



GLOBAL PRICING



Objectives

- List and explain the drivers of foreign market pricing
- Discuss the issue of global pricing contracts
- Explain the concept of price escalation
- Define transfer pricing
- Describe gray markets and the process of coordinating prices

HIGHEST AND LOWEST PRICES IN ECU OF PRODUCTS IN EU CITIES

		Lowest*		Highest*	Price coefficient**
Bosch 500-2 power drill	Brussels	70.94-56.75	Milan	99.34-83.48	1.47
Bosch 4542 washing machine	London	462.69-402.34	Milan	672.74-565.33	1.40
Braun Silencio hairdryer	London	18.44-16.03	Athens	50.60-43.62	2.72
Coca Cola, 1.5l bottle	Amsterdam	.82-.69	Copenhagen	2.04-1.45	2.10
Colgate toothpaste, 100ml	Athens	1.33-1.15	Milan	1.88-1.72	1.50
EMI Compact disc: Tina Turner "Foreign Affair"	Athens	14.39-12.41	Madrid	21.72-19.39	1.36
EMI cassette of same	London	8.7-7.57	Copenhagen	21.84-17.9	2.36
Financial Times	London	.67-.67	Copenhagen	1.54-1.54	2.30
Gillette Contour razor blades, 5-pack	Athens	1.99-1.72	Copenhagen	3.53-2.76	1.60
Heinz ketchup, 570gm	London	.86-.86	Madrid	2.04-1.92	1.98
Hitachi 630 videorecorder	London	452.17-393.19	Athens	749.64-551.21	1.40
Hoover 3726 vacuum cleaner	Luxembourg	118.31-105.63	Amsterdam	260.31-219.67	2.08
IBM 30-021 personal computer, 20MB, colour display	Athens	1629.21-1404.49	Copenhagen	4065.75-3332.58	1.60
Kelloggs cornflakes, 375 gm	Amsterdam	1.26-1.06	Cologne	1.95-1.82	1.72
Kodak 35mm Gold 100 film	Cologne	3.4-2.98	Copenhagen	5.98-4.90	1.64
Levi 501 jeans	London	50.01-43.49	Madrid	74.65-66.65	1.53
Mars Bar	London	.27-.27	Copenhagen	.67-.55	2.04
Nescafé, 200gm	Athens	3.67-3.16	Milan	7.78-7.14	2.26
Olivetti E165 electronic typewriter	Brussels	331.37-278.46	Lisbon	638.37-545.62	1.96
Pampers, Midi 52, boy's	Dublin	10.47-8.51	Milan	11.70-10.73	1.26
Sony 2121 television	London	536.45-466.48	Copenhagen	1091.74-894.87	1.92
Timotel shampoo, 200ml	London	1.23-1.07	Amsterdam	2.09-1.76	1.64
Toblerone, 100gm	Amsterdam	.85-.72	Lisbon	1.49-1.38	1.92

*Prices in ECU, converted at rate of April 27, 1990. The first set of figures in each column is the retail price, the second the price before tax.

**Ratio of highest to lowest pre-tax prices. Data supplied by Runzheimer Mitchell Europe.

Source: "Counting Costs of Dual Pricing in the Run-up to 1992," *The Financial Times* (July 9, 1990), p.4. Reprinted by permission.



1. Drivers of Foreign Market Pricing

- Company Goals
- Company Costs
- Customer Demand
- Competition

THE COST OF A PACK OF MARLBORO CIGARETTES VS. THE HIGHEST- AND LOWEST-PRICE BRANDS IN EACH MARKET

Country	Marlboro price (Marketer)	Highest-price cigarette (Marketer)	Lowest-price cigarette (Marketer)
Russia*	62¢ (Philip Morris)	87¢ Davidoff (Reemstma)	6¢ Dymok (Not available)
S. Korea	\$1.00 (Philip Morris)	\$2.50 Davidoff (Not available)	25¢ Chongja and Baekja (Korea Tobacco & Ginseng Corp.)
Brazil	\$1.25 (Philip Morris)	\$1.42 Capri (Souza Cruz)	64¢ Imperador (Philip Morris)
Chile	\$1.25 (Facil SA)	\$1.40 Barclay (Chile Tobacco)	65¢ Lifc (Chile Tobacco)
Mexico	\$1.26 (Cigatam)	\$1.35 Benson & Hedges (Cigatam)	35¢ Delicados (Cigatam)
Hungary	\$1.36 (Philip Morris)	\$1.57 Evc (Philip Morris)	51¢ Symphonia (Reemstma)
Japan	\$2.20 (Japan Tobacco)	\$2.48 Parliament (Philip Morris)	\$1.76 Hope, Peace (Japan Tobacco)
France	\$2.40 (Philip Morris)	\$2.59 Dunhill (Rothman's)	\$1.38 Gauloises Brunes (Seita)
Hong Kong	\$2.80 (Philip Morris)	\$3.50 Cartier (Rothman's Far East)	\$2.00 Double Happiness (Nanyang Bros. Tobacco)
Germany	\$2.90 (Philip Morris)	\$3.13 Dunhill (Rothman's)	\$2.68 West (Reemstma)
Australia	\$2.99 (Philip Morris)	\$3.24 Camel (R.J. Reynolds)	\$4.86** Horizon (WD & HO Wills)
U.K.	\$3.45 (Rothman's)	\$3.45 Camel (R.J. Reynolds)	\$2.70 Red Band (Nurdin & Peacock)

*800 rubles to the dollar.

**Sold in packs of 50 cigarettes.



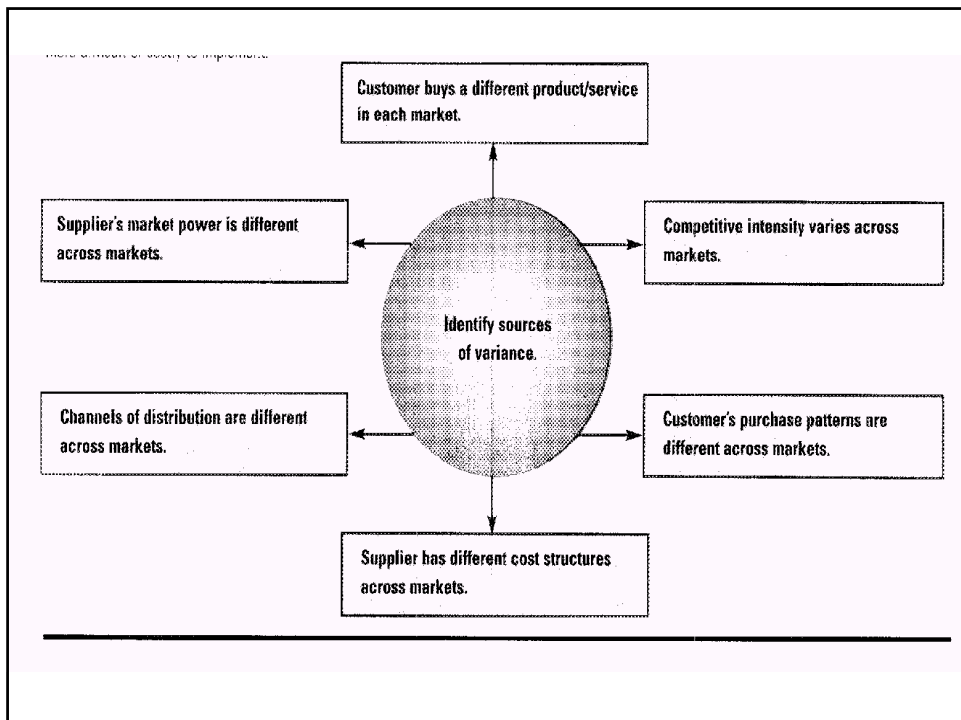
Drivers of Foreign Market Pricing (cont)

➤ Distribution Channels

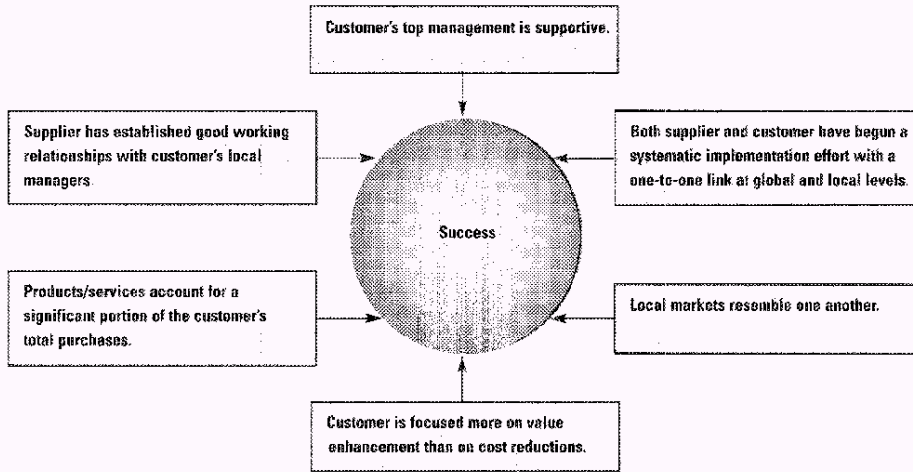
➤ Government Policies



Global pricing




Factors That Affect the Success of a Global-Pricing Contract



Price escalation

	Domestic channel		Foreign marketing channel	
	(a)	(b)	(c)	
	Firm	Firm	Firm	
	↓	↓	↓	Border
	Wholesaler	Wholesaler	Importer	Border
	↓	↓	↓	
	Retailer	Retailer	Wholesaler	
	↓	↓	↓	
	Consumer	Consumer	Retailer	
			↓	
			Consumer	
	£	£	£	
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 VAT)	168	203	234	
% price escalation over domestic channel	—	21	39	



Managing Price Escalation

1. Rearrange the distribution channel
2. Eliminate costly features (or make them optional)
3. Downsize the product
4. Assemble or manufacture the product in foreign markets
5. Adapt the product to escape tariffs and tax levies



Transfer Pricing

Tax effect of low versus high transfer price on net income (\$)

	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%/55%)	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: Adapted from Eitmann and Stonehill (1986).



Transfer Pricing

Determinants of Transfer Prices

- Tax regimes
- Local market conditions
- Market imperfections
- Joint partner venture
- Morale of local country managers



Transfer Pricing

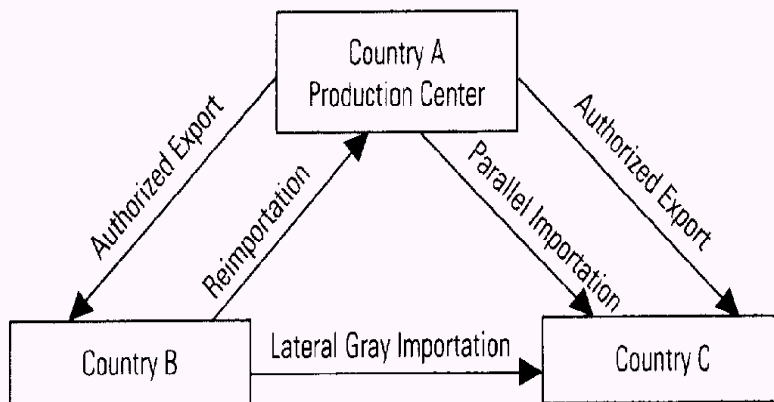
➤ Setting Transfer Prices

- Arm's length
- Cost-based
- Negotiated



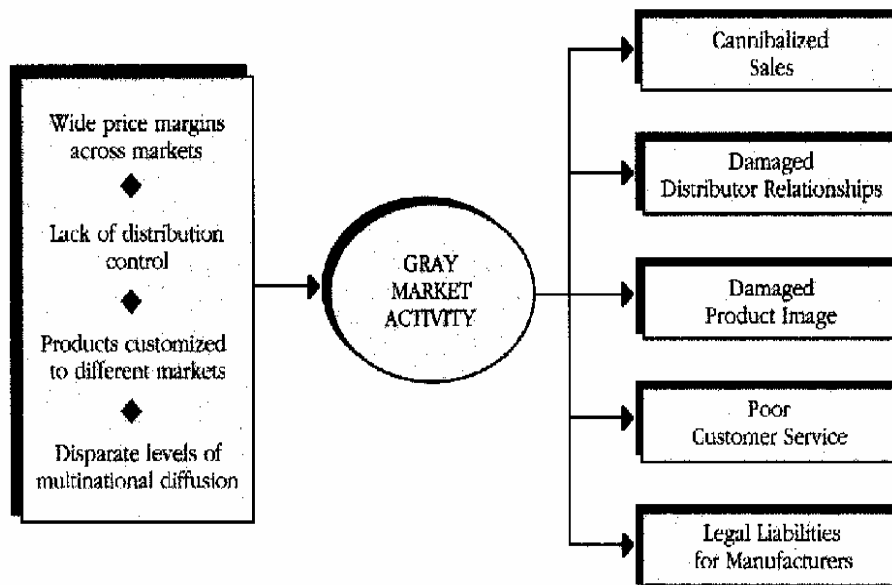
Parallel imports

Figure 1 Gray Markets



Note: Price in Country B < price in Country A < price in Country C.

The Implementation Network



Regions, Markets, and Industries Affected by Gray Market Imports

<i>Region</i>	<i>Percent of Firms Reporting Gray Market Activity</i>	<i>Industries Affected Within Region</i>	<i>Country Market Having Most Gray Market Activity</i>	<i>Products Affected in Country with Most Gray Market Activity</i>
North America (including Mexico)	13%	Fabricated metal products; measuring, analyzing, and controlling equipment; durable goods	Mexico	Auxiliary lighting (autos), process controls and software, coaxial cable, microwave systems
Latin America	17%	Industrial and commercial machinery; measuring, analyzing, and controlling equipment; electronics; durable goods; fabricated metal products	Colombia	Industrial coatings, thread compounds, commercial refrigerators, fluid pumps and tanks
Middle East	5%	Industrial and commercial machinery		
Sub-Saharan Africa	1%	Industrial and commercial machinery		
Pacific Rim	27%	Rubber and plastics; industrial and commercial machinery; primary metals; fabricated metal products; durable goods	Japan	Cookware, compressors and pumps, pumping systems, machine tools, drill bits, specialty-cut plastics
Western Europe	27%	Industrial and commercial machinery; measuring, analyzing, and controlling equipment; electronics; durable goods; fabricated metal products; miscellaneous manufacturing; paper products; chemicals and allied products	Germany U.K.	Work platforms, boat hardware, pneumatic pumps, packaging equipment, firearms Welding alloys, hand cleanser, dental care products, electronic ignition systems, conveyor belts
Scandinavia	3%	Industrial and commercial machinery		
Former Soviet Union	7%	Industrial and commercial machinery; electronics; measuring, analyzing, and controlling equipment; miscellaneous manufacturing	Russia	Earth-moving equipment, laboratory equipment, grain silos, glass-cutting equipment

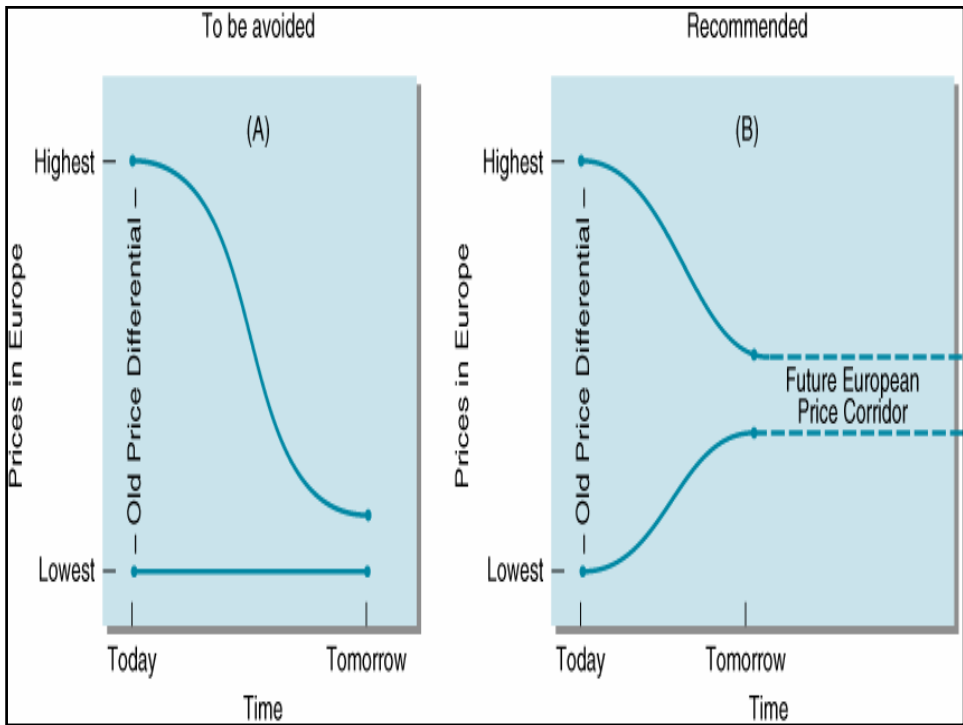


Figure 2 A Framework for Selecting a Coordination Method

		Environmental Complexity	
		Low	High
Level of Local Resources	Low	Centralization	Formalization
	High	Economic Measures	Informal Coordination

	Costs and Risks	Benefits
Economic Measures	<ul style="list-style-type: none"> • Costs of vertical information flows. • Local managers may "cheat," i.e., make decisions not in the corporate interest, if corporate and individual objectives are not completely aligned. 	<ul style="list-style-type: none"> • Country managers collect their own information and make their own pricing decisions. • Alignment of individual and corporate goals results in maximum efforts.
Formal Coordination: Centralization	<ul style="list-style-type: none"> • Costs of vertical information flows. • Lack of local managers' commitment. • Poor quality information at central headquarters. 	<ul style="list-style-type: none"> • Complete coordination of pricing with global strategy and other elements of marketing mix. • Complete control over gray markets.
Formal Coordination: Formalization	<ul style="list-style-type: none"> • Costs of training local managers. • Risk of suboptimal pricing decisions in all countries. • Risk of losing innovativeness and creativity when adapting to changing conditions. 	<ul style="list-style-type: none"> • Neutralized power relationship between headquarters and subsidiaries. • "Free ride" on competitor's approach to gray markets.
Informal Coordination	<ul style="list-style-type: none"> • Costs of horizontal information flows and socialization. • Up-front costs for selection of global managers. • Unresolvable conflict between local managers. 	<ul style="list-style-type: none"> • Manager's commitment to implementation. • Application of best local knowledge.