Globalisation and Pricing Strategies: Impact for Management Accountants

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Introduction

Pricing policy is crucial to the implementation of strategy in a firm, regardless of the district, domestic or international. From a marketing perspective, pricing is one of the important elements in the marketing-mix that helps organisations achieve success. Nevertheless, the pricing of industrial products can be a difficult process due to the uncertainties associated with today's dynamic environments. This level of difficulty is compounded further when companies venture overseas. By attempting to operate in multiple markets and setting pricing strategies in the international arena, multinational firms are confronted with an even more complex and dynamic set of environmental contingencies. International operations are viewed by managers as a means of boosting corporate growth, increasing market share and ensuring company survival and long term viability, therefore marketing strategy constitutes a critical component of a firm's global strategy. (Theodosiou & Katsikeas, 2001)

Globalisation

The emergence of globalisation and the falling trade barriers between national markets have opened up the market and it has become a "borderless world" of trade and opportunities. Companies utilise these opportunities by either exporting or in the form of foreign operations, and are prepared to gain benefit from enormous economies of scale in production, distribution, marketing and management. Levitt believes that market share is gained through aggressive low pricing supported by standardisation (Marsh, 2000). On the other hand, Ohmae's opinion: "When it comes to product strategy, managing in a borderless world doesn't mean managing by averages…it doesn't mean that the appeal of operating globally removes the obligation to localize products" (Ohmae, 1990). The same concept applies to implementing global pricing strategy. For simplicity and standardisation, companies might adopt the pricing strategy which is standardized across different countries; however, it lacks the flexibility to adapt to changes in competitive markets. Therefore, the concept of 'one-price-for all' is a myth, as the different factors that are specific to different country preferences have to be taken into account for international pricing decision.

Corporations face a critical task of deciding which International marketing programs should be chosen to increase the firms' revenue and profitability levels. The approach adopted by MNC has important implications as it affects its long-term direction with respect to international operations (Theodosiou & Katsikeas, 2001). The literature identifies 2 key perspectives to the pricing strategies followed by manufacturing subsidiaries of multinational corporations:

- The Standardization perspective
- The Adaptation perspective

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The Standardization Perspective

The standardization approach has gained increasing popularity due to the developments in the international business environments and the growth of international market segments with similar needs and preferences. The most significant advantages of standardization are its contribution to the achievement of economies of scale and cost savings in production, research and development and marketing (Keegan, 1969)

Adaptation Perspective

The adaptation approach allows deeper penetration of foreign market and thus increased market share and sales volume for the firm. The adaptation approach facilitates firm’s capabilities in analysing and understanding foreign markets and quickly responding to the shifts in customer preferences (Craig and Douglas, 1996)

Standardization process has been widely used and corporations have been successful in implementing global pricing strategy based on this strategy, the four major factors which have been empirically tested and are potentially important in influencing the extent, to which MNCs standardize their international pricing, are as follows:

- Economic environment
- Legal environment
- Customer characteristics and behaviour
- Stage of the Product life cycle

Economic Environment

The level of economic and industrial development in a country determines the purchasing power of the customers which in turn determines the customers priorities in terms of the products they consider essential (Jain, 1989). These factors determine demand potential for a particular product and impact the firms cost structure. The economic environment of a country also determines the cost of raw material, labour and energy which can have serious implications on the cost structure of the manufacturer.

Legal Environment

The government laws and regulations across markets are major obstacles to standardization (Baalbaki and Malhotra 1995). Safeguarding the interest of the local manufacturers and protection of consumers from unfair exploitation could be of importance and price controls may be imposed on certain products. For example the American auto companies continued to ask the U.S. government for protection from Japanese car imports. In 1992 when General Motors closed 21 auto plants in North America, those workers losing their jobs developed anti-Japanese sentiment. Thus firms may incur extra costs which might force them to charge a higher price or compress the profit margins. Government intervention also represents a significant business risk to all firms. Impediments such as, price controls, antitrust legislation, or other financial reporting requirement requires multinational corporations to continually scan governmental activities, which may have an impact on their strategic pricing decisions. An example of government intervention is the use of antitrust legislation in foreign markets.

Customer Characteristics and Behaviour

Customer’s tastes and preferences and purchasing patterns with respect to various price levels are a key consideration in developing a pricing policy. Price level is among the most important criteria used by customers in evaluating competing products (Levitt, 1983). If the price perception is similar between the domestic and foreign customers then a standardized pricing policy is more appropriate. In some circumstances, products value is not determined by the cost of the materials, but rather it is the customer perception of that value. In Japanese market, perceived value is the main determinant of product success. The images of quality are far more important than the actual value of the product, as in people's mind, quality is connected with high prices. This is demonstrated by Johnny Walker whisky marketing in Japan, also represented images of high status. With the intent to gain market share from its main competitor Chivas, it lowered its price. However, Japanese consumers perceived the reduction in price associated with a reduction in quality and status, resulting in a drastic decline in sales (Howard & Herbig, 1996). In order to survive in a market or foreign countries, organisations are required to adapt their pricing with an understanding of the specific country preferences and consumer behaviour.

Stage of the Product Life Cycle

The life cycle of a product consists of four major stages-introductions, growth, maturity and decline. Pricing policy needs to be modified to take into account the particular local market conditions (Rau & Preble, 1987) and thus different marketing strategies need to be taken at different stages of product life cycle. The crux of the analysis is that the extent to which multinationals standardize their international pricing strategy depends on the level of similarity between the home and host countries in terms of customer characteristics, legal environment, economic conditions, and stage of PLC (Theodosiou & Katsikeas, 2001).

The standardization and adaptation decision are situation specific therefore a separate analysis should be performed for the environmental and market conditions prevailing in targeted foreign market. The ultimate objective of managers in setting international pricing policy is focused on revenue maximization which could be achieved through premium pricing (i.e. demand is strong and competition is weak) or competitive pricing (i.e. demand is weak and competition is intense)

Other International Factors to Consider – Environmental determinants

Competitive Structure/ Markets

Different geographic markets have various level of competition. Market share plays a significant role in strategic marketing. The Porter five forces' model suggests that market share will influence the strategic intent of an organisation by affecting buyers' and suppliers' power, the number and strength of potential entrants, and the level of competition within an industry (Porter, 1980). From a strategic pricing perspective, larger firms must focus on external factors if they want to minimise the effects of competition. Barriers to entry also play a significant role in developing pricing strategies (Naumann & Lincoln, 1991). Where firms in those industries with high barriers to entry, tend to be in a better position and benefit from retaining relatively high prices and profits without fear of competition. On the other hand, in those industries where barriers to entry are low, firms are prepared to accept relatively low price or even "price wall". Managers have to be carefully evaluating competitors pricing policies before setting prices is important as in both international and domestic markets.

Price Structure

Products can be positioned with a high price in one country and a low price in another. It can be demonstrated in the Heineken case, it is positioned as an averaged price beer in its home country, which in restaurants and bars can be compared with the price of soft drinks and mineral water. However, it uses a global positioning strategy of premium price and high quality when it is sold internationally (Weinstein, 1994). As in the case, price differentials are present across international markets, for some products. This highlights that price differential can be attributed to the determinant of products pricing policy by the managerial judgement of the extent to which the price differentials can be exploited.

Distribution Structure

The distribution structure of the international market will also determine the pricing of products. For those exporting companies, they are experiencing a significant price escalation through the lengthening of the channels of distribution. The costs are even higher for those companies that have middlemen as channels of distribution, especially, when they are not familiar with the foreign markets. Alternatively, large firms might think of operating in foreign countries to alter the price escalation.

Exchange rates/ Currencies

Companies entering international markets are now dealing with more than one currency, i.e. foreign currencies. In such situations, companies are exposed to losses as a result of unfavourable exchange-rate movements. Therefore, the effect of fluctuating exchange rates should have an effect on the pricing strategies of firms. There are many exposure management techniques available for companies to minimise the adverse effect of exchange-rate, the most popular is being hedging strategies, such as forward and future foreign currency contracts and swaps.

Tariffs/ Tax regulations

Tariffs are typically used as sources of government revenue and to protect local industries from foreign competition. Hence, they act as a deterrent to market efficiency. In addition, tariffs placed on imported products are also utilized to control the sales of products in a foreign country. They effectively raise the prices of a firm's products and diminish their competitiveness in a foreign market

Inflation

Inflation, especially hyperinflation, plays a main role in international pricing. Devaluation of the local currency relative to foreign currency is a consequence of significant inflation. Also due to inflation, cost of marketing products to customers will be affected as costs may rise faster than prices. Therefore, cost of providing products in inflationary economies will be higher and unpredictable than more stable companies. It is evident that the varying levels of inflations will require firms to use more adoptive pricing strategies in order to make a profit.

Overview of Some Key International Pricing Strategies

Transfer pricing strategy

Transfer pricing refers to the prices that one division or subsidiary of a company charges to another in a different country. Transfer prices differ in two respects, which mean that products can be 'transferred' at the market price or at cost. Transfer prices will vary according to variables such as tax rates. Therefore, if tax rates are higher in the exporting firms' country, then it is likely that the transfer price will be at cost and on the other hand if income taxes are higher in the importing country the transfer price is likely to be at the market price. However one of the problems with this strategy is that it can lead to increased discontent between disparate profit oriented divisions or departments in a firm.

Cost-plus pricing strategy

This is the most widely used pricing strategy and one of the main reasons it's used by managers is their risk avoidance mentality (Forman & Hunt, 2004). This pricing strategy plays an important role in export pricing of industrial products, especially when firms begin to export to guard against market related uncertainty. Therefore, when venturing into foreign markets it is easiest to develop a price based on the most accurate available information and internal cost figures.

Second market pricing strategy

In this strategy firms charge different prices based on distinct international markets. However if the price differences are too great, parrel markets may be formed and reduce overall profitability. This strategy is important in the industrial sector as most of the dumping (an extreme form of second market pricing) complaints filed with the International Trade Commission are for goods such as chemicals and machine parts.

Conclusion

In today's dynamic environment pricing is one of the most important components of the marketing-mix, especially for firms venturing in to the international markets as multinational firms are confronted with an even more complex and dynamic set of environmental contingencies. The standardization decision depends upon the level of similarity between home and host countries in terms of customer characteristics, legal environment, economic conditions and stage of the product life cycle. Pricing decisions are situation specific therefore a separate analysis should be performed for the environmental and market conditions prevailing in targeted foreign market. Thus the concept of 'one-price-for all' is a myth, as the different factors that are specific to different country preferences have to be taken into account for international pricing decision.

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