

Low inflation presents pricing challenges of a different type.

For example, though the U.S. had low inflation and strong demand in the 1990s, excess manufacturing, high European unemployment, and the Asian recession made price hikes difficult. Globalization, the Internet, a flood of low-cost imports from China, and a new cost-consciousness among buyers were also significant price-constraining factors.

Government Controls, Subsidies, and Regulations

Governmental policies and regulations that affect pricing include dumping legislation, resale price maintenance legislation, price ceilings, and general reviews of price levels. Government action that limits price adjustment puts pressure on margins. Under certain conditions, government actions may pose a threat to the profitability of a subsidiary operation. In a country with severe financial difficulties or crisis, government officials are under pressure to take action (e.g., Brazil).

When selective controls are imposed, foreign companies are more vulnerable than local businesses particularly, if the outsiders lack the political influence over government decisions than local managers have. For example, Procter & Gamble encountered strict price controls in Venezuela in the late 1980s, receiving only 50 percent of the price increases requested.

Government control can also take other forms. Companies are sometimes required to deposit funds in noninterest-bearing escrow accounts for a specified period of time if they wish to import products.

Cash deposit requirements clearly create an incentive for a company to minimize the stated value of the imported goods; lower prices mean smaller deposits. Other government requirements that affect the pricing decision are profit transfer rules that restrict the conditions under which profits can be transferred out of a country. Under such rules, a high transfer price paid for imported goods by an affiliated company can be interpreted as a device for transferring profits out of a country.

Government regulations can affect prices in other ways. The German government's recent moves toward deregulation have improved the climate for market entry by foreign firms in a range of industries, including insurance, telecommunications, and air travel.

Deregulation is also giving German companies their first experience with price competition in the domestic market. In some instances, deregulation represents a *quid pro quo* that will allow German companies wider access to other country markets.

Competitive Behavior

Pricing decisions are bounded not only by cost and the nature of demand but also by competitive action. If competitors do not adjust their prices in response to rising costs, management will be severely constrained in its ability to adjust prices accordingly.

Conversely, if competitors are manufacturing or sourcing in a lower-cost country, it may be necessary to cut prices to stay competitive.

Levi Strauss and Company jeans are under price pressures from several directions—in the U.S. and overseas.

Using Sourcing as a Strategic Pricing Tool

The global marketer has several options for addressing the problem of price escalation or the environmental factors discussed in the last section.

Product and market competition, in part, dictate the marketer's choices.

Marketers of domestically manufactured finished products may be forced to switch to offshore sourcing of certain components to keep costs and prices competitive.

China is quickly gaining a reputation as the "the world's workshop" (e.g. U.S. bicycle manufacturers rely on production sources in China and Taiwan).

Another option is an audit of the distribution structure in the target markets. A rationalization of the distribution structure can reduce markups required to achieve distribution in international markets.

Rationalization may include selecting new intermediaries, reassigning responsibilities, or establishing direct marketing operations.

GLOBAL PRICING: THREE POLICY ALTERNATIVES
√ (Learning Objective #5)

A company has three positions it can take on worldwide pricing.

Extension or Ethnocentric

The first position, known as **extension or ethnocentric pricing** calls for the per-unit price of an item to be the same no matter where in the world the buyer is located.

In such instances, the importer must absorb freight and import duties.

The extension approach has the **advantage** of extreme simplicity because it does not require information on competitive or market conditions is required for implementation.

Its main **disadvantage** is that the ethnocentric approach does not respond to the competitive and market conditions of each national market and, therefore, does not maximize the company's profits in each national market or globally.

Adaptation or Polycentric

The second policy, **adaptation** or **polycentric pricing**, permits subsidiary or affiliate managers or independent distributors to establish whatever price they believe is most appropriate in their market environment.

There is no requirement that prices be coordinated from one country to the next. IKEA takes a polycentric approach to pricing.

One recent study of European industrial exporters found that companies utilizing independent distributors were the most likely to utilize polycentric pricing.

Such an approach is sensitive to local market conditions, but valuable knowledge and experience within the corporate system concerning effective pricing strategies are not brought to bear on each local pricing decision.

Arbitrage is also a potential problem with the polycentric approach. When disparities in prices between different country markets exceed the transportation and duty costs separating the markets, enterprising individuals can purchase goods in the lower-price country market and then transport them for sale in markets where higher prices prevail.

Geocentric

The third approach, geocentric pricing, is more dynamic and proactive than the other two. A company using **geocentric pricing** neither fixes a single price worldwide, nor allows subsidiaries or local distributors to make independent pricing decisions. Instead, the geocentric approach represents an intermediate course of action.

Geocentric pricing is based on the realization that unique local market factors should be recognized in arriving at pricing decisions. These factors include local costs, income levels, competition, and the local marketing strategy. Price must also be integrated with other elements of the marketing program.

The geocentric approach recognizes that price coordination from headquarters is necessary in dealing with international accounts and product arbitrage. This approach also consciously and systematically seeks to ensure that accumulated national pricing experience is leveraged and applied wherever relevant.

With geocentric pricing, local costs plus a return on invested capital and personnel fix the price floor for the long term.

GRAY MARKET GOODS
√ (Learning Objective #6)

Gray market goods are trademarked products that are exported from one country to another where they are sold by unauthorized persons or organizations.

Parallel importing occurs when companies employ a polycentric, multinational pricing policy that calls for setting different prices in different country markets.

Gray markets can flourish when a product is in short supply, when producers employ skimming strategies in certain markets, or when the goods are subject to substantial markups.

Gray markets impose several costs or consequences on global marketers. These include:

Dilution of exclusivity. Authorized dealers are no longer the sole distributors.

Free riding. If the manufacturer ignores complaints from authorized channel members, those members may engage in *free riding*. In this practice, channel members may opt to take various actions to offset the downward pressure on margins.

Damage to channel relationships. Competition from gray market products can lead to channel conflict as authorized distributors attempt to cut costs, complain to manufacturers, and file lawsuits against the gray marketers.

Undermining segmented pricing schemes. A variety of forces—including falling trade barriers, the information explosion on the Internet, and modern distribution capabilities—hamper a company's ability to pursue local pricing strategies.

Reputation and legal liability. Even though gray market goods carry the same trademarks as goods sold through authorized channels, they may differ in quality, ingredients, or some other way.

Companies should develop proactive strategic responses to gray markets.

DUMPING

√ (Learning Objective #7)

Dumping is an important global pricing strategy issue. GATT's 1979 antidumping code defined dumping as the sale of an imported product at a price lower than that normally charged in a domestic market or country of origin. In addition, many countries have their own policies and procedures for protecting national companies from dumping.

The U.S. Congress has defined **dumping** as an unfair trade practice that results in "injury, destruction, or prevention of the establishment of American industry."

In 2000, the U.S. Congress passed the so-called **Byrd Amendment**; this law calls for antidumping revenues to be paid to U.S. companies harmed by imported goods sold at below-market prices.

In Europe, antidumping policy is administered by the European Commission; a simple majority vote by the Council of Ministers is required before duties can be imposed on dumped goods.

To provide positive proof that dumping has occurred in the United States, the complainant must demonstrate that both price discrimination and injury occurred.

Price discrimination is the practice of setting different prices when selling the same quantity of "like-quality" goods to different buyers.

PRICE FIXING
√ (Learning Objective #8)

In most instances, it is illegal for representatives of two or more companies to secretly set similar prices for their products. **Price fixing** is generally held to be an anticompetitive act.

In ***horizontal price fixing***, 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 or retailers (i.e., channel members at different "levels" from the manufacturer) to ensure certain retail prices are maintained.

TRANSFER PRICING
√ (Learning Objective #9)

Transfer pricing refers to the pricing of goods, services, and intangible property bought and sold by operating units or divisions of the same company.

Transfer pricing concerns *intracorporate exchanges*, which are transactions between buyers and sellers that have the same corporate parent. For example, Toyota subsidiaries both sell to, and buy from, each other.

In determining transfer prices to subsidiaries, global companies must address a number of issues, including taxes, duties, and tariffs, country profit transfer rules, conflicting objectives of joint venture partners, and government regulations.

Tax authorities take a keen interest in transfer pricing policies.

Three major alternative approaches can be applied to transfer pricing decisions:
1. A **market-based transfer price** is derived from the price required to be competitive in the global marketplace.
2. **Cost-based transfer pricing** uses an internal cost as the starting point in determining price. This kind of transfer pricing can take the same forms as the cost-based pricing methods discussed earlier in the chapter.
3. **Negotiated transfer price** occurs when the organization's affiliates determine the prices among themselves. This method may be employed when market prices are subject the frequent changes. (Table 11-3)

Tax Regulations and Transfer Prices

Because global companies conduct business in world characterized by different corporate tax rates, there is an incentive to maximize income in countries with the lowest tax rates and to minimize income in high-tax countries.

In recent years, many governments have tried to maximize national tax revenues by examining company returns and mandating reallocation of income and expenses.

Sales of Tangible and Intangible Property

Each country has its own set of laws and regulations for dealing with controlled intracompany transfers.

Whatever the pricing rationale, executives and managers involved in global pricing policy decisions must familiarize themselves with the laws and regulations in the applicable countries.

COUNTERTRADE

√ (Learning Objective #10)

In recent years, many exporters have been forced to finance international transactions by taking full or partial payments in some form other than money. A number of alternative finance methods, known as *countertrade,* are widely used.

In a **countertrade** transaction, a sale results in product flowing in one direction to a buyer; a separate stream of products and services, often flowing in the opposite direction, is also created.

Countertrade generally involves a seller from the West and a buyer in a developing country.

Countertrade flourishes when hard currency is scarce. Exchange controls may prevent a company from expatriating earnings; the company may be forced to spend money in-country for products that are then exported and sold in third-country markets.

Historically, the single most important driving force behind the proliferation of countertrade was the decreasing ability of developing countries to finance imports through bank loans.

Generally, several conditions affect the probability that some form of countertrade will be used:

- The priority attached to the import. The higher the priority, the less likely it is that countertrade will be required.
- The value of the transaction. The higher the value, the greater the likelihood that countertrade will be involved.
- The availability of products from other suppliers. If a company is the sole supplier of a differentiated product, it can demand monetary payment.

Barter

The term **barter** describes the least complex and oldest form of bilateral, non-monetized countertrade.

Simple barter is a direct exchange of goods or services between two parties. Although no money is involved, both partners construct an approximate shadow price for products flowing in each direction.

Counterpurchase

The **counterpurchase** form of countertrade, also termed *parallel trading* or *parallel barter*, is distinguished from other forms in that each delivery in an exchange is paid for in cash.

Offset

Offset is a reciprocal arrangement whereby the government in the importing country seeks to recover large sums of hard currency spent on expensive purchases such as military aircraft or telecommunications systems.

Distinguishing characteristics between offset and counterpurchase:

- Counterpurchase is characterized by smaller deals over shorter periods of time.
- Offset is not contractual but rather reflects a memorandum of understanding that sets out the dollar value of products to be offset and the time period for completing the transaction.
- Offsets have become a controversial facet of today’s trade environments.

Compensation Trading

Compensation trading, also called **buyback**, is a form of countertrade that involves two separate and parallel contracts.

In one contract, the supplier agrees to build a plant or provide plant equipment, patents or licenses, or technical, managerial, or distribution expertise for a hard currency down payment at the time of delivery.

In the other contract, the supplier company agrees to take payment in the form of the plant’s output equal to its investment (minus interest) for a period of as many as 20 years.

Essentially, the success of compensation trading rests on the willingness of each firm to be both a buyer and a seller.

Switch Trading

Also called *triangular trade* and *swap*, **switch trading** is a mechanism that can be applied to barter or countertrade. In this arrangement, a third party steps into a simple barter or other countertrade arrangement when one of the parties is not willing to accept all the goods received in a transaction.

The third party may be a professional switch trader, switch trading house, or a bank.

The switching mechanism provides a "secondary market" for countertraded or bartered goods and reduces the inflexibility inherent in barter and countertrade.

CASES

Case 11-1: Global Automakers Target Low-Income Consumers

Overview: The Logan is a case study in driving down costs. Established automakers in developing countries are racing to develop low-cost vehicles for the entry-level buyers. The question is: Can the auto companies come up with the optimal value proposition?

11-9. What is the key to the Logan's low price?

> Logans are manufactured in seven countries so supply is close to demand; the company is driving down costs everywhere: Windshields are nearly flat, outside mirrors are identical, and the Logan shares an engine and gear box with Renault's other models. All of these and other cost saving methods keep Logan's price as low as possible.

11-10. Do you think Tata will be able to save the Nano? Which steps should the company take?

> Since Tata's target market is consumers in those emerging markets that currently travel by scooter, the Nano should be a success. It is in the emerging markets of India, China, Southern Asia, and other countries where consumers are seeing a rapid increase in their life-styles and consumer goods. The steps taken will vary by student.

11-11. Assess Carlos Ghosn's plan to revive the Datsun nameplate in India. Can a car that sells for $3,000 make a profit for the parent company?

> Ghosn's plan is based on his beliefs and his past. Thorough study of the consumer in his target market may not have been done. Does the consumer want transportation or does status play a role also? Can a $3000 car make a company profit – I don't know.

11-12. Low-cost cars such as the Nano and Datsun lack the multilayered safety and quality features required by regulators in high-income markets. Is it appropriate to create "bare-bones" cars with fewer safety features for emerging markets?

> Student's answers will vary on this question, but study of the consumer in the target market must be done for a complete analysis.

Case 11-2: Global Consumer-Products Companies Target Low-Income Consumers

Overview: In "Frugal engineering." "Indovation." "Reverse innovation." These are some of the terms that marketers at GE, Procter & Gamble, Siemens, and Unilever are using to describe efforts to penetrate more deeply into emerging markets. As growth in mature markets slows, executives and managers at many global companies are realizing that the ability to serve the needs of the world's poorest consumer will be a critical source of competitive advantage in the decades to come.

Two-thirds of the world's population, more than 4 billion people, live on less than $2 per day. This segment is sometimes referred to as the "bottom of the pyramid" and includes an estimated 1.5 million people who live "off the grid".

Not every company has been successful targeting the low-income segment.

11-13. Why are companies such as Siemens, GE, Nestle, and Procter and Gamble targeting the "bottom of the pyramid"?

> Several answers are available for this question and the students' answers will vary, depending on the industry they discuss. For example, it is estimated that 1.5 billion people have no access to electricity. This situation has provided an opportunity for companies to create innovative sources of renewal energy.

11-14. Review the Chapter 4 discussion of diffusion theory. How might an understanding of the characteristics of innovations help marketers succeed in emerging markets?

Characteristics of Innovations:

Five factors affect the rate of adoption:

- *Relative advantage*: How a new product compares with existing products or methods.
- *Compatibility*: How consistent a product is with existing values and past experiences.
- *Complexity*: How difficult the new product is to understand and use.
- *Divisibility*: How easy it is to try a product on a limited basis without great expense.
- *Communicability*. How well the benefits or value of a product are communicated.

By analyzing the above five factors that affect the rate of adoption of new products, all five of these factors will need to be considered in depth, especially the complexity factor in one person's opinion.

11-15. Which types of marketing communications may be necessary to launch an innovative product such as Procter & Gamble's PUR in emerging markets? Which changes in consumer attitudes and behavior are required for successfully launching a product such as PUR?

> In emerging markets, word-of-mouth/social media will most likely work the best for a product like P&G's PUR. Consumers need to be open to a new way of doing things and based on culture and values, this may be hard to do. Using local resources to help in the marketing efforts will also help quite a bit.

11-16. Which key concepts discussed in Chapter 1 apply to Nestle's experience in Latin America?

> The issue of standardization versus adaptation in global marketing comes to mind. Nestle decided that to be successful, they needed to embrace adapting their products to the local markets.

Case 11-3: LVMH and Luxury Goods Marketing

Overview: One fashion house that is changing with the times is LVMH Moët Hennessy Louis Vuitton SA, the largest marketer of luxury products and brands in the world. Chairman Bernard Arnault presides over a diverse empire of products and brands, sales of which totaled nearly $40 billion in 2013. Arnault, whom some refer to as "the pope of high fashion," summed up the luxury business: "We are here to sell dreams. When you see a couture show on TV around the world, you dream. When you enter a Dior boutique and buy your lipstick, you buy something affordable, but it has the dream in it." The company's specialty group includes Duty Free Shoppers (DFS) and Sephora. DFS operates stores in international airports around the world; Sephora, which LVMH acquired in 1997, is Europe's second-largest chain of perfume and cosmetics stores.

11-17. What were the possible risks of Louis Vuitton's first-ever television advertising campaign?

> Executives raised wholesale prices in an effort to prevent discount retailers from purchasing designer products for resale in mass-market outlets. They also raised prices in countries that have experienced currency devaluations. Finally, cutting back on advertising and other promotional expenses may have helped maintain profitability.

11-18. In fall 2011, the euro/dollar exchange rate was €1 = $1.35. By spring 2015, the dollar had strengthened to €1 = $1.10. Assume that a European luxury goods marketer cuts the price of an $8,000 tweed suit by 10 percent when launching its spring 2015 collection. How will revenues be affected when dollar prices are converted to euros?

> An $8,000 suit in euros is equal to 8,800 euros at the $1.1 / 1 rate. With a 10% price cut, the $8,000 suit is now $7,200 but only 7,920 euros. The seller "lost" 880 euros for a $800 price decline.

11-19. Louis Vuitton executives raised prices in the late 2000s, and sales continued to increase. What does this say about the demand curve of the typical Louis Vuitton customer?

> In most cases, luxury products are characterized by superior craftsmanship. Luxury goods prices are based on perceived exclusivity and differentiation of the brands. Certainly, the performance of the U.S. economy bodes well for luxury goods marketers. Consumer confidence runs high and the economy has shown resilience; naturally many will want "the best," which means luxury brands.

11-20. Compare and contrast LVMH's pricing strategy with that of "accessible brands" such as Coach.

> Coach's brand positioning can be described as "accessible luxury", while LV describes itself as "selling dreams". LV markets are small, niche brands catering to the very rich. Finally, while Coach has continued to sell leather-based products, LVMH has branched

out to include wines and spirits, selective retailing, perfume and cosmetics, watches and jewelry in addition to its branded leather goods.

TEACHING TOOLS AND EXERCISES

Activity: Students should be preparing or presenting their Cultural-Economic Analysis and Marketing Plan for their country and product as outlined in Chapter 1.

Out-of-Class Reading: Nagle, Thomas T. and Reed Holden. *The Strategy and Tactics of Pricing: A Guide to Profitable Decision Making* 3/e. Upper Saddle River, New Jersey: Prentice Hall, 2002.

Internet Exercise: Look up prices for some upscale watch brands (like Movado, Tag Heur, or Rolex) from traditional U.S.-based merchants like Macy's or Saks Fifth Avenue. Then go to www.alibaba.com and checkout the prices for these "similar" products. What are the price differentials? Is the "price" for the genuine article worth the "difference" for the knockoffs?

Go to www.overstock.com and check out the prices of these similar products through the "grey market. Again, is the price differential worth the monetary difference? Explain your rationale.

Guest Speaker: Invite a local service provider (attorney, shopkeeper) and asked them to speak to the class about how they "price" their particular service. Compare and contrast "how" they price from the descriptions and strategies outlined in this chapter.

SUGGESTED READING

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