

# **An Examination of Factors that Affect Pricing Decisions for Export Markets**

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## **ABSTRACT**

Pricing strategy has played an important role in consumer purchasing behavior and decision making process (Richard, 1985; Myers, 1997). For international markets, pricing is one of the most important elements of marketing product mix, generates cash and determines a company's survival (Yaprak, 2001). However, scholars have not paid enough attention to international and export pricing (Kotabe and Aulak, 1993); Graham and Gronhaug, 1987). This paper examines factors that affect pricing decision for export markets, and sheds light on international pricing strategies in a global competitive market.

## **INTRODUCTION**

Marketing theory states clearly that price is one of the 5 P's (Product, Positioning, Place, Promotion and Price) that contributes to the marketing mix in order to get potential customers' attention, motivate them, and get them to buy products or services. The marketing strategy helps you define, promote and distribute your product, and maintain a relationship with your customers. Pricing, as part of the marketing mix, is essential and has been always one of the most difficult decisions in marketing because of heightened competition (Myers 1997), gray market activities (Assmus and Wiese, 1995), counter-trade requirements (Cavusgil and Sikora ,1988), regional trading blocks (Weekly, 1992), emergency of intra-market segments (Dana 1998), and volatile exchange rates (Knetter, 1994). Consumers have different perception of the products depending on the price. Therefore, pricing products for consumers is a difficult task, mainly because a high price may cause negative feelings about products, and also a low price can be misleading on other products features such as quality.

There are many pricing objectives that lead to different strategies and businesses have to develop and apply the best strategy in various situations. Some of the ways of pricing a product are: premium and penetration pricing, price skimming, economy and psychological pricing, product and optional product pricing, captive and product bundle pricing, promotional, geographical and value pricing. However, the situation is further complicated when it comes to pricing for international and global markets.

Setting prices for international markets is not an easy task. Decisions with regards to product, price, and distribution for international markets are unique to each country (Jain, 1989) and differ from those in the domestic market (Diller and Bukhari, 1994) Furthermore, other factors such as: the rate of return, market stabilization, demand and competition-led pricing, market penetration, early cash recovery, prevention of competitive entry, company and product factors, market and environmental factors, as well as economic, political, social and cultural factors, have to be considered in the decision making process. The objective of this paper is to review and examine factors that affect pricing decision making process for international/global markets as a consumer behavior variable.

## **NEOCLASICAL PRICE THEORY**

Marshall has developed the theory of how price influences customer's behavior, called "Neoclassical Theory." The theory states that customers have different tastes and preferences, and choose among products to maximize satisfaction or utility (Monroe & Lee, 1999). "Utility means want-satisfying power that resides in the mind of buyer and is common to all products and services...Since it is assumed that prices serve only to indicate the amount of

money that buyers must give up to acquire a product, how much to acquire of a particular product depends on the relation between the marginal utility of acquiring an additional unit and the price of that additional unit. Furthermore, the assumption of diminishing marginal utility implies that buyers are capable of ranking all alternatives in terms of increasing preference, and that they purchase first the most preferred product,” (Monroe, 1999).

### **REASONS FOR SELLING ABROAD OR EXPORTING**

Firms go and sell international for “pull” factors, based on the attractiveness of a potential foreign market, as well as for “push” factors, which make firm’s domestic market appear less attractive. The following are some of the factors that push firms to sell abroad: Sometimes companies develop product for international and export markets only; Domestic market may be too small and exporting maybe a viable option to exploit economies of scale; the nature of the business or product requires firms to operate internationally or in foreign markets (airlines); companies seek foreign expansion in order to minimize and spread the risk, and reduce its dependence on one geographical market; because of saturation of domestic market, companies seek foreign markets and usually product life cycle reaches its maturity stages in the domestic market, while being at earlier stages of the life cycle in less developed markets (sub-Saharan Africa).

It is important to emphasize that all companies face international competition, not only in export markets, but in domestic markets as well. Becoming internationally competitive is therefore not only an essential requirement for successful exporters, but also the best means of defense that local companies can use to counter foreign imports. Successful exporting contributes positively to a country's economy not only on the macro level, but on the micro level as well. Exporting offers companies many additional opportunities that they cannot obtain from domestic markets. These include the following: increased sales and opportunities; added sales volume may lower the production cost; lower production cost may improve overall profitability; competing in foreign markets should contribute to increasing the company's overall competitiveness; improving the status of the company by competing in foreign markets; reducing risks by selling to diverse markets; taking advantage of economies of scale by enlarging the sales base in order to spread fixed costs; compensating for seasonal fluctuations in domestic sales; finding new markets for products with declining domestic sales potential, thereby extending the product's life cycle; exploiting opportunities in untapped markets; taking advantage of high-volume purchases in large markets overseas such as the US, Europe and Asia; learning about advanced technical methods used abroad; following domestic competitors who are already selling overseas; testing opportunities for overseas licensing, franchising or production; contributing to the company's general expansion; improving the company's overall return on investment; research and development costs can be set off against a large sales base; new markets might yield ideas for further innovations; fluctuations in business cycles can be leveled out by selling in different markets; declining sales in one market might be offset by a boom in another market.

**Figure 1: Decision Process for Export Price Determination (Cavusgil, 1988)**

## PITFALLS OF EXPORTING

It is important for prospective exporters must know that there are some potential pitfalls in exporting. They include the following: management might need to devote a considerable amount of time to the start-up procedures and decisions, key personnel might have to be diverted from domestic responsibilities to help with the company's export activities; additional plant facilities might be needed; catalogues, brochures and other sales promotion material might need to be translated into a foreign language; the product might need to be modified to meet foreign market specifications; credit terms might need to be extended because of competition, local custom and transit time. Exporting is generally an expensive activity and will require additional financial resources.

## EXPORTING VS DOMESTIC SELLING

To begin with, there are numerous factors that impact on the external environment in which exporting takes place. Compared with the domestic environment, which is fairly uniform in nature, the external environment is far more complex and exporter faces numerous additional problems when selling across international borders. These can be summarized as follows: **new parameters** that include import duties and restrictions, different modes of transport, international, trade documentation, foreign currencies, and different and additional marketing channels; **new environments** such as foreign markets that represent unfamiliar environments. These include the cultural, legal, political, social and economic environments that the exporter has to contend with. : Operating in foreign markets exposes the exporter to far wider and more intense competition than would be the case in the domestic market.

### Figure 2: Factors impacting on the exporting environment

Exporting involves additional markets, as well as new parameters and environments, which means that the exporter has to deal with a greater number of marketing and management issues. Pricing for international markets involves other factors related to foreign customer behaviors such as: economic and political ideologies of target market, education and technological, values and attitudes, social and cultural, language, religion and beliefs, legal as well as competitive factors to mention a few.

### **Figure 3: Factors that affect foreign customer behavior**

*(Source: International Marketing Strategy, Chartered Institute of Marketing)*

## **UNDERSTANDING FOREIGN MARKETS**

Firms have to think beyond their domestic markets in order to survive and prosper. They have to think globally and act locally. The task of international marketing management is the same as the task in domestic markets. In all markets, customers are the driving force of marketing and companies need to produce products efficiently. Products have to be distributed through the most appropriate channels and priced according to local market environment conditions. Local market conditions may be different and companies have to adapt to the needs of local customers. The **PEST** (Political, Economic, Social, Technological) factors have been used to analyze foreign market opportunities, and what makes them different.

### **Figure 4: PEST**

#### **Policy Environment**

For marketers considering an entry strategy into a foreign country or region, a number of environmental factors should be used to assess market opportunities and constraints. Cultural and structural issues are commonly evaluated as a first step in the market expansion process. Environmental monitoring should continue throughout the business cycle. In light of multilateral trade agreements and other economic and policy integrations, marketers must also become adept at evaluating country standards, multilateral standards, and their interaction effects. Since marketers must comply with the law, an understanding of governmental policy and the process by which it is created is central to effective marketing decision-making.

To operate, international firms must understand the policy-making process and different categories of laws, and marketers must also investigate the general policy climate and local laws that affect the operation of their business. In developing marketing and business objectives, decision-makers can unintentionally create incentives and pressures that run counter to legal and ethical standards. Although not always conceptualized in this way, the objective-setting component of marketing strategy is pivotal to customer satisfaction, financial performance, and compliance. As Ferrell *et al.* (1998, p. 361) suggest, "...an overwhelming number of crimes in business (i.e. price fixing, product misrepresentation, copyright violation, etc.) stem from employee misconduct designed to benefit the company. Employees often believe that corporate objectives have greater importance than legal and ethical requirements..."

Common marketing objectives, especially quantitative targets, should be developed with an understanding of rules for competitive behavior. Regardless of product, industry, or geographical focus, marketers are concerned with standards on advertising, product safety and liability, product labeling, selling, electronic commerce, data privacy, and general competitive behavior. This suggests that marketers have to ensure that legal and regulatory concerns are monitored and integrated into marketing decision-making.

### **Political Factors**

Researches have stated that pricing is influenced by laws and regulations which necessitate product modifications, in compliance with health and safety standards, environmental regulations, measures systems, that may prevail in foreign markets (Theodosiou 2000). Government policies influence the legislative and economic frameworks. Perhaps the most ominous cloud from the political arena is the threat of wars. World War III has been avoided thus far, but "smaller" wars and threats of war can have serious regional and even wider implications, especially with the nature of weapons that may be used - from nuclear to biological to chemical (Iraq).

### **Economic Factors**

The level of GDP is the main measure of economic attractiveness of foreign markets. As GDP increases, the demand for goods and services increases too. Furthermore marketers consider the distribution of income within a country, in order to identify niche and segment markets. Marketers always watch not only the present economic prosperity of a country, but also its future development in terms of population and density, inflation and economic growth, age and distribution of income, level of urbanization as well as other economic activities that will affect markets and pricing.

**Figure 5: Economic Environmental Factors**

The economic environment of the foreign or host country influences pricing decisions. It has a significant impact on firm's costs, determines demand potential for a particular product/service, in addition to the prices that local customers can afford and are willing to pay (Whitelock and Pimblett 1997). For example, some products that are considered essential in western countries, are viewed as luxury items in my country (Rwanda), and most of the sub-Saharan African countries. This confirms the hypothesis that the demand for a product/service at different price levels is a function of the purchasing power of targeted customers, determined by the level of economic development of the country (Jain 1989).

### **Social Factors**

People from different cultures have different tastes, buy different products and respond in different ways to the same service or product. Therefore, the demographic structure of a foreign market should be considered. The aging of population in major western markets, and the increase in population in several countries such as India and China, is another continuing development that will affect international marketing. As teens around the world are becoming a global market segment today, and sub-Saharan Africa is becoming part of global market, the marketing strategies mix, including international and export pricing will have to adapt to social factors. That is when pricing for international markets, one has to take into consideration of local material culture, language, aesthetics, education and religion, as well as attitudes and values. Firms need to examine carefully target market country's characteristics and purchasing behaviors, to select appropriate pricing strategy. Price level is an important criteria used by consumers in evaluating competing products. Other criteria such as product quality and performance are important to customers (Douglass and Wind 1987). Thus, in developing pricing strategy, firms must be aware of foreign consumers' preferences, perceptions, and purchasing behaviors with respect to various price levels (Theodosiou, 2000).

### **Technological Factors**

Firms need to analyze the technological environment of foreign markets. Well-developed communication infrastructure is an important factor to respond rapidly to customer's needs. International firms often rely on existing local distribution infrastructure in order to transport and distribute their products to consumers. This may have significant effect on costs, and in turn may influence price, as well as profits. Technology change is another dynamic but ongoing phenomenon. A perfect example is the internet. Internet allows online contact with the firm's customers, suppliers, and partners and subsidiaries around the world, but it may also increases the opportunities for existing competitors and openings for new competitors. Therefore, technology provides both opportunities and challenges. Pricing is a strategic choice, and it will be partially influenced by environmental factors. Taking into account elements of cost, the behavioral assumptions of self-interest lead firms to take advantage when environmental forces fluctuate (Williamson, 1975). However, some environmental factors, such as: economic and regulatory volatility, and competitive intensity, have been identified as moderating effects between strategy and performance (Cavusgil and Zou, 1994; Myers 1997).

**Figure 6: Antecedents and Outcomes of Export Pricing Control (Myers 2001)**

## PRICING STRATEGIES

Price is the amount of money charged for a product or service. **Price = product + service + profit + image.** Price will include the cost of producing your product, the cost of providing any needed services that may accompany the product, the amount of profit that you need to make in order to stay in business. Often the firm is trying to portray the best quality or the lowest price. Therefore, price can be a direct reflection of quality or even perceived quality. There are several basic pricing strategies considered when making decisions for export:

### **Economy and Premium**

Premium pricing is adopted when there is a substantial competitive advantage, and the product or service is unique (Concord flights), and economy pricing strategy when the cost of marketing and manufacture is kept at a minimum.

### **Penetration or Low Price**

This first model uses a low profit margin to penetrate the market. It is designed to grab market share quickly. Penetrating the market with an exceptionally low-priced item creates a broad customer base. It also provides high-value-for-the-dollar to the customer. Penetration is used when prices are set first low in order to attract new customers and to gain market share, and then the price is increased after the market share has been achieved. To penetrate the market and gain market share, businesses set a low price in comparison to other competitors. Note that also low price is sometimes perceived as indication of low quality product. It may also be difficult to increase price in the future without incurring loss.

### **Skimming**

This is appropriate for some product to be priced as high as the market will bear. However, few buyers are attracted, and lower sales volumes can be achieved when price is such high. This strategy is often used when a new product is introduced into the market, and is in great demand. For this strategy, the product or service is charged high because of a substantial competitive advantage. This high price tend to attract new customers into the market, and then falls due to lower unit cost as economies of scale are achieved. Skimming is the opposite of penetration and is a high priced model, sometimes called "top pricing." The idea behind this pricing strategy is to return high profits, even at the cost of losing a large number of customers. Typically, when a company launches a new product, they charge higher prices in the beginning to help recoup R&D expenditures as fast as possible. To be successful, firms must have a unique product that's in demand. For example, "chip manufacturers" often use this methodology during the introductory phase of a new proprietary product. Another model that closely resembles "skimming the cream," is the high cost option called "prestige pricing." Companies like Mercedes-Benz or BMW are good examples of this model. Customers purchase products from them knowing they probably paid too much. But, these companies have the prestigious reputation of high quality products and customer service.

### **Competitor's Pricing**

To attract the largest number of customers and generate consistent turnover, it may be necessary to set price not too high, not too low, just in the middle in line with other competitors. Prices are tagged to the competition and profits are acceptable. "In the long run, no single pricing strategy will always work best, and producers should be prepared to adjust to any opportunities or dangers which arise in the ever-changing market." For export pricing, exporters should consider other factors such as freight and transport, duties, and risks.

	LOW	HIGH
LOW	Economy	Penetration
HIGH	Skimming	Premium

**Figure 7: Pricing Strategy Matrix.**

Even though premium pricing, penetration pricing, economy pricing, and price skimming are the main pricing strategies for marketing mix, there are other strategies to pricing such as: psychological pricing, product line and optional product pricing, captive and product bundle pricing, promotional, geographical, value pricing, rigid and flexible cost-plus strategy, dynamic increment, marginal cost, and loss leader pricing strategies.

### **Rigid Cost-Plus Strategy**

In order to make profits, managers adopt rigid cost-plus pricing strategy. This is accomplished by adding international customer costs and a gross margin to domestic manufacturing costs. Hence, the cost to the customer includes administrative and R&D costs, transportation, packaging, insurance, and other marketing expenses. Cost-plus pricing strategy appears to be the most dominant strategy among Americans firms (Cavusgil 1988).

### **Flexible Cost-plus Strategy**

Flexible strategy allows price variations depending on circumstances. For example there may be some discounts depending on the customer, the order, or competitive factors. This strategy is often used to encounter competitive pressures or exchange rate fluctuations.

### **Dynamic Incremental Strategy**

The strategy assumes that fixed and variable domestic costs are incurred regardless of export sales. In this strategy, some domestic costs such as: R&D, domestic promotion and marketing costs, are disregarded. The dynamic incremental strategy also assumes that there will be always unused capacity or excess supply, and therefore exported products cannot be sold at full cost. This helps companies to enter, penetrate and compete in international markets.

**Figure 8: The Three C's Model for Price Setting**

## **EXPORT PRICING**

### **Marginal Costing**

In highly competitive markets, some companies may want to consider turning to marginal costing to ensure that their products are competitively priced. Marginal costing ignores the fixed cost incurred by companies, on the assumption that these costs will be incurred by domestic sales anyway, whether or not the company exports and therefore, only variable costs need to be considered in export pricing. Ignoring fixed costs will naturally reduce total costs, enabling lower prices to be set. Where possible, however, companies should not resort to this method of pricing.



## **The Right Optimum Price**

The optimum pricing strategy for a product or service meets the needs of both the buyer and the seller. Because when you find the right price, profits will skyrocket and your business will prosper. The buyer determines if a price is right by looking at the benefits to them and how a company's profit structure compares to the competition. The seller sets their price to maximize profits, while considering the bigger picture of a business model (i.e., high price/low volume or low price/high volume). The company must pay for the cost of production, marketing and overhead, and still produce a profit.

## **The Loss Leader:**

Want to kill the competition? The loss leader is the business pricing model to get the job done. No matter the cost, even at a loss in profits, this strategy has one objective to eliminate the competition. The consequences of even a slight misjudgment in using this retail pricing strategy could be devastating to your business. History gives us a great example. The "Gasoline Price Wars" of the late 50s and early 60s started as a result of companies using this strategy. It marked the beginning of the end to many small, individually owned gasoline stations in the U.S. Today, we see a more modern version of this pricing strategy being used by supermarkets and clothing store chains. The objective in these cases is to lure the customer into the store with a loss-leader. The hope is that when customers show up to buy the "sale" item, the company will make up the loss in profits through additional customer purchases. When used in this form, the "loss leader" is actually a variation of "pricing to penetrate."

## **Psychology of Pricing: Value Bundling and Discounting**

Psychology plays an important role in the marketing world. It helps build the perception of price and value. The psychology of retail pricing is probably more important than the price itself. For example, the psychology of not using values ending in "0" or "1" in the price gives the customer the perception of saving. For example...\$19.99 is viewed as a greater value over a product priced at an even \$20. Logically, the customer knows the difference is not great. But there is still that sense of saving. *Value Bundling* gives the customer the feeling of getting "something for nothing." For example, buy one, and get second free. *Discounting also builds loyalty* and encourages bulk purchases. Percentage off the normal retail price attracts customers and the greater the discount, the happier the customer would be.

## **SUMMARY AND CONCLUSION**

Pricing is probably one of the toughest problems for a decision maker, when trying to price a product or service. It may include the cost of producing and providing the product, the profit that you need to make to stay in the business. Proper pricing takes into account costs, market demand and competition. In domestic markets, few companies are free to set prices without considering their competitors' pricing policies. This is also true in exporting. If a foreign market is serviced by many competitors, you may have little choice but to match the going price, or go below it, to win a share of the market. If your product or service is new to a market, you may, however, be able to set a higher price. Pricing in the international marketplace requires a shrewd of market strategy and companies need to define their pricing strategies, know their products, and understand host country's environmental factors.

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