

# Product and pricing decisions

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## Learning objectives

After studying this chapter you should be able to do the following:

- Discuss the influences that lead a firm to standardize or adapt its products.
- Explore how international service strategies are developed.
- Discuss the challenge of developing new products for foreign markets.
- Explain and illustrate the alternatives in the product communication mix.
- Define and explain the different branding alternatives.
- Explain what is meant by a 'green' product.
- Discuss alternative environmental management strategies.
- Explain how internal and external variables influence international pricing decisions.
- Explain why and how prices escalate in export selling.
- Discuss the strategic options in determining the price level for a new product.
- Explain the necessary sales volume increase as a consequence of a price decrease.
- Explain what is meant by experience curve pricing.
- Explore the special roles and problems of transfer pricing in global marketing.
- Discuss how varying currency conditions challenge the international marketer.

## 11.1 Introduction

The product decision is among the first decisions that a marketing manager makes in order to develop a global marketing mix. This chapter examines product-related issues and suggests conceptual approaches for handling them. Also discussed are international brand (labelling) strategies and service policies.

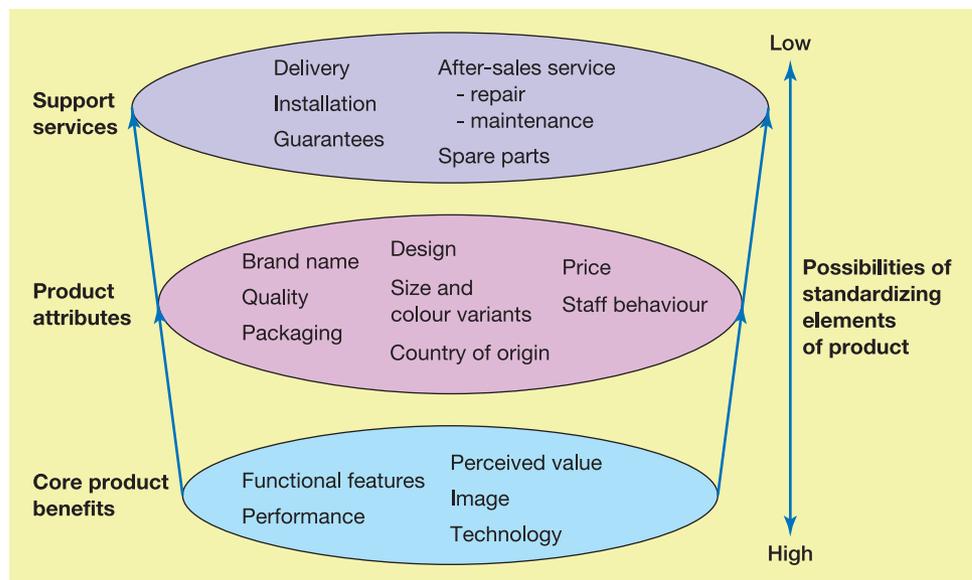
The pricing decision must be integrated with the other three Ps of the marketing mix. Price is the only area of the global marketing mix where policy can be changed rapidly without large direct cost implications. This characteristic, plus the fact that overseas consumers are often sensitive to price changes, results in the danger that pricing action may be resorted to as a quick fix instead of changes being made in other areas of the firm's marketing programme. It is thus important that management realizes that constant fine-tuning of prices in overseas markets should be avoided and that many problems are not best addressed by pricing action.

Generally, pricing policy is one of the most important yet often least recognized of all the elements of the marketing mix. The other elements of the marketing mix all lead to costs. The only source of profit to the firm comes from revenue, which in turn is dictated by pricing policy. In this chapter we focus on a number of pricing issues of special interest to international marketers.

## 11.2 The dimensions of the international product offer

In creating an acceptable product offer for international markets it is necessary to examine first what contributes to the 'total' product offer. Kotler (1997) suggests five levels of the product offer that should be considered by marketers in order to make the product attractive to international markets. In the product dimensions of Figure 11.1

Figure 11.1 The three levels of a product



we include not just the core physical properties, but also additional elements such as packaging, branding and after-sales service that make up the total package for the purchaser.

We can also see from Figure 11.1 that it is much easier to standardize the core product benefits (functional features, performance, etc.) than it is to standardize the support services, which often have to be tailored to the business culture and sometimes to individual customers, i.e. personalization (Vesanen, 2007).

### 11.3 Developing international service strategies

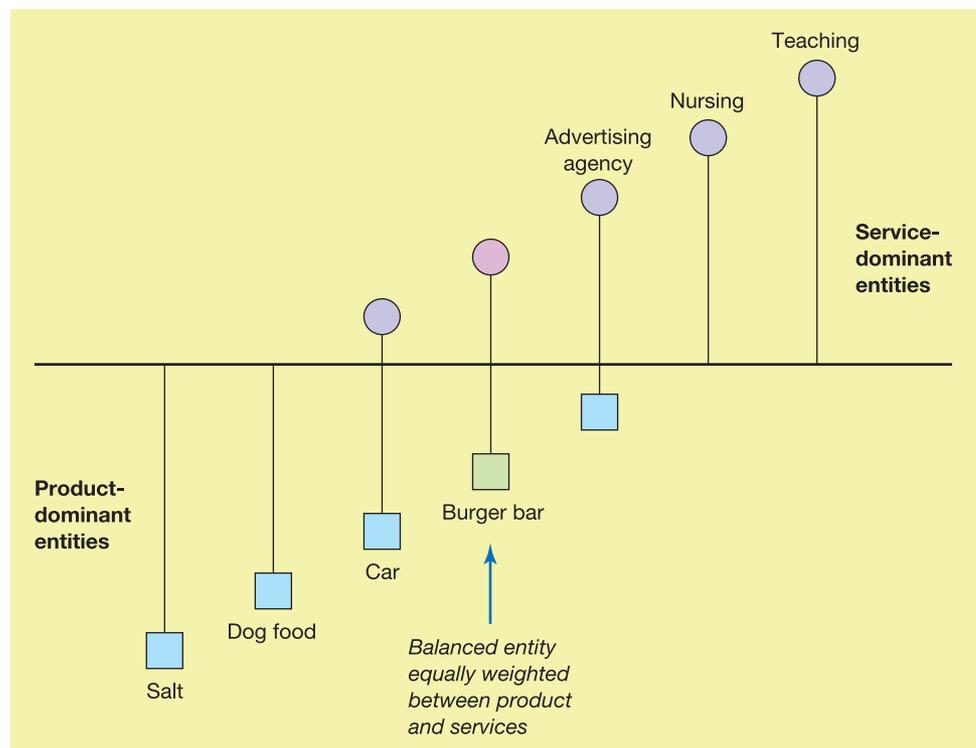
We have seen from the definition of a product that services often accompany products, but products are also an increasingly important part of our international economy in their own right. As Figure 11.2 shows, the mix of product and service elements may vary substantially.

#### Characteristics of services

Before considering possible international service strategies it is important to consider the special nature of global service marketing. Services are characterized by the following features:

- *Intangibility.* As services such as air transport or education cannot be touched or tested, the buyers of services cannot claim ownership or anything tangible in the

Figure 11.2 Scale of elemental dominance



Source: Czinkota and Ronkainen, *International Marketing*, 4th edn, (1995), p. 526.

traditional sense. Payment is for use or performance. Tangible elements of the service, such as food or drink on airlines, are used as part of the service in order to confirm the benefit provided and to enhance its perceived value.

- *Perishability*. Services cannot be stored for future use – for example, unfilled airline seats are lost once the aircraft takes off. This characteristic causes considerable problems in planning and promotion in order to match supply and demand. To maintain service capacity constantly at levels necessary to satisfy peak demand will be very expensive. The marketer must therefore attempt to estimate demand levels in order to optimize the use of capacity.
- *Heterogeneity*. Services are rarely the same because they involve interactions between people. Furthermore, there is high customer involvement in the production of services. This can cause problems of maintaining quality, particularly in international markets where there are quite different attitudes towards customer service.
- *Inseparability*. The time of production is very close to or even simultaneous with the time of consumption. The service is provided at the point of sale. This means that economies of scale and experience curve benefits are difficult to achieve, and supplying the service to scattered markets can be expensive, particularly in the initial setting-up phase.

## Global marketing of services

There are some specific problems in marketing services internationally. There are particular difficulties in achieving uniformity of the different marketing parameters in remote locations where exerting control can be especially problematic. Pricing, too, can be extremely difficult, because fixed costs can be a very significant part of the total service costs. Consumers' ability to buy and their perceptions of the service they receive may vary considerably between markets, resulting in significantly different prices being set and profits generated. Moreover, preserving customer loyalty in order to obtain repeat business may prove difficult because of the need to provide personalized services.

## Categories of service

All products, both goods and services, consist of a core element that is surrounded by a variety of optional supplementary elements. If we look first at the core service products we can assign them to one of three broad categories depending on their tangibility and the extent to which customers need to be physically present during service production. These categories are presented in Table 11.1.

## Categories of supplementary service

The core service provider, whether a bed for the night or a bank account, is typically accompanied by a variety of supplementary elements, which can be grouped into eight categories (Lovelock and Yip, 1996):

- *Information*. To obtain full value from any good or service, customers need relevant information about it, ranging from schedules to operating instructions, and from user warnings to prices. Globalization affects the nature of that information (including the languages and format in which it is provided). New customers and prospects are especially information hungry and may need training in how to use an unfamiliar service.
- *Consultation and advice*. Consultation and advice involve a dialogue to probe customer requirements and then develop a tailored solution. Customers' need for

Table 11.1 Three categories of service

Categories of service	Characteristics	Examples (service provider)	Possibilities of worldwide standardization (hence utilizing economies of scale, experience effects, lower costs)
People processing	Customers become part of the production process. The service firm needs to maintain local geographic presence.	Education (schools, universities). Passenger transport (airlines, car rental). Health care (hospitals). Food service (fast-food, restaurants). Lodging service (hotel).	No good possibilities: because of 'customer involvement in production' many local sites will be needed, making this type of service very difficult to operate globally.
Possession processing	Involves tangible actions to physical objects to improve their value to customers. The object needs to be involved in the production process, but the owner of the object (the customer) does not. A local geographic presence is required.	Car repair (garages). Freight transport (forwarding agent). Equipment installation (e.g. electrician). Laundry service (launderette).	Better possibilities: compared to people-processing services, this involves a lower degree of contact between the customer and the service personnel. This type of service is not so culture sensitive.
Information-based services	Collecting, manipulating, interpreting and transmitting data to create value. Minimal tangibility. Minimal customer involvement in the production process.	Telecommunication services (telephone companies). Banking. News. Market analysis. Internet services (producers of homepages on the WWW, database providers).	Very good possibilities: of worldwide standardization from one central location (single sourcing) because of the 'virtual' nature of these services.

advice may vary widely around the world, reflecting such factors as level of economic development, nature of the local infrastructure, topography and climate, technical standards and educational levels.

- *Order taking.* Once customers are ready to buy suppliers need to make it easy for them to place orders or reservations in the language of their choice, through telecommunications and other channels, at times and in locations that are convenient to them.
- *Hospitality: taking care of the customer.* Well-managed businesses try, at least in small ways, to treat customers as guests when they have to visit the supplier's facilities (especially when, as is true for many people-processing operations, the period extends over several hours or more). Cultural definitions of appropriate hospitality may differ widely from one country to another, such as the tolerable length of waiting time (much longer in Brazil than in Germany) and the degree of personal service expected (not much in Scandinavia, but lavish in Indonesia).
- *Safekeeping: looking after the customer's possessions.* When visiting a service site customers often want assistance with their personal possessions, ranging from car parking to packaging and delivery of new purchases. Expectations may vary by country, reflecting culture and levels of affluence.
- *Exceptions.* Exceptions fall outside the routine of normal service delivery. They include special requests, problem solving, handling of complaints/suggestions/compliments, and restitution (compensating customers for performance failures). Special requests are particularly common in people-processing services, such as in the travel and lodging industries, and may be complicated by differing cultural norms. International airlines, for example, find it necessary to respond to an array of medical and dietary needs, sometimes reflecting religious and cultural values.

Problem solving is often more difficult for people who are travelling overseas than it would be in the familiar environment of their native country.

- *Billing.* Customers need clear, timely bills that explain how charges are computed. With abolition of currency exchange restrictions in many countries bills can be converted to the customer's home currency. Hence currencies and conversion rates need to be clarified on billing statements. In some instances prices may be displayed in several currencies, even though this policy may require frequent adjustments in the light of currency fluctuations.
- *Payment.* Ease and convenience of payment (including credit) are increasingly expected by customers when purchasing a broad array of services. Major credit cards and travellers cheques solve the problem of paying in foreign funds for many retail purchases, but corporate purchasers may prefer to use electronic fund transfers in the currency of their choice.

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Not every core service is surrounded by all eight supplementary elements. In practice the nature of the product, customer requirements and competitive pressures help to determine which supplementary service must be offered. In many cases the provider of the supplementary services can be located in one part of the world and the services delivered electronically to another. For example, order taking/reservations and payment can be handled through telecommunication channels, ranging from voice telephone to the Web. As long as appropriate languages are available many such service elements could be delivered from almost anywhere.

In summary, the information-based services offer the best opportunities of global standardization. The two other types of service (people processing and possession processing) both suffer from their inability to transfer competitive advantages across borders. For example, when Euro Disneyland in Paris opened Disney suffered from not being able to transfer the highly motivated staff of its US parks to Europe.

The accelerating development within information technology (the Internet/the Web) has resulted in the appearance of new types of information service (e.g. information on international flight schedules), which offer great opportunities for standardization.

## Service in the business-to-business market

Business-to-business markets differ from customer markets in many ways:

- fewer and larger buyers, often geographically concentrated;
- a derived, fluctuating and relatively inelastic demand;
- many participants in the buying process;
- professional buyers;
- a closer relationship;
- absence of intermediaries;
- technological links.

For services in consumer markets an alternative for dissatisfied consumers is always to exit from the supplier–consumer relationship, as the number of firms offering the same kind of products is usually high. Therefore it is easy to switch between products and firms.

In the business-to-business market, however, bonds between the buyer and seller make the firms more unwilling to break the relationship. Of course the exit opportunity also exists to some extent in the business-to-business market, but the loss of investment in bonds and commitment tends to create exit barriers, because the costs of changing supplier are high. Furthermore, it can be difficult to find a new supplier.

Professional service firms, such as consulting engineering firms, have similarities with typical business-to-business service firms, but they involve a high degree of customization and have a strong component of face-to-face interaction. The service frequently takes the form of a hundred-million-dollar project and is characterized by the development of long-term relationships between firms, but also the management of day-to-day relationships during the project. When a professional service firm (whether it be an accountant, architect, engineer or management consultant) sells to its clients it is less the services of the firm than the services of specific individuals that it is selling. As a consequence professional service firms require highly skilled individuals.

Filiatrault and Lapierre (1997) made a study of the cultural differences in consulting engineering projects between Europe (France) and North America (Canada). In North America the consulting engineering firms are generally smaller and they work in an economic environment closer (than in Europe) to pure competition. The contracts in Europe are very large and often awarded by governments. The French consultants recognize that there is more flexibility in managing in North America than in Europe. Subcontracting also appears to be more popular in North America.

## 11.4 The product communication mix

Having decided upon the optimum standardization/adaptation route and the newness of the product, the next most important (and culturally sensitive) factor to be considered is that of international promotion.

Product and promotion go hand in hand in foreign markets and together are able to create or destroy markets in very short order. We have considered above the factors that may drive an organization to standardize or adapt its product range for foreign markets. Equally important are the promotion or the performance promises that the organization makes for its product or service in the target market. As with product decisions, promotion can be either standardized or adapted for foreign markets.

Keegan (1995) has highlighted the key aspects of marketing strategy as a combination of standardization or adaptation of the product and promotion of elements of the mix, and offers five alternative and more specific approaches to product policy. These approaches are shown in Figure 11.3.

Figure 11.3 Product/communication mode

		Product		
		<i>Standard</i>	<i>Adapt</i>	<i>New</i>
Promotion	<i>Standard</i>	Straight extension	Product adaptation	Product invention
	<i>Adapt</i>	Promotion adaptation	Dual adaptation	

Source: Based on Keegan, 1995, pp. 489–94 and p. 498, Table 13.1.

## Straight extension

This involves introducing a standardized product with the same promotion strategy throughout the world market (one product, one message worldwide). By applying this strategy successfully major savings can be made on market research and product development. Since the 1920s Coca-Cola has adopted a global approach, which has allowed the company to make enormous cost savings and benefits from continual reinforcement of the same message. While a number of writers have argued that this will be the strategy adopted for many products in the future, in practice only a handful of products might claim to have achieved this already. A number of firms have tried and failed. Campbell's soups, for example, found that consumers' taste in soup was by no means international.

An example of successful extension is Unilever's worldwide introduction of Organics Shampoo, which was first launched in Thailand in late 1993 after joint development work by Unilever's Hair Innovation Centres in Bangkok and Paris. By 1995 the brand was sold in over 40 countries, generating sales of £170 million. You can see below a two-page advertisement from a magazine, used during the product's introduction into Argentina. The basic advertising concept all over the world (including Argentina) has been 'Organics – the first ever root-nourishing shampoo'.

## Promotion adaptation

Use of this strategy involves leaving a product unchanged but fine-tuning promotional activity to take into account cultural differences between markets. It is a relatively cost-effective strategy as changing promotion messages is not as expensive as adapting products. An example of this strategy is illustrated in the following Lux example.

### LUX soap (Unilever): the United Kingdom versus India

The UK version of the LUX advertisement is based on the classic transborder advertising campaign, 'the beauty soap of film stars', which has been standardized to a high degree. In India the LUX campaign has been given a special local touch.

The advertisement is split into two vertical panels. The left panel shows a woman with long, flowing brown hair against a desert background. The right panel shows a green bottle of Organics Shampoo with bubbles rising from it, set against a desert landscape. Text in Spanish is present on both pages.

**HA NACIDO LA TERCERA GENERACION PARA EL CUIDADO DEL PELO.**

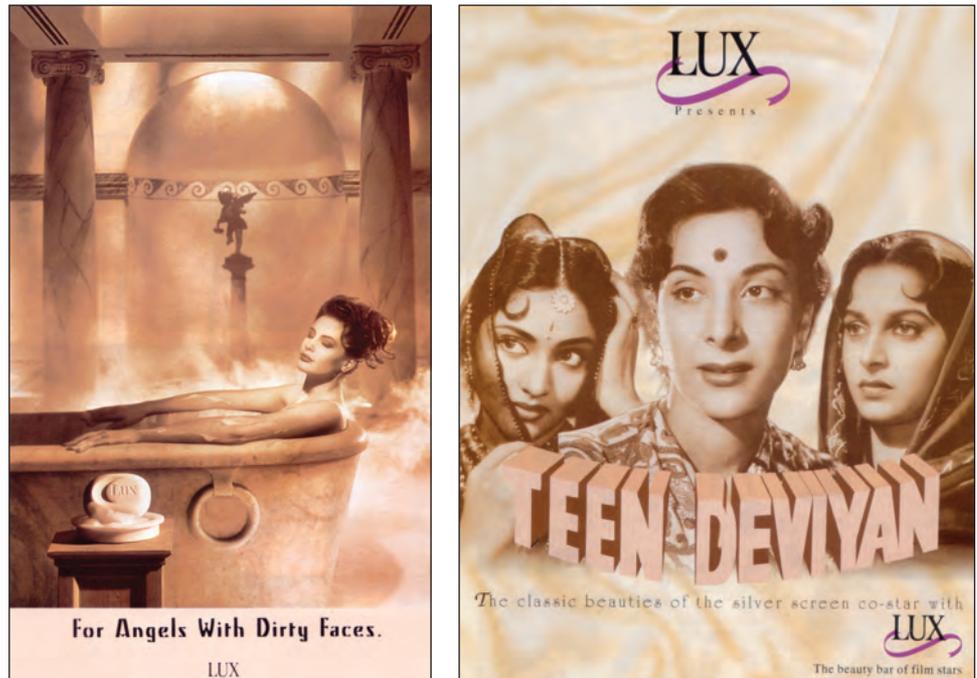
**ORGANICS**  
SHAMPOO NUTRIENTE DE LA RAIZ

**ORGANICS**  
EL PRIMER SHAMPOO NUTRIENTE DE LA RAIZ

Organics es la primera línea para el cuidado del pelo con Glucasil, el nutriente natural del pelo que actúa en lo más profundo: la raíz. Organics fortalece todo tu pelo llenándolo de vida, dejándolo más sano y hermoso cada día.

ELTIDA  
WATER  
INSTITUTE

'Straight extension' of Organics Shampoo to Argentina



Advertisements for Lux in UK and India

The Indian version is one of three advertisements that trace LUX's association with film stars from the past era to the current stars of today and the potential film stars of tomorrow. The advertisement focuses on three past legendary beauties of Indian cinema who have endorsed the brand. The creative statement is in a cinema poster style, keeping the brand image in mind, and in a sepia colour tone to give it a nostalgic feel.

### Product adaptation

By modifying only the product a manufacturer intends to maintain the core product function in the different markets. For example, electrical appliances have to be modified to cope with different electrical voltages in different countries. A product can also be adapted to function under different physical environmental conditions. Exxon changed the chemical composition of petrol to cope with the extremes of climate, but still used the 'Put a tiger in your tank' campaign unchanged around the world.

### Dual adaptation

By adapting both product and promotion for each market the firm is adopting a totally differentiated approach. This strategy is often adopted by firms when one of the previous three strategies has failed, but particularly if the firm is not in a leadership position and is therefore reacting to the market or following competitors. It applies to the majority of products in the world market. The modification of both product and promotion is an expensive but often necessary strategy.

An example of dual adaptation is shown below, with the launch of Kellogg's Basmati Flakes in the nascent breakfast cereal market in India. This product was specially created to suit Indian tastes, India being a large rice-eating country. The advertising campaign was a locally adapted concept based on international positioning. Note that the product is available only in the Bombay area.



Kellogg's dual adaptation for the Indian market

### Product invention

Product invention is adopted by firms usually from advanced nations that are supplying products to less developed countries. Products are specifically developed to meet the needs of the individual markets. Existing products may be too technologically sophisticated to operate in less developed countries, where power supplies may be intermittent and local skills limited. Keegan (1995) uses a hand-powered washing machine as a product example.

## 11.5 Product positioning

Product positioning is a key element in the successful marketing of any organization in any market. The product or company that does not have a clear position in the customer's mind consequently stands for nothing and is rarely able to command more than a simple commodity or utility price. Premium pricing and competitive advantage are largely dependent upon the customer's perception that the product or service on offer is markedly different in some way from competitive offers. How can we achieve a credible market position in international markets?

Since it is the buyer/user perception of benefit-generating attributes that is important, product positioning is the activity by which a desirable 'position' in the mind of the customer is created for the product. Positioning a product for international markets begins with describing specific products as comprising different attributes that are capable of generating a flow of benefits to buyers and users.

The global marketing planner puts these attributes into bundles so that the benefits generated match the special requirements of specific market segments. This product design problem involves not only the basic product components (physical, package, service and country of origin) but also brand name, styling and similar features.

Viewed in a multidimensional space (commonly denoted as ‘perceptual mapping’), a product can be graphically represented at a point specified by its attributes. The location of a product’s point in perceptual space is its ‘position’. Competitors’ products are similarly located (see also Johansson and Thorelli, 1985). If points representing other products are close to the point of the prototype then these other products are close competitors of the prototype. If the prototype is positioned away from its closest competitors in some international markets and its positioning implies important features for customers, then it is likely to have a significant competitive advantage.

### Country-of-origin effects

The country of origin of a product, typically communicated by the phrase ‘made in [country]’, has a considerable influence on the quality perception of that product. Some countries have a good reputation and others have a poor reputation for certain products. For example, Japan and Germany have good reputations for producing cars. The country-of-origin effects are especially critical among eastern European consumers. A study (Ettensén, 1993) examined the brand decision for televisions among Russian, Polish and Hungarian consumers. These consumers evaluated domestically produced television products much lower than western-made products, regardless of brand name. There was a general preference for televisions manufactured in Japan, Germany and the United States.

#### Exhibit 11.1 Chinese piano manufacturers are experiencing the ‘Country Of Origin’ (COO) effect

The Chinese piano industry is a useful example to show the opportunities and challenges facing Chinese brands. China has overtaken Japan and South Korea to become the world’s largest piano-producing nation. One of the brand manufacturers, Pearl River, has become the world’s largest piano manufacturer with annual sales of about 100,000 units. As piano making is still a labour-intensive industry, Chinese manufacturers enjoy a big cost and price advantage. This also motivates international dealers to stock Chinese pianos, because of a larger profit margin. However, the biggest branding dilemma facing Chinese piano manufacturers is negative perceptions of ‘made in China’ as a label. It is difficult for individual firms to change this perception and requires the country to change its image in general, which may take a generation. It has taken Japanese Yamaha more than 30 years to change its image from a cheap ‘me-too’ product to a leading global brand. An important buying influence also comes from music teachers, and many of them advise their students not to buy Chinese-made instruments.

To overcome this difficulty, Chinese manufacturers could try to link their brands to Western-oriented values and names. For example, Longfeng Piano could emphasize that its Kingsburg model is designed by the world-renowned German designer Klaus Fenner.

Sources: Adapted from Fan (2007)

The country of origin is more important than the brand name and can be viewed as good news for western firms that are attempting to penetrate the eastern European region with imports whose brand name is not yet familiar. Another study (Johansson *et al.*, 1994) showed that some products from eastern Europe have done well in the West, despite negative country-of-origin perceptions. For example, Belarus tractors have sold well in Europe and the United States not only because of their reasonable price but also because of their ruggedness. Only the lack of an effective distribution network has hindered the firm’s ability to penetrate western markets to a greater degree.

When considering the implications of product positioning it is important to realize that positioning can vary from market to market, because the target customers for the

product differ from country to country. In confirming the positioning of a product or service in a specific market or region it is therefore necessary to establish in the consumer's perception exactly what the product stands for and how it differs from existing and potential competition. In developing a market-specific product positioning the firm can focus upon one or more elements of the total product offer, so the differentiation might be based upon price and quality, one or more attributes, a specific application, a target consumer or direct comparison with one competitor.

## 11.6 Brand equity

A study by Citibank and Interbrand in 1997 found that companies basing their business on brands had outperformed the stock market for 15 years. The same study does, however, note the risky tendency of some brand owners to have reduced investments in brands in the mid-1990s with negative impacts on their performance (Hooley *et al.*, 1998, p. 120).

The following two examples show that brands add value for customers:

- 1 The classic example is that in blind test 51 per cent of consumers prefer Pepsi to Coca-Cola, but in open tests 65 per cent prefer Coca-Cola to Pepsi: soft drink preferences are based on brand image, not taste (Hooley *et al.*, 1998, p. 119).
- 2 Skoda cars have been best known in the United Kingdom as the butt of bad jokes, reflecting a widespread belief that the cars are of very low quality. In 1995 Skoda was preparing to launch a new model in the United Kingdom, and did 'blind and seen' tests of the consumers' judgement of the vehicle. The vehicle was rated as better designed and worth more by those who did not know the make. With the Skoda name revealed perceptions of the design were less favourable and estimated value was substantially lower. This leads us from the reputation of the company to branding (Hooley *et al.*, 1998, p. 117).

### Exhibit 11.2 Madame Tussauds - a brand which brings people closer to celebrities on a global basis

The attraction's history is a rich and fascinating one with roots dating back to the Paris of 1770. It was here that Madame Tussaud learnt to model wax likenesses under the tutelage of her mentor, Dr Philippe Curtius. Her skills were put to the test during the French Revolution when she was forced to prove her allegiance making the death masks of executed aristocrats. It was in the early 19th century that she came to Britain, bringing with her a travelling exhibition of revolutionary relics and effigies of public heroes and rogues.

The Tussauds Group strategy is to develop an international entertainment business of successful visitor attractions that are special, imaginative and offer exceptional visitor value.

With over 13 million guests a year, the Tussauds Group is today Europe's largest operator and developer of visitor attractions and is sixth largest in the world. In 1998 the Group was acquired by Charterhouse Development Capital after 20 years of ownership by Pearson plc.

In March 2005 the Tussauds Group, that owns Madame Tussauds, was sold to Dubai International Capital, a private equity firm backed by the Dubai government and the Crown Prince of Dubai. They paid £800 million to take control.

#### Brand experience

The future for brands is about building memorable consumer experiences. Experience-oriented companies like Madame Tussauds need to have something that goes beyond the product. Madame Tussauds' selling point is not about waxworks, it is about bringing people closer to celebrities and what they do in life.



Robbie Williams (London) and the local Chinese popstars (Twins) (Shanghai)

Sources: Madame Tussauds London (left) and Madame Tussauds Shanghai (right).

### Choice of new location

The choice of a new location is based on many different criteria. Madame Tussauds has a product development team that investigates how many tourists visit a city, whether they fit the profile of the attraction's visitors and whether there's enough space. Detailed research is vital to take a concept into a new market. After opening in Hong Kong Madame Tussauds recently opened its second Asian branch in Shanghai. As China's largest and wealthiest city with over 13 million residents and nearly 40 million tourists a year, Shanghai represents a good opportunity for Madame Tussauds.

### Interactivity with the waxwork figures

The new Shanghai branch has the most interactivity of all the attractions, with fewer waxwork figures and more to do around them. The Tiger Woods exhibit allows visitors to putt on the green and see their scores come up. The latest guest to have a hole-in-one is recorded on the leaderboard. Visitors can also go into a karaoke booth with models of some famous Chinese popstars, called Twins (see the photo), sing with them and view themselves on video. People can also dress up like Charlie Chaplin and see themselves on a movie screen in black and white.

### Balancing local and global branding

The research of Madame Tussauds shows a 98 per cent brand recognition in the UK market. However, in Asia, the term 'madame' sometimes implies a bar or club to many consumers, and saying that the brand is a 'wax attraction' does not mean anything in the Asian market as there is no tradition of that type of museum there.

For Madame Tussauds it is important to make sure the brand maintains a good mix of local and global content. This is a delicate balance: too much local content does not fit with the idea of a global brand, while too little emphasis on global figures can disappoint international customers. The new Chinese venue overwhelmingly features local faces, such as actor Ge You, kung fu king Jackie Chan, the pop-group Twins and basketball superstar Yao Ming; it also has global figures such as David Beckham, Michael Jackson and Brad Pitt. The London attraction has a wide range of global figures such as Angelina Jolie, Beyonce Knowles and Robbie Williams (see the photo), but international tourists also love Margaret Thatcher, Princess Diana, Winston Churchill and the Queen. The photos illustrate the Madame Tussauds mixture of global content (like Robbie Williams) and local content (like the Twins).

Expanding the Madame Tussauds brand on a global scale is a challenge, but when it comes down to the essentials, Madame Tussauds is not about waxworks – it is about consumer experiences and bringing people into interaction with the celebrities.

Sources: With kind permission from Madame Tussauds Group, especially Global Marketing Director Nicky Marsh from London ([www.madame-tussauds.com](http://www.madame-tussauds.com)) and Cathy Wong, External Affairs Consultant from Shanghai ([www.madame-tussauds.com.cn](http://www.madame-tussauds.com.cn)); Marsh, N. (2006) 'Translating experiences across the world', *Brand Strategy*, June, p. 11; Macalister, T. (2005) 'Madame Tussauds to open in Shanghai', *The Guardian* (London), 19 September, p. 20.

## Definitions of 'brand equity'

### Brand equity

A set of brand assets and liabilities, which can be clustered into five categories: brand loyalty, brand awareness, perceived quality, brand associations and other proprietary brand assets. Brand equity is the premium a customer/consumer would pay for the branded product or service compared to an identical unbranded version of the same product/service.

Although the definition of **brand equity** is often debated, the term deals with the brand value, beyond the physical assets associated with its manufacture.

David Aaker of the University of California at Berkeley, one of the leading authorities on brand equity, has defined the term as 'a set of *brand assets and liabilities* linked to the brand, its name and symbol, that add to or subtract from the value provided by a product or service to a firm or to the firm's customers (Aaker, 1991, p. 15).

Aaker has clustered those assets and liabilities into five categories:

- 1 *Brand loyalty*. Encourages customers to buy a particular brand time after time and remain insensitive to competitors' offerings.
- 2 *Brand awareness*. Brand names attract attention and convey images of familiarity. May be translated to: how big a percentage of the customers know the brand name.
- 3 *Perceived quality*. 'Perceived' means that the customers decide upon the level of quality, not the company.
- 4 *Brand associations*. The values and the personality linked to the brand.
- 5 *Other proprietary brand assets*. Include trademarks, patents and marketing channel relationships.

Brand equity can be thought of as the additional cash flow achieved by associating a brand with the underlying values of the product or service. In this connection it is useful (although incomplete) to think of a brand's equity as *the premium a customer/consumer would pay for the branded product or service compared to an identical unbranded version of the same product/service*.

Hence brand equity refers to the strength, depth and character of the consumer–brand relationship. A strong equity implies a positive force that keeps the consumer and the brand together, in the face of resistance and tension. The strength, depth and character of the customer–brand relationship is referred to as the *brand relationship quality* (Marketing Science Institute, 1995).

## 11.7 Branding decisions

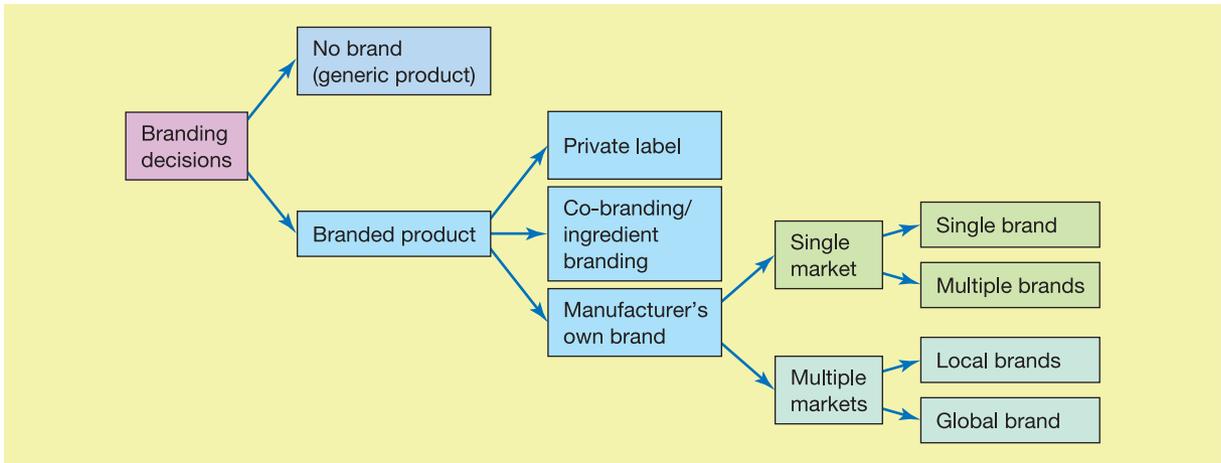
Closely linked to product positioning is the question of branding. The basic purposes of branding are the same everywhere in the world. In general, the functions of branding are as follows:

- to distinguish a company's offering and differentiate one particular product from its competitors;
- to create identification and brand awareness;
- to guarantee a certain level of quality and satisfaction;
- to help with promotion of the product.

All of these purposes have the same ultimate goals: to create new sales (market shares taken from competitors) or induce repeat sales (keep customers loyal).

As seen from Figure 11.4 there are four levels of branding decisions. Each alternative at the four levels has a number of advantages and disadvantages, which are presented in Table 11.2. We will discuss these options in more detail below.

Figure 11.4 Branding decisions



Source: Adapted from Onkvisit and Shaw, 1993, p. 534.

### Exhibit 11.3 Unilever's Snuggle fabric softener - an example of local brands in multiple markets

An effective example of promotion adaptation is illustrated by Unilever's Snuggle Fabric softener. The product was initially launched in Germany as an economy brand in a category dominated by Procter and Gamble. In order to counteract the negative quality inferences associated with low price, Unilever emphasized softness as the product's key point of difference. The softness association was communicated through the name, 'Kuschelweich', which means 'enfolded in softness', and this was illustrated through a picture of a teddy bear on the package. When the product was launched in France, Unilever kept the brand positioning of economy and softness but changed the name to 'Cajoline', meaning softness in French. In addition, the teddy bear that had been inactive in Germany now took the centre stage in the French advertising as the brand symbol for softness and quality. Success in France led to global expansion and in each case the brand name was changed to connote softness in the local language while the advertising featuring the teddy bear remained virtually identical across global markets. By the 1990s, Unilever marketed the fabric softener around the globe with over a dozen brand names, all with the same product positioning and advertising support. More importantly, the fabric softener was generally number 1 or number 2 brand in each market.

Source: Adapted from Keller and Sood (2001).

### Brand versus no brand

Branding is associated with added costs in the form of marketing, labelling, packaging and promotion. Commodities are 'unbranded' or undifferentiated products. Examples of products with no brand are cement, metals, salt, beef and other agricultural products.

### Private label versus co-branding versus manufacturer's own brand

These three options can be graded as shown in Figure 11.5.

The question of consumers having brand loyalty or shop loyalty is a crucial one. The competitive struggle between the manufacturer and the retailer actualizes the need for

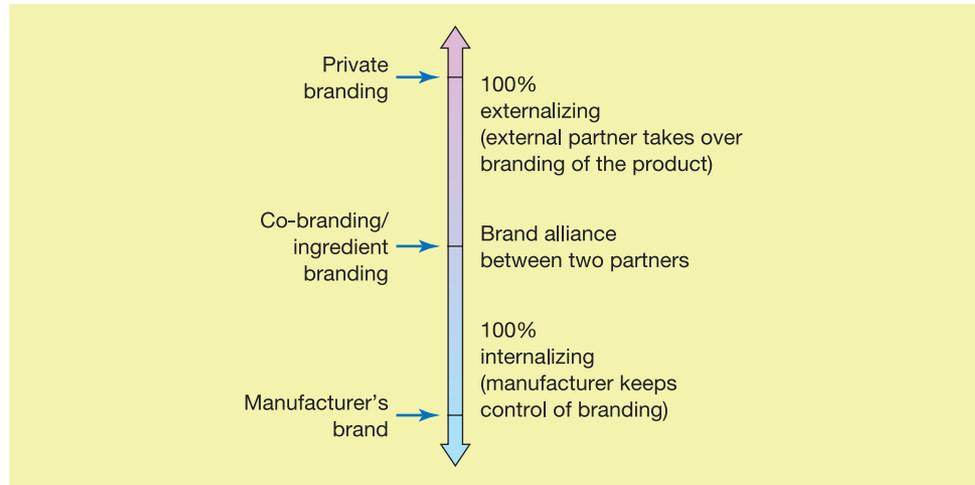
**Table 11.2** Advantages and disadvantages of branding alternatives

	Advantages	Disadvantages
<i>No brand</i>	Lower production cost. Lower marketing cost. Lower legal cost. Flexible quality control.	Severe price competition. Lack of market identity.
<i>Branding</i>	Better identification and awareness. Better chance for production differentiation. Possible brand loyalty. Possible premium pricing.	Higher production cost. Higher marketing cost. Higher legal cost.
<i>Private label</i>	Possibility of larger market share. No promotional problems.	Severe price competition. Lack of market identity.
<i>Co-branding/ ingredient branding</i>	Adds more value to the brand. Sharing of production and promotion costs Increases manufacturer's power in gaining access to retailers' shelves. Can develop into long-lasting relationships based on mutual commitment.	Consumers may become confused. Ingredient supplier is very dependent on the success of the final product. Promotion cost for ingredient supplier.
<i>Manufacturer's own brand</i>	Better price due to higher price inelasticity. Retention of brand loyalty. Better bargaining power. Better control of distribution.	Difficult for small manufacturer with unknown brand. Requires brand promotion.
<i>Single market, single brand</i>	Marketing efficiency. Permits more focused marketing. Eliminates brand confusion. Good for product with good reputation (halo effect).	Assumes market homogeneity. Existing brand's image harmed when trading up/down. Limited shelf space.
<i>Single market, multiple brands</i>	Market segmented for varying needs. Creates competitive spirit. Avoids negative connotation of existing brand. Gains more retail shelf space. Does not harm existing brand's image.	Higher marketing cost. Higher inventory cost. Loss of economies of scale.
<i>Multiple markets, local brands (see also Exhibit 11.4)</i>	Meaningful names. Local identification. Avoidance of taxation on international brand. Allows variations of quantity and quality across markets.	Higher marketing cost. Higher inventory cost. Loss of economies of scale. Diffused image.
<i>Multiple markets, global brand</i>	Maximum marketing efficiency. Reduction of advertising costs. Elimination of brand confusion. Good for culture-free product. Good for prestigious product. Easy identification/recognition for international travellers. Uniform worldwide image.	Assumes market homogeneity. Problems with black and grey markets. Possibility of negative connotation. Requires quality and quantity consistency. LDCs' opposition and resentment. Legal complications.

Source: Adapted from Onkvisit and Shaw 1989. Published with permission from Emerald Publishing Ltd. [www.emeraldinsight.com](http://www.emeraldinsight.com)

a better understanding of shopping behaviour. Both actors need to be aware of determinants of shop choice, shopping frequency and in-store behaviour. Where manufacturers pay little attention to the shopping behaviour of their consumers, this helps to anticipate the increasing power of certain retail chains.

Figure 11.5 The three brand options



### Private label

Private labelling is most developed in the United Kingdom, where Marks & Spencer, for instance, only sell own-label (**private label**) products. At Sainsbury's own labels account for 60 per cent of the sales. Compared with the high share of private labelling in northern Europe, the share in southern Europe (e.g. Spain and Portugal) is no higher than 10 per cent.

**Private label**  
Retailers own brand,  
e.g. Marks & Spencer's  
St Michael.

#### *The retailer's perspective*

For the retailer there are two main advantages connected with own-label business:

- 1 *Own labels provide better profit margins.* The cost of goods typically makes up 70–85 per cent of a retailer's total cost (*The Economist*, 4 March 1995, p. 10). So if the retailer can buy a quality product from the manufacturer at a lower price this will provide a better profit margin for the retailer. In fact private labels have helped UK food retailers to achieve profit margins averaging 8 per cent of sales, which is high by international standards. The typical figure in France and the United States is 1–2 per cent.
- 2 *Own labels strengthen the retailer's image with its customers.* Many retail chains try to establish loyalty to their particular chain of shops by offering their own quality products. In fact premium private-label products (e.g. Marks & Spencer's St Michael) that compete in quality with manufacturers' top brands have seen a growth in market share, whereas the share of cheap generics is tiny and declining.

#### *The manufacturer's perspective*

Although private brands are normally regarded as threats for manufacturers there may be situations where private branding is a preferable option (Herstein and Gamliel, 2006):

- Since there are no promotional expenses associated with private branding for the producer, the strategy is especially suitable for SMEs with limited financial resources and limited competences in the downstream functions.
- The private brand manufacturer gains access to the shelves of the retail chains. With increasing internationalization of the big retail chains this may also result in export business for the SME that has never been in international markets.

There are also a number of reasons why private branding is bad for the manufacturer:

- By not having its own identity, the manufacturer must compete mainly on price, because the retail chain can always switch supplier.
- The manufacturer loses control over how its products should be promoted. This may become critical if the retailer does not do a good job in pushing the product to the consumer.
- If the manufacturer is producing both its own brands and private brands there is a danger that the private brands will cannibalise the manufacturer's brand-name products.

Exhibit 11.4 shows an example with Kellogg, which has moved from a brand strategy to a private brand strategy.

#### Exhibit 11.4 Kellogg is under pressure to produce under Aldi's own label

In February 2000 Kellogg (the cereal giant) made an own-label deal with German supermarket chain Aldi. It is the first time that Kellogg has supplied own label.

A slogan on Kellogg's cereal packets claims: 'If you don't see Kellogg's on the box . . . it isn't Kellogg's in the box.' But now Kellogg has negotiated a deal with Aldi to supply products in Germany bearing a different brand name. Reports in Germany say that the deal was made after Aldi announced it would no longer pay brand suppliers' prices and threatened to cut top brands from its shelves.

Source: Adapted from various public media.

Quelch and Harding (1996) argue that many manufacturers have over reacted to the threat of private brands. Increasing numbers of manufacturers are beginning to make private-label products to take up excess production capacity. According to Quelch and Harding (1996), more than 50 per cent of US manufacturers of branded consumer packaged goods already make private-label goods as well.

Managers typically examine private-label production opportunities on an incremental marginal cost basis. The fixed overhead costs associated with the excess capacity used to make the private-label products would be incurred anyway. But if private-label manufacturing were evaluated on a full-cost basis rather than on an incremental basis it would, in many cases, appear much less profitable. The more private-label production grows as a percentage of total production, the more an analysis based on full costs becomes relevant (Quelch and Harding, 1996).

#### Manufacturer's own brand

From the Second World War until the 1960s brand manufacturers managed to build a bridge over the heads of the retailers to the consumers. They created consumer loyalty for their particular brand by using sophisticated advertising (culminating in TV advertising) and other promotional techniques. Developing a global brand is not an easy task. Firms must decide how to manage brands that span different geographic regions and product lines and determine who should control the positioning and marketing of such brands. B2B brands are also good candidates for global branding. Often it is the seller's reputation combined with the buyer's own level of awareness and degree of loyalty shown to the manufacturer (seller), that are important considerations in the purchasing decisions (Beverland *et al.*, 2007; Kotler and Pfoertsch, 2007).

Since the 1960s various sociological changes (notably the car) have encouraged the rise of large, efficient retailers. Nowadays the distribution system is being turned upside down. The traditional supply chain, powered by manufacturer ‘push’, is becoming a demand chain, driven by consumer ‘pull’. Retailers have won control over distribution not just because they decide the price at which goods are sold, but also because both individual shops and retail companies have become much bigger and more efficient. They are able to buy in bulk and to reap economies of scale, mainly due to advances in transport and, more recently, in information technology. Most retail chains have not only set up computer links between each store and distribution warehouses, they are also hooked up with the computers of the firm’s main suppliers, through an (electronic data interchange) system.

After some decades of absence private labels reappeared in the 1970s as generic products pioneered by Carrefour in France but were soon adopted by UK and US retailers. Ten years ago there was a distinct gap in the level of quality between private-label and brand-name products. Today the gap has narrowed: private-label quality levels are much higher than ever before, and they are more consistent, especially in categories historically characterized by little product innovation.

### Co-branding/ingredient branding

Despite the similarities between co-branding and ingredient branding there is also an important difference, as we shall see below.

#### Co-branding

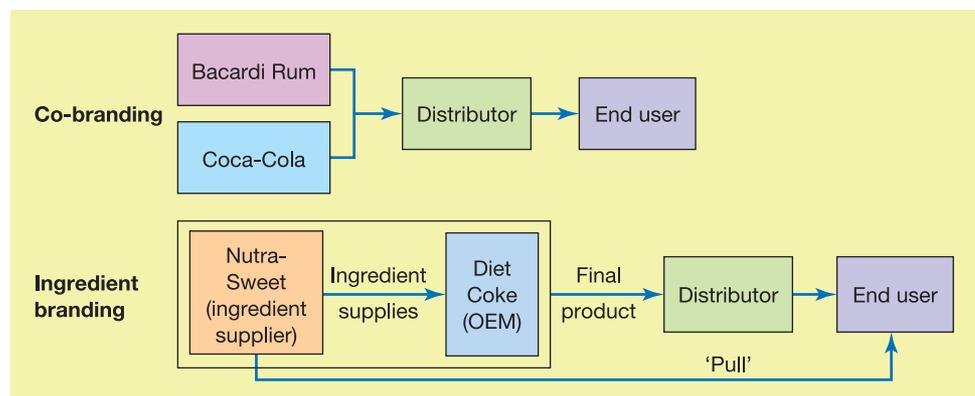
##### Co-branding

Form of cooperation between two or more brands, which can create synergies that create value for both participants, above the value they would expect to generate on their own.

**Co-branding** is a form of cooperation between two or more brands with significant customer recognition, in which all the participants’ brand names are retained. It is of medium to long-term duration and its net value creation potential is too small to justify setting up a new brand and/or legal joint venture. The motive for co-branding is the expectation of synergies that create value for both participants, above the value they would expect to generate on their own (Bengtsson and Servais, 2005).

In the case of co-branding, the products are often complementary, in the way that one product can be used or consumed independently of the other (e.g. Bacardi Rum and Coca-Cola). Hence co-branding may be an efficient alternative to traditional brand extension strategies (Figure 11.6).

**Figure 11.6** Illustration of co-branding and ingredient branding



### Exhibit 11.5 Shell's co-branding with Ferrari and Lego

In 1999–2000 Shell ran a £50 million co-branding campaign with Ferrari and LEGO. Some people might have thought that this was an attempt to persuade people, mainly in the West, that Shell's controversial attempt to dump the Brent Spar oil platform in the North Sea was not a true reflection of the company.

However, it may be more accurate to say that Shell was seeking a 'brand image transfer'. In the petrol retailer market traditionally driven by price and more price promotions, Shell wanted both Ferrari's sexy, sporty image and the family values of LEGO. Furthermore Shell was and is no longer only in the petroleum and oils business, where price promotions are the main focus of marketing activity. The company is also involved in food retailing, where loyalty programmes are important.

What were the benefits for Ferrari and LEGO? Ferrari gained sponsorship and royalty income from model car sales, while LEGO got improved global distribution. The co-branding strategy involved the use of ten exclusive small boxed toys and a big Ferrari LEGO car carrying a Shell logo. Shell wanted to sell between 20 and 40 million units of LEGO globally. It made Shell one of the world's largest toy distributors.

Source: Adapted from various public media.

#### *Ingredient branding*

Normally the marketer of the final product (OEM) creates all of the value in the consumer's eyes. But in the case of Intel and NutraSweet the ingredient supplier is seeking to build value in its products by branding and promoting the key component of an end product. When promotion ('pull' strategy: see Figure 11.6) of the key component brand is initiated by the ingredient supplier the goal is to build awareness and preference among consumers for that ingredient brand. Simultaneously, it may be the manufacturer (OEM) that seeks to benefit from a recognized ingredient brand. Some computer manufacturers are benefiting from the quality image of using an Intel chip.

However, **ingredient branding** is not suitable for every supplier of components. An ingredient supplier should fulfil the following requirements:

- The ingredient supplier should be offering a product that has a substantial advantage over existing products. DuPont's Teflon, NutraSweet, Intel chips and the Dolby noise reduction system are all examples of major technological innovations, the result of large investments in R&D.
- The ingredient should be critical to the success of the final product. NutraSweet is not only a low-calorie sweetener, but has a taste that is nearly identical to that of sugar.

#### **Ingredient branding**

The supplier delivers an important key component to the final OEM-product, e.g. Intel delivers its processor to the major PC-manufacturers.

#### **Single brand versus multiple brands (single market)**

A single brand or family brand (for a number of products) may be helpful in convincing consumers that each product is of the same quality or meets certain standards. In other words, when a single brand in a single market is marketed by the manufacturer, the brand is assured of receiving full attention for maximum impact.

The company may also choose to market several (multiple) brands in a single market. This is based on the assumption that the market is heterogeneous and consists of several segments.

#### **Local brands versus a global brand (multiple markets)**

A company has the option of using the same brand in most or all of its foreign markets or of using individual, local brands. A single, global brand is also known as an international or universal brand. A Eurobrand is a slight modification of this approach, as it

is a single product for a single market of 15 or more European countries, with an emphasis on the search for intermarket similarities rather than differences.

A global brand is an appropriate approach when a product has a good reputation or is known for quality. In such a case a company would be wise to extend the brand name to other products in the product line. Examples of global brands are Coca-Cola, Shell and the Visa credit card. Although it is possible to find examples of global brands, local brands are probably more common among big multinational companies than people realize. Boze and Patton (1995) have studied the branding practices in 67 countries all over the world of six multinational companies:

- 1 Colgate-Palmolive – headquartered in the United States.
- 2 Kraft General Foods (now part of Philip Morris) – headquartered in the United States.
- 3 Nestlé – headquartered in Switzerland.
- 4 Procter & Gamble – headquartered in the United States.
- 5 Quaker Oats – headquartered in the United States.
- 6 Unilever – headquartered in the United Kingdom and the Netherlands.

The findings of the research are summarized in Table 11.3. Of the 1,792 brands found in the 67 countries, 44 per cent were only marketed in one country. Only 68 brands (4 per cent) could be found in more than half of the countries. Of these 68 brands, only the following six were found in all 67 countries: Colgate, Lipton, Lux, Maggi, Nescafé and Palmolive. Hence these were the only true world brands.

Surprisingly, each of the six multinational corporations (MNCs) seems to follow the practice of multiple brands in a single market. No official explanation was offered for this strategy, but a Nestlé manager explained ‘that he believed it is a very important marketing advantage to provide a brand name not found in any other country, especially those adjacent to the nation or bigger than it’ (Boze and Patton, 1995, p. 24).

The use of umbrella brands varies a lot among the MNCs examined. Of the six MNCs Colgate is the most intensive user of its two company names:

- 1 *Colgate*. Mostly dental products: toothpaste, tooth powder, toothbrushes, dental floss, mouthwash, and shaving cream.
- 2 *Palmolive*. Hair products, shaving products, hand lotion, talc, deodorant, sun screen, toilet soap, bath products, liquid detergent (dishes and fine fabrics) and automatic dishwasher detergent.

It should be emphasized that the big MNCs prefer to acquire some local brands instead of using a global brand.

**Table 11.3** Brands of six multinational companies in 67 countries

Company	Total no. of brands	Brands found in 50% or more countries		Brands in only one country	
		Number	% of total	Number	% of total
Colgate	163	6	4	59	36
Kraft GF	238	6	3	104	44
Nestlé	560	19	4	250	45
P & G	217	18	8	80	37
Quaker	143	2	1	55	38
Unilever	471	17	4	236	50
Total	1,792	68	4	784	44

Source: Boze and Patton, 1995, p. 22. Reproduced with kind permission from the *Journal of Consumer Marketing*, Emerald Group Publishing Ltd.

## Implications of the Internet for collaboration with customers on product decisions

Firms are realizing the importance of collaboration for creating and sustaining competitive advantage. Collaboration with partners and even competitors has become a strategic imperative for firms in the networked world of business. More recently, scholars in strategy and marketing have focused on collaboration with customers to cocreate value (Prahalad and Ramaswamy, 2004).

The Internet is an open, cost-effective and ubiquitous network. These attributes make it a global medium with unprecedented reach, contributing to reduce constraints of geography and distance. The Internet enhances the ability of firms to engage customers in collaborative innovation in several ways. It allows firms to transform episodic and one-way customer interactions into a persistent dialogue with customers. Internet-based virtual environments allow the firm to engage in interaction with a much larger number of customers without significant compromises on the richness of the interaction (Evans and Wuster, 2000).

### Customization and closer relationships

The new business platform recognizes the increased importance of customization of products and services. Increased commoditization of standard features can only be countered through customization, which is most powerful when backed up by sophisticated analysis of customer data.

Mass-marketing experts such as Nike are experimenting with ways of using digital technology to enable customization. Websites that can display three-dimensional images, for example, will certainly boost the attractiveness of custom tailoring.

The challenge is clear: to use IT to get closer to customers. There are already many examples of this. Dell is building a closer relationship with its end customer by letting them design their own PCs on the Internet. Customers who have ordered their computers from Dell can then follow their computers along the various stages of the production process in real time on their personalized website. Such experimentation is advisable because the success of 'build-to-order' models such as Dell's represents a challenge to current 'build-to-stock' business platforms, which Compaq generally uses. A comparison of the business models of Dell and HP shows that Dell's basic business principle is the close relationship between the PC manufacturer and the end customer, without further intermediaries in the distribution channel. This allows Dell to individualize the computers to customers' specific needs.

Computers can also be remotely diagnosed and fixed over the network today; this may soon be true of many other appliances. Airlines now communicate special fares to preferred customers through e-mails and special websites. Cars will soon have Internet protocol addresses, which will make possible a range of personal, in-vehicle information services.

Customers can also be involved in the early stages of product development so that their inputs can shape product features and functionality. Pharmaceutical companies are experimenting with the possibility of analysing patients' genes to determine precisely what drugs should be administered in what dosages.

The transformation in the business platform can be seen in university textbook publishing. This industry – which has seen little innovation since the advent of the printing press – is now in the midst of major changes. Publishers are creating supplementary website links to provide additional ways for students and lecturers to be

connected during courses (e.g. [www.pearsoneduc.com](http://www.pearsoneduc.com) and [www.wiley.com](http://www.wiley.com)). The publisher's role, which traditionally was selling textbooks at the beginning of term, is becoming that of an educational consultant or value-adding partner throughout the term.

### Exhibit 11.6 Ducati motorcycles - product development through web communities

Founded in 1926, Italian Ducati builds racing-inspired motorcycles characterized by unique engine features, innovative design, advanced engineering and overall technical excellence. The company produces motorcycles in six market segments which vary in their technical and design features and intended customers: Superbike, Supersport, Monster, Sport Touring, Multistrada and the new SportClassic. The company's motorcycles are sold in more than 60 countries worldwide, with a primary focus in western European, Japanese and North American markets. Ducati has won 13 of the last 15 World Superbike Championship titles and more individual victories than the competition put together.

Ducati was quick to realize the potential of using the Internet to engage customers in its new product development efforts. The company set up a web division and a dedicated website, [www.ducati.com](http://www.ducati.com), in early 2000, inspired by the internet sales of the MH900 evolution, a limited-production motorcycle. Within 30 minutes, the entire year's production was sold out, making Ducati a leading international e-commerce player. Since then, Ducati has evolved its site to create a robust virtual customer community that had 160,000 registered users as of July 2004. Community management has become so central at Ducati that management has replaced the words 'marketing' and 'customer' with the words 'community' and 'fan'. Ducati considers the community of fans to be a major asset of the company and it strives to use the Internet to enhance the 'fan experience'. Ducati involves its fans on a systematic basis to reinforce the places, the events and the people that express the Ducati life style and Ducati's desired brand image. The community function is tightly connected with the product development and the fan involvement in the community directly influences product development.

Virtual communities play a key role in helping Ducati to explore new product concepts. Ducati has promoted and managed ad hoc online forums and chat rooms for over three years to harness a strong sense of community among Ducati fans.

Ducati also realized that a significant number of its fans spend their leisure time not only riding their bikes, but also maintaining and personalizing them. As a result, Ducati fans have deep technical knowledge that they are eager to share with other fans. To support such knowledge sharing, the company has created the 'Tech Café', a forum for exchanging technical knowledge. In this virtual environment, fans can share their projects for customizing motorcycles, provide suggestions to improve Ducati's next generation products, and even post their own mechanical and technical designs, with suggestions for innovations in aesthetic attributes as well as mechanical functions.

While not all fans participate in the online forums, those who do participate provide rich inputs for exploring new product concepts and technical solutions. These forums also help Ducati to enhance customer loyalty, because its fans are more motivated to buy products they helped to create.

Ducati managers also monitor vertical portals created for bikers, including [Motorcyclist.com](http://Motorcyclist.com) and [Motoride.com](http://Motoride.com); and Ducati monitors other virtual communities that have lifestyle associations with the Ducati brand. For instance, Ducati has entered into a partnership with the fashion company DKNY to tap into its community and interact with its members.

To validate its insights, Ducati uses online customer surveys to test product concepts and to quantify customer preferences. As a testimony to the ability of Ducati to create an ongoing customer dialogue and create a sense of engagement with its fans, Ducati gets extraordinary response rates, often in excess of 25 per cent when it surveys its customers. Ducati uses customer feedback for activities that go beyond product development.



### Exhibit 11.6 continued

Ducati also pursues Internet-based customer collaboration at the back end of its NPD process. Virtual communities play an important role at the product design and market testing stages. For instance, in early 2001, the community managers of Ducati.com identified a group of customers on its website that had particularly strong relationships with the company. They decided to transform such customers into active partners, involving them in virtual teams that cooperate with Ducati professionals from R&D, Product Management and Design. These virtual teams of customers work with the company's engineers to define attributes and technical features for the 'next bike'.

Within the virtual community, current and future Ducati bike owners discuss and review proposed product modifications that can be tested online in the form of virtual prototypes. They can even vote to reject proposed modifications, personalize products to their preferences, and can ask Ducati technicians for suggestions on personalizing their bikes to individual taste.

Source: adapted from [www.ducati.com](http://www.ducati.com) and Sawhney *et al.* (2005). Images from Ducati.

## Dynamic customisation of product and services

The second stage of the customer interaction vector focuses on the opportunities and challenges in dynamically customizing products and services. Competitive markets are rapidly eroding margins due to price-based competition, and companies are seeking to enhance margins through customized offerings. Dynamic customization is based on three principles: modularity, intelligence, and organization.

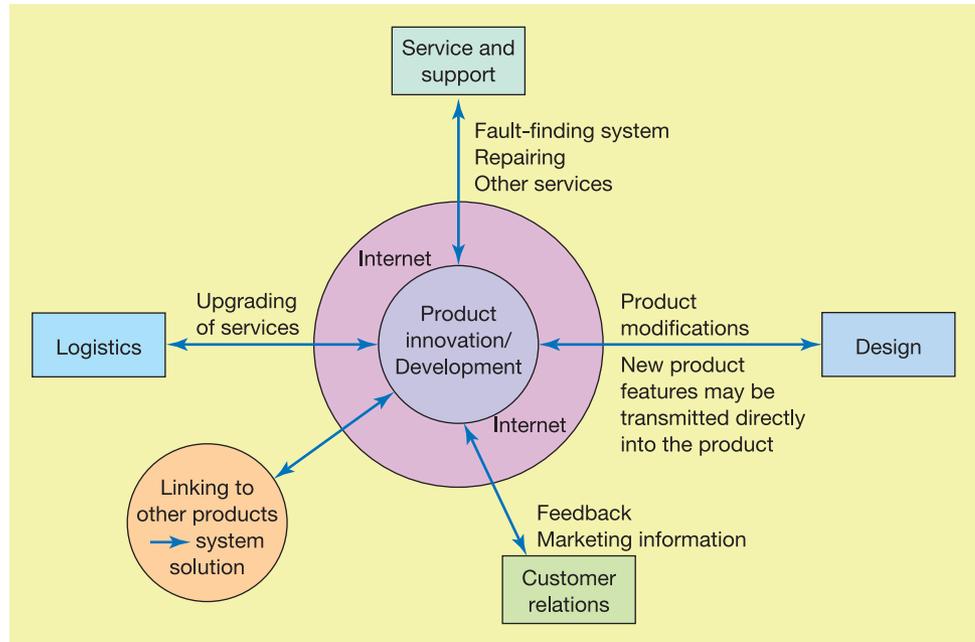
- 1 *Modularity*: An approach for organizing complex products and processes efficiently. Product or service modularity requires the partitioning of a task into independent modules that function as a whole within overall architecture.
- 2 *Intelligence*: Continuous information exchange with consumers allows companies to create products and processes using the best possible modules. Website operators can match buyer and seller profiles and make recommendations based on their shared interests. The result is intelligent sites that learn their visitors' (potential buyers') tastes and deliver dynamic, personalised information about products and services.
- 3 *Organization*: Dynamic customisation of products and services requires a customer-oriented and flexible approach that is fundamentally committed to operating in this new way.

## How can the Internet be integrated in the future product innovation?

Figure 11.7 shows some of the implications of the Internet on future product innovation. The Internet is seen as the medium through which each 'box' communicates with the R&D function in the company.

- *Design*. Data is gathered directly from the product and is part of designing and developing the product. New product features (such as new versions of software programs) may be built into the product directly from the Internet.
- *Service and support*. The service department can perform troubleshooting and correction directly through the Internet set-up. For example a Mercedes car driving on the highway may be directly connected to the Mercedes service department. It will monitor the main functions of the car and if necessary make online repairs of, for example, the software of the car.

Figure 11.7 Product innovation through the Internet



- *Customer relations.* Data gathered from the product may form part of statistics, comparisons between customers, etc. In this way the customer can compare the performance of their product (e.g. a car) with other customers' product (a kind of benchmarking). This may also strengthen an existing customer relationship.
- *Logistics.* Concurrently with increasing demands for just-in-time deliveries, the Internet will automatically find the distribution and transport that will take the goods from the subsupplier to the producer and then to the customers in the cheapest and most efficient way (and on time).

A fundamental shift in thinking is to replace the term 'supply chain' with 'demand chain'. The critical difference is that demand-chain thinking starts with the customers and works backwards. This breaks away from parochial approaches that focus solely on reducing transport costs. It supports a 'mass customization' viewpoint, in which bundles of goods and services are offered in ways that support customers' individual objectives.

This does not necessarily imply product differentiation. In fact the service aspects often require differentiation. For example, a company such as Unilever will provide the same margarine to both Tesco and Sainsbury's. However, the ways in which the product is delivered, transactions are processed and other parts of the relationship are managed, can and should be different, since these two competing supermarket chains each have their own ways of evaluating performance. The information systems required to coordinate companies along the demand chain require a new and different approach to that required within individual companies. Some managers believe that if they and their suppliers choose the same standard software package, such as SAP, they will be able to integrate their information systems.

- *Link to other products.* Sometimes a product is used as a subcomponent in other products. Through links in the Internet such subcomponents may be essential inputs for more complex product solutions. The car industry is an example of an industry that already makes a targeted effort in this direction. New 'stylish' cars are

linked together by the Internet. In the wake of this development a new industry is created, the purpose of which is to provide integrated transport. In this new industry developing and producing cars is only one of several important services. Instead systems are to be developed that can diagnose cars (and correct the error) while the car is running, systems for regulation of traffic, interactive systems that enable drivers to have the desired transport at their disposal when and where they want it without tiresome rental agreements, etc.

The music industry is also undergoing a change. Today you can buy portable 'players' that can download music from the Internet using the MP3 format, and subsequently play the music that is stored in the 'player'. The CD is skipped – and so is the whole distribution facility. The music industry will become completely altered through the different economic conditions. The struggle will be about creating the best portal to the Internet, where the consumer can find the best information on music and the largest selection of music. The problems regarding rights are, however, still being discussed, and the lawyers and politicians have to find a final solution before the market can increase significantly.

Thus innovative product development of the future demands that a company possesses the following characteristics:

- *Innovative product development and strategic thinking.* Product development will contain much technology and demand an interdisciplinary, strategic overview and knowledge in order to find out what new services are worth aiming at.
- *Management of alliances.* Few companies have all the necessary qualifications themselves – innovative product development and the resulting services demand that companies enter into alliances very dynamically and yet in a structured way.
- *New customer relations.* The above-mentioned car industry example clearly shows that the customers are not car buyers any longer but *buyers of transport services*, and that is quite another matter. This means that companies have to focus on understanding the customers' needs in a quite different way.

## Developing brands on the Internet

Clearly consumer product companies such as Procter & Gamble, Colgate, Kraft Foods, and consumer durables and business-to-business companies such as General Motors, General Electric, Allied Signal and Caterpillar have crafted their business strategies by leveraging physical assets and developing powerful global brands supported by mass advertising and mass distribution. But remote links with customers apply equally well to these companies. Remote and continuous links with customers become critical as the concepts of brand identity and brand equity are redefined by the Internet.

Kraft Interactive Kitchen ([www.kraftfoods.com](http://www.kraftfoods.com)) is an example of a consumer products company keeping in touch with its consumers by providing information-based services such as meal planners, recipes, tips and cooking techniques. Kraft's intention is to have remote connections and interactions with consumers in new ways.

However, some companies find it difficult to translate a strong offline brand (such as Nike and Levi's) to the Internet, because many of the well-known brands are based on an extensive 'physical' retail distribution system, and many of the retailers are reluctant to support online brands because of the fear of disintermediation (see section 11.5 for more discussion of this issue).

In fact many sites that are run by top brands register minimal online traffic, according to a report by Forrester Research. Forrester studied brand awareness and web surfing behaviour among 16–22-year-olds, whom advertisers consider to be strongly brand conscious.

Companies are taking a broad approach to branding, integrating it with an overall advertising and marketing strategy. On the net branding is more than logos and colour schemes; it is about creating experiences and understanding customers. Consequently web brand building is not cheap. Building a brand requires a persistent online presence. For some brands that entails a mass-appeal site; for others brand building requires a combination of initiatives, from banner ads to sponsorships.

## 11.9 Green marketing strategies

As understanding grows about the impact of human activity on the earth's ecosystems, consumer concern about the environment and its links to health and safety will intensify. At the same time, humankind's passion for consumption will persist. The challenge for companies will be to devise business practices and products that are friendly to the environment while also meeting the needs of consumers.

Environmentalists were once considered the only people concerned about the depletion of natural resources, waste accumulation and pollution. Environmentalists around the world are now becoming global in their scope and scale of operations. Their aim is to increase people's awareness of the importance of environmental preservation on a global scale and how the lack of it will have a harmful effect on our planet.

Because ecological grassroots campaigns gain widespread recognition and support, and global media networks such as CNN continue to report on environmental issues and disasters, today's consumer is becoming more environmentally conscious. Various polls and surveys reveal that many consumers are taking environmental issues into consideration as they buy, consume and dispose of products. Consequently there is a direct connection between a company's ability to attract and keep consumers and its ability to develop and execute environmentally sound strategies.

As consumer preferences and government policies increasingly favour a balanced business approach to the environment, managers are paying more attention to the strategic importance of their environmental decisions. Irresponsible behaviour by some firms has led to consumer boycotts, lengthy lawsuits and large fines. Such actions may have harmed firms in less direct ways, such as negative public relations, diversion of management attention and difficulty in hiring top employees.

In Europe particularly the green consumer movement is large and growing, and certain countries can be considered leaders and standard setters in green awareness. Of German consumers, for instance, 80 per cent are willing to pay premiums for household goods that are recycled, recyclable and non-damaging to the environment; in France 50 per cent of consumers will pay more at the supermarket for products they perceive as being environmentally friendly. This trend is growing elsewhere too: according to a European study, consumers throughout the OECD area are willing to pay more for green goods (Vandermerwe and Oliff, 1991).

Several retailers have also committed themselves to marketing green products (**green marketing**). Clearly, failing to consider the environmental impact of strategic decisions may affect the financial stability of the firm and the ability of that firm to compete with others in the industry.

**Green marketing**  
Integrating business practices and products that are friendly to the environment while also meeting the needs of the consumers.

### Strategic options

Businesses realize that they must be prepared to provide their customers with information on the environmental impact of their products and manufacturing processes.

**Figure 11.8** Types of environmental strategic posture

		Value creation approach	
		Benefit enhancement for customers	Cost reduction
Change orientation	Proactive	Green product Innovation (major modification) ①	Pollution prevention Beyond compliance ③
	Accommodative	Green product Differentiation (minor modification) ②	Pollution prevention Compliance ④

Source: Adapted from Starik et al., (1996), 'Growing an environmental strategy', *Business Strategy and the Environment*, 5, p. 17.

Figure 11.8 presents four strategic options that are available for the firm with environmental concerns. The choice of strategic environmental posture will depend on how an organization wants to create value for its green customers and how change oriented its approach is.

As can be seen from Figure 11.8, if a firm is more oriented to cost reduction than to benefit enhancement for customers, pollution prevention strategies (options 3 and 4) would probably be chosen in preference to the development of green products: for example by using natural or recycled materials. If a firm is more proactive than accommodative, it tends to be more innovative than otherwise (options 1 and 3).

Although going beyond compliance (i.e. doing more than required according to environmental legislation) is generally perceived as highly desirable, SMEs may not have the resources to act proactively, and hence need to focus on compliance and minor product modification (options 2 and 4).

However, because consumers buy products and services primarily to fulfil individual needs and wants, companies should continue to highlight the direct benefits of their products. They should not forget to emphasize the traditional product attributes of price, quality, convenience and availability and make only a secondary appeal to consumers on the basis of environmental attributes (Ginsberg and Bloom, 2004).

### Green alliances between business and environmental organizations

Strategic alliances with environmental groups (e.g. Greenpeace) can provide five benefits to marketers of consumer goods (Mendleson and Polonsky, 1995):

- 1 *They increase consumer confidence in green products and their claims.* It can be assumed that, if an environmental group supports a firm, product or service, consumers are more likely to believe the product's environmental claims.
- 2 *They provide firms with access to environmental information.* It is in their role as an information clearing house that environmental groups may be of immense benefit to organizations with which they form strategic alliances. Manufacturers facing environmental problems may turn to their strategic partners for advice and information. In some cases environmental partners may actually have technical staff who can be used to assist in solving organizational problems or implementing existing solutions.

- 3 *They give the marketer access to new markets.* Most environmental groups have an extensive support base, which in many cases receives newsletters or other group mailings. Their members receive catalogues marketing a variety of licensed products, all of which are less environmentally harmful than other commercial alternatives. Environmental group members represent a potential market that can be utilized by producers, even if these groups do not produce specialized catalogues. An environmental group's newsletter may discuss how a firm has formed a strategic alliance with the group, as well as the firm's less environmentally harmful products. Inclusion of this information in a newsletter is a useful form of publicity.
- 4 *They provide positive publicity and reduce public criticism.* Forming strategic alliances with environmental groups may also stimulate increased publicity. When the Sydney Olympic Bid Committee announced that Greenpeace was the successful designer for the year 2000 Olympic Village the story appeared in all major newspapers and on the national news. It is highly unlikely that this publicity would have been generated if a more conventional architect had been named as the designer of the village. Once again the publicity associated with the alliance was positive and credible.
- 5 *They educate consumers about key environmental issues for the firm and its product(s).* Environmental groups are valuable sources of educational information and materials. They educate consumers and the general public about environmental problems and also inform them about potential solutions. In many cases the public views these groups as credible sources of information, without a vested interest. Marketers can also play an important role as providers of environmental information through their marketing activities. In doing so they create environmental awareness of specific issues, their products and their organizations. For example, Kelloggs in Norway educated consumers and promoted its environmental concern by placing environmental information on the packaging of its cereals relating to various regional environmental problems (World Wide Fund for Nature, 1993).

Choosing the correct alliance partner is not a simple task, as environmental groups have different objectives and images. Some groups may be willing to form exclusive alliances, where they partner only one product in a given product category. Other groups may be willing to form alliances with all products that comply with their specific criteria.

The marketer must determine what capabilities and characteristics an alliance partner can bring to the alliance. As with any symbiotic relationship, each partner must contribute to the success of the activity. Poor definition of these characteristics may result in the firm searching out the wrong partner.

McDonald's offers an example of a company that gained credibility through collaboration. The company's collaboration with EDF (Environmental Defense Fund) in the early 1990s over its decision to move from Styrofoam to paper packaging similarly allowed the company to increase its credibility on environmental issues with consumers (Argenti, 2004).

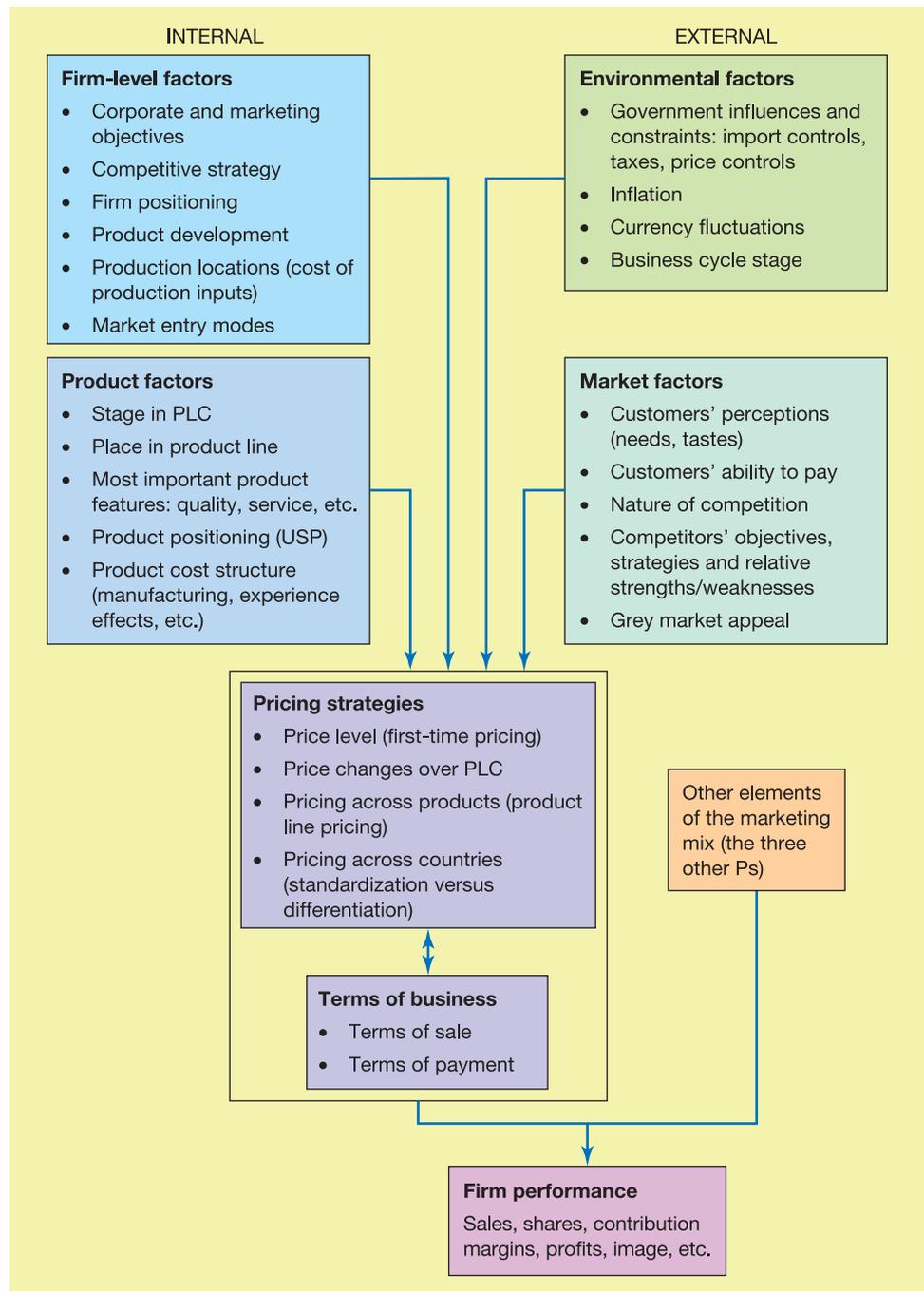
## 11.10 Factors influencing international pricing decisions

An SME exporting for the first time, with little knowledge of the market environment that it is entering, is likely to set a price that will ensure that the sales revenue generated at least covers the costs incurred. It is important that firms recognize that the cost structures of products are very significant, but they should not be regarded as sole determinants when setting prices.

Pricing policy is an important strategic and tactical competitive weapon that, in contrast to the other elements of the global marketing mix, is highly controllable and inexpensive to change and implement. Therefore pricing strategies and action should be integrated with the other elements of the global marketing mix.

Figure 11.9 presents a general framework for international pricing decisions. According to this model, factors affecting international pricing can be broken down into two main groups (internal and external factors) and four subgroups, which we will now consider in more detail.

Figure 11.9 International pricing framework



## Firm-level factors

International pricing is influenced by past and current corporate philosophy, organization and managerial policies. The short-term tactical use of pricing in the form of discounts, product offers and reductions is often emphasized by managers at the expense of its strategic role, and yet pricing over recent years has played a very significant part in the restructuring of many industries, resulting in the growth of some businesses and the decline of others. In particular, Japanese firms have approached new markets with the intention of building market share over a period of years by reducing price levels, establishing the brand name, and setting up effective distribution and servicing networks. The market share objectives of the Japanese firms have usually been accomplished at the expense of short-term profits, as international Japanese firms have consistently taken a long-term perspective on profit. They are usually prepared to wait much longer for returns on investments than some of their western counterparts.

The choice of foreign market entry mode also affects the pricing policy. A manufacturer with a subsidiary in a foreign country has a high level of control over the pricing policy in that country.

## Product factors

Key product factors include the unique and innovative features of the product and the availability of substitutes. These factors will have a major impact on the stage of the product life cycle, which will also depend on the market environment in target markets. Whether the product is a service or a manufactured or commodity good sold into consumer or industrial markets is also significant.

The extent to which the organization has had to adapt or modify the product or service, and the level to which the market requires service around the core product, will also affect cost and thereby have some influence on pricing.

Costs are also helpful in estimating how rivals will react to the setting of a specific price, assuming that knowledge of one's own costs helps in the assessment of competitors' reactions. Added to the above is the intermediary cost, which depends on channel length, intermediary factors and logistical costs. All these factors add up and lead to **price escalation**.

The example in Table 11.4 shows that, due to additional shipping, insurance and distribution charges, the exported product costs some 21 per cent more in the export market than at home. Through the use of an additional distribution link (an importer), the product costs 39 per cent more abroad than at home.

Many exporters are not aware of rapid price escalation; they are preoccupied with the price they charge to the importer. However, the final consumer price should be of vital concern because it is on this level that the consumer can compare prices of different competitive products and it is this price that plays a major role in determining the foreign demand.

Price escalation is not a problem for exporters alone. It affects all firms involved in cross-border transactions. Companies that undertake substantial intracompany shipment of goods and materials across national borders are exposed to many of the additional charges that cause price escalation.

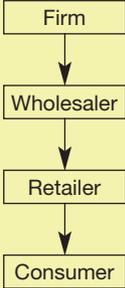
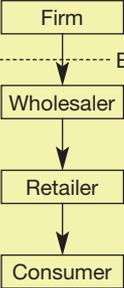
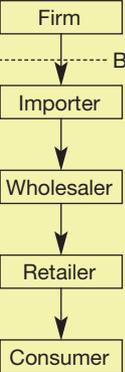
The following management options are available to counter price escalation:

- *Rationalizing the distribution process.* One option is to reduce the number of links in the distribution process, either by doing more in-house or by circumventing some channel members.
- *Lowering the export price from the factory* (firm's net price), thus reducing the multiplier effect of all the mark-ups.

### Price escalation

All cost factors (e.g. firms' net ex-works price, shipping costs, tariffs, distributor mark-up) in the distribution channel add up and lead to price escalation. The longer the distribution channel, the higher the final price in the foreign market.

**Table 11.4** Price escalation (examples)

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

- *Establishing local production of the product* within the export market to eliminate some of the cost.
- *Pressurizing channel members to accept lower profit margins.* This may be appropriate if these intermediaries are dependent on the manufacturer for much of their turnover.

It may be dangerous to overlook traditional channel members. In Japan, for example, the complex nature of the distribution system, which often involves many different channel members, makes it tempting to consider radical change. However, existing intermediaries do not like to be overlooked, and their possible network with other channel members and the government may make it dangerous for a foreign firm to attempt to cut them out.

### Environmental factors

The environmental factors are external to the firm and thus uncontrollable variables in the foreign market. The national government control of exports and imports is usually based on political and strategic considerations.

Generally speaking, import controls are designed to limit imports in order to protect domestic producers or reduce the outflow of foreign exchange. Direct restrictions commonly take the form of tariffs, quotas and various non-tariff barriers. Tariffs

directly increase the price of imports unless the exporter or importer is willing to absorb the tax and accept lower profit margins. Quotas have an indirect impact on prices. They restrict supply, thus causing the price of the import to increase.

Since tariff levels vary from country to country there is an incentive for exporters to vary the price somewhat from country to country. In some countries with high customs duties and high price elasticity the base price may have to be lower than in other countries if the product is to achieve satisfactory volume in these markets. If demand is quite inelastic the price may be set at a high level, with little loss of volume, unless competitors are selling at lower prices.

Government regulations on pricing can also affect the firm's pricing strategy. Many governments tend to have price controls on specific products related to health, education, food and other essential items. Another major environmental factor is fluctuation in the exchange rate. An increase (revaluation) or decrease (devaluation) in the relative value of a currency can affect the firm's pricing structure and profitability.

### Market factors

One of the critical factors in the foreign market is the purchasing power of the customers (customers' ability to pay). The pressure of competitors may also affect international pricing. The firm has to offer a more competitive price if there are other sellers in the market. Thus the nature of competition (e.g. oligopoly or monopoly) can influence the firm's pricing strategy.

Under conditions approximating pure competition price is set in the marketplace. Price tends to be just enough above costs to keep marginal producers in business. Thus, from the point of view of the price setter, the most important factor is cost. The closer the substitutability of products, the more nearly identical the prices must be, and the greater the influence of costs in determining prices (assuming a large enough number of buyers and sellers).

Under conditions of monopolistic or imperfect competition the seller has some discretion to vary the product quality, promotional efforts and channel policies in order to adapt the price of the total product to serve preselected market segments. Nevertheless the freedom to set prices is still limited by what competitors charge, and any price differentials from competitors must be justified in the minds of customers on the basis of differential utility: that is, perceived value.

When considering how customers will respond to a given price strategy, Nagle (1987) has suggested nine factors that influence the sensitivity of customers to prices:

- 1 More distinctive product.
- 2 Greater perceived quality of products.
- 3 Consumers less aware of substitutes in the market.
- 4 Difficulty in making comparisons (e.g. in the quality of services such as consultancy or accountancy).
- 5 The price of a product represents a small proportion of total expenditure of the customer.
- 6 The perceived benefit for the customer increases.
- 7 The product is used in association with a product bought previously, so that, for example, components and replacements are usually extremely highly priced.
- 8 Costs are shared with other parties.
- 9 The product or service cannot be stored.

Price sensitivity is reduced in all these nine cases.

In the following sections we discuss the different available pricing strategies.

## 11.11 International pricing strategies

In determining the price level for a new product the general alternatives are as shown in Figure 11.10.

### Skimming

In this strategy a high price is charged to ‘skim the cream’ from the top end of the market, with the objective of achieving the highest possible contribution in a short time. For a marketer to use this approach the product has to be unique, and some segments of the market must be willing to pay the high price. As more segments are targeted and more of the product is made available the price is gradually lowered. The success of skimming depends on the ability and speed of competitive reaction.

Products should be designed to appeal to affluent and demanding consumers, offering extra features, greater comfort, variability or ease of operation. With skimming the firm trades off a low market share against a high margin.

Problems with skimming are as follows:

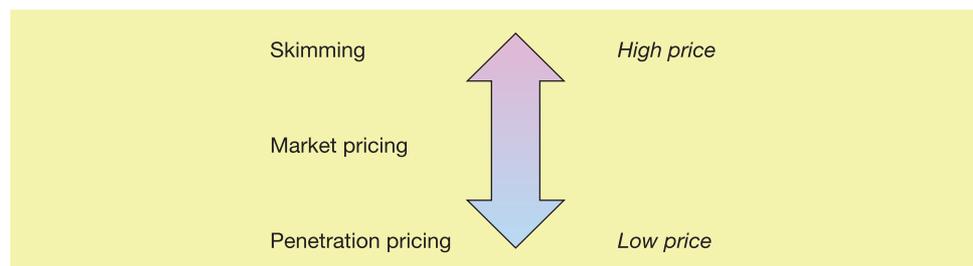
- Having a small market share makes the firm vulnerable to aggressive local competition.
- Maintenance of a high-quality product requires a lot of resources (promotion, after-sales service) and a visible local presence, which may be difficult in distant markets.
- If the product is sold more cheaply at home or in another country grey marketing (parallel importing) is likely.

### Market pricing

If similar products already exist in the target market, market pricing may be used. The final customer price is based on competitive prices. This approach requires the exporter to have a thorough knowledge of product costs, as well as confidence that the product life cycle is long enough to warrant entry into the market. It is a reactive approach and may lead to problems if sales volumes never rise to sufficient levels to produce a satisfactory return. Although firms typically use pricing as a differentiation tool the global marketing manager may have no choice but to accept the prevailing world market price.

From the price that customers are willing to pay it is possible to make a so-called retrograde calculation where the firm uses a ‘reversed’ price escalation to calculate backwards (from market price) to the necessary (ex-factory) net price. If this net price can create a satisfactory contribution margin then the firm can go ahead.

Figure 11.10 Strategies for pricing a new product



## Penetration pricing

A penetration pricing policy is used to stimulate market growth and capture market shares by deliberately offering products at low prices. This approach requires mass markets, price-sensitive customers and reduction in unit costs through economies of scale and experience curve effects. The basic assumption that lower prices will increase sales will fail if the main competitors reduce their prices to a correspondingly low level. Another danger is that prices might be set so low that they are not credible to consumers. There exist 'confidence levels' for prices below which consumers lose faith in the product's quality.

Motives for pricing at low levels in certain foreign markets might include the following:

- Intensive local competition from rival companies.
- Lower income levels of local consumers.
- Some firms argue that, since their R&D and other overhead costs are covered by home sales, exporting represents a marginal activity intended merely to bring in as much additional revenue as possible by offering a low selling price.

Japanese companies have used penetration pricing intensively to gain market share leadership in a number of markets, such as cars, home entertainment products and electronic components.

## Price changes

Price changes on existing products are called for when a new product has been launched or when changes occur in overall market conditions (such as fluctuating foreign exchange rates).

Table 11.5 shows the percentage sales volume increase or decrease required to maintain the level of profit. An example (the figure in bold type in Table 11.5) shows how the table functions. A firm has a product with a contribution margin of 20 per cent. The firm would like to know how much the sales volume should be increased as a consequence of a price reduction of 5 per cent, if it wishes to keep the same total profit contribution. The calculation is as follows:

### *Before price reduction*

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

### *After price reduction (5%)*

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

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

If a decision is made to change prices, related changes must also be considered. For example, if an increase in price is required it may be accompanied, at least initially, by increased promotional efforts.

When reducing prices the degree of flexibility enjoyed by decision makers will tend to be less for existing products than for new products. This follows from the high probability that the existing product is now less unique, faces stronger competition and is

**Table 11.5** Sales volume increase or decrease (%) required to maintain total profit contribution

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

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

aimed at a broader segment of the market. In this situation the decision maker will be forced to pay more attention to competitive and cost factors in the pricing process.

The timing of price changes can be nearly as important as the changes themselves. For example, a simple tactic of time lagging competitors in announcing price increases can produce the perception among customers that you are the most customer-responsive supplier. The extent of the time lag can also be important.

In one company an independent survey of customers (Garda, 1995) showed that the perception of being the most customer-responsive supplier was generated just as effectively by a six-week lag in following a competitor’s price increase as by a six-month lag. A considerable amount of money would have been lost during the unnecessary four-and-a-half-month delay in announcing a price increase.

**Experience curve pricing**

Combination of the experience curve (lowering costs per unit with accumulated production of the product) with typical market price development within an industry.

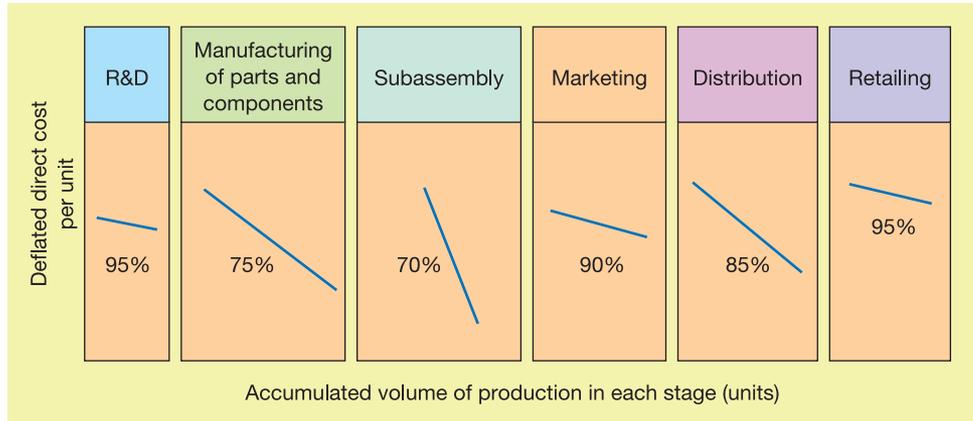
**Experience curve pricing**

Price changes usually follow changes in the product’s stage in the life cycle. As the product matures more pressure will be put on the price to keep the product competitive because of increased competition and less possibility of differentiation.

Let us also integrate the cost aspect into the discussion. The experience curve has its roots in a commonly observed phenomenon called the learning curve, which states that as people repeat a task they learn to do it better and faster. The learning curve applies to the labour portion of manufacturing cost. The Boston Consulting Group extended the learning effect to cover all the value-added costs related to a product – manufacturing plus marketing, sales, administration and so on.

The resulting experience curves, covering all value chain activities (see Figure 11.11), indicate that the total unit costs of a product in real terms can be reduced by a certain percentage with each doubling of cumulative production. The typical decline in cost is 30 per cent (termed a 70 per cent curve), although greater and lesser declines are observed (Czepiel, 1992, p. 149).

Figure 11.11 Experience curves of value chain activities

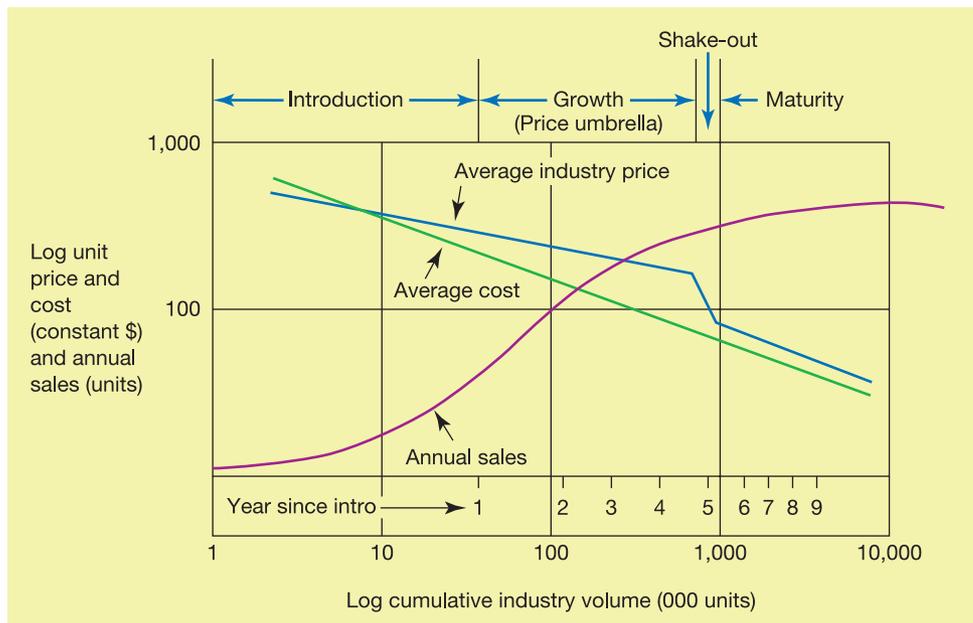


Source: Czepiel, 1992, *Competitive Marketing Strategy*, pub. Prentice-Hall, p. 154.

If we combine the experience curve (average unit cost) with the typical market price development within an industry we will have a relationship similar to that shown in Figure 11.12.

Figure 11.12 shows that after the introduction stage (during part of which the price is below the total unit cost), profits begin to flow. Because supply is less than demand prices do not fall as quickly as costs. Consequently the gap between costs and prices widens, in effect creating a price umbrella, attracting new competitors. However, the competitive situation is not a stable one. At some point the umbrella will be folded by one or more competitors reducing the prices in an attempt to gain or retain market share. The result is that a shake-out phase will begin: inefficient producers will be shaken out by rapidly falling market prices, and only those with a competitive price/cost relationship will remain.

Figure 11.12 Product life cycle stages and the industry price experience curve



Source: Czepiel, 1992, *Competitive Marketing Strategy*, pub. Prentice-Hall, p. 167.

## Pricing across products (product line pricing)

With across-product pricing the various items in the line may be differentiated by pricing them appropriately to indicate, for example, an economy version, a standard version and a top-of-the-range version. One of the products in the line may be priced to protect against competitors or to gain market share from existing competitors.

Products with less competition may be priced higher to subsidize other parts of the product line, so as to make up for the lost contribution of such ‘fighting brands’. Another strategy is price bundling (total ‘package’ price), where a certain price is set for customers who simultaneously buy several items within the product line (one price for a personal computer package with software and printer). In all such cases a key consideration is how much consumers in different countries want to save money, to spend time searching for the ‘best buy’ and so forth. Furthermore, some items in the product line may be priced very low to serve as loss leaders and induce customers to try the product. A special variant of this is the so-called buy in–follow on strategy (Weigand, 1991). A classic example of this strategy is the razor blade link where Gillette, for example, uses a penetration price on its razor (buy in) but a skimming pricing (relatively high price) on its razor blades (follow on). Thus the linked product or service – the follow on – is sold at a significant contribution margin. This inevitably attracts hitchhikers who try to sell follow-on products without incurring the cost of the buy in.

The buy in–follow on strategy is different from a low introductory price, which is based on the hope that the customer (of habit) will return again and again at higher prices. With the buy in–follow on strategy sales of two products or services are powerfully linked by factors such as legal contracts, patents, trade secrets, experience curve advantages and technological links.

Other examples of the strategy are as follows:

- The price of a Polaroid instant camera is very low, but Polaroid hopes that this will generate sales of far more profitable films for many years.
- The telephone companies sell mobile (cellular) telephones at a near giveaway price, hoping that the customer will be a ‘heavy’ user of the profitable mobile telephone network.

### Product-service bundle pricing

Bundling product and services together in a system-solution product. If the customer thinks that entry price is a key barrier, service contracts can be priced higher, which allows for lower entry product pricing – the practice in many software businesses.

## Product-service bundle pricing

The structure and level of pricing is perhaps the most crucial design choice in embedded *services*. To get pricing right, a company needs a clear grasp of its strategic intent and its sources of competitive advantage and must often make trade-offs between product penetration and the growth and margins of its *service* business.

A company’s strategic intent largely determines the appropriate extent of product-*service* bundling and the *value* attributed to *services* in such bundles. Companies that focus on enhancing or protecting core products should price their *services* to improve their product penetration. The pricing strategy to achieve such product pull-through varies according to customer purchasing decisions. Companies can raise the *value* of the product in use and increase its pull-through by bundling products and *services* into a higher-*value* solution. If the entry price is a key factor, *service* contracts can be priced higher, which allows for lower product pricing – the practice in many software businesses. In some cases, companies can raise the price of maintenance *service* contracts to accelerate the rate of product upgrades. The strategic goal of product pull-through also means that sales and field agents should have some flexibility and authority in the pricing of *services*. However, companies must still actively manage pricing discipline by ensuring that these salespeople are accountable for the total profitability of the bundles they sell.

By contrast, companies aiming to create an independent, growth-oriented *service* business should price their offerings to achieve profitable growth and set pricing targets as close to the *service's value* to customers as competitive alternatives permit. These companies should set pricing guidelines and delegate authority centrally, with relatively limited freedom for sales and field personnel and clear rules for discounting. Bundling prices for *services* and products is usually a bad idea for a growth platform in *services*, since within any given customer's organization, the person who buys the *service* might not be the one who buys the product. It is also difficult to bundle prices while holding both product and *service* business units accountable for their independent sales and margin targets.

The source of competitive advantage – scale or skill – mainly affects pricing structures. If economies of scale drive a business, its pricing should be based on standard units (such as terabytes of storage managed) and it should offer volume discounts to encourage growth in usage. Such companies ought to make the price of any customized variation from their standard *service* offerings extremely high, since these exceptions push up costs throughout the business.

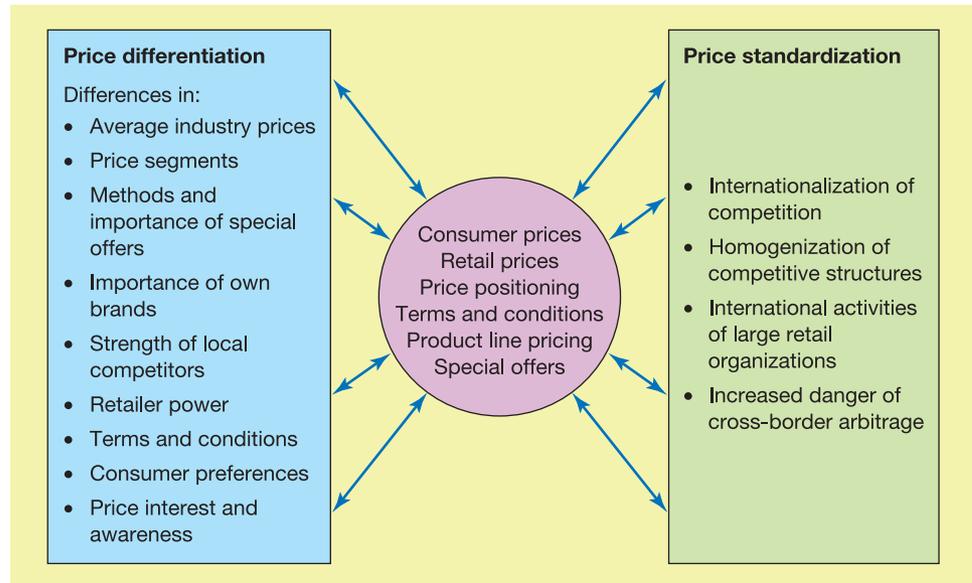
By contrast, if a *service* business relies mostly on special skills, it should base its prices on the costs its customers avoid by using its *services* or on the cost of the next-best alternative. Such *value*-based pricing requires a sophisticated analysis of a customer segment's total cost of ownership and a deep understanding of the cost structure of the *service* business. Competitive benchmarks and the cost of deploying the skills should determine the respective upper and lower bounds for these price levels. In the best case, companies can package this intelligence into pricing tools that allow sales and field agents to estimate customer *value* more accurately and thus improve field-level pricing decisions (Auguste *et al.*, 2006).

### Pricing across countries (standardization versus differentiation)

A major problem for companies is how to coordinate prices between countries. There are two essential opposing forces: first, to achieve similar positioning in different markets by adopting largely standardized pricing; and second, to maximize profitability by adapting pricing to different market conditions. In determining to what extent prices should be standardized across borders two basic approaches appear:

- 1 *Price standardization.* This is based on setting a price for the product as it leaves the factory. At its simplest it involves setting a fixed world price at the headquarters of the firm. This fixed world price is then applied in all markets after taking account of factors such as foreign exchange rates and variance in the regulatory context. For the firm this is a low-risk strategy, but no attempt is made to respond to local conditions and so no effort is made to maximize profits. However, this pricing strategy might be appropriate if the firm sells to very large customers, who have companies in several countries. In such a situation the firm might be under pressure from the customer only to deliver at the same price to every country subsidiary, throughout the customer's multinational organization. In Figure 11.13 this is exemplified, for example, by the international activities of large retail organizations. Another advantage of price standardization includes the potential for rapid introduction of new products in international markets and the presentation of a consistent (price) image across markets.
- 2 *Price differentiation.* This allows each local subsidiary or partner (agent, distributor, etc.) to set a price that is considered to be the most appropriate for local conditions, and no attempt is made to coordinate prices from country to country. Cross-cultural empirical research has found significant differences in customer characteristics,

**Figure 11.13** Structural factors of standardized versus differentiated pricing in European consumer goods markets



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

preference and purchasing behaviour among different countries (Theodosiou and Katsikeas, 2001). The weakness with 'price differentiation' is the lack of control that the headquarters has over the prices set by the subsidiary operations or external partner. Significantly different prices may be set in adjacent markets, and this can reflect badly on the image of multinational firms. It also encourages the creation of parallel importing/grey markets, whereby products can be purchased in one market and sold in another, undercutting the established market prices in the process.

The underlying forces favouring standardization or differentiation are shown in Figure 11.13.

### An international pricing taxonomy

As we discussed previously, pricing decisions in the international environment tend to be a function of the interplay between the external, market-related complexities that shape firm operations and the capabilities of the firm to respond effectively to these contingencies. Solberg's (1997) framework captures this interface in a meaningful way and leads to sufficiently important consequences for the export pricing behaviour of firms in foreign markets. Solberg suggests that firms' international strategic behaviour is shaped primarily by two dimensions: (a) the degree of globalism of the firm's industry (a measure of the market related factors) and (b) its degree of preparedness for internationalization (a measure of the firm's abilities to respond to these factors). These two dimensions are discussed in Chapter 1 (Figure 1.2) with the purpose of suggesting under which circumstances the firm should 'stay at home', 'strengthen the global position' or something in between. In Figure 11.14 an international pricing taxonomy is proposed along these two dimensions (Solberg *et al.*, 2006).

A global industry is dominated by a few, large major competitors that 'rule' their categories in world markets within their product category. Thus, the degree of globalism along the industry globalism dimension is considered to vary between two extremes: a monopoly at one end (the right) and atomistic competition at the other (the left).

Figure 11.14 A taxonomy of international pricing practices



Source: Adapted from Solberg *et al.*, 2006, p. 31. In the original article Solberg has used the concept 'Globality' instead of 'Globalism'.

The strategic implication of this perspective is that the monopolistic and oligopolistic global player would be the price setter, whereas the firm in the atomistic (multilocal) market setting would be exposed to local market forces, finding itself needing to follow market prices in every case. Although most firms fall into intermediate positions along this continuum, we believe that the leverage of the individual international firm in setting its pricing strategy will be greatly influenced by the globalism of the competitive environment in which it will operate.

On the other dimension, *preparedness for internationalization*, experienced firms find international pricing to be a more complicated matter, even though they devote additional resources to collecting and processing greater amounts of information. These firms are found to have the international preparedness that is necessary to offset the effects of reduced prices when they penetrate new markets or respond to competitive attacks, to be more self-confident in setting pricing strategies, and, in general, to enjoy higher market shares in the export market. In contrast, smaller and more inexperienced firms seem to be too weak both in relation to their local counterparts and in terms of generating local market insight to be able to determine effective price levels for their products in foreign markets. Therefore, they tend to possess smaller shares in their markets and to follow the pricing practices of their competitors or segment leaders.

Looking through the lens of this framework we assume that large, internationally experienced exporters will be likely to centralize their pricing decisions and will prefer higher degrees of control over those decisions, whereas smaller, often new-to-export, and internationally inexperienced firms will be likely to experiment with decentralized and often opportunistic modes of price-setting behaviour in their market.

The following discusses the characteristics of each of the four strategic prototypes in Figure 11.14.

### Prototype 1: The local price follower firm

In this cell the firm (manufacturer) will only have limited international experience, and consequently, the firm's local export intermediate (agent or distributor) will serve as the key informant for the firm. This information asymmetry bears the danger that the export intermediate might mislead the exporter by exercising opportunism or by pursuing goals that are in conflict with those of the exporter. That may cause further transaction costs, and lead to internalization (see section 3.3 on transaction cost analysis).

Because of the limited market knowledge the exporter is prone to calculate its prices crudely and most likely on the basis of cost and the (sometimes insufficient or biased) information from its local export intermediary. In the extreme case such an exporter would respond only to unsolicited offers from abroad, and will tend following a pricing procedure based on internal cost information, thus missing potential international business opportunities.

### **Prototype 2: The global price follower firm**

Firms that fall into the global price follower cell have limited preparedness for internationalization. In contrast, however, global price follower firms are often more motivated in expanding their international market involvement, as they are 'pushed' by the global market. Firms in this cell are expected to charge a standardized price in all countries because the interconnected international markets have more or less the same price level.

Given their marginal position in global markets, such firms have limited bargaining leverage and may be compelled to adopt the price level set by global market leaders, often very large global customers. The Prototype 2 firms are typically under constant pressure from their more efficient distribution and globally branded counterparts to adjust their prices.

### **Prototype 3: The multilocal price setter firm**

Firms in this cell are well-prepared international marketers with well-entrenched positions in local markets. Typically they are capable of assessing local market conditions through in-depth analyses and evaluation of market information, established market intelligence systems and/or deeply rooted market knowledge. They tend to have a tight control of their local market distribution networks through information and feedback systems. Prototype 3-firms adapt their prices from one market to the next in light of the differentiated requirements of each local market and manage the different market and pricing structures they cope with in their many (multidomestic) markets with relatively high sophistication.

In contrast to their local price follower counterparts (Prototype 1), however, these firms are often the pricing leaders in their local markets and base their pricing strategy primarily on local market conditions in each market. Given their multidomestic orientation, these firms tend to shift pricing decision-making authority to local subsidiary managers, even though their headquarters personnel closely monitors sales trends in each local market. Firms in this cell face challenges from grey market imports in their local markets that are motivated by the opportunity for cheaper producers to exploit price differences across markets.

### **Prototype 4: The global price leader firm**

Firms in this cell hold strong positions in key world markets. They manage smoothly functioning marketing networks, operating mainly through hierarchical entry modes or in combination with intermediate modes like joint ventures or alliances in major world markets. Prototype 4-firms compete against a limited number of competitors in each major market, similar to a global (or a regional) oligopoly. Typical of oligopoly players, they tend to be challenged by the cross-border transparency of the price mechanism; manage global (or regional) constraints, such as demand patterns and market regulation mechanisms; and set prices pan-regionally (i.e. across the EU). Global price leaders tend to maintain relatively high price levels in their markets, though possibly not as effectively as their multilocal counterparts. Compared with the global price leader firm, the multilocal price setter more effectively erects local entry barriers, such

as brand leadership, has closer relationships with its local distributors and a deeper understanding of local conditions in each local market, thus protecting itself from the downside of international price competition (Solberg *et al.*, 2006).

### Establishing global-pricing contracts (GPCs)

**Global pricing contract**  
A customer requiring one global price (per product) from the supplier for all its foreign SBUs and subsidiaries.

As globalization increases the following sentence is heard frequently among global suppliers and global customers: ‘Give me a **global-pricing contract** (GPC) and I’ll consolidate my worldwide purchase with you.’ Increasingly, global customers are demanding such contracts from suppliers. For example, in 1998 General Motor’s Powertrain Group told suppliers of components used in GM’s engines, transmissions and subassemblies to charge GM the same for parts from one region as they did for parts from another region.

Suppliers do not need to lose out when customers globalize. The most attractive global-pricing opportunities are those that involve suppliers and customers working together to identify and eliminate inefficiencies that harm both. Sometimes, however, suppliers do not have a choice – they cannot afford to shut themselves out of business with their largest and fastest-growing customers.

Suppliers and customers have different advantages and disadvantages with global-pricing contracts and Table 11.6 illustrates some of these.

**Table 11.6** Global pricing contracts (GPCs): advantages and disadvantages

	Customers	Suppliers
<i>Advantages</i>	<p>Lower prices worldwide coupled with higher levels of service.</p> <p>Standardization of products and services offered across markets.</p> <p>Efficiencies in all processes, including new product development, manufacturing, inventory, logistics and customer service</p> <p>Faster diffusion of innovations globally.</p>	<p>Easily gain access to new markets and grow the business.</p> <p>Consolidate operations and achieve economies of scale.</p> <p>Work with industry leaders and influence market development by using them as showcase accounts.</p> <p>Collaborate with customers and develop strong relationships that are difficult for potential competitors to break into.</p> <p>Rectify price and service anomalies in a customer relationship across country markets.</p>
<i>Disadvantages</i>	<p>Customer might be less adaptable to local market variance and changes over time.</p> <p>Supplier might not have capabilities to provide consistent quality and performance across markets.</p> <p>Supplier might use customer’s over-dependence to extract higher prices.</p> <p>Local managers might resist global contracts and prefer dealing with local suppliers.</p> <p>Costs of monitoring global contracts might outstrip the benefits.</p>	<p>Local managers sometimes resist change, and supplier may get caught in the crossfire between customer’s HQ and country managers.</p> <p>Supplier might lose the ability to serve other attractive customers.</p> <p>Customer might not be able to deliver on promises.</p> <p>Customer might take advantage of cost information shared in the relationship.</p> <p>Supplier might become over-dependent on one customer, even when there are other more attractive customers to serve.</p> <p>Supplier might have a conflict with existing channels of distribution in the new markets.</p>

Source: Adapted from Narayandas *et al.*, 2000, pp. 61–70.

One chemicals manufacturer concentrated on relationships with a few select customers. It had decided that its strength lay in value-added services but that potential customers in emerging markets were fixated on price. The select customers, however, were interested in money-saving supply and inventory management initiatives developed jointly with the supplier.

Global customers' demands for detailed cost information can also put suppliers at risk. Toyota, Honda, Xerox and others force suppliers to open their books for inspection. Their stated objectives: to help suppliers identify ways to improve processes and quality while reducing costs – and to build trust. But in an economic downturn the global customer might seek price reductions and supplementary services.

### European pricing strategy

In 1991 price differentials for identical consumer goods across Europe were around 20 per cent on average, but much greater differences were apparent in certain products (Simon and Kucher, 1993). In another study (Diller and Bukhari, 1994) there were also considerable price differences for identical take-home ice-cream products.

The causes of price differentials are differences in regulations, competition, distribution structures and consumer behaviour, such as willingness to pay. Currency fluctuations can also influence short-term price differences. The pressures of regionalization are accelerating the move to uniform pricing, but Simon and Kucher (1993) warn that this is a potential time bomb, as the pressure is for uniform pricing to be at the lowest pricing levels.

Europe was a price differentiation paradise as long as markets were separated. But it is becoming increasingly difficult to retain the old price differentials. There are primarily two developments that may force companies to standardize prices across European countries:

- 1 International buying power of cross-European retail groups.
- 2 Parallel imports/grey markets. Because of differentiated prices across countries, buyers in one country are able to purchase at a lower price than in another country. As a result there will be an incentive for customers in lower-price markets to sell goods to higher-price markets in order to make a profit.

Simon and Kucher (1993) suggest a price 'corridor' (Figure 11.15). The prices in the individual countries may only vary within that range. Figure 11.15 is also interesting in the light of the euro, which had been fully implemented by January 2002. However, price differences that can be justified by transportation costs and short-term competitive conditions, etc., may still be maintained. They recommend that business in smaller countries should be sacrificed, if necessary, in order to retain acceptable pricing levels in the big markets such as France, Germany, the United Kingdom and Italy. For example, for a pharmaceutical manufacturer it is more profitable not to sell in the Portuguese pharmaceutical market than to accept a price reduction of 10 per cent in the German market due to parallel imports from Portugal.

#### Transfer pricing

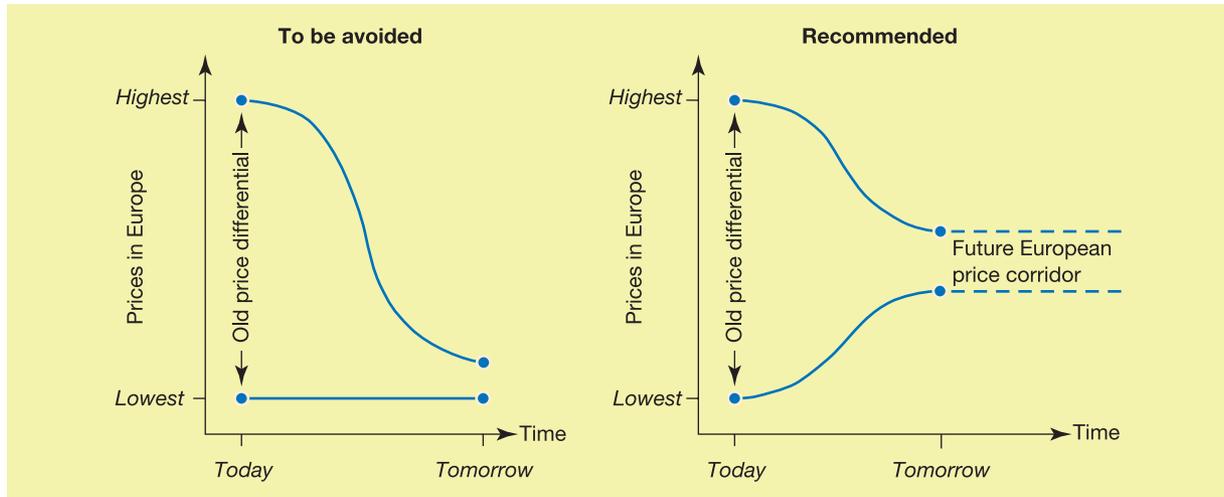
Prices charged for intracompany movement of goods and services. While transfer prices are internal to the company, they are important externally for cross-border taxation purposes.

### Transfer pricing

Transfer prices are those charged for intracompany movement of goods and services. Many purely domestic firms need to make transfer-pricing decisions when goods are *transferred* from one domestic unit to another. While these transfer prices are internal to the company they are important externally because goods being transferred from country to country must have a value for cross-border taxation purposes.

The objective of the corporation in this situation is to ensure that the transfer price paid optimizes corporate rather than divisional objectives. This can prove difficult

Figure 11.15 Development of prices in Europe



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

when a company internationally is organized into profit centres. For profit centres to work effectively a price must be set for everything that is transferred, be it working materials, components, finished goods or services. A high transfer price – for example, from the manufacturing division to a foreign subsidiary – is reflected in an apparently poor performance by the foreign subsidiary (see the high mark-up policy in Table 11.7), whereas a low price would not be acceptable to the domestic division providing the goods (see the low mark-up policy in Table 11.7). This issue alone can be the cause of much mistrust between subsidiaries.

The ‘best’ of Table 11.7’s two mark-up policies seen from the consolidated point of view is to use a high mark-up policy, since it generates a net income of \$550, as against

**Table 11.7** Tax effect of low versus high transfer price on net income (\$)

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

Note: Manufacturing affiliate pays income taxes at 25%. Distribution affiliate pays income taxes at 50%.

Source: Adapted from Eiteman and Stonehill, 1986. *Multinational Business Finance*, 4th edn, pub. Addison Wesley.

\$475 from using a low mark-up policy. The 'best' solution depends on the tax rates in the countries of the manufacturing and distribution affiliates (subsidiaries).

There are three basic approaches to transfer pricing:

- 1 *Transfer at cost.* The transfer price is set at the level of the production cost and the international division is credited with the entire profit that the firm makes. This means that the production centre is evaluated on efficiency parameters rather than profitability. The production division normally dislikes selling at production cost because it believes it is subsidizing the selling subsidiary. When the production division is unhappy the selling subsidiary may get sluggish service, because the production division is serving more attractive opportunities first.
- 2 *Transfer at arm's length.* Here the international division is charged the same as any buyer outside the firm. Problems occur if the overseas division is allowed to buy elsewhere when the price is uncompetitive or the product quality is inferior, and further problems arise if there are no external buyers, making it difficult to establish a relevant price. Nevertheless the arm's-length principle has now been accepted worldwide as the preferred (not required) standard by which transfer prices should be set (Fraedrich and Bateman, 1996).
- 3 *Transfer at cost plus.* This is the usual compromise, where profits are split between the production and international divisions. The actual formula used for assessing the transfer price can vary, but usually it is this method that has the greatest chance of minimizing executive time spent on transfer-price disagreements, optimizing corporate profits and motivating the home and international divisions. A senior executive is often appointed to rule on disputes.

A good transfer-pricing method should consider total corporate profile and encourage divisional cooperation. It should also minimize executive time spent on transfer-price disagreements and keep the accounting burden to a minimum.

## Currency issues

A difficult aspect of export pricing is the decision about what currency the price should be quoted in. The exporter has the following options:

- the foreign currency of the buyer's country (local currency);
- the currency of the exporter's country (domestic currency);
- the currency of a third country (usually US dollars);
- a currency unit such as the euro.

If the exporter quotes in the domestic currency then not only is it administratively much easier, but also the risks associated with changes in the exchange rate are borne by the customer, whereas by quoting prices in the foreign currency the exporter bears the exchange rate risk. However, there are benefits to the exporter in quoting in foreign currency:

- Quoting in foreign currency could be a condition of the contract.
- It could provide access to finance abroad at lower interest rates.
- Good currency management may be a means of gaining additional profits.
- Customers normally prefer to be quoted in their own currency in order to be able to make competitive comparisons and know exactly what the eventual price will be.

Another difficult problem that exporters face is caused by fluctuating exchange rates. A company in a country with a devalued currency can (all other things being equal) strengthen its international competitive position. It can choose to reduce prices in foreign currencies or it can leave prices unchanged and instead increase profit margins.

When the Italian lira dropped by 15–20 per cent in value against the German mark it gave the Italian car producer Fiat a competitive advantage in pricing. The German car exporters, such as Volkswagen, were adversely affected and had to lower its list prices. In this respect the geographic pattern of a firm's manufacturing and sales subsidiaries compared with those of its main competitors becomes very important, since a local subsidiary can absorb most of the negative effects of a devaluation.

## 11.12 Implications of the Internet for pricing across borders

Europe's single currency, the euro (<http://europa.eu.int/euro/>) has finally become a reality after more than a decade of planning and preparation. In one stroke the single currency has created the largest single economy in the world, with a larger share of global trade and a greater number of consumers than in the United States.

The implication is that Europe suddenly became a single market by the end of 2000, and people can purchase from another country as easily as they can from a shop across the road. The same currency will be used; only the language issue remains. Opinion in Europe is that, as more of the population goes online, and as Europe starts using its new single currency, online shopping will experience a tremendous growth.

Most of this growth has been fuelled by aggressive price cutting from internet service providers (ISPs). A number of UK companies, for example, are now offering free internet access or pay-as-you-go models, which have encouraged new sections of the population to try the Internet for the first time.

A European single currency was a long-held ambition for members of the European Union. The idea was first considered in the 1970s, but knocked off-course by oil price rises. It re-emerged in the early 1980s and was finally agreed to in the 1992 Maastricht Treaty. There were many accounting criteria to be met by each country, such as the control of the rate of inflation and the debt/GDP ratio. Most countries have met these criteria and were permitted to join the European Monetary Union.

The euro is now the currency of 13 European Union member states: Belgium, Germany, Greece, Spain, France, Ireland, Italy, Luxembourg, the Netherlands, Austria, Portugal, Finland and Slovenia. Other member states are looking to adopt the euro in the near future.

The United Kingdom being outside the euro region will be quite inconvenient for many US companies who trade heavily with UK companies or have UK subsidiaries.

The main detailed implications of the euro will be that it will:

- lower prices for consumers by making prices transparent across Europe;
- create a real single market by reducing 'friction' to trade caused by high transaction costs and fluctuating currencies;
- enhance competition by forcing companies to concentrate on price, quality and production instead of hiding behind weak currencies;
- benefit SMEs and consumers by making it easier for the former to enter 'foreign' markets and allowing the latter, increasingly via the internet, to shop in the lowest priced markets;
- establish inflation and interest rate stability via the new European Central Bank; and
- lower the costs of doing business through lower prices, lower interest rates, no transaction costs or loss through exchanging currencies, and the absence of exchange rate fluctuations.

In short, the single currency will significantly increase competition, lower transaction costs, and bring about greater certainty. These new forces will bring about structural reforms in Europe. Almost every aspect of Europe's business and political environment will be affected.

Perhaps most importantly, marketing and pricing strategies need rethinking. Because the euro will allow easy price comparison across Europe (especially via the Internet), it will reveal the differences between higher and lower priced markets.

For those selling via the Internet the euro will make it easier to do business and give encouragement to companies selling to European customers. Since Europeans will now be able to shop and compare prices at the click of a mouse they will also be more favourably inclined towards e-commerce.

In any single European country there is not usually much competition for a given product, since purchasing habits have always been local (in one's own country). Now that Europeans will be able to shop internationally via the Internet they will become aware of other choices and prices for the same product that were not previously known. Competition will heat up for the buyer's euro, and this should put a downward pressure on prices.

However, recent research has also shown that the Internet is not creating a state of perfect competition with decreasing prices as a result. In fact, in some cases, online prices are higher than those of conventional retail outlets. Research has also shown that online consumers are not as price sensitive as had previously been thought. Consumers become less price sensitive and more loyal as the level of quality information on a site increases (Kung and Monroe, 2002).

## 11.13 Summary

In deciding the product policy abroad, it is important to decide what parts (product levels) should be standardized and what parts should be adapted to the local environment. This chapter has discussed the variety of factors that are relevant to this decision.

A very important issue is the question of branding. Different branding alternatives have been discussed. For example, because large (often transnational) retail chains have won control over distribution, they try to develop their own labels. For the retailer, private labels provide better profit margins and strengthen the retailer's image with its customers. Because of the power shift to the retailers the percentage of retail grocery sales derived from private brands has increased in recent years.

This chapter has also discussed issues that are experiencing increasing interest: for example, green marketing strategies, including the need for product adaptation in a 'green' direction. Consumers, shareholders and society at large all stand to benefit when a company integrates environmental friendliness into its marketing strategy. If properly implemented, green marketing can help to increase the emotional connection between consumers and brands. Being branded a green company can generate a more positive public image, which can, in turn, enhance sales and increase stock prices. A green image may also lead consumers to have an increased affinity for a company or a specific product, causing brand loyalty to grow.

The major pricing issues covered in this chapter include the determinants of price, pricing strategy, how foreign prices are related to domestic prices, price escalation, the elements of price quotation, and transfer pricing.

Several factors must be taken into consideration in setting price, including cost, competitors' prices, product image, market share/volume, stage in the product life

cycle and number of products involved. The optimum mix of these ingredients varies by product, market and corporate objectives. Price setting in the international context is further complicated by such factors as foreign exchange rates, different competitive situations in each export market, different labour costs and different inflation rates in various countries. Also local and regional regulations and laws in setting prices have to be considered.

## CASE STUDY 11.1

### Zippo Manufacturing Company: Has product diversification beyond the lighter gone too far?

#### History

Zippo ([www.zippo.com](http://www.zippo.com)) was founded in Bradford, Pennsylvania in 1932 when George G. Blaisdell decided to create a lighter that would look good and be easy to use. Blaisdell obtained the rights for an Austrian windproof lighter with a removable top, and redesigned it to his own requirements. He made the case rectangular and attached the lid to the bottom with a welded hinge, and surrounded the wick with a windhood. Fascinated by the sound of the name of another recent invention, the zipper, Blaisdell called his new lighter 'Zippo', and backed it with a Lifetime Guarantee. The 70-year old brand's fame took off during the Second World War, when Zippo's entire production was distributed through commercial outlets run by the US military.

#### Today

Zippo has produced over 375 million windproof lighters since its founding in 1932. Except for improvements in the flint wheel and modifications in case finishes, Blaisdell's original design remains virtually unchanged. The Lifetime Guarantee that accompanies every Zippo lighter still guarantees that 'It works or we fix it free™'.

Although the windproof lighter is the most popular Zippo product, Zippo has been hurt by the anti-smoking campaigns. Its business is fundamentally tied to smokers, and it has suffered from US tobacco regulations. Cigarette makers order thousands of Zippos to promote their brands, distributing them to smokers in exchange for coupons. One of the company's recent advertising campaigns suggested 101 ways to use your Zippo. Warming your hands and

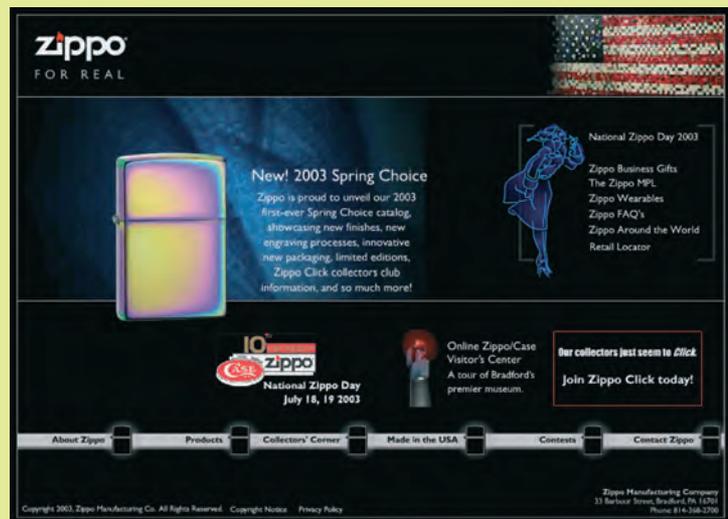
de-icing car locks were on the list; lighting a cigarette was not.

The success of this product led Zippo to expand the line to its current product family of tape measures, pocket knives, money clips, writing instruments, key holders and its newest product, the Multi-Purpose Lighter. All of these items can be imprinted with company logos or trademarks.

In 1993 Zippo licensed its name to Itochu Fashion System Co., a large clothing manufacturer in Japan. Zippo leather jackets, Zippo jeans and Zippo gloves are now available in Tokyo, and Zippo may license clothes in the United States too. Today Japan is still the biggest export market for Zippo.

Zippo has expanded its sales operations nationally and internationally through a wide network of sales representatives. In more than 120 countries throughout the world Zippo is synonymous with US-made quality and craftsmanship.

Zippo windproof lighters enjoy a widespread and enviable reputation as valuable collectibles. The



Source: zippo.com.

company produces the *Zippo Lighter Collectors' Guide*, containing illustrations of the lighters and descriptions of the series, as well as an explanation of the date code found on the bottom of every Zippo lighter. Clubs for lighter collectors have been organized in the United Kingdom, Italy, Switzerland, Germany, Japan and the United States. Zippo also sponsors its own collectors club, Zippo Click.

### Questions

- 1 What are the pros and cons of the product diversification strategy that Zippo has been following recently?
- 2 On [www.sramarketing.com/experience/outdoor/case\\_studies/zippo\\_casestudy.cfm](http://www.sramarketing.com/experience/outdoor/case_studies/zippo_casestudy.cfm) you will find a case story, where Zippo in the late 1990s was repositioned as an essential tool for avid outdoorsmen. However the outdoor market was entirely new to the Zippo salesforce, who were accustomed to calling on tobacconists and convenience stores. How would you use the PLC concept for this case story?
- 3 What obstacles would Zippo Manufacturing Company face if it repeated the outdoor campaign in other countries?

For further exercises and cases, see this book's website at [www.pearsoned.co.uk/hollensen](http://www.pearsoned.co.uk/hollensen)



## Questions for discussion

- 1 How would you distinguish between services and products? What are the main implications of this difference for the global marketing of services?
- 2 To what degree should international markets be offered standardized service and warranty policies that do not differ significantly from market to market?
- 3 Why is the international product policy likely to be given higher priority in most firms than other elements of the global marketing mix?
- 4 What are the requirements that must be met so that a commodity can effectively be transformed into a branded product?
- 5 Discuss the factors that need to be taken into account when making packaging decisions for international product lines.
- 6 What are the distinguishing characteristics of services? Explain why these characteristics make it difficult to sell services in foreign markets.
- 7 Identify the major barriers to developing international brands.
- 8 Discuss the decision to add or drop products to or from the product line in international markets.
- 9 What are the characteristics of a good international brand name?
- 10 What are the major causes of international price escalation? Suggest possible courses of action to deal with this problem.
- 11 Explain how exchange rate and inflation affect the way you price your product.
- 12 In order to protect themselves, how should marketers price their product in a country with high inflation?
- 13 International buyers and sellers of technology frequently disagree on the appropriate price for knowledge. Why?

- 14 What methods can be used to compute a transfer price (for transactions between affiliated companies)?
- 15 Why is it often difficult to compute fair arm's-length transfer prices?

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