International Pricing & Logistics

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Session objectives
- Components of pricing
- The pricing pitfalls
- Parallel imports
- Types of distribution channels
- Distribution patterns
- Role of middleman

Views regarding pricing
- Active instrument of accomplishing marketing objectives?
- Static element in a business decision?

Importance of pricing
- Pricing represents one of the most critical and complex issues in global marketing (due to economic, financial, and mathematical implications)
- Price is the only marketing mix element that generates revenues. All other elements entail costs
- Directly associated with profit and increase in shareholder wealth
- Foreign exchange complications
- Transfer pricing

Factors affecting price
- Company and product factors
  - Corporate and marketing objectives
  - Firm and product positioning
  - Product range, life cycle, substitutes, product differentiation and unique selling propositions
  - Cost structures, manufacturing, experience effect and economies of scale
  - Marketing, product development
  - Available resources
  - Inventory
  - Shipping costs

Development and implementation of pricing strategy
- Factors affecting pricing: Company and product
- Market
- Environmental
- Analysis
- Confirm impact of corporate strategies on pricing policy
- Corporate objective
- Options evaluation
- Selection of most appropriate pricing option
- Use of tactics and procedures to set SBU prices
- Dealing with international pricing problems
- Price management
Factors influencing pricing

- Market factors
  - Consumers perceptions, expectations and ability to pay
  - Need for product adaptation, market servicing
  - Market structure, distribution channels discounting pressures
  - Market growth, demand elasticity
  - Need for credit
  - Competition objectives, strategies and strengths

Factors influencing prices

- Environmental factors
  - Government influences and constraints
  - Currency fluctuations
  - Business cycle stage, level of inflation
  - Use of non-money payment and leasing

Considerations for setting price

- Does the price reflect the product’s quality?
- Is the price competitive given local market conditions?
- Should firm pursue market penetration, market skimming, or some other pricing objective?
- What types of discounts or allowances should be offered to international customers?
- Should prices differ with market segment?
- What pricing options are available if the firm’s costs increase or decrease? Is demand in the international market elastic or inelastic?
- Are the firm’s prices likely to be viewed by the host-country government as reasonable or exploitative?
- Do the foreign country’s dumping laws pose a problem?

International Pricing Approach

<table>
<thead>
<tr>
<th>Full cost pricing</th>
<th>Variable cost pricing</th>
</tr>
</thead>
<tbody>
<tr>
<td>Every product bears a part of the total cost</td>
<td>Underutilization of production capacity</td>
</tr>
<tr>
<td>Foreign sales is calculated</td>
<td>Foreign sales is bonus</td>
</tr>
<tr>
<td>Appropriate for co.s having high variable cost</td>
<td>Appropriate for co.s having high fixed cost</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Skimming pricing</th>
<th>Penetration pricing</th>
</tr>
</thead>
<tbody>
<tr>
<td>Premium pricing</td>
<td>Low pricing</td>
</tr>
<tr>
<td>Niche marketing</td>
<td>Mass marketing</td>
</tr>
<tr>
<td>Innovative product</td>
<td>Old product</td>
</tr>
<tr>
<td>2 income segments</td>
<td>More than 2 income segments</td>
</tr>
</tbody>
</table>

Price Escalation

- Cost of Exporting
  - Taxes
  - Tariffs
  - Administrative Costs
  - Inflation
  - Exchange Rate Fluctuations
  - Varying Currency Values

Price escalation: an example

<table>
<thead>
<tr>
<th>Escalation of Costs Through Exporting</th>
<th>Export price (£)</th>
<th>Domestic price (£)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Manufacturer’s FOB price</td>
<td>10.00</td>
<td>10.00</td>
</tr>
<tr>
<td>Sea freight and insurance</td>
<td>1.20</td>
<td></td>
</tr>
<tr>
<td>Landed cost (CIF)</td>
<td>11.20</td>
<td></td>
</tr>
<tr>
<td>Import tariff: 8 per cent on CIF value</td>
<td>0.90</td>
<td></td>
</tr>
<tr>
<td>CIF plus tariff</td>
<td>12.10</td>
<td></td>
</tr>
<tr>
<td>17.5 per cent VAT</td>
<td>2.12</td>
<td>1.75</td>
</tr>
<tr>
<td>Distributor purchase price</td>
<td>14.32</td>
<td>11.75</td>
</tr>
<tr>
<td>Distributor mark-up (15 per cent)</td>
<td>2.15</td>
<td>1.75</td>
</tr>
<tr>
<td>Retailer purchase price</td>
<td>16.47</td>
<td>13.50</td>
</tr>
<tr>
<td>Retail margin 40 per cent</td>
<td>10.98</td>
<td>9.00</td>
</tr>
<tr>
<td>Consumer purchase price</td>
<td>27.45</td>
<td>22.50</td>
</tr>
</tbody>
</table>
### Approaches to lessening Price Escalation

- Lower Cost of Goods
  - Manufacturing overseas
  - Eliminate features or product quality
- Lower the Tariffs
  - Reclassification
  - Persuading foreign country’s government
  - Modification of product to fit in another class
- Lower the distribution cost
  - Eliminate or reduction of middlemen
- Use of FTZ
- Dumping

### Export Strategies Under Varying Currency Conditions

**When Domestic Currency is WEAK...**
- Stress, price benefits
- Expand product line and add more costly features
- Shift sourcing and manufacturing to domestic market
- Exploit export opportunities in all markets
- Conduct conventional cash-for-goods trade
- Use full-costing approach, but use marginal-cost pricing to penetrate new/competitive markets

**When Domestic Currency is STRONG...**
- Engage in nonprice competition by improving quality, delivery, and after-sale service
- Improve productivity and engage in vigorous cost reduction
- Shift sourcing and manufacturing overseas
- Give priority to exports to relatively strong-currency countries
- Deal in countertrade with weak-currency countries
- Trim profit margins and use marginal-cost pricing

### Export Strategies Under Varying Currency Conditions

**When Domestic Currency is WEAK...**
- Speed repatriation of foreign-earned income and collections
- Minimize expenditures in local, host country currency
- Buy needed services (advertising, insurance, transportation, etc.) in domestic market
- Minimize local borrowing
- Bill foreign customers in domestic currency

**When Domestic Currency is STRONG...**
- Keep the foreign-earned income in host country, slow collections
- Maximize expenditures in local, host country currency
- Buy needed services abroad and pay for them in local currencies
- Borrow money needed for expansion in local market
- Bill foreign customers in their own currency

### Parallel imports

- The basis: different prices by companies in different countries
- Parallel imports develop when importers buy products from distributors in one country and sell them in another to distributors who are not part of the manufacturer’s regular distribution system
- The possibility of a parallel market occurs whenever price differences are greater than the cost of transportation between two markets
- For example, the ulcer drug Losec sells for only $18 in Spain but goes for $39 in Germany; and the heart drug Plavix costs $55 in France and sells for $79 in London
- Thus, it is possible for an intermediary to buy products in countries where it is less expensive and divert it to countries where the price is higher and make a profit
- Exclusive distribution, can create a favourable condition for parallel importing

### Effects of parallel imports

- Long term harm to brand
- Quality problems
- Reducing parallel imports
  - Policing distribution channels
  - Getting help from the legal system

### Leasing

- Leasing opens the door to a large segment of nominally financed foreign firms that can be sold on a lease option but might be unable to buy for cash
- Leasing helps guarantee better maintenance and service on overseas equipment
- Equipment leased and in use helps to sell other companies in that country
- Lease revenue tends to be more stable over a period of time than direct sales would be

Countertrade

- Barter
  - Goods to goods
- Compensation deals
  - Goods to goods and in cash
- Counterpurchase or offset trad
  - 1st contract: Goods to cash
  - 2nd contract: Cash to investment
- Product buy-back agreement
  - Output buying by the original eqp. seller

Why countertrade?

- To preserve currency
- To improve balance of trade
- To gain access to new markets
- To upgrade manufacturing capabilities
- To maintain prices of export goods

Transfer pricing

- Prices of goods transferred from a company’s operations or sales units in one country to its units elsewhere, which refers to intra-company pricing or transfer pricing, may be adjusted to enhance the ultimate profit of the company as a whole
- Transfer pricing arrangements
  - Sales at the local manufacturing cost plus a standard mark-up
  - Sales at the cost of the most efficient producer in the company plus a standard mark-up
  - Sales at negotiated prices
  - Arm’s-length sales using the same prices as quoted to independent customers

Administered Pricing

- Cartels
- Government Influenced Pricing

Basics of Distribution process

- Physical handling and the distribution of goods
- The passage of ownership
- Buying and Selling negotiation between Producer – Middleman – Customer

Global supply chain

- Customer Service Requirements
- Performance Metrics
- Organizational Design and Training Requirements
- Business Processes
- Plant and Distribution Center Network Design
- Information Systems
- Outsourcing and Third-Party Logistics Relationships
- Key Customer and Supplier Relationships
- Inventory Management
- Performance Goals
**Distinction Between Eastern & Western Distribution System**
- A structure dominated by many small middlemen dealing with many small retailers
- Channel control by manufacturer
- A business philosophy shaped by a unique culture
- Laws that protect the foundation of the system – the small retailer

**Comparison of Distribution Channel Between the US & Japan**

**Automobile parts: Japan**
- Independent parts makers
- Repair parts makers
- Cooperative sales companies
- Independent wholesalers
- Retailers
- Large users
- Gasoline stations
- Automatted repair shops

**Automobile parts: United States**
- Wholesalers
- Special agents
- Sub-dealers
- Dealers
- Independent parts makers
- Repair parts makers
- Cooperative sales companies
- Independent wholesalers
- Retailers
- Large users
- Gasoline stations
- Automated repair shops

**Comparison of Distribution Channel Between the US & Japan**

**Automobile parts: United States**
- Manufacturer
- Warehouse distributor
- Jobber buying groups
- Jobber
- Installer
- Customer

**Automobile parts: Japan**
- 18%
- 21%
- Mass merchandiser
- Repair specialist

**Large-scale Retail Store Law**
- Protect Small Retailer
  - 500 Sq Meters (5,382 Sq. Ft.)
- Approval from MITI and Prefectural government to:
  - Build
  - Expand
  - Changing Operating Hours
  - Change Days Closed
- Local Retailers must unanimously approve plan
- Months to years for approval
  - Japanese Supermarket - 10 years
  - Toy "R" US - 3 years
- Licenses required to operate
- Full Service Store - 39 Licenses need approval

**General patterns in distribution**
- Middlemen Services
- Product Line Breadth
- Costs and Margins
- Channel Length
- Nonexistent Channels
- Blocked Channels
- Stocking
- Power and Competition

SOURCE: McKinsey industry studies
Retail patterns

- Retail Size Patterns
- Direct Marketing
- Resistance to Change
- Alternative Middleman Choices

Exhibit 14.3: Retail Structure in Selected Countries

<table>
<thead>
<tr>
<th>Country</th>
<th>All Retailers (2012)</th>
<th>People Served per Retailer</th>
<th>Interest (per 1000)</th>
</tr>
</thead>
<tbody>
<tr>
<td>United States</td>
<td>752</td>
<td>255</td>
<td>70%</td>
</tr>
<tr>
<td>Canada</td>
<td>112</td>
<td>276</td>
<td>45%</td>
</tr>
<tr>
<td>Argentina</td>
<td>294</td>
<td>127</td>
<td>86%</td>
</tr>
<tr>
<td>Germany</td>
<td>416</td>
<td>286</td>
<td>33%</td>
</tr>
<tr>
<td>Pakistan</td>
<td>286</td>
<td>99</td>
<td>20%</td>
</tr>
<tr>
<td>Brazil</td>
<td>412</td>
<td>263</td>
<td>67%</td>
</tr>
<tr>
<td>China</td>
<td>21,183</td>
<td>61</td>
<td>1%</td>
</tr>
<tr>
<td>Japan</td>
<td>1,042</td>
<td>336</td>
<td>44%</td>
</tr>
<tr>
<td>Australia</td>
<td>98</td>
<td>208</td>
<td>27%</td>
</tr>
</tbody>
</table>

Home Country Middlemen

- Global Retailers
- Export Management Company
- Trading Companies (Foreign)
- Complementary Marketers
- Manufacturer's Export Agents
- Home Country Brokers
- Buying Offices
- SELLING GROUPS
- Foreign Sales Corporations
- Norazi Agents
- Export Merchants
- Export Jobbers

Foreign Country Middlemen

- Manufacturer's Representatives
- Distributors
- Brokers
- Managing Agents and Compradors
- Dealers
- Import Jobbers
- Wholesalers
- Retailers

Exhibit 14.4: International Channel of Distribution Alternatives
6 C's of channel strategy

- Cost
- Capital Requirements
- Control
- Coverage
- Character
- Continuity

Locating middleman

- Commercially published directories
- Foreign consulates
- Chamber-of-commerce groups located abroad
- Other manufacturers producing similar but noncompetitive goods
- Middlemen associations
- Business publications
- Management consultants
- Department of Commerce

Selecting middleman

- Screening based on the following criteria:
  - Reputation
  - Creditworthiness
  - Markets served
  - Products carried
  - Number of stores
  - Store size

Motivating middleman

- Financial rewards
- Psychological rewards
- Communications
- Company support, and
- Corporate rapport

The export order process

1. Initial Enquiry
2. Pro-Forma Invoice
3. Confirmed Order
4. Letter of Credit
5. Shipping Goods
6. Shipment of Documents
7. Commercial Invoice & Documents in Letter of Credit
8. Payment
9. Issuing Bank
10. Customer

Diagram showing the export order process with labeled stages and responsibilities.

The diagram includes the following stages:
- Initial Enquiry
- Pro-Forma Invoice
- Confirmed Order
- Letter of Credit
- Shipping Goods
- Shipment of Documents
- Commercial Invoice & Documents in Letter of Credit
- Payment
- Issuing Bank
- Customer

Exhibit 13.6: Who’s Responsible for Costs under Various Terms?

<table>
<thead>
<tr>
<th>Cost Item/Term</th>
<th>FOR Inland Carries at Factory</th>
<th>FOR Inland Carries at Point of Shipment</th>
<th>Rail Vessel or Plane at Port of Shipment</th>
<th>CIF at Port of Destination</th>
</tr>
</thead>
<tbody>
<tr>
<td>Export packing</td>
<td>Buyer</td>
<td>Buyer</td>
<td>Buyer</td>
<td>Buyer</td>
</tr>
<tr>
<td>Inland freight</td>
<td>Buyer</td>
<td>Buyer</td>
<td>Buyer</td>
<td>Buyer</td>
</tr>
<tr>
<td>Port charges</td>
<td>Buyer</td>
<td>Buyer</td>
<td>Buyer</td>
<td>Buyer</td>
</tr>
<tr>
<td>Insurance</td>
<td>Buyer</td>
<td>Buyer</td>
<td>Buyer</td>
<td>Buyer</td>
</tr>
<tr>
<td>Loading or unloading at quays</td>
<td>Buyer</td>
<td>Buyer</td>
<td>Buyer</td>
<td>Buyer</td>
</tr>
<tr>
<td>Ocean freight</td>
<td>Buyer</td>
<td>Buyer</td>
<td>Buyer</td>
<td>Buyer</td>
</tr>
<tr>
<td>Cargo insurance</td>
<td>Buyer</td>
<td>Buyer</td>
<td>Buyer</td>
<td>Buyer</td>
</tr>
<tr>
<td>Customs duties</td>
<td>Buyer</td>
<td>Buyer</td>
<td>Buyer</td>
<td>Buyer</td>
</tr>
<tr>
<td>Ownership of inland carriers</td>
<td>Buyer</td>
<td>Buyer</td>
<td>Buyer</td>
<td>Buyer</td>
</tr>
</tbody>
</table>

*Note: The diagram and exhibit are explained in the context of the export order process.*