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STRATEGY OF INTERNATIONAL AGRARIAN MARKETING

COURSE BOOK

for English-Speaking Students
of Economics and Management Faculty, 1st year of study master's degree,
specialty: 073 Management
Educational program "Administrative management"

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Topic 1. VIEW OF THE MARKETING PROCESS

Plan

1. Understanding the meaning and role of marketing

2. Jumpstarting your marketing program

1. Understanding the meaning and role of marketing

You're not alone if you opened this book in part to find the answer to the question: "What is marketing anyway?" Everyone seems to know that marketing is an essential ingredient for business success, but when it comes time to say exactly what it is, certainty takes a nosedive. If you pick up the phone and call any number of marketing professors, marketing vice presidents, or marketing experts and ask them to define marketing, odds are you won't get the same answer twice. In fact, if you look the word up in different dictionaries, you'll find many different definitions. To settle the matter right up front, here is a plain-language description of what marketing - and what this book - is all about.

Marketing is the process through which you create - and keep - customers.

✓ Marketing is the matchmaker between what your business is selling and what your customers are buying.

✓ Marketing covers all the steps that are involved to tailor your products, messages, distribution, customer service, and all other business actions to meet the desires of your most important business asset: your customer.

✓ Marketing is a win-win partnership between your business and its market.

Marketing isn't about talking to your customers; it's about talking with them. Marketing relies on two-way communication between your business and your buyer. Marketing is a nonstop cycle. It begins with customer knowledge and goes round to customer service before it begins all over again. Along the way, it involves product development, pricing, packaging, distribution, advertising and promotion, and all the steps involved in making the sale and serving the customer well.

The marketing wheel of fortune

Every successful marketing program — whether for a billion-dollar business or a hardworking individual - follows the marketing cycle illustrated in Figure 1-1. The process is exactly the same whether yours is a start-up or an existing business, whether your budget is large or small, whether your market is local or global, and whether you sell through the Internet, via direct mail, or through a bricks and mortar location. Just start at the top of the wheel and circle round clockwise in a neverending process to win and keep customers and to build a strong business in the process.

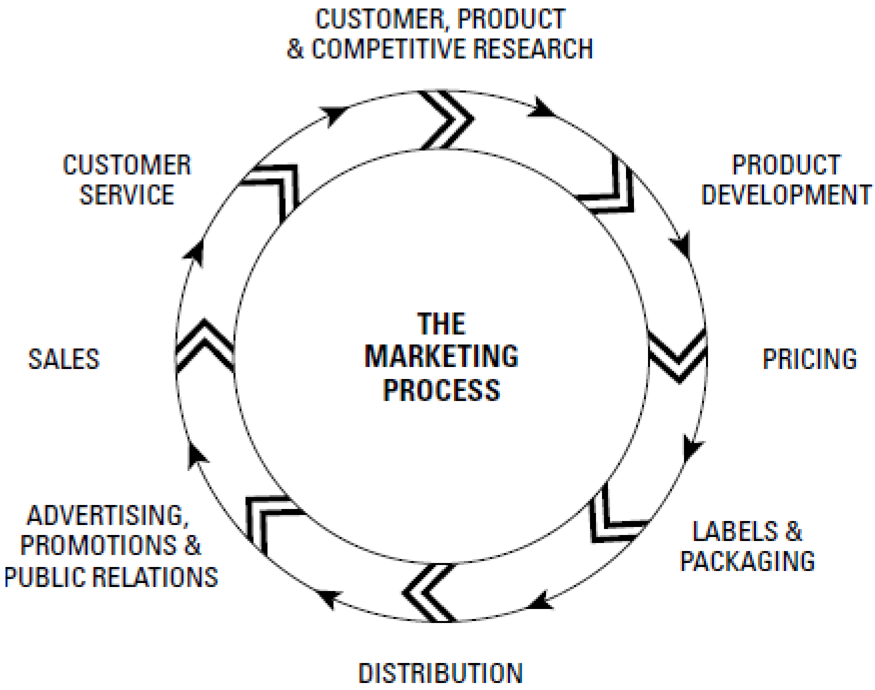

Fig. 1.1 The marketing “wheel of fortune.”

As you loop around the marketing wheel, here are the actions you take:

1. **Get to know your target customer and your marketing environment**.
2. **Tailor your product, pricing, packaging, and distribution strategies** to address your customers’ needs, your market environment, and the competitive realities of your business.
3. **Create and project marketing messages** to grab attention, inspire interest, and move your prospects to buying decisions.
4. **Go for and close the sale — but don’t stop there**.
5. **Once the sale is made, begin the customer-service phase**. Work to ensure customer satisfaction so that you convert the initial sale into repeat business and word-of-mouth advertising for your business.
6. **Talk with customers to gain input about their wants and needs and your products and services**. Combine what you learn with other research about your market and competitive environment and use your findings to fine-tune your product, pricing, packaging, distribution, promotional messages, sales, and service.

And so the marketing process goes round and round. In marketing, there are no shortcuts. You can’t just jump to the sale, or even to the advertising stage. To build a successful business, you need to follow every step in the marketing cycle, and that’s what the rest of the chapters are all about.

2. Jumpstarting Your Marketing Program

Business owners clear their calendars for the topic of marketing typically at three predictable moments:

- ► At the time of business start-up

- ► When it's time to accelerate business growth
- ► When there's a bump on the road to success, perhaps due to a loss of business because of economic or competitive threats

Marketing a start-up business

If your business is just starting up, you face a set of decisions that existing businesses have already made. Existing companies have existing business images to build upon, whereas your start-up business has a clean slate upon which to write exactly the right story. Before sending messages into the marketplace, know your answers to these questions:

- ✓ What kind of customer do you want to serve?
- ✓ How will your product compete with existing options available to your prospective customer?
- ✓ What kind of business image will you need to build in order to gain your prospect's attention, interest, and trust?

Marketing to grow your business

Established businesses grow their revenues by following one of two main routes:

- ✓ Grow market share by pulling business away from competitors.
- ✓ Grow customer share by increasing purchases made by existing customers, either by generating repeat business or by achieving larger sales volume at the time of each purchase.

Almost always, the smartest route is to look inside your business first, work to shore up your product and service offerings, and strengthen your existing customer satisfaction and spending levels *before* trying to win new prospects into your clientele.

Scaling your program to meet your goal

Whether you're launching a new business or accelerating growth of an existing enterprise, start by defining what you're trying to achieve.

Too often, small business owners feel overwhelmed by uncertainty over the scope of the marketing task. They aren't sure how much money they should dedicate to the effort, whether they need to hire marketing professionals, and whether to create ads, brochures, and Web sites. They may have all kinds of other questions that get in the way of forward motion. And they delay launching their marketing efforts as a result.

Here's the solution: Rather than worry about the tools you need to do the job, first put the task in perspective by focusing on what it is you're trying to accomplish. Ask yourself:

- ✓ How much business are we trying to gain?
- ✓ How many clients do we want to add?

Topic 2. AGRARIAN MARKETING

Plan

1. Agrarian marketing
2. Agrarian Marketing campaign developing
3. Seven steps to better marketing

1. Agrarian Marketing

Centuries ago, you ate what was grown locally.

If you had the money, there might be some exceptions: dried fruits, wines, spices, maybe some olive oil. However, for the most part, you ate what you or your close neighbors grew-provided the rains came, the harvest was good, and there were no natural disasters to sweep it away. If you didn’t grow your own food, you probably knew who did, buying it from them personally at the village market.

Then came the modern agricultural revolution, and suddenly a greater variety of foods were available from around the world. Improvements in technology and transportation produced food surpluses and enabled people to obtain food from the furthest reaches of the globe. Today, instead of buying most of our food from farmers, we buy from supermarkets that have gathered selections of food from thousands of farms from around the world . This is excellent news for the consumer, but a challenge for the farmer, who now must compete in a global market instead of a local one.

Our food choices today are unprecedented, but they are also increasingly complex. Consumers can buy food from other countries—but are they better off buying food grown locally to help the economy? Should a farmer use environmentally responsible practices? What about genetically modified foods? “Organic” foods?

Such questions offer farmers many opportunities, as they attempt to differentiate their produce from similar produce in the market. But such a task depends upon successful communication with customers and distributors, as they try to market their products better than the competition.

Who use Agricultural Marketing?

- Agricultural products are perishable; therefore, a failure to sell on time results in wasted harvest. All wasted harvest represents a cost of land, water, labor, storage - and no income to show for it.
- Agricultural prices can be quite variable, impacted by changes in weather and harvests in far corners of the world.
- Different production methods mean that not all food is the same - but this information is meaningful only if the consumer knows about it

Agricultural marketing techniques are used in every corner of "agribusiness," including small farms, corporate farms, and collectives; distributors; manufacturers of farm equipment, pesticides, and genetic enhancements for crops and livestock; feed and seed sellers; and more. Additionally, there are also government agencies which monitor and direct agribusiness practices.

- *Farmers seek* higher prices for their produce, and protection from price fluctuations. They try to reduce the amount of post-harvest waste, and secure guarantees for the sale of their produce. They may also work to open up new markets or channels, such as selling directly to consumers instead of through producers.
- *Agrichemical companies* promote solutions to farm problems, offering farmers higher yields and protection from pests. However, many solutions would be more strongly resisted by consumers, if it weren't for effective public relations.
- *Government agencies* at both the federal and state level campaign for farm production. The USDA Agricultural Marketing Service runs a number of different programs to promote farm sales (and prices). The agriculture-rich state of California produces some $30 billion dollars' worth of agricultural products annually, and is one of the largest food exporters in the world. To protect this investment, the state has government-mandated programs covering about 66 percent of its agricultural production.

The ultimate target for agricultural marketing practices are those who actually buy and eat the farm produce. As this consumer base represents nearly everyone, marketing campaigns often focus on one segment of the population at a time. People from different regions, as well as different cultural and socioeconomic backgrounds, tend to purchase different foods.

2. Agrarian Marketing campaign developing

Marketing is fundamentally about communicating information to increase demand for a product or service. Effectively gathering and using information in agricultural marketing poses some unique challenges.

For example, the most important information signal in the marketplace is price; however, agriculture is often subject to price controls, and thus the wrong message can be communicated to customers. Market analysts must seek additional sources of information about supply and demand, and stay aware of what efforts are being made by companies and countries to increase supplies of agricultural products.

- Community-supported agriculture
- On-farm sales and tourism
- Restaurant sales
- Subscriptions for meat products
- Extending marketing seasons
- Creating value-added products

A second challenge for agricultural marketing involves product branding. Similar or competitive products often go by different names. Some campaigns focus on the issue of naming a product, establishing its brand in the minds of consumers.

Effective agricultural marketing campaigns are developed with multiple targets, including consumers, restaurants, supermarkets, and government industries.

In fact, some states have mandated marketing programs; that is, producers are required to pay the state for its marketing efforts on the industry's behalf. The state engages in generic marketing instead of brand marketing, aiming to increase the consumer demand for a given product instead of a particular brand. The state also issues requirements regarding quality, size, and packaging of products, standardizing many agricultural products between different producers.

Sales and Marketing Representatives work in a variety of agribusiness companies, promoting agricultural inputs (such as seed and fertilizer) and services (such as soil sampling). What do they do?

- communicate about agronomy products, and make appropriate recommendations to prospective customers
- create campaigns for growing market shares and opening new markets
- sales presentations with producers
- monitor prices of competitors' products, as well as the prices (and prospective prices) of their customers' produce; and strategically respond

Public Relations Specialists, Communications Managers, and Lobbyists work to inform their target audience about the virtues and needs of their business, as well as those of their business' products. What do they do?

- handle media relations, issue press releases, respond to negative press, and arrange for coverage of positive developments and important legislative issues
- develop official statements, question-and-answer documents, background materials, positioning messages, and other communications materials
- develop their organization's public identity and branding (for example, by promoting the company's dedication to "organic" methods, or reputation for quality)
- develop educational/promotional materials informing about their industry
- protect regional labeling
- meet with legislators to advocate measures promoting or protecting their company
-

Agricultural Marketing Specialists work for government agencies, promoting farm and commodity interests in their state or region. What do they do?

- direct/manage marketing campaigns for particular commodities
- promote the purchase of local produce, and seek customers for local produce in new areas
- administer government grants and cost-sharing programs
- meet with farmers, food buyers, agribusiness leaders, and members of the media
- monitor and adjust inspection and quality-control programs
- promote nutrition and education programs, if part of that agency's mandate

3.Seven steps to better marketing in AgriBusiness

Marketing is planning to have what you can sell at a good price. Marketing, like most things on a well-run farm or ranch, is a well-planned management activity.

7 key steps to better marketing.

Step 1 - Decide what to produce

A farm manager's first marketing decision is what to produce. Which crops will you grow this year? Will you sell weaned calves, bred heifers, or finished steers? Price is the market signal that tells farm managers what to produce. Gather price information, market outlook, and price forecasts to help you decide what to produce each year. You'll also want to consider crop rotation, grazing needs, and other farm specific factors.

Step 2 - Understand unit cost of production (COP)

Calculate your cost per unit to identify which crops are most profitable. One tool you can use to do this is our Crop Returns Calculator, which allows you to calculate production costs, breakeven points, and returns to equity based on your inputs.

Step 3 - Set price targets & thresholds

Determine what you think the market will give over the year and how much profit you think you can make based on your cost of production. Calculate your breakeven price and look at your cash flow needs (loans, cash obligations, etc.) over the next year.

Step 4 - Determine timing of sales

Set price targets for each crop and market portions of your grain throughout the year to manage price risk. Look at your cash needs, storage capacity, and price patterns to determine when you should sell portions of your harvest.

Step 5 - Inform yourself of market information

Look at basis levels, price trends, and other current market information.

Step 6 - Consider your marketing alternatives

Consider your alternatives: you can sell for cash (spot) prices, pool your grain sales with other producers to receive the average price over several months (price pooling), use deferred delivery contracts, or hedge using futures and options. Don't forget to consider delivery costs, premiums for quality attributes, and cost of carry (interest and storage). For more information about these marketing options and how to manage risk, see: the Marketing Guide and the Marketing Decision Tool.

Step 7 - Make a marketing plan

Make a plan and stick to it. Evaluate, review and modify your marketing plan throughout the year based on current market information.

Marketing Decisions

To make good farm marketing decisions you need:

1. Price information - current market cash prices and, if applicable, futures prices.

2. Market Analysis - an explanation of what's happening in the market place, how prices changed and why they changed.

3. Outlook - a carefully researched opinion on what market conditions and prices are expected to be in the future.

4. Market strategies- one or more suggested market strategies to deal with current and expected market situations.

Topic 3. NATURE OF STRATEGIC INTERNATIONAL MARKETING

Plan

1. Process of international marketing
2. International dimensions of marketing
3. Domestic marketing vs. international marketing
4. The applicability of marketing

1. Process of international marketing

Strategic marketing according to Wensley (1982) has been defined as: "Initiating, negotiating and managing acceptable exchange relationships with key interest groups or constituencies, in the pursuit of sustainable competitive advantage within specific markets, on the basis of long run consumer, channel and other stakeholder franchise".

A study of international marketing should begin with an understanding of what marketing is and how it operates in an international context. A definition adopted by the AMA (American Marketing Association) is used as a basis for the definition of international marketing given here: **international marketing** *is the multinational process of planning and executing the conception, pricing, promotion, and distribution of ideas, goods, and services to create exchanges that satisfy individual and organizational objectives*. Only the word *multinational* has been added. That word implies that marketing activities are undertaken in several countries and that such activities should somehow be coordinated across nations.

This definition is not completely free of limitations. By placing individual objectives at one end of the definition and organizational objectives at the other, the definition stresses a relationship between a consumer and an organization. In effect, it fails to do justice to the significance of **business-to-business marketing**, which involves a transaction between two organizations. In the world of international marketing, governments, quasigovernment agencies, and profit-seeking and nonprofit entities are frequently buyers.

Nonetheless, the definition does offer several advantages by carefully describing the essential characteristics of international marketing. First, what is to be exchanged is not restricted to tangible products (goods) but may include concepts and services as well. When the United Nations promote such concepts as birth control and breast-feeding, this should be viewed as international marketing.

Second, the definition removes the implication that international marketing applies only to market or business transactions. International nonprofit marketing, which has received only scant attention, should not be overlooked. Governments are very active in marketing in order to attract foreign investment.

Third, the definition recognizes that it is improper for a firm to create a product first and then look for a place to sell it. Rather than seeking consumers for a firm's existing product, it is often more logical to determine consumer needs before creating a product. For overseas markets, the process may call for a modified product. In some cases, following this approach may result in foreign needs being satisfied in a new way (i.e., a brand new product is created specifically for overseas markets).

Fourth, the definition acknowledges that “place” (distribution) is only part of the marketing mix and that the distance between markets makes it neither more nor less important than the other parts of the mix. It is thus improper for any firms to regard their international function as simply to export (i.e., move) available products from one country to another. Finally, the “multinational process” implies that the international marketing process is not a mere repetition of using identical strategies abroad. The four Ps of marketing (product, place, promotion, and price) must be integrated and coordinated across countries in order to bring about the most effective marketing mix. In some cases, the mix may have to be adjusted for a particular market for better impact. Coca-Cola’s German and Turkish divisions, for example, have experimented with berry-flavored Fanta and a pear-flavored drink respectively. In other cases, a multinational marketer may find it more desirable to use a certain degree of standardization if the existing market differences are somewhat artificial and can be overcome.

2. International dimensions of marketing

One way to understand the concept of international marketing is to examine how international marketing differs from similar concepts. **Domestic marketing** is concerned with the marketing practices within a researcher’s or marketer’s home country. From the perspective of domestic marketing, marketing methods used outside the home market are **foreign marketing**. A study becomes **comparative marketing** when its purpose is to contrast two or more marketing systems rather than examine a particular country’s marketing system for its own sake. Similarities and differences between systems are identified.

Some marketing textbooks differentiate international marketing from **global marketing** because international marketing in its literal sense signifies marketing between nations (*inter* means *between*).The word *international* may thus imply that a firm is not a corporate citizen of the world but rather operates from a home base. For those authors, global or world marketing is the preferred term, since nothing is foreign or domestic about the world market and global opportunities.

One might question whether the subtle difference between international marketing and multinational marketing is significant. For practical purposes, it is merely a distinction without a difference. As a matter of fact, multinational firms themselves do not make any distinction between the two terms. It is difficult to believe that International Business Machines will become more global if it changes its corporate name to Multinational Business Machines. Likewise, there is no compelling reason for American Express and British Petroleum to change their names to, say, Global Express and World Petroleum. For purposes of the discussion in this text, international, multinational, and global marketing are used interchangeably.

International marketing *involves:*

1) Identifying needs and wants of customers in international markets

2) Taking marketing mix decisions related to product, pricing, distribution and communication keeping in view the diverse consumer and market behaviour across different countries on one hand and firm's goals towards globalization on the other hand

3) Penetrating into international markets using various mode of entry and taking decisions in view of dynamic international marketing environment.

The extreme form of international marketing is multi-domestic marketing, where a company establishes an independent foreign subsidiary in each and every foreign market. The foreign subsidiaries operate independently without any measureable control from the headquarters.

Marketing Focus	Differentiation in country markets by way of developing or acquiring new brands
Orientation	Polycentric
Marketing Mix Decisions	Developing local products depending upon country needs. Decision by individual subsidiaries.

Once a company establishes its manufacturing and marketing operations in multiple markets, it begins to consolidate its operations on regional basis so as to take advantage of economies of scale in manufacturing and marketing mix decisions. Various markets are divided into regional sub-segments on the basis of their similarity to respond to marketing mix decisions. It is known as ***multinational marketing.***

Marketing Focus	Consolidation of operations on regional basis. Gains from economies of scale.
Orientation	Regiocentric
Marketing Mix Decisions	Product standardization within regions but not across them on regional basis

The extreme view of ***global marketing*** refers to the use of a single marketing method across the international markets with little adaptation.

Marketing Focus	Consolidating firm's operations on global basis
Orientation	Geocentric
Marketing Mix Decisions	Globalization of marketing mix decisions with local variations. Joint decision making across firm's global operations.

In practice, global marketing hardly means complete standardization of the marketing mix decisions, but it increasingly means a strategic approach to have a global perspective to have economies of scale.

Transnational marketing involves entering foreign markets with a solid marketing plan that helps a company create a positive brand presence and resonates with residents of the foreign country

3. Domestic marketing vs. international marketing

It would beg the question to say that life and death are similar in nature, except in degree. As pointed out by Lufthansa, it would be just as *incorrect to say that domestic and international marketing are similar in nature but not in scope*, meaning that international marketing is nothing but domestic marketing on a larger scale.

Domestic marketing involves one set of uncontrollables derived from the domestic market. International marketing is much more complex because a marketer faces two or more sets of uncontrollable variables originating from various countries. The marketer must cope with different cultural, legal, political, and monetary systems. Digital Microwave Corporation's annual report makes this point very clear when it states:

The Company is subject to the risks of doing business internationally, including unexpected changes in regulatory requirements, fluctuations in foreign currency exchange rates, imposition of tariffs and other barriers and restrictions, the burdens of complying with a variety of foreign laws, and general economic and geopolitical conditions, including inflation and trade relationships

As shown in Figure 3.1, the two or more sets of environmental factors overlap, indicating that some similarities are shared by the countries involved. A firm's marketing mix is determined by the uncontrollable factors within each country's environment as well as by the interaction between the sets (see Figure 3.2). For optimum results, a firm's marketing mix may have to be modified to conform to a different environment, though wholesale modification is not often necessary. The degree of overlap of the sets of uncontrollable variables will dictate the extent to which the four Ps of marketing must change – the more the overlap, the less the modification.

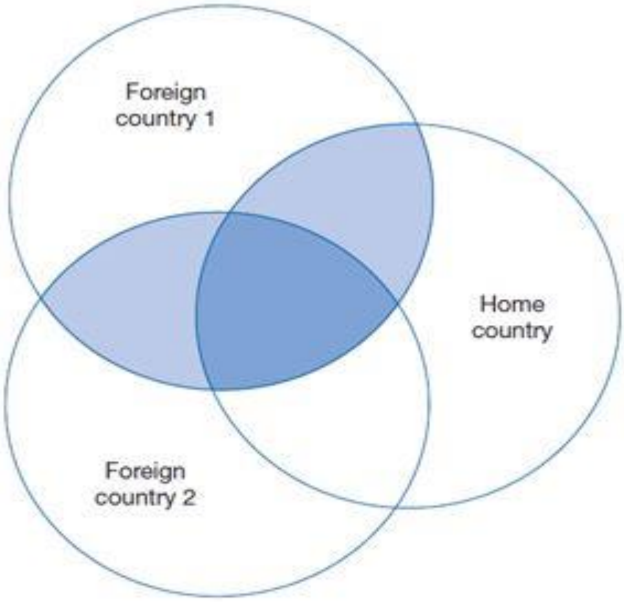

Fig. 3.1. **Environmental divergence and convergence**

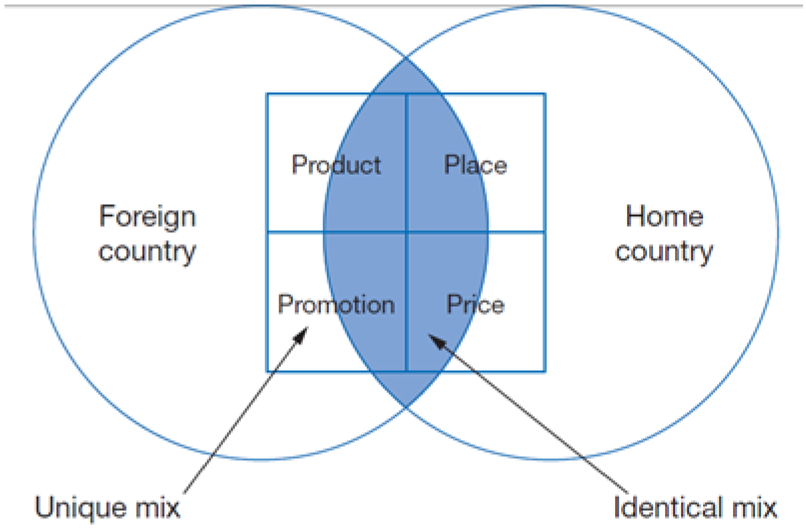

Fig. 3.2. **Environmental effect on international marketing mix**

The varying environments within which the marketing plan is implemented may often rule out uniform marketing strategies across countries. McDonald's, although world renowned for its American symbols and standardization, has actually been flexible overseas. Recognizing the importance of foreign markets and local customs, the company customizes its menu by region. In fact, it has even excluded beef from its menu in India in deference to the country's Hindu tradition.

4. The applicability of marketing

Marketing is a *universal* activity that is widely applicable, regardless of the political, social, and economic systems of a country. However, it does not mean that consumers in all parts of the world must or should be satisfied in exactly the same way. Consumers from various countries are significantly different due to varying culture, income, level of economic development, and so on. Therefore, consumers may use the same product without having the same need or motive, and in turn may use different products to satisfy the same need. For example, different kinds of foods are used in different countries to satisfy the same hunger need. Further, Americans and Europeans may use gas or electric heat to keep warm, whereas people in India may meet the same need by burning cow dung.

Too often, marketing mix is confused with marketing principles. Sound marketing principles are universal. One basic principle states that marketers should adopt the marketing concept (i.e., using the integrated marketing approach to satisfy both customers' and corporate goals). Regardless of their nationalities, marketers everywhere should be customer-oriented. However, this universal principle in no way implies a uniform marketing mix for all markets. To be customer-oriented does not mean that the same marketing strategy should be repeated in a different environment.

Topic 4. TRADE THEORIES AND ECONOMIC DEVELOPMENT

Plan

1. Basis for international trade

Production possibility curve

Principle of absolute advantage

Principle of comparative/relative advantage

2. Exchange ratios, trade, and gain

3. Factor endowment theory

1. Basis for international trade

Whenever a buyer and a seller come together, each expects to gain something from the other. The same expectation applies to nations that trade with each other. It is virtually impossible for a country to be completely self-sufficient without incurring undue costs. Therefore, trade becomes a necessary activity, though, in some cases, trade does not always work to the advantage of the nations involved. Virtually all governments feel political pressure when they experience trade deficits. Too much emphasis is often placed on the negative effects of trade, even though it is questionable whether such perceived disadvantages are real or imaginary. The benefits of trade, in contrast, are not often stressed, nor are they well communicated to workers and consumers.

Why do nations trade? A nation trades because it expects to gain something from its trading partner. One may ask whether trade is like a zero-sum game, in the sense that one must lose so that another will gain. The answer is no, because, though one does not mind gaining benefits at someone else’s expense, no one wants to engage in a transaction that includes a high risk of loss. For trade to take place, both nations must anticipate gain from it. In other words, trade is a positive-sum game. Trade is about “mutual gain”

In order to explain how gain is derived from trade, it is necessary to examine a country’s production possibility curve. How absolute and relative advantages affect trade options is based on the trading partners’ production possibility curves.

Production possibility curve

Without International trade, a nation would have to produce all commodities by itself in order to satisfy all its needs. Figure 4.1 shows a hypothetical example of a country with a decision concerning the production of two products: computers and automobiles. This graph shows the number of units of computer or automobile the country is able to produce. The production possibility curve shows the maximum number of units manufactured when computers and automobiles are produced in various combinations, since one product may be substituted for the other within the limit of available resources. The country may elect to specialize or put all its resources into making either computers (point A) or automobiles (point B). At point C, product specialization has not been chosen, and thus a specific number of each of the two products will be produced.

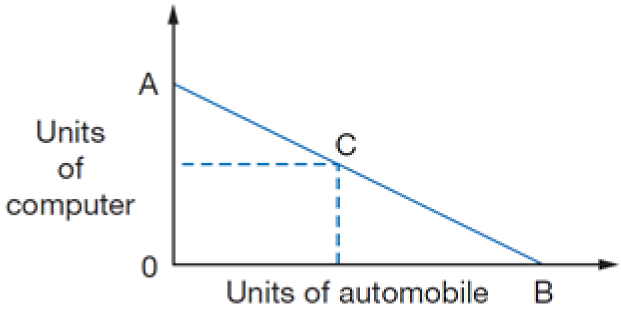

Fig. 4.1. **Production possibility curve: constant opportunity cost**

Because each country has a unique set of resources, each country possesses its own unique production possibility curve. This curve, when analyzed, provides an explanation of the logic behind international trade. Regardless of whether the opportunity cost is constant or variable, a country must determine the proper mix of any two products and must decide whether it wants to specialize in one of the two. Specialization will likely occur if specialization allows the country to improve its prosperity by trading with another nation. The principles of absolute advantage and relative advantage explain how the production possibility curve enables a country to determine what to export and what to import.

Principle of absolute advantage

Adam Smith may have been the first scholar to investigate formally the rationale behind foreign trade. According to this principle, a country should export a commodity that can be produced at a lower cost than can other nations. Conversely, it should import a commodity that can only be produced at a higher cost than can other nations.

Consider, for example, a situation in which two nations are each producing two products. Table 4.1 provides hypothetical production figures for the USA and Japan based on two products: the computer and the automobile. Case 1 shows that, given certain resources and labor, the USA can produce twenty computers or ten automobiles or some combination of both. In contrast, Japan is able to produce only half as many computers (i.e., Japan produces ten for every twenty computers the USA produces).This disparity may be the result of better skills by American workers in making this product. Therefore, the USA has an absolute advantage in computers. But the situation is reversed for automobiles: the USA makes only ten cars for every twenty units manufactured in Japan. In this instance, Japan has an absolute advantage.

Table 4.1. **Possible physical output**

	Product	**USA**	**Japan**
Case 1	Computer	20	10
	Automobile	10	20
Case 2	Computer	20	10
	Automobile	30	20
Case 3	Computer	20	10
	Automobile	40	20

Based on Table 4.1, it should be apparent why trade should take place between the two countries. The USA has an absolute advantage for computers but an absolute disadvantage for automobiles. For Japan, the absolute advantage exists for automobiles and an absolute disadvantage for computers. If each country specializes in the product for which it has an absolute advantage, each can use its resources more effectively while improving consumer welfare at the same time. Since the USA would use fewer resources in making computers, it should produce this product for its own consumption as well as for export to Japan. Based on this same rationale, the USA should import automobiles from Japan rather than manufacture them itself. For Japan, of course, automobiles would be exported and computers imported.

An analogy may help demonstrate the value of the principle of absolute advantage. A doctor is absolutely better than a mechanic in performing surgery, whereas the mechanic is absolutely superior in repairing cars. It would be impractical for the doctor to practice medicine as well as repair the car when repairs are needed. Just as impractical would be the reverse situation, namely for the mechanic to attempt the practice of surgery. Thus, for practicality, each person should concentrate on and specialize in the craft which that person has mastered. Similarly, it would not be practical for consumers to attempt to produce all the things they desire to consume. One should practice what one does well and leave the manufacture of other commodities to people who produce them well.

Principle of comparative/relative advantage

One problem with the principle of absolute advantage is that it fails to explain whether trade will take place if one nation has absolute advantage for all products under consideration. Case 2 of Table 2.1 shows this situation. Note that the only difference between Case 1 and Case 2 is that the USA in Case 2 is capable of making thirty automobiles instead of the ten in Case 1. In the second instance, the USA has absolute advantage for both products, resulting in absolute disadvantage for Japan for both. The efficiency of the USA enables it to produce more of both products at lower cost.

At first glance, it may appear that the USA has nothing to gain from trading with Japan. But nineteenth-century British economist David Ricardo, perhaps the first economist to fully appreciate relative costs as a basis for trade, argues that absolute production costs are irrelevant. More meaningful are relative production costs, which determine what trade should take place and what items to export or import. According to Ricardo’s principle of relative (or comparative) advantage, one country may be better than another country in producing many products but should produce only what it produces best. Essentially, it should concentrate on either a product with the greatest comparative advantage or a product with the least comparative disadvantage. Conversely, it should import either a product for which it has the greatest comparative disadvantage or one for which it has the least comparative advantage.

Case 2 shows how the relative advantage varies from product to product. The extent of relative advantage may be found by determining the ratio of computers to automobiles. The advantage ratio for computers is 2:1 (i.e., 20:10) in favor of the

USA. Also in favor of the USA, but to a lesser extent, is the ratio for automobiles, 1.5:1 (i.e., 30:20). These two ratios indicate that the USA possesses a 100 percent advantage over Japan for computers but only a 50 percent advantage for automobiles. Consequently, the USA has a greater relative advantage for the computer product. Therefore, the USA should specialize in producing the computer product. For Japan, having the least comparative disadvantage in automobiles indicates that it should make and export automobiles to the USA.

Consider again the analogy of the doctor and the mechanic. The doctor may take up automobile repair as a hobby. It is even possible, though not probable, that the doctor may eventually be able to repair an automobile faster and better than the mechanic. In such an instance, the doctor would have an absolute advantage in both the practice of medicine and automobile repair, whereas the mechanic would have an absolute disadvantage for both activities. Yet this situation would not mean that the doctor would be better off repairing automobiles as well as performing surgery, because of the relative advantages involved. When compared to the mechanic, the doctor may be far superior in surgery but only slightly better in automobile repair. If the doctor's greatest advantage is in surgery, then the doctor should concentrate on that specialty. And when the doctor has automobile problems, the mechanic should make the repairs because the doctor has only a slight relative advantage in that skill. By leaving repairs to the mechanic, the doctor is using time more productively while maximizing income.

2. Exchange ratios, trade, and gain

Although an analysis of relative advantage can indicate what a country should export and import, that analysis cannot explain exactly how a country will gain from trading with a partner. In order to determine the extent of trading gain, an examination of the domestic exchange ratio is required.

Theoretically, trade should equalize the previously unequal domestic exchange ratios and bring about a new ratio, known as the world market exchange ratio, or terms of trade. This ratio, which will replace the two different domestic exchange ratios, will lie between the limits established by the pre-trade domestic exchange ratios.

Such benefits derived from trade do not imply that trade must always take place and that all nations will always gain from trade. We will carry the hypothetical example a step further. In Case 3 of Table 2.1, the USA now makes forty automobiles (instead of ten as in Case 1 and thirty as in Case 2). Not only does the USA have absolute advantage for both products, but it also has the same domestic exchange ratio as that of Japan. This situation is graphically expressed by two parallel production possibility curves (Figure 4.2).

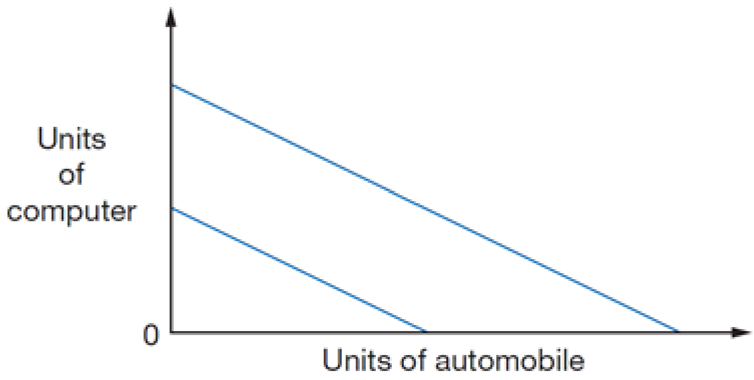

Fig. 4.2. **Absolute advantage without relative advantage (identical domestic exchange ratios)**

Under these circumstances, trade probably will not occur for two principal reasons. First, since the USA is 100 percent better than Japan for each product, the relative advantage for the USA is identical for both products. Second, since both countries have the identical domestic exchange ratio, there is no incentive or gain from trading for either party. Whether in the USA or in Japan, one unit of computer will fetch two automobiles. When such other costs as paperwork and transportation are taken into account, it becomes too expensive to export a product from one country to another. Thus international trade is a function of the varying domestic exchange ratios, and these ratios cause variations in comparative costs or prices.

3. Factor endowment theory

The principles of absolute and relative advantage provide a primary basis for trade to occur, but the usefulness of these principles is limited by their assumptions. One basic assumption is that the advantage, whether absolute or relative, is determined solely by labor in terms of time and cost. Labor then determines comparative production costs and subsequent product prices for the same commodity.

If labor is indeed the only factor of production or even a major determinant of product content, countries with high labor cost should be in serious trouble. An interesting fact is that Japan and Germany, in spite of their very high labor costs, have remained competitive and have performed well in trade. It thus suggests that absolute labor cost is only one of several competitive inputs that determine product value.

It is misleading to analyze labor costs without also considering the quality of that labor. A country may have high labor cost on an absolute basis; yet this cost can be relatively low if productivity is high. Countries with low wages tend to have low productivity. Any subsequent productivity gains usually result in higher wages and currency appreciation.

Furthermore, the price of a product is not necessarily determined by the amount of labor it embodies, regardless of whether or not the efficiency of labor is an issue. Since product price is not determined by labor efficiency alone, other factors of production must be taken into consideration, including land and capital (i.e., equipment). Together, all of these production factors contribute significantly to the creation of value within a particular product.

One reason for the importance of identifying other factors of production is that different commodities require different factor inputs and that no country is well endowed in all production factors. The varying proportion of these factors embodied in various goods has a great deal of impact on what a country should produce. Corn, for instance, is best produced where there is an abundance of land (relative to labor and capital), even though corn can be grown in most places in the world. Oil refining, in contrast, requires relatively more capital and relatively less labor and land because of expensive equipment and specialized personnel. In clothing production the most important input factor is that the economy is labor-intensive.

Since countries have different factor endowments, a country would have a relative advantage in a commodity that embodies in some degree that country's comparatively abundant factors. A country should thus export that commodity which is relatively plentiful (i.e., in comparison to other commodities) within the relatively abundant factor (i.e., in comparison to other countries).

Each nation possesses factors of production that may be grouped into these broad categories: human resources, physical resources, knowledge resources, capital resources, and infrastructure. Interestingly or surprisingly, a nation's abundance of a particular production factor may sometimes undermine instead of enhance the country's competitive advantage.

The quality of human resources is a function of human development. The United Nations Development Program has prepared the Human Development Index (HDI) to measure well-being. The HDI, ranging from zero (low human development) to one (high human development), is an arithmetic average of a country's achievements in three basic dimensions: longevity (measured by life expectancy at birth); educational attainment (measured by combination of adult literacy rate and enrollment ratio in primary, secondary, and tertiary education); and living standards (measured by GDP per capita in US dollars at purchasing power parity). Both the HDI and per capita income are highly correlated with the other widely used measures of poverty.

Topic 5. TRADE DISTORTIONS AND MARKETING BARRIERS

Plan
1.Protection of local industries
2.Government: a contribution to protectionism
3.Marketing barriers: tariffs
4. Marketing barriers: nontariff barriers

1. Protection of local industries

While countries generally do not mind exporting, they simply do not like imports. According to a survey of more than 28,000 people in twenty-three countries, even well-educated workers in poorer countries are against free trade. In addition, workers in the industries that face foreign competition tend to be against free trade. On the other hand, well-educated people in well-educated countries are more likely to favor trade.

Why do nations impede free trade when the inhibition is irrational? One reason why governments interfere with free marketing is to protect local industries, often at the expense of local consumers as well as consumers worldwide. Regulations are created to keep out or hamper the entry of foreign- made products. Arguments for the protection of local industries usually take one of the following forms: (1) keeping money at home, (2) reducing unemployment, (3) equalizing cost and price, (4) enhancing national security, and (5) protecting infant industry.

Keeping money at home

Trade unions and protectionists often argue that international trade will lead to an outflow of money, making foreigners richer and local people poorer. This argument is based on the fallacy of regarding money as the sole indicator of wealth. Other assets, even products, may also be indicators of wealth. For instance, it does not make sense to say that a man is poor just because he does not have much cash on hand when he owns many valuable assets such as land and jewelry. In addition, this protectionist argument assumes that foreigners receive money without having to give something of value in return. Whether local consumers buy locally made or foreign products, they will have to have money to pay for such products. In either case, they receive something of value for their money.

Reducing unemployment

It is standard practice for trade unions and politicians to attack imports and international trade in the name of job protection. The argument is based on the assumption that import reduction will create more demand for local products and subsequently create more jobs. Most economists see this kind of thinking as one sided, though not completely without merits. At the least, import reduction makes foreigners earn fewer dollars with which they can buy US exports. As a result, foreign demand for American products declines. In addition, foreign firms may refuse to invest in the USA. They are inclined to invest only when import demand is great enough to justify building and using local facilities.

Another problem with protectionism is that it may lead to inflation. Instead of using protective relief to gain or regain market share and for competitive investment, local manufacturers often cannot resist the temptation to increase their prices for quick profits.

With higher prices at home, consumers become poorer and buy less, and the economy suffers. To make matters worse, other countries will often retaliate by refusing to import products. On a related subject, note that the establishment of foreign operations is not necessarily harmful to employment at home. In fact, jobs are often created rather than lost.

Equalizing cost and price

Some protectionists attempt to justify their actions by invoking economic theory. They argue that foreign goods have lower prices because of lower production costs. Therefore, trade barriers are needed to make prices of imported products less competitive and local items more competitive. This argument is not persuasive to most analysts for several reasons. First, to determine the cause of price differentials is unusually difficult. Is it caused by labor, raw materials, efficiency, or subsidy? Furthermore, costs and objectives vary greatly among countries, making it impossible to determine exactly what costs need to be equalized.

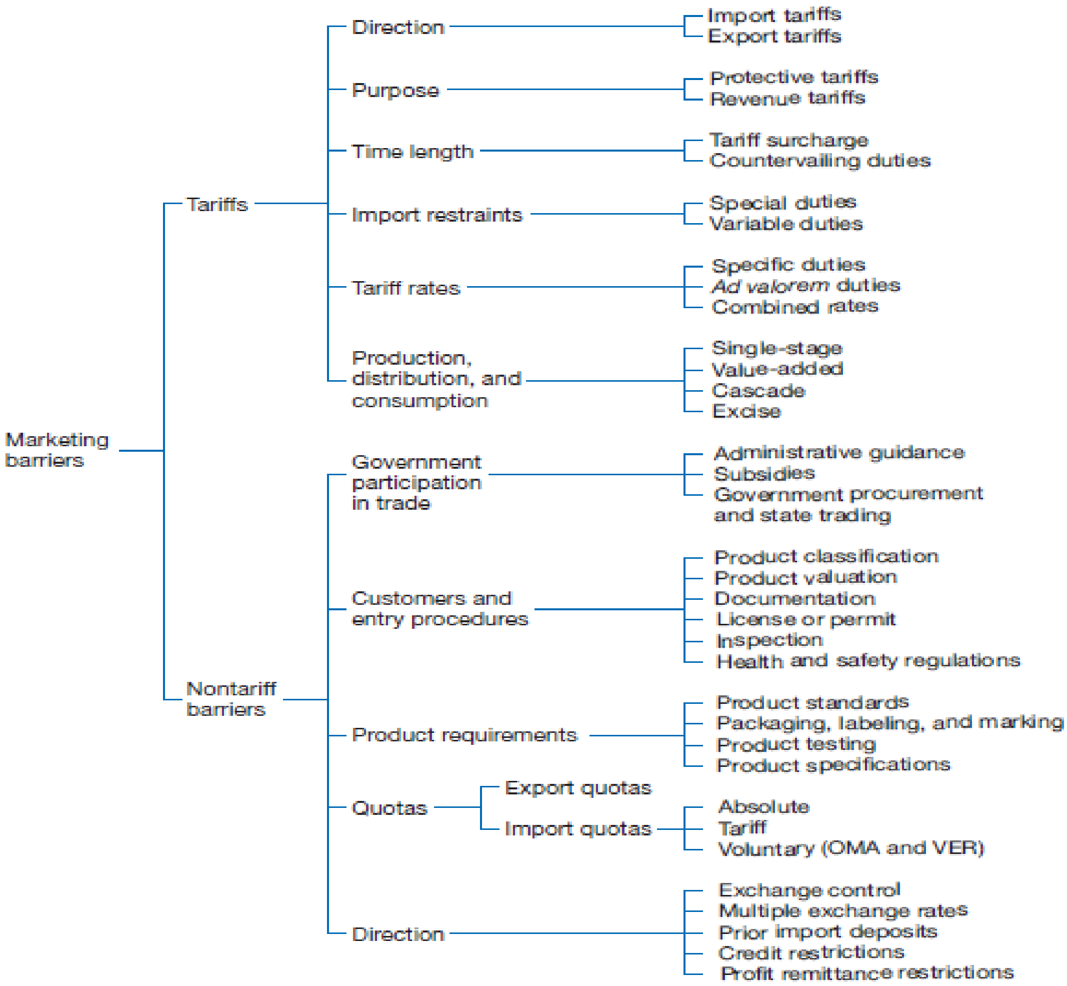

Figure 5.1. **Marketing barriers**

Second, even if the causes of price differentials can be isolated and determined, it is hard to understand why price and cost have to be artificially equalized in the first place. Trade between nations takes place due to price differentials; otherwise, there is no incentive to trade at all. Although the estimates of the cost of protection vary, they all point to the same conclusion: the costs to consumers are enormous. While the US International Trade Commission ruled that imports hurt American steel-makers, the Consuming Industries Trade Action Coalition (CITAC) contended that quotas on steel imports could cost American manufacturers nine jobs for every job saved in the steel industry. According to CITAC, tariffs on imported steel would cost consumers between $2 billion and $4 billion and between 36,000 and 75,000 jobs (or eight times the number of steel industry jobs saved). The steel industry conducted its own study which showed that American steel, due to overcapacity, could easily replace imports, thus adding less than $2 to the cost of each automobile. In any case, the WTO also ruled in 2003 that steel tariffs imposed by the USA were illegal.

If cost/price equalization is a desired end, then international trade may be the only instrument that can achieve it. For example, if wages are too high in one country, that country will attract labor from a lower-wage country. That process will increase the labor supply in the high-wage country, driving the wages down. On the other hand, the labor supply in the lower-wage nation will decrease, driving up wages. Thus, equalization is achieved.

Enhancing national security

Protectionists often use the patriotic theme. They usually claim that a nation should be self-sufficient and even willing to pay for inefficiency in order to enhance national security. That point of view has some justification — to a certain extent.

Opponents of protectionism dismiss appeals to national security. A nation can never be completely self-sufficient because raw materials are not found in the same proportion in all areas of the world. The USA itself would be vulnerable if the supply of certain minerals were cut off. Moreover, national security is achieved at the cost of higher product prices, and money could be used for something more productive to the national interest. In addition, in the case of such scarce resources as oil, if the USA were to try to be self-sufficient, it would quickly use up its own limited resources. The country may be better off exploiting or depleting the resources of others. North Korea’s brand of self-sufficiency, coupled with its defense budget, has virtually driven the nation to starvation.

Protecting infant industry

The necessity to protect an infant industry is perhaps the most credible argument for protectionist measures. Some industries need to be protected until they become viable. South Korea serves as a good example. It has performed well by selectively protecting infant industries for export purposes.

In practice, it is not an easy task to protect industries. First, the government must identify deserving industries. Second, appropriate incentives must be created to encourage productivity. Finally, the government has to make sure that the resultant protection is only temporary. There is a question of how long an “infant” needs to grow up to be an “adult.” A spoiled child often remains spoiled. A person taught to be helpless often wants to remain helpless or does not know how to stop being helpless. In a practical sense, there is no incentive for an infant industry to abandon protection and eliminate inefficiency.

2. Government: a contribution to protectionism

Government can be considered to be the root of all evil — at least as far as international trade is concerned. A government's mere existence, even without tariffs or any attempt to interfere with international marketing, can distort trade both inside and outside of its area. At the international level, different governments have different policies and objectives, resulting in different rates for income and sales taxes.

Taxation is not the only cause of tax and income differences. Some governments allow cartels to operate. A cartel is an international business agreement to fix prices and divide markets, in addition to other kinds of cooperation. Such an arrangement is illegal in the USA, but it is permissible and even encouraged in many countries. Australia and New Zealand, for example, allow livestock firms to cooperate with each other in exporting beef to the USA.

Economic cooperation among governments yields economic benefits and problems by significantly affecting internal and external trade patterns. The CAP (Common Agricultural Policy) of the European Union is a good example. The CAP, with more than twenty price systems, was adopted to satisfy France's demand to protect its farmers as a condition for joining the European Community. The practice requires the EU to impose variable-levy tariffs on many imported farm products in order to raise prices to European levels so that EU farmers will not be undersold at home regardless of world prices. Furthermore, authorities agree to buy surplus produce to maintain high target prices. The practice encourages farmers to overproduce products, which are later often sold abroad at lower prices. Based on the results of a number of studies, because of the CAP, the EU has experienced an average loss of GDP of about 1 percent as well as a large redistribution of income to farmers from consumers and taxpayers.

In conclusion, governments everywhere seem to be the main culprits in distorting trade and welfare arrangements in order to gain some economic and political advantage or benefit. These governments use a combination of tariff and nontariff methods. A discussion of the various kinds of tariff and nontariff barriers and their marketing implications follows.

3. Marketing barriers: tariffs

Tariff, derived from a French word meaning rate, price, or list of charges, is a customs duty or a tax on products that move across borders. Tariffs may be classified in several ways. The classification scheme used here is based on direction, purpose, length, rate, and distribution point. These classifications are not necessarily mutually exclusive.

Direction: import and export tariffs

Tariffs are often imposed on the basis of the direction of product movement; that is, on imports or exports, with the latter being the less common one. When export tariffs are levied, they usually apply to an exporting country's scarce resources or raw materials (rather than finished manufactured products).

Purpose: protective and revenue tariffs

Tariffs may be classified as protective tariffs and revenue tariffs. This distinction is based on purpose.

The purpose of a protective tariff is to protect home industry, agriculture, and labor against foreign competitors by trying to keep foreign goods out of the country.

The purpose of a revenue tariff, in contrast, is to generate tax revenues for the government. Compared to a protective tariff, a revenue tariff is relatively low. As in the case of the EU, it applies tariffs of up to 236 percent on meat and 180 percent on cereals, while its tariffs on raw materials and electronics rarely exceed 5 percent.

Specific duties

Specific duties are a fixed or specified amount of money per unit of weight, gauge, or other measure of quantity. Based on a standard physical unit of a product, they are specific rates of so many dollars or cents for a given unit of measure (e.g., 350 euros/ton on sugar imports into the EU). Product costs or prices are irrelevant in this case. Because the duties are constant for low- and high-priced products of the same kind, this method is discriminatory and effective for protection against cheap products due to their lower unit value; that is, there is a reverse relationship between product value and duty percentage. As product price goes up, a duty when expressed as a percentage of this price will fall. On the other hand, for a cheap product whose value is low, the duty percentage will rise accordingly.

Ad valorem duties

Ad valorem duties are duties "according to value." They are stated as a fixed percentage of the invoice value and applied at a percentage to the dutiable value of the imported goods. This is the opposite of specific duties since the percentage is fixed but the total duty is not. Based on this method, there is a direct relationship between the total duties collected and the prices of products; that is, the absolute amount of total duties collected will increase or decrease with the prices of imported products. The strength of this method is that it provides continuous and relative protection against all price levels of a particular product. Such protection becomes even more crucial when inflation increases prices of imports. If specific duties were used, their effects lessen with time because inflation reduces the proportionate effect. Another advantage is that ad valorem duties provide an easy comparison of rates across countries and across products.

Combined rates

Combined rates (or compound duty) are a combination of the specific and ad valorem duties on a single product. They are duties based on both the specific rate and the ad valorem rate that are applied to an imported product. For example, the tariff may be 10 cents per pound plus 5 percent ad valorem. Under this system, both rates are used together, though in some countries only the rate producing more revenue may apply.

One important fact is that the average tariff rates affect the poor the most. After all, working-class consumers spend a large share of their income on the necessities of daily life, and many such necessities are imported. Affluent consumers, in comparison, are not bothered as much by tariffs because these necessities represent only a fraction of what they earn.

Distribution point: distribution and consumption taxes

Some taxes are collected at a particular point of distribution or when purchases and consumption occur. These indirect taxes, frequently adjusted at the border, are of four kinds: single-stage, value- added, cascade, and excise.

Single-stage taxes

Single-stage sales tax is a tax collected at only one point in the manufacturing and distribution chain. This tax is perhaps most common in the USA, where retailers and wholesalers make purchases without paying any taxes by simply showing a sales tax permit. The single-stage sales tax is not collected until products are purchased by final consumers.

Value-added tax

A value-added tax (VAT) is a multi-stage, noncumulative tax on consumption. It is a national sales tax levied at each stage of the production and distribution system, though only on the value added at that stage. It’s important feature is that it credits taxes paid by companies on their material inputs against taxes they must collect on their own sales. In other words, each time a product changes hands, even between middlemen, a tax must be paid, but the tax collected at a certain stage is based on the added value and not on the total value of the product at that point. Sellers in the chain collect the VAT from a buyer, deduct the amount of VAT they have already paid on their purchase of the product, and remit the balance to the government. European Union customs officers collect the VAT upon importation of goods based on the CIF (cost, insurance, and freight) value plus the duty charged on the product.

Excise tax

An excise tax is a one-time charge levied on the sales of specified products. Alcoholic beverages and cigarettes are good examples. It is also common to levy excise taxes on motor vehicles, petroleum, and consumer durables. Excise taxes account for about 19 percent of all tax revenues.

These four kinds of indirect taxes are often adjusted at the border. Border taxes can be used to raise prices of imports or lower prices of exports. Prices of imports are raised by charging imported goods with (in addition to customs duties) a tax usually borne by domestic products. For exported products, their export prices become more competitive (i.e., lower) when such products are relieved of the same tax that they are subject to when produced, sold, and consumed domestically.

4. Marketing barriers: nontariff barriers

Tariffs, though generally undesirable, are at least straightforward and obvious. Nontariff barriers, in comparison, are more elusive or nontransparent. Tariffs have declined in importance, reaching the lowest level ever of about 4 percent on average after fifty years and eight global rounds of trade negotiation. In the meantime, nontariff barriers have become more prominent. Often disguised, the impact of nontariff barriers can be just as devastating, if not more so, as the impact of tariffs.

There are several hundred types of nontariff barriers. According to the US Trade Representative, countries use a variety of barriers that include nonscientific sanitary standards, customs procedures, and government monopolies. Japan's telecommunications, agriculture, and pharmaceuticals sectors have "structural rigidity, excessive regulation, and market access barriers." China, on the other hand, has import standards and sanitary requirements that act as import barriers. China must act to improve the protection of intellectual property rights.

Nontariff barriers may be grouped into five major categories. Each category contains a number of different nontariff barriers.

Government participation in trade

The degree of government involvement in trade varies from passive to active. The types of participation include administrative guidance, state trading, and subsidies.

Administrative guidance. Many governments routinely provide trade consultation to private companies. Japan has been doing this on a regular basis to help implement its industrial policies. This systematic cooperation between government and business is labeled "Japan, Inc." To get private firms to conform to the Japanese government's guidance, the government uses a carrot- and-stick approach by exerting the influence through regulations, recommendations, encouragement, discouragement, or prohibition. Japan's government agencies' administrative councils are influential enough to make importers restrict their purchases to an amount not exceeding a certain percentage of local demand. The Japanese government denies that such a practice exists, claiming that it merely seeks reports on the amounts purchased by each firm.

Subsidies. According to GATT, subsidy is a "financial contribution provided directly or indirectly by a government and which confers a benefit." Subsidies may take many forms - including cash, interest rate, value- added tax, corporate income tax, sales tax, freight, insurance, and infrastructure. Subsidized loans for priority sectors, preferential rediscount rates, and budgetary subsidies are among the various subsidy policies of several Asian countries.

There are several other kinds of subsidies that are not so obvious. Brazil's rebates of the various taxes, coupled with other forms of assistance, may be viewed as subsidies. Tennessee, Ohio, Michigan, and Illinois, in order to attract foreign automakers to locate their plants in those states, provided such services as highway construction, training of workers, and tax breaks, which are simply subsidies in disguise.

Customs and entry procedures. Customs and entry procedures may be employed as nontariff barriers. These restrictions involve classification, valuation, documentation, license, inspection, and health and safety regulations.

Classification. How a product is classified can be arbitrary and inconsistent and is often based on a customs officer's judgment, at least at the time of entry. Product classification is important because the way in which a product is classified determines its duty status. A company can sometimes take action to affect the classification of its product. Sony argued that its PlayStation 2, equipped with a 128-

bit microprocessor, a DVD player, and Internet connection, was a big improvement over its PlayStation original and that it should thus qualify as a computer. However, the British customs office chose to continue to classify PlayStation 2 in the video games category, in effect imposing a duty of 2.2 percent or about $9. Had Sony prevailed in getting the "digital processing units" (computers) classification, there would be no import tax.

Valuation. Regardless of how products are classified, each product must still be valued. The value affects the amount of tariffs levied. A customs appraiser is the one who determines the value. The process can be highly subjective, and the valuation of a product may be interpreted in different ways, depending on what value is used (e.g., foreign, export, import, or manufacturing costs) and how this value is constructed. In Japan, a commodity tax is applied to the FOB factory price of Japanese cars. Yet American cars are valued on the CIF basis, adding $1000 more to the final retail price of these cars.

Documentation. Documentation can present another problem at entry because many documents and forms are often necessary, and the documents required can be complicated.

Without proper documentation, goods may not be cleared through customs. At the very least, such complicated and lengthy documents serve to slow down product clearance. France, requiring customs documentation to be in French, even held up trucks from other European countries for hours while looking for products' nonFrench instruction manuals which were banned.

License or permit. Not all products can be freely imported; controlled imports require licenses or permits. For example, importations of distilled spirits, wines, malt beverages, arms, ammunition, and explosives into the USA require a license issued by the Bureau of Alcohol, Tobacco, and Firearms. India requires a license for all imported goods. An article is considered prohibited if not accompanied by a license. It is not always easy to obtain an import license, since many countries will issue one only if goods can be certified as necessary.

Inspection. Inspection is an integral part of product clearance. Goods must be examined to determine quality and quantity. This step is closely related to other customs and entry procedures. First, inspection classifies and values products for tariff purposes. Second, inspection reveals whether imported items are consistent with those specified in the accompanying documents and whether such items require any licenses. Third, inspection determines whether products meet health and safety regulations in order to make certain that food products are fit for human consumption or that the products can be operated safely. Fourth, inspection prevents the importation of prohibited articles.

Marketers should be careful in stating the amount and quality of products, as well as in providing an accurate description of products. Any deviation from the statements contained in invoices necessitates further measurements and determination, more delay, and more expenses. Inspection can be used intentionally to discourage imports. Metal baseball bats from the USA, for instance, are required to carry a stamp of consumer safety, and this must be “ascertained” only after expensive on-dock inspection.

Health and safety regulations. Many products are subject to health and safety regulations, which are necessary to protect the public health and environment. Health and safety regulations are not restricted to agricultural products. The regulations also apply to TV receivers, microwave ovens, X-ray devices, cosmetics, chemical substances, and clothing.

Concern for safety was used by Japan against aluminum softball bats from the USA. The manufacturing process leaves a small hole in the top which is fitted with a rubber stopper. Japan thus bans the bats on the ground that the stopper might fly out and hurt someone. According to US manufacturers, this fear is unfounded.

Quotas. Quotas are a quantity control on imported goods. Generally, they are specific provisions limiting the amount of foreign products imported in order to protect local firms and to conserve foreign currency. Quotas may be used for export control as well. An export quota is sometimes required by national planning to preserve scarce resources. From a policy standpoint, a quota is not as desirable as a tariff since a quota generates no revenues for a country. There are three kinds of quotas: absolute, tariff, and voluntary.

Absolute quotas. An absolute quota is the most restrictive of all. It limits in absolute terms the amount imported during a quota period. Once filled, further entries are prohibited. Some quotas are global, but others are allocated to specific foreign countries. Japan imposes strict quotas on oranges and beef. To appease the EU, it has lifted quotas on skimmed milk powder and tobacco for Europe. The most extreme of the absolute quota is an embargo, or a zero quota, as shown in the case of the US trade embargoes against Libya and North Korea.

Tariff quotas. A tariff quota permits the entry of a limited quantity of the quota product at a reduced rate of duty. Quantities in excess of the quota may be imported but are subject to a higher duty rate. Through the use of tariff quotas, a combination of tariffs and quotas is applied with the primary purpose of importing what are needed and discouraging excessive quantities through higher tariffs. When the USA increased tariffs on imported motorcycles in order to protect the US motorcycle industry, it exempted from this tax the first 6000 big motorcycles from Japan and the first 4000 -5000 units from Europe.

Voluntary quotas. A voluntary quota differs from the other two kinds of quota, which are unilaterally imposed. A voluntary quota is a formal agreement between nations, or between a nation and an industry. This agreement usually specifies the limit of supply by product, country, and volume. Two kinds of voluntary quota can be legally distinguished: VER (voluntary export restraint) and OMA (orderly marketing agreement).

Topic 6. CONSUMER BEHAVIOR IN THE INTERNATIONAL CONTEXT

Plan

1. Perspectives on consumer behavior
2. Motivation
3. Learning
4. Personality
5. Psychographics

1. Perspectives on consumer behavior

Consumer behavior may be defined as a study of human behavior within the consumer role and includes all the steps in the decision-making process. The study must go beyond the explicit act of purchase to include an examination of less observable processes, as well as a discussion of why, where, and how a particular purchase occurs.

Domestically, marketing scholars have employed a variety of techniques and concepts, including the cultural approach, to study consumer behavior. Yet consumer study on an international basis has employed the cultural approach almost exclusively without much regard for other psychological and social concepts. This is a very curious approach since it is the norm for virtually all consumer behavior textbooks to treat culture as only one of the many theoretical concepts which can affect purchase and the other behavioral dimensions.

It is a questionable practice to rely on culture as the sole determinant of behavior or as the only concept that largely, if not entirely, explains behavior. Culture undoubtedly affects the psychological and social processes and thus affects consumer behavior. However, too much emphasis is placed on a single concept (i.e., culture). Consumer behavior research must include international dimensions.

Differences in behavioral dimensions among national groups “should not be attributed to differences in culture unless components of culture have been specified.” For group mean differences to be meaningful, there should be some explanation as to why these differences should exist. Furthermore, there may be a need to develop an international consumer behavior model so that studies of consumer behavior in various countries can be more systematic and better coordinated.

The major behavioral sciences relevant to consumer study are psychology, sociology, and cultural anthropology. Psychology, with the *individual* as its central unit of analysis, is the study of individual and interpersonal behavior. Behavior is governed by a person’s cognitions, such as values, attitudes, experiences, needs, and other psychological phenomena. Purchase, then, becomes a function of the psychological view of products, and the consumer buys a product not only for consumption but also because of a perception of how a product can be used to communicate with other people. Some psychological concepts relevant to the study of consumer behavior are motivation, learning, personality, perception, and attitude.

Sociology is the study of groups and human interactions. The unit of analysis is not the individual but rather the *group.* The group, consisting of a set of individuals who interact over time, is important because it can exert a significant influence on a person's preferences and consumption behavior. In many instances, it may be useful for a marketer to view consumers as a group. For example, a family, not an individual, often makes a purchase decision that affects all members of the family group. Important sociological concepts are reference group and family.

Cultural anthropology is the study of human culture. Thus, the analytic perspective may be quite large. Culture involves an aggregate, social category level (i.e., a large group), and the social categories are significant in the sense that they influence consumers' cognitive and personality development. The concepts from this discipline usually included in the analysis of consumer behavior are culture, subculture, and social class.

2. Motivation

Consumer motives are determined largely by buying habits, though motives can vary, and it is important to recognize the various types of motives. Motives may be classified as rational and nonrational. Examples of **rational motives** are price, durability, and economy in operation. **Nonrational appeals**, in comparison, include prestige, comfort, and pleasure.

The problem with the conventional classification (i.e., rational vs. emotional) is that a consumer may not recognize emotional motives and may have a tendency to rationalize personal behavior by assigning only rational and socially acceptable motives. In addition, the process of classification is not always straightforward. Convenience, for instance, can be both rational and nonrational at the same time.

In the end, the success of a product is greatly affected by whether its target customers are properly motivated. Whether a motive is rational or irrational is not particularly important. What is important is to identify specific motives relevant for marketing purposes. A critical task is to select, carefully and properly, a relevant motive for the purpose of product promotion. In addition, the relevance of a particular motive may vary across countries. For example, one study of youths in Hong Kong, Singapore, Canada, and Hawaii compared their beliefs in money, business ethics, *quanxi*, and machiavellian personality. Surprisingly, Canadians believe that money can work wonders - even more so than their Hong Kong and Singapore counterparts.

3. Learning

Like all habits, food and drink habits are learned. Before World War II, the British were accustomed to drinking tea, not coffee. Then along came the American troops, who brought the American taste for coffee — at first a relatively light, almost blond coffee. Before long, Britons had learned to drink coffee too. In another example, a large lunch with wine presents no problem to a Swiss, but the same will put an American to sleep. On the other hand, American-style cocktails may prove to be too much for Europeans, who are accustomed to milder drinks. Marketers must take these habits into consideration.

Motives, cultural norms, and consumption habits are all learned. Therefore, a marketer should understand the learning process. Learning is a change in behavior that occurs over time relative to a given set of external stimulus conditions. Baskin-Robbins, as the first fast-food franchise in Vietnam, has to teach the Vietnamese about the concept of fast food. When the ice cream parlor first opened, most Vietnamese customers walked in and sat down, expecting to be waited on. When they were asked to go to the counter, some felt insulted and left. In addition the Vietnamese are accustomed to linger at café tables and are thus not used to having to pay immediately. Naturally, a number of them got angry and felt that Baskin-Robbins did not trust them by asking them to pay for the ice cream immediately. Interestingly, one learned behavior is that the rum raisin flavor, not that popular in the plain vanilla US market, is quite popular among the Vietnamese as well as many other Asians.

A marketer can play a significant role in facilitating the learning process by using a variety of rewards to encourage learning. Infant formula, as an example, is useful in many non-Western countries for well-to-do women who do not want to bother with breast-feeding. Poor women seek the reward of using this status symbol and of having fatter babies — a benefit implied by this product. Furthermore, young mothers like the prestige of using American or European products.

4. Personality

Personality study has long been a subject of interest to marketers due to the assumption that product purchases are an extension of a consumer's personality. Personality, derived from a Latin word meaning "personal" or "relating to person," is the individual characteristics that make a person unique as well as consistent in adjustments to a changing environment. Personality is an integrated system that holds attitude, motivation, and perception together. To study a personality is to study the person as a whole - not only the separate, individual elements that make up a person.

Personality traits

Personality traits are relatively stable qualities, but they do vary in degree from person to person. Because personality study applies to a person rather than to a group, it is difficult to make generalizations about personality traits among people of a particular country. Nevertheless, it is useful to consider the concept of national character, which states that "people of each nation have a distinctive, enduring pattern of behavior and/or personality characteristics." The English, for example, are highly impulse-restrained and unassertive.

Despite the difficulty, particular personality traits seem dominant in certain countries. Koreans see themselves as being driven by two complementary passions that are uniquely theirs: *han* (bitterness) and *jong* (devoted love).The interplay of the two explains Korea's ability to be at once intensely productive and violent, to both drive and stall a society, and to be capable simultaneously of love and hate.

While both South Korea and Japan display a mixture of ancient and modern Asian cultures, they also differ in a number of ways. In spite of South Korea's Confucian culture and the bowing, deference, traditions, and formality, the Koreans are also passionate, emotional, intense, energetic, emotional, fun-loving, and impatient. In fact, one of the phrases that is heard most often in South Korea is “balli, balli” (hurry, hurry). Compared to Tokyo, Seoul is more chaotic.

One study used the Myers-Briggs Type Inventory to contrast Canadian and Japanese MBA students and found differences in cognitive style. On the judging—perceiving dimension, the Canadians sought fast decisions and rushed to closure on data collection, while such actions may frustrate the Japanese who showed a preference for larger amounts of information. On the thinking—feeling dimension, the Japanese, as expected, preferred forming personal relationships before business was transacted.

One personality trait that has gained recent attention is consumer ethnocentrism. Adapted from the general concept of ethnocentrism, consumer ethnocentrism explains that, due to patriotic and nationalistic sentiments as well as a personal level of prejudice against imports, some consumers feel that it is inappropriate or even immoral to buy imported products. Highly ethnocentric consumers thus tend to buy domestic products.

The national markets also possess some other personality characteristics which may affect marketing strategies. Scotland set up Project Galore to develop a strategy to promote the commercial power of Scottishness. Based on the reactions received in Scotland and other parts of the world, tenacity is a true Scottish characteristic. Integrity is another core value, since Scotland and the world believe that Scotland has this attribute to a greater extent than most, if not all, other countries. Spirit is another virtue that defines Scotland. However, although the Scots (as well as the English) believe that they have inventiveness, the rest of the world does not seem to subscribe to the same notion, since they do not have enough knowledge of Scotland’s inventiveness.

While the European Union is unifying markets, it will take time to construct a unified set of European marketing theories. There is still a wide divergence in terms of economic development levels, languages, religions, and legal systems. Generalizations are both difficult and dangerous. Marketers must still consider a country’s history, national character, and cognitive styles.

Hofstede's national cultures

Hofstede has strongly indicated that ethnocentric management theories (i.e., based on a particular country’s value system) are untenable. Based on his study of work-related values in fifty countries, national cultures have four largely independent dimensions: (1) individualism vs. collectivism, (2) large or small power distance, (3) strong or weak uncertainty avoidance, and (4) masculinity vs. femininity. Power distance describes how a society treats unequal people. “Collectivist countries always show large power distance, but individualist countries do not always show small power distance.” Regarding uncertainty avoidance, some countries have weak uncertainty avoidance in the sense that they accept uncertainty and they are thus able to take risks easily. In contrast, strong uncertainty avoidance societies create institutions to offer security and avoid risk. With regard to masculinity /femininity, the classification is derived from whether a society has well-defined roles for men and women. A masculine society clearly expects men to be assertive and dominant and women to assume more service-oriented and caring roles. This society clearly differentiates between what men should do and what women are supposed to do.

Based on Hofstede's research, countries that are low in power distance, masculinity, and uncertainty avoidance include Australia, Canada, Denmark, the United Kingdom, the Netherlands, Norway, New Zealand, Sweden, and the USA. In comparison, those cultures that are low in individualism but high in power distance, masculinity, and uncertainty avoidance include Greece, Mexico, Pakistan, Peru, the Philippines, Taiwan, Thailand, Venezuela, and Japan.

As explained by Hofstede, management is an American invention. However, the practices of management in many parts of the world can deviate greatly from management as practiced in the USA. American management theories emphasize market processes, managers, and individualism — things that assume less significance elsewhere. In Japan, the emphasis is on workers — not managers. In fact, management as practiced in the USA does not bear much resemblance to management practiced in Japan.

A literature review of the five dimensions of national culture (individualism, power distance, masculinity, uncertainty avoidance, and Confucian dynamic) led Nakata and Sivakumar to propose that these dimensions affect new product development — both positively and negatively.

One study of ten countries and sixty regions found that cultural power distance, cultural individualism, and regional socioeconomics affect brand image strategies (see Figure 6.1).

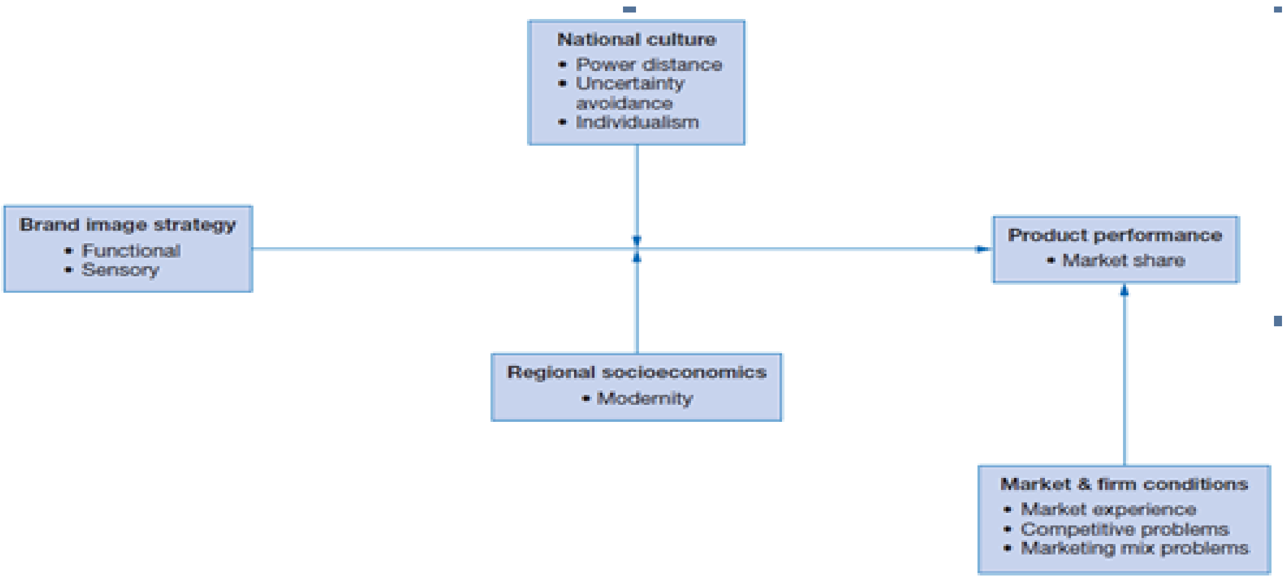

Fig. 6.1. **Cultural and socioeconomic factors and brand image strategies**

The dimensions of national culture have marketing relevance. A study of TV commercials from Japan, Russia, Sweden, and the USA in terms of the masculine - feminine continuum found that feminine countries showed a higher degree of use of relationships for male and female characters. Since not all cultures share the same values, advertising standardization appears to be strategically unwise.

Clustering: commonality and diversity

The impact of Hofstede's fifty-country study requires no debate. It has spawned a great deal of discussion as well as numerous studies. Another rigorous and large-scale study is just as valuable even though it is yet to attract the same kind of attention. Project GLOBE (Global Leadership and Organizational Behavior Effectiveness), based on a collaboration of scholars in all parts of the world, is a study of thousands of middle managers in food processing, finance, and telecommunications industries in sixty-one countries. The study focuses on nine dimensions of national cultures: performance orientation, future orientation, assertiveness, power distance, humane orientation, institutional collectivism, in-group collectivism, uncertainty avoidance, and gender egalitarianism. In the process, six global leadership attributes have been identified.

5. Psychographics

Because of the disappointing results in using personality to predict purchase behavior, marketers have turned to other meaningful purchase variables that might be used in conjunction with personality characteristics. This area of purchase behavior study is known as psychographics, also known as lifestyle or AIO (activities, interests, and opinions) study. Psychographics is a quantitative analysis of consumers' lifestyles and activities with the purpose of relating these variables to buying behavior. The analysis encompasses both the strength of the qualitative nature of Sigmund Freud's psychoanalytic theory and the statistical and methodological sophistication of trait and factor theories. As a result, questions are well organized, and responses are subject to numerical representation and multivariate analysis.

Questions normally included in psychographic studies are those related to demographics, personality traits, and activities such as media habits, retail patronage, and general interests. People can be classified by their lifestyles and then be contrasted in terms of their consumption habits. For example, respondents from England and Denmark do not view Denmark's furnishing interiors in the same way. The two cultures have different ideas of appropriate product syntax or how furnishing items could and should be combined.

Topic 7. MARKETING RESEARCH AND INFORMATION SYSTEM

Plan

1. Nature of marketing research
2. Marketing information system and sources
3. Categories for a global intelligence system
4. Market segmentation

"To survive in this new globally competitive world, we had to modernize. Information technology is the glue for everything we do. "

JAMES WOGSLAND
Vice Chairman,
Caterpiller

1. Nature of marketing research

According to the American Marketing Association, **marketing research** involves the "systematic gathering, recording, and analyzing of data about problems relating to the marketing of goods and services." This definition provides a useful description of the nature of marketing research, but it fails to include pre-research analysis, which is an important aspect of the research process. Before data collection, careful planning is required to specify both the kind of information needed and the purpose of such information. Without pre-research activities, there is a great danger that critical information may not be obtained and that what is obtained may turn out to be irrelevant or unsuitable.

People with the profile of your current customers are apt to become customers as well. That's why target marketing starts with customer knowledge. By knowing everything you possibly can about the person who currently buys from your business, you can direct your marketing efforts toward others who match that same profile.

Do-it-yourself fact-finding

You can get a good start on conducting customer research without ever walking out the front door of your business.

Marketing research is the project specific, systematic gathering of the data in search scanning mode.

There are two ways to conduct marketing research

1. One to design and implement a study with in house staff.
2. Other is to use an outside firm specializing in marketing research.

Research methods

Consider the information in Table 7.1 as you make research decisions.

Table 7.1. **Research Approaches**

Method	***Purpose***	***Advantages***	***Challenges***
Questionnaires and surveys	Obtain general information	Anonymous. Inexpensive. Easy to analyze. Easy to format and conduct.	Impersonal. Feedback may not be accurate. Wording can skew results.
Interviews	Obtain information and probe answers.	Develops customer relationships. Adaptable to each situation. Accesses fuller range of information.	Time-consuming. Reliant on good interviewers. Difficult to analyze.
Observation	Document actual buyer behavior	Anonymous. Immediate findings. Relatively easy to implement.	Can be difficult to interpret findings. Can be difficult to target which behaviors to monitor. Can be expensive.
Documentation review	Study factual review history of clients and transactions	Readily available. Not disruptive to operations. Not subject to interpretation.	Time-consuming. May be incomplete. Research is limited to previously collected data.
Focus groups	Learn about and compare customer experiences and reactions	Convey information to customers. Collect customer impressions.	Requires expert facilitation. Requires advance scheduling. Difficult to analyze findings.

Doing it yourself doesn’t mean doing it all on your own. Here are places where an investment in professional advice pays off:

✓ **Questionnaires:** Figure out what you want to learn and create a list of questions. Retain a trained marketer or market researcher to review the wording, sequence, and format for you. Then have a member of your staff or a freelance designer prepares the handout or mailer so that it makes a good visual impression on your business’s behalf. Include a letter or introductory paragraph explaining why you’re conducting research and presenting your business as a strong, forward-thinking organization that cares about its customers’ opinions and experiences.

✓ **Phone or in-person surveys:** Employ an outside group to do the questioning on your behalf. When you ask the questions yourself, it’s easy to let your biases, preconceptions, and business pressures leak through and sway your customers. Posing questions so that they don’t skew the results is a real art. Plus, customers are more apt to be candid with third parties. (If you need proof, think of all the things people are willing to say behind someone’s back that they’d never say to the person’s face. The same premise applies in customer research.)

✓ **Focus groups:** If you’re assembling a group of favorite clients to talk casually about a new product idea, you’re fine to go it alone. But if you’re trying to elicit helpful information from outsiders or if you want to learn opinions about such delicate areas as customer service or pricing, use a professional facilitator who is experienced in managing group dynamics so that a single dominant participant doesn't steer the group outcome.

The process of collecting data and converting it into useful information can be divided into ***five basic steps***:

STEP:1 IDENTIFYING THE RESEARCH PROBLEM

- Research is often undertaken after a problem or opportunity has presented itself. It is a truism of market research that "a problem well defined is a problem half solved". Thus, regardless of what institution sets the research effort in motion, the first two questions a marketer should ask are,"What information do I need"? and "Why do I need this information"?
- The research problem often involves assessing the nature of the market opportunity, a phase that is also known as presearch. This, in turn depends in part on whether the market that is the focus of the *research effort can be classified as existing or potential.*
- Existing markets are those in which client needs for secondary information are already being served. In many countries, data about size of existing market – in terms of dollar volume and unit sales – are readily available.
- Potential markets can be further sub-divided into latent and incipient market.

STEP:2 DEVELOPING A RESEARCH PLAN

After defining the problem to be studied or the question to be answered, the marketer must address a new set of questions.

-What is the information worth to me in monetary units?

-What will we gain by collecting this data?

-What would be the cost of not getting the data that could be converted into useful information?

Research requires the investment of both money and managerial time, and it is necessary to perform a cost-benefit analysis before proceeding further.

STEP:3 COLLECTING DATA

Are data available in company files, a library, industry or state journals or on-line? When is the information needed? Marketers must address these issues as they proceed to the data collection step of the research.

Secondary Data

A low cost approach to marketing research and data collection begins with desk research. Personal files, company or public libraries, on-line databases, government records, and trade associations are just a few of the data sources that can be tapped with minimal effort and often at no cost. Data from these sources already exist. Such data are known as secondary data because they were not gathered for the specific project at hand. Syndicated studies published by research companies are another source of secondary data and information.

Primary Data Survey Research

When data are not available through published statistics or studies, direct collection is necessary. Survey research, interviews, and focus groups are some of the tools used to collect primary market data.

Personal interview-with individuals or groups-allow researchers to ask ”why” and then explore answers. ***A focus group is a group interview led by a trained moderator who facilitates discussion of a product concept, advertisement, social trend or other topic.***

Survey research often involves obtaining data from customers or some other designated group by means of a questionnaire. Survey can be designed to generate quantitative data (“How often would you buy?”), qualitative data (“Why would you buy?”), or both. Survey research generally involves administering a questionnaire by mail, by telephone, or in person. A good questionnaire has three main characteristics:

1. It is simple.
2. It is easy for respondents to answer and for the interviewer to record.
3. It keeps the interview to the point and obtains desired information.

STEP:4 ANALYZING RESEARCH DATA

Demand Pattern Analysis

- Industrial growth patterns provide an insight into market demand. Because they generally reveal consumption patterns, production patterns are helpful in assessing market opportunities.
- Additionally, trends in manufacturing production indicate potential market for companies that supply manufacturing inputs

Income Elasticity Measurements

- Income elasticity describes the relationship between demand for a good and changes in income.
- According to the Engel’s law’ which states that as income rises, smaller proportion of income is spent on food. Demand for durable consumer goods such as furniture and appliances tend to be income elastic, increasing relatively faster than the increases in income.

Market Estimation by Analogy

- Estimating market size with available data presents challenging analytic tasks.
- When data are unavailable, as in frequently the case in both less developed countries and industrialized countries, resourceful techniques are required. One resourceful technique is estimation by analogy. There are two ways to use this technique:

1) *Cross-sectional comparisons*: amounts simply to positing the assumption that there is an analogy between the relationship of a factor and demand for particular product or commodity in two countries.

2) *Displace a time series in time*: it is based on the assumption that an analogy between markets exists in different time periods or in other words markets in question are going through the same stages of market development. This method is useful when data are available for two markets at different level of development.

Cluster Analysis

The objective of cluster analysis is to group variables into clusters that maximize within group similarities and between group differences.

STEP:5 PRESENTING THE FINDINGS

- The report based on the marketing research must be useful to managers as input to the decision making process.
- The report should clearly relate to the problem or opportunity identified and it should be clearly stated and provide basis for the managerial action.
- As the data is available on a worldwide basis it becomes possible to analyze marketing expenditure effectiveness across national boundaries. Therefore, manager can decide where they are achieving the greatest marginal effectiveness for their marketing expenditure and can adjust expenditure accordingly.

2. Marketing information system and sources

Global Marketing Information Systems (GMIS)

The purpose of a marketing information system (MIS) is to provide managers and others decision makers with a continuous flow of information about markets, customers, competitors, and company operations. A MIS provide a means for gathering, analyzing, classifying, storing, retrieving, and reporting relevant data about customers, markets, channels, sales and competitors. A companies MIS should also cover important aspects of a company's external environment. For eg: companies in any industry need to pay close attention to government, regulation, mergers, acquisition, and alliances. The internet has also dramatically expanded our ability to access up to date information. Poor operating results can often be traced to insufficient data and information about events both inside and outside the company. It is no easy task to organize, implement, and monitor global marketing information and research strategies and programs. Today's economic and political environments require worldwide news information on a daily basis. Geocentric global companies generally have intelligence systems that meet the challenges.

Starting point for a global MIS is a list of subjects about which information is desired. The resulting subject agenda should be tailored to the specific needs and objectives of the company. The general framework is suggested in table, consisting of six broad information areas.

CATEGORY	COVERAGE
1. Markets	Demand estimates, consumers behavior, products, channels, communication media availability and cost, and market responsiveness.
2. Competition	Corporate, business and functional strategies and plans.
3. Foreign exchange	Balance of payment, interest rates, attractiveness of country currency, expectation of analysts.
4. Prescriptive information	Laws, regulations, ruling concerning taxes, earnings, dividend in both host and home country.
5. Resource information	Availability of human, financial, information and physical resources.

CATEGORY	COVERAGE
6. General conditions	Overview of socio cultural, political, technological environments.

Elements of the information system

The following constitute the elements of the global information system. Data may be specific or general or both and used for decisions on whether to enter markets or not, in what degree and what emphasis in terms of the marketing mix.

General information includes data on the following:

· *Economic* - rate of growth of GNP, level of inflation, incomes
· *Social* - people, demographics, culture, subculture
· *Political* - risk, instability, attitudes to "foreigners"
· *Technology* - current, rate of change, infrastructure
· *Resources* - money, manpower, materials, acquisitions, joint ventures
· *Fiscal* - taxes, exchange rates
· *Institutions* - money markets
· *Managerial* – funds

3. Categories for a global intelligence system

1. Market information	
Market statistics and potential	Consumer attitudes and behaviour, spending power, per capita income
Physical features - infrastructure, communications, money markets, banks etc.	Channels of distribution - type, availability, effectiveness
Media - availability, effectiveness and cost	Information sources - quality, availability and cost
Resources - money, human, materials (availability, cost, quality, development)	
2. Environmental factors **Economic factors**	
Economic - rate of growth, structure, conduct, capital, economic blocs, (SADC), GNP, GDP, Nl	Social - customs, culture, attitudes, preferences
Political/Legal - laws, regulations, investment, "climate", government ideology, stability.	Technology - state, trends development
Competition - type, structure, operations, strategy plans, programs, acquisitions, mergers	Trading partner(s)
Management capability	Foreign embassies, NGOs and other developmental thrust

3. Financial/Exchange Balance of payments	
Terms of access - quotas, tariffs, duties etc	Inflation rates
Monetary and fiscal policy	Expectations - economists, bankers, business people
Commodity exchanges	Currency alterations and movements, controls and regulations
International competitors	Taxes - inflation, incentives, dividends tax rules, earnings, repatriation of profits
Spot, forward market	Intervention by outside bodies e.g. IMF or World Bank and their effect on policy

Sources of market information

Human source- Although scanning is a vital source of information, research has shown that headquarters executives of global companies obtain as much as 2/3 of the information they need from personal sources.

-A great deal of external information comes from executives based abroad in company subsidiaries, affiliates and braches. These executives are likely to have established communication with distributors, consumers, customers, suppliers, and government officials. Other important sources are friends' acquaintances, professional colleagues, consultants and prospective new employees. The latter are particularly important if they have worked for competitors.

- The most secure way of transmitting information is face to face rather than in writing.

Executives based abroad, specific "look see" missions which are very important, and sales people, customers, suppliers, distributors, and government officials. This information is "internal" to the firm as opposed to documentary sources which are generally external. Most of the information is gathered on a face to face basis.

Documentary sources - One of the most important developments in global marketing research is the extraordinary expansion in the quantity and quality of documentary sources of information. The information explosion is an explosion in the availability of documentary information not only in print but increasingly on-line and on the internet and the intranet for company-restricted information. The two broad categories of documentary information are published public information and unpublished private documents. The former is available on the internet, and the latter is available on the intranet or company password- restricted – access networks created by organizations for their own employees.

Internet sources - The range and depth of information available on the internet are vast and growing every day. Companies, governments, nongovernmental organizations, market research companies, data assemblers and packagers, security analysts, news gathering organizations, universities and university faculty to mentioned just a few are all sources that can be accessed on–line. The internet is a unique information source: it combines the three basic information source types: human documentary (published and private) and direct perception. A number of electronic resources have been developed in recent years. These include the national trade data base, which is available on CD-ROM, from the department of commerce. The Gate ways company in Manchester, Massachusetts, has developed pc software called “the world trader” to help small firms find opportunities in export markets.

Direct perception - direct sensory perception provides a vital background for the information that comes from human and documentary sources. Direct perception could be achieved by in country visits, where it would be possible to exercise all the sensory receptors sight, taste, touch, intuition, hearing and smell. Often there is no substitute to "feeling out" a situation. Participation in exhibitions, discussions with importing organizations and participation in Government working parties can all be useful sources of data.

The evaluation process becomes much more complicated if secondary data from various countries must be compared in order to analyze the business potential of each country. A problem for marketers is that secondary data on international marketing may not be comparable for several reasons. First, countries may employ different data collection methods. Second, there may be a problem with classification differences. Third, the unit of measurement employed could differ. Finally, definitional differences are another common problem because countries tend to use various definitions in collecting the same kind of information. For example, regarding the “urban” concept, Denmark defines it as a locality of 200 or more inhabitants, while it must be at least 20,000 for Nigeria. In the case of Bermuda and Singapore, the entire countries comprise an urban area.

4. Market segmentation

MARKET SEGMENTATION is the process of subdividing a market into distinct subsets of customers that behave in the same way or have similar needs. Each subset may conceivably be chosen as a market target to be reached with a distinctive marketing strategy. The process begins with the basis of segmentation – a product specific factor that reflects differences in customers’ requirements or responsiveness to marketing variables.

Global market segmentation is a process of dividing the world market into distinct subsets of customers that behave in the same way or have similar needs, or, as one author put it, it is “the process of identifying specific segments - whether they be country groups or individual consumer groups - of potential customers with homogeneous attributes who are likely to exhibit similar buying behaviour”.

GEOGRAPHIC SEGMENTATION

Geographic segmentation is dividing the world into geographic subsets.

The advantage of geography is proximity: markets in geographic segments are closer to each other and easier to visit on same trip or to call on during the same time window.

Limitations: the mere fact that markets are in the same world geographic does not meant that they are similar. Japan and Vietnam are both in East Asia, but one is high income, postindustrial society and the other is an emerging less developed, pre industrial society.

DEMOGRAPHIC SEGMENTATION

- Demographic segmentation is based on measureable characteristics of population such as age, gender, income, education and occupation.
- A number of demographic trends-aging population, fewer children, more women working outside the home and higher income and living standards - suggest the emergence of global segment.
- For most consumer and industrial products, national income is the single most important segmentation variable and indicator of market potential.
- To know the standard of living of people in a country, it is necessary to determine the purchasing power of the local currency. In low income countries the actual purchasing power of the local currency is much higher than the implied by exchange values.
- Age is another useful demographic variable. One global segment based on demographics is global teenagers-young people between the ages of 12 and 19. Teens, by virtue of their interest in fashion, music and a youthful life style, exhibit consumption behavior that is remarkably consistent across borders.
- Another global segment is so called elite: older, more affluent consumers who are well travelled and have the money to spend on prestigious products with an image of exclusivity. This segment's needs and wants are spread over various product categories.

PSYCHOGRAPHIC SEGMENTATION

Psychographic segmentation involves grouping people in terms of their attitudes, values and lifestyles. Data are obtained from questionnaires that requires respondents to indicate the extent to which they agree or disagree with series of statements.

BEHAVIOUR SEGMENTATION

Behaviour segmentation focuses on whether people buy and use a product, as well as how often and how much they use it.

Consumers can be categorized in terms of usage rates e.g. heavy, medium, light and nonuser.

Consumers can also be segmented according to user status: potential users, non-users, ex users, regulars, first-timers and users of competitors, products.

BENEFIT SEGMENTATION

Global benefit segmentation focuses on the numerator of the value equation - the B in V=B/P. This approach can achieve excellent results by virtue of markerters' superior understanding of the problem a product solves or the benefit it offers, regardless of geography.

VERTICAL VERSUS HORIZONTAL SEGMENTATION

Vertical segmentation is based on product category or modality and price points. E.g. ,in medical imaging there is X-ray, computed axial tomography(CAT) scan, magnetic resonance imaging (MRI) and so on. Each modality has its own price points.

SELECTING A GLOBAL TARGET MARKET STRATEGY

There are three basic categories of target marketing strategies:

Standardized Global Marketing is analogous to mass marketing in a single country. It involves creating the same marketing mix for a broad market of potential buyers. This strategy calls for existence distribution in the maximum number of retail outlets. The appeal of standardized global marketing is clear: greater sales volume, lower production costs and greater profitability. The same is true of standardized global communications: lower production costs and if done well, higher quality and greater effectiveness of marketing communication.

Concentrated Global Marketing involves devising a marketing mix to reach a single segment of the global market. This is the strategy employed by the hidden champions of global marketing: companies that most people have never heard of that have adopted strategies of concentrated marketing on a global scale. These companies define their markets narrowly. They go for global depth rather than national breadth.

Differentiated Global Marketing is a variation of concentrated global marketing. It entails targeting two or more distinct market segments with different marketing mixes. This strategy allows a company to achieve wider marker coverage.

GLOBAL PRODUCT POSITIONING

Positioning is the location of your product in the mend of your customer. Thus, one of the most powerful tools of marketing is not something that a marketer can do to the product or to any element of the marketing mix: positioning is hat happens in the mind of the customer. The position that a product occupies in the mind of a customer depends on the host of variables, many of which are controlled by the marketer. After the global market has been segmented and one or more segments have been targeted, it is essential to plan a way to reach the target(s). To achieve this task, marketers use positioning. In today’s global market environment, many companies find it increasingly important to have a unified global positioning strategy.

Topic 8. FOREIGN MARKET ENTRY STRATEGIES

Plan

1. Foreign direct investment (FDI)
2. Exporting
3. Licensing
4. Management contract
5. Joint venture
6. Manufacturing

1. Foreign direct investment (FDI)

Economists usually advocate a free flow of capital across national borders because capital can then seek out the highest rate of return. Owners of capital can diversify their investment, while governments will be less able to pursue bad economic policies. In addition, a global integration of capital markets spreads best practices in corporate governance, accounting rules, and legal traditions.

However, some critics point out that free capital flows are driven by speculative and short-term considerations. For some reason, one noticeable feature of FDI flows is that their share in total inflows is higher in countries where the quality of institutions is lower. In other words, a high share of FDI in a country's total capital inflows may reflect its institutions' weakness instead of its strengths. However, empirical evidence indicates that FDI benefits developing host countries.

One indisputable fact is that developed countries are both the largest recipients and sources of FDI. The phenomenon is dominated by the triad of the European Union, the USA, and Japan, accounting for 71 percent of inward flows and 82 percent of outward flows.

Certain countries have managed to attract large amounts of FDI. In the case of Africa, to attract FDI, African countries have relied on their natural resources, locational advantages, and targeted policies. Above all, the countries that are successful in attracting FDI have certain traits: political and macroeconomic stability and structural reforms. "Strong, pro-democracy political leadership that has embraced policies to overcome social and political strife and a firm commitment to economic reform are key factors linked with sizable FDI inflows." Therefore, even those countries that lack natural resources or location advantages still can attract foreign investors by adopting sound economic policies within an open political environment.

Corruption has a negative impact on FDI. From the ethics standpoint, foreign investors generally avoid corruption because it is morally wrong. From the economic standpoint, investors prefer not to have to manage such costly risks.

2. Exporting

Exporting is a strategy in which a company, without any marketing or production organization overseas, exports a product from its home base. Often, the exported product is fundamentally the same as the one marketed in the home market.

The main advantage of an exporting strategy is the ease in implementing the strategy. Risks are minimal because the company simply exports its excess production capacity when it receives orders from abroad. As a result, its international marketing effort is casual at best. This is very likely the most common overseas entry approach for small firms. Many companies employ this entry strategy when they first become involved with international business and may continue to use it on a more or less permanent basis. R.R. Donnelley Japan K.K., for example, has issued American Showcase/Japan which is a “catalog of catalogs.” This marketing program involves several American catalogers, and allows Japanese consumers to request American catalogs and order merchandise.

The problem with using an exporting strategy is that it is not always an optimal strategy. A desire to keep international activities simple, together with a lack of product modification, make a company’s marketing strategy inflexible and unresponsive.

The exporting strategy functions poorly when the company’s home country currency is strong. In the 1970s, the Swiss franc was so strong that Swiss companies found it exceedingly difficult to export and sell products in the US market. Swiss companies had to resort to investing abroad in order to reduce the effects of the strong franc. During the first term of the Reagan administration, the US dollar had also gained an extremely strong position. US firms not only found it extremely difficult to export US products but they also had to contend with a flood of inexpensive imports that became even more inexpensive as the dollar became stronger. A currency can remain strong over a stretch of several years, creating prolonged difficulties for the country’s exports. Continuing the long-term trend, the Japanese yen surged 20 percent against the US dollar in early 1995 and greatly harmed Japanese exporters.

Austria represents a small but open economy that requires international exchange. Based on a study of the effects of determinants on export performance, the most promising predictors of export performance are firm size, management’s motives to internationalize, and use of the differentiation strategy. Another study of small and medium-sized exporters found that decision makers’ cosmopolitanism influenced export initiation. These decision makers often learned of foreign opportunities through their existing social ties – rather than formal scanning and market research. The findings were consistent across different industrial settings.

One study measured the export-entrepreneurial orientation construct so as to derive a high versus low export-entrepreneurial taxonomy. While Nigerian firms in the study perceive domestic environmental problems, high export-entrepreneurial firms appear to be better able to adapt and subsequently exhibit a higher tendency to initiate exporting. In addition, high export-entrepreneurial firms are more proactive and innovative in developing exporting while being less averse to exporting risks.

It should be noted that research in international exchange tends to focus on the perspective of exporters. A more complete understanding requires an inclusion of the perspective of importers in the dyad. Based on a study of thirty-six exporter-importer dyads operating in four countries, the best performing dyads exhibited maintenance of close relationships by people on either side.

3. Licensing

When a company finds exporting ineffective but is hesitant to have direct investment abroad, licensing can be a reasonable compromise. Licensing is an agreement that permits a foreign company to use industrial property (i.e., patents, trademarks, and copyrights), technical know-how and skills (e.g., feasibility studies, manuals, technical advice), architectural and engineering designs, or any combination of these in a foreign market. Essentially, a licensor allows a foreign company to manufacture a product for sale in the licensee's country and sometimes in other specified markets.

Examples of licensing abound. Some 50 percent of the drugs sold in Japan are made under license from European and US companies. *Playboy* used to take licensed materials from France's *Lui* for its *Oui* magazine, which was distributed in the US market. *Playboy*'s more common role, however, is that of a licensor, resulting in nine *Playboy* foreign editions. *Penthouse* magazine, likewise, has Japanese and Brazilian versions under license in addition to those in Spain, Australia, and Italy. German-speaking countries account for *Penthouse's* largest overseas edition.

Licensing is not only restricted to tangible products; a service can be licensed as well. Chicago Mercantile Exchange's attempt to internationalize the futures market led it to obtain licensing rights to the Nikkei stock index.

In spite of a general belief that foreign direct investment is generally more profitable and thus the preferred scheme, licensing offers several advantages. It allows a company to spread out its research and development and investment costs, while enabling it to receive incremental income with only negligible expenses. In addition, granting a license protects the company's patent and/or trademark against cancellation for nonuse. This protection is especially crucial for a firm that, after investing in production and marketing facilities in a foreign country, decides to leave the market either temporarily or permanently. The situation is especially common in Central and South America, where high inflation and devaluation drastically push up operating costs.

There are other reasons why licensing should be used. Trade barriers may be one such reason. A manufacturer should consider licensing when capital is scarce, when import restrictions discourage direct entry, and when a country is sensitive to foreign ownership. The method is very flexible because it allows a quick and easy way to enter the market. Licensing also works well when transportation cost is high, especially relative to product value. Although Japan banned all direct investment and restricted commercial loans in South Africa, Japan's success there was due to licensing agreements with local distributors.

A company can avoid substantial risks and other difficulties with licensing. Most French designers, for example, use licensing to avoid having to invest in a business. In another example, Disney obtains all of its royalties virtually risk-free from the $500 million Tokyo Disneyland theme park owned by Keisei Electric

Railway and Mitsui. The licensing and royalty fees as arranged are very attractive: Disney receives 10 percent of the gate revenue and 5 percent of sales of all food and merchandise. Moreover, Disney, with its policy of using low-paid young adults as park employees, does not have to deal with the Japanese policy of lifetime employment.

An owner of a valuable brand name can benefit greatly from brand licensing. In addition to receiving royalties from sales of merchandise bearing its name or image, the trademark owner receives an intangible benefit of free advertising which reinforces the brand's image. Another benefit is that the brand is extended into new product categories in which the trademark owner has no expertise. Coca-Cola, for example, has licensed its brand name to more than 3000 products which are marketed by 200 licensees in thirty countries.

4. Management contract

In some cases, government pressure and restrictions force a foreign company either to sell its domestic operations or to relinquish control. In other cases, the company may prefer not to have any FDI. Under such circumstances, the company may have to formulate another way to generate the revenue given up. One way to generate revenue is to sign a management contract with the government or the new owner in order to manage the business for the new owner. The new owner may lack technical and managerial expertise and may need the former owner to manage the investment until local employees are trained to manage the facility.

Management contracts may be used as a sound strategy for entering a market with a minimum investment and minimum political risks. Club Med, a leader in international resort vacations, is frequently wooed by developing countries with attractive financing options because these countries want tourism. Club Med's strategy involves having either minority ownership or none at all, even though the firm manages all the resorts. Its rationale is that, with management contracts, Club Med is unlikely to be asked to leave a country where it has a resort.

Management contract is a common strategy in the hotel business. Accor SA, a French hotel giant, for example, has purchased a large stake in Zenith Hotels International.[11] Zenith itself manages nine hotels in China and one hotel in Thailand without owning them, and most of its hotels do not carry the Zenith name. Accor's acquisition is an attempt to catch up in China with Bass PLC, the parent of Holiday Inn. It hopes to use Zenith's connections and experience to land more management contracts. Accor's Sofitel brand also has a hotel in China. In the USA, the Motel 6 chain is also operated by Accor.

5. Joint venture

The joint venture is another alternative a firm may consider as a way of entering an overseas market. A joint venture is simply a partnership at corporate level, and it may be either domestic or international. For the discussion here, an international joint venture is one in which the partners are from more than one country.

Much like a partnership formed by two or more individuals, a joint venture is an enterprise formed for a specific business purpose by two or more investors sharing ownership and control. Joint ventures, like licensing, involve certain risks as well as certain advantages over other forms of entry into a foreign market. In most cases, company resources, circumstances, and the reasons for wanting to do business overseas will determine if a joint venture is the most reasonable way to enter the overseas market. According to one study, firms tend to use joint ventures when they enter markets that are characterized by high legal restrictions or high levels of investment risks.

Marketers consider joint ventures to be dynamic because of the possibility of a parent firm's change in mission or power. There are two separate overseas investment processes that describe how joint ventures tend to evolve. The first is the "natural," nonpolitical investment process. In this case, a technology-supplying firm gains a foothold in an unfamiliar market by acquiring a partner that can contribute local knowledge and marketing skills. Technology tends to provide dominance to the technology-supplying firm. As the technology partner becomes more familiar with the market, it buys up more or all equity in the venture or leaves the venture entirely. A contributor of technology, however, is not likely to reduce its share in a joint venture while remaining active in it. The second investment process occurs when the local firm's "political" leverage, through government persuasion, halts or reverses the "natural" economic process. The foreign, technology-supplying partner remains engaged in the venture without strengthening its ownership position, the consequence being a gradual takeover by the local parties.

Joint ventures often have social implications. The familial and tightly knit relationship between suppliers and middlemen is prevalent in many countries. In Japan, this relationship is known as *keiretsu*, which means that family-like business groups are linked by cross-ownership of equity. Such customs and business relationships make it difficult for a new supplier to gain entry. Even in the event that the new supplier is able to secure some orders, those orders may be terminated as soon as a member of the family is able to supply the product in question. A joint venture thus provides an opportunity for the foreign supplier to secure business orders through the back door.

A joint venture can also simultaneously work to satisfy social, economic, and political circumstances since these concerns are highly related. In any kind of international business undertaking political risks always exist, and a joint venture can reduce such risks while it increases market opportunities. In this sense, a joint venture can make a difference between securely entering a foreign market or not entering it at all.

6. Manufacturing

The manufacturing process may be employed as a strategy involving all or some manufacturing in a foreign country. IBM, for example, has sixteen plants in the USA and eighteen more in other countries.

One kind of manufacturing procedure, known as sourcing, involves manufacturing operations in a host country, not so much to sell there but for the purpose of exporting from that company’s home country to other countries. This chapter is concerned more with another manufacturing objective: the goal of a manufacturing strategy may be to set up a production base inside a target market country as a means of invading it. There are several variations on this method, ranging from complete manufacturing to contract manufacturing (with a local manufacturer) and partial manufacturing.

From the perspective of the host countries, it is obvious as to why they want to attract foreign capital. Although job creation is the main reason, there are several other benefits for the host country as well. Foreign direct investment, unlike other forms of capital inflows, almost always brings additional resources that are very desirable to developing economies. These resources include technology, management expertise, and access to export markets.

There are several reasons why a company chooses to invest in manufacturing facilities abroad. One reason may involve gaining access either to raw materials or to take advantage of resources for its manufacturing operations. As such, this process is known as *backward vertical integration.* Another reason may be to take advantage of lower labor costs or other abundant factors of production (e.g., labor, energy, and other inputs). Hoover was able to cut its high British manufacturing costs by shifting some of its production to France. The strategy may further reduce another kind of cost - transportation. British publishing firms have begun to print more books abroad because they can save 25 to 40 percent in production and shipping costs. Manufacturing in a host country can make the company’s product more price competitive because the company can avoid or minimize high import taxes, as well as other trade barriers. Honda, with 68 percent of its car sales coming from exports and 43 percent from the US market, has a good reason to be sensitive to trade barriers. In order to avoid future problems of this nature, it set up plants in Ohio.

A manufacturer interested in manufacturing abroad should consider a number of significant factors. One study investigated the incentive preferences of MNCs and found absence of restrictions on intercompany payments to be the most important determinant. The other important incentives include: no controls on dividend remittances, import duty concessions, guarantees against expropriation, and tax holidays.

From the marketing standpoint, *product image* deserves attention. Although Winston cigarettes are made in Venezuela with the same tobaccos and formula as the Winston cigarettes in the USA,

Venezuelans still prefer the more expensive US- made Winston. Philip Morris and R.J. Reynolds face this same problem in Russia when setting up manufacturing plants there. Unilever had a similar problem when it began manufacturing locally in Nepal where people prefer Indian-made products.

Competition is an important factor, since to a great extent competition determines potential profit. Another factor is resources of various countries, which should be compared to determine each country’s comparative advantage. The comparison should also include production considerations,

Topic 9. PRODUCT STRATEGIES: BASIC DECISIONS AND PRODUCT PLANNING

Plan

1. What is a product?
2. New product development
3. Market segmentation
4. Product adoption
5. Theory of international product life cycle (IPLC)

1. What is a product?

A product is often considered in a narrow sense as something tangible that can be described in terms of physical attributes, such as shape, dimension, components, form, color, and so on. This is a misconception that has been extended to international marketing as well, because many people believe that only tangible products can be exported. A student of marketing, however, should realize that this definition of product is misleading since many products are intangible (e.g., services). Actually, intangible products are a significant part of the American export market. For example, American movies are distributed worldwide, as are engineering services and business-consulting services. In the financial market, Japanese and European banks have been internationally active in providing financial assistance, often at handsome profits. Even when tangible products are involved, insurance services and shipping are needed to move the products into their markets.

2. New product development

There are six distinct steps in new product development. The *first step* is the *generation of new product ideas.* Such ideas can come from any number of sources (e.g., salesperson, employees, competitors, governments, marketing research firms, customers)..

The *second step* involves the *screening of ideas.* Ideas must be acknowledged and reviewed to determine their feasibility. To determine suitability, a new product concept may simply be presented to potential users, or an advertisement based on the product may be drawn and shown to focus groups to elicit candid reactions. As a rule, corporations usually have predetermined goals that a new product must meet. Kao Corporation, a major Japanese manufacturer of consumer goods, is guided by the following five principles of product development: (1) a new product should be truly useful to society, not only now but also in the future, (2) it should make use of Kao's own creative technology or skill, (3) it should be superior to the new products of competitors, both from the standpoint of cost and performance, (4) it should be able to stand exhaustive product tests at all stages before it is commercialized, and (5) it should be capable of delivering its own message at every level of distribution.

The *third step* is *business analysis,* which is necessary to estimate product features, cost, demand, and profit. Xerox has small so-called product synthesis teams to test and weed out unsuitable ideas. Several competing teams of designers produce a prototype, and the winning model that meets preset goals then goes to the "product development" team.

The *fourth step* is *product development*, which involves lab and technical tests as well as manufacturing pilot models in small quantities. At this stage, the product is likely to be handmade or produced by existing machinery rather than by any new specialized equipment. Ideally, engineers should receive direct feedback from customers and dealers. Goldstar Co., by letting its engineers out of the laboratories and into the market to see what Korean customers want, got an idea to make a refrigerator that can keep *kimchi* (fermented pickled cabbage or radishes which are Korea's national dish) fresh and odorless for a long time.

The fifth step involves *test marketing* to determine potential marketing problems and the optimal marketing mix. Anheuser Busch pulled Budweiser out of Germany after a six-month Berlin market test. Its Busch brand was another disappointment in France, where this type of beer did not yet correspond to French tastes.

Finally, assuming that things go well, the company is ready for *full-scale commercialization* by actually going through with full-scale production and marketing.

It should be pointed out that not all of these six steps in new product development will be applicable to all products and countries. Test marketing, for example, may be irrelevant in countries where most major media are more national than local. If the television medium has a nationwide coverage, it is not practical to limit a marketing campaign to one city or province for test marketing purposes.

3. Market segmentation

Market segmentation is a concept to which marketers and academics like to pay a great deal of attention. All conceivable possibilities for segmenting the US market have been thoroughly studied. For example, Visa has designed its consumer credit products and non-credit products for diverse market segments. Some of its products are: Visa Classic, Visa Gold, Visa Platinum, Visa Signature, Visa Infinite, Visa check card, and Visa Buxx.

Yet on the international scale, American marketers are prone to treat market segmentation as an unknown and unfamiliar concept, and they apparently leave their knowledge about market segmentation at home when they go abroad. More often than not, there is hardly any serious or conscious attempt by American businessmen to segment a foreign market. This phenomenon probably derives from an assumption that, by going abroad, geographic segmentation has been implemented. But geographic segmentation, an obvious choice, is often overemphasized and is usually inappropriate. Marketers fail to realize that the purpose of segmentation is to satisfy consumer needs more precisely — not to segment the market just for the sake of the segmentation.

Another mistake marketers make in foreign countries is in attempting to capture the total market at once. The resulting disappointment in market performance demonstrates that two major problems have been overlooked. First, consumers in a foreign country are unlikely to be homogeneous. Usually, marketers must distinguish urban consumers from rural consumers. Even in largely homogeneous Japan, American Express found it necessary to segment Japanese consumers. It introduced the luxury gold yen card for the affluent segment and the green card for the middle-income segment.

Second, a "total market" strategy places the company in head-to-head competition with strong, local competitors. The success of Japanese products in the USA and in many other countries may be explained in part by the explicit and conscientious attempt by the Japanese to segment the market. Japanese firms usually pick their targets carefully, avoiding head-to-head competition with major US manufacturers in mature industries.

The most important reason behind the employment of market segmentation is market *homogene- ity/heterogeneity*. Based on the national boundary, homogeneity can be *vertical* (i.e., homogeneous within the same country) or *horizontal* (i.e., homogeneous across countries).Therefore, two countries exhibiting the lack of vertical homogeneity within their borders may still be homogeneous horizontally when a particular segment of one country is similar to an equivalent segment of another country.

Nevertheless, market segmentation is not always necessary or desirable. This is especially true when either consumer needs within a country are largely homogeneous or a mass market exists.

4. Product adoption

In breaking into a foreign market, marketers should consider factors that influence product adoption. As explained by diffusion theory, at least six factors have a bearing on the adoption process: relative advantage, compatibility, trialability/divisibility, observability, complexity, and price. These factors are all perceptual and thus subjective in nature.

For a product to gain acceptance, it must demonstrate its *relative advantage* over existing alternatives. Products emphasizing cleanliness and sanitation may be unimportant in places where people are poor and struggle to get by one day at a time.Wool coats are not needed in a hot country, and products reducing static cling (e.g., Cling Free) are useless in a humid country. A sunscreen film attached to auto windshields to block out sunlight may be a necessity in countries with a tropical climate, but it has no such advantage in cold countries. Dishwashing machines do not market well in countries where manual labor is readily available and inexpensive.

A product must also be *compatible* with local customs and habits.A freezer would not find a ready market in Asia, where people prefer fresh food. In Asia and such European countries as France and Italy, people like to sweep and mop floors daily, and thus there is no market for carpet or vacuum cleaners. Deodorants are deemed inappropriate in places where it is the custom for men to show their masculinity by having body odor. Dryers are unnecessary in countries where people prefer to hang their clothes outside for sunshine freshness. Kellogg's had difficulties selling Pop Tarts in Europe because many homes have no toaster. Unlike American women, European women do not shave their legs, and thus have no need for razors for that purpose. The Japanese, not liking to have their lifestyles altered by technology, have skillfully applied technology to their traditional lifestyle. The electrical *kotatsu* (foot warmer) is a traditional form of heater in Japan. New *kotatsu* are equipped with a temperature sensor and microcomputer to keep the interior temperature at a comfortable level.

A new product should also be compatible with consumers' other belongings. If a new product requires a replacement of those other items that are still usable, product adoption becomes a costly proposition.

A new product has an advantage if it is capable of being *divided* and *tested* in small trial quantities to determine its suitability and benefits. This is a product's *trialability/divisibility* factor. Disposable diapers and blue jeans lend themselves to trialabil- ity rather well, but when a product is large, bulky, and expensive, consumers are much more apprehensive about making a purchase. Thus, washers, dryers, refrigerators, and automobiles are products that do not lend themselves well to trialability/ divisibility. This factor explains one reason why foreign consumers do not readily purchase American automobiles, knowing that a mistake could ruin them financially. Many foreign consumers therefore prefer to purchase more familiar products, such as Japanese automobiles, that are less expensive and easier to service and whose parts are easier to replace.

Observation of a product in public tends to encourage social acceptance and reinforcement, resulting in the product's being adopted more rapidly and with less resistance. If a product is used privately, other consumers cannot see it, and there is no prestige generated by its possession. Blue jeans, quartz watches, and automobiles are used publicly and are highly observable products. Japanese men flip their ties so that labels show. Refrigerators, on the other hand, are privately consumed products, though owners of refrigerators in the Middle East and Asia may attempt to enhance observability (and thus prestige) by placing the refrigerator in the living room, where guests can easily see it. In any case, a distinctive and easily recognized logo is very useful.

Complexity of a product or difficulty in understanding a product's qualities tends to slow down its market acceptance. Perhaps this factor explains why ground coffee has had a difficult time in making headway to replace instant coffee in many countries. Likewise, 3M tried unsuccessfully in foreign markets to replace positive-acting printing plates with presensitized negative subtractive printing plates, which are very popular in the USA. It failed to convert foreign printers because the sales and technical service costs of changing printers' beliefs were far too expensive. Computers are also complex but have been gradually gaining more and more acceptance, perhaps in large part because manufacturers have made the machines simpler to operate. Ready-made software can also alleviate the necessity of learning computer languages, a timeconsuming process.

5. Theory of international product life cycle (IPLC)

The international product life cycle theory, developed and verified by economists to explain trade in a context of comparative advantage, describes the diffusion process of an innovation across national boundaries. The life cycle begins when a developed country, having a new product to satisfy consumer needs, wants to exploit its technological breakthrough by selling abroad. Other advanced nations soon start up their own production facilities, and before long less developed countries do the same. Efficiency/comparative advantage shifts from developed countries to developing nations. Finally, advanced nations, no longer cost-effective, import products from their former customers. The moral of this process could be that an advanced nation becomes a victim of its own creation.

IPLC theory has the potential to be a valuable framework for marketing planning on a multinational basis. In this section, the IPLC is examined from the marketing perspective, and marketing implications for both innovators and initiators are discussed.

Stages and characteristics

There are five distinct stages (Stage 0 through Stage 4) in the IPLC. Figure 9.1 shows three life cycle curves for the same innovation: one for the initiating country (i.e., the USA in this instance), one for other advanced nations, and one for LDCs (less developed countries). For each curve, net export results when the curve is above the horizontal line; if under the horizontal line, net import results for that particular country. As the innovation moves through time, directions of all three curves change. Time is relative, because the time needed for a cycle to be completed varies from one kind of product to another. In addition, the time interval also varies from one stage to the next.

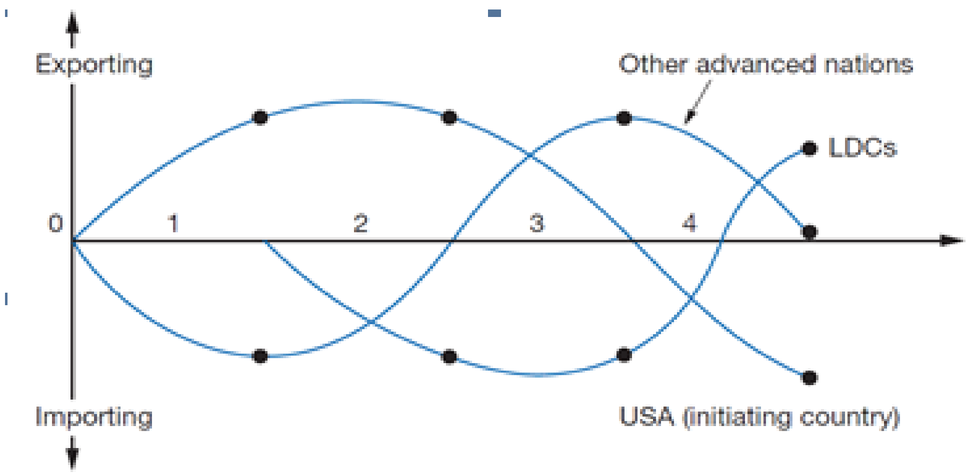

Fig. 9.1. **IPLC curves**

Stage 0 - Local innovation

Stage 0, depicted as time 0 on the left of the vertical importing/exporting axis, represents a regular and highly familiar product life cycle in operation within its original market. Innovations are most likely to occur in highly developed countries because consumers in such countries are affluent and have relatively unlimited wants. From the supply side, firms in advanced nations have both the technological know-how and abundant capital to develop new products.

Many of the products found in the world's markets were originally created in the USA before being introduced and refined in other countries. In most instances, regardless of whether a product or not is intended for later export, an innovation is designed initially with an eye to capture the US market, the largest consumer nation.

Stage 1 - Overseas innovation

As soon as the new product is well developed, its original market well cultivated, and local demands adequately supplied, the innovating firm will look to overseas markets in order to expand its sales and profit. Thus this stage is known as a "pioneering" or "international introduction" stage. The technological gap is first noticed in other advanced nations because of their similar needs and high income levels. Not surprisingly, English-speaking countries such as the United Kingdom, Canada, and Australia account for about half of the sales of US innovations when first introduced to overseas countries with similar cultures, and economic conditions are often perceived by exporters as posing less risk and thus are approached first before proceeding to less familiar territories.

Stage 2 - Maturity

Growing demand in advanced nations provides an impetus for firms there to commit themselves to starting local production, often with the help of their governments' protective measures to preserve infant industries. Thus these firms can survive and thrive in spite of relative inefficiency.

Development of competition does not mean that the initiating country's export level will immediately suffer. The innovating firm's sales and export volumes are kept stable because LDCs are now beginning to generate a need for the product. Introduction of the product in LDCs helps offset any reduction in export sales to advanced countries.

Stage 3 - Worldwide imitation

This stage means tough times for the innovating nation because of its continuous decline in exports. There is no more new demand anywhere to cultivate. The decline will inevitably affect the US innovating firm's economies of scale, and its production costs thus begin to rise again. Consequently, firms in other advanced nations use their lower prices (coupled with product differentiation techniques) to gain more consumer acceptance abroad at the expense of the US firm. As the product becomes more and more widely disseminated, imitation picks up at a faster pace. Toward the end of this stage, US export dwindles almost to nothing, and any US production still remaining is basically for local consumption. The US automobile industry is a good example of this phenomenon. There are about thirty different companies selling cars in the USA, with several on the rise. Of these, only two (General Motors and Ford) are US firms, with the rest being from Western Europe, Japan, South Korea, and others.

Stage 4 - Reversal

Not only must all good things end, but misfortune frequently accompanies the end of a favorable situation. The major functional characteristics of this stage are *product standardization and comparative disadvantage.* This innovating country's comparative advantage has disappeared, and what is left is comparative disadvantage. This disadvantage is brought about because the product is no longer capital-intensive or technology-intensive but instead has become labor-intensive - a strong advantage possessed by LDCs. Thus LDCs - the last imitators - establish sufficient productive facilities to satisfy their own domestic needs as well as to produce for the biggest market in the world, the

Validity of the IPLC

Several products have conformed to the characteristics described by the IPLC. The production of semiconductors started in the USA before diffusing to the United Kingdom, France, Germany, and Japan. Production facilities are now set up in Hong Kong and Taiwan, as well as in other Asian countries. Similarly, at one time, the USA used to be an exporter of typewriters, adding machines, and cash registers. However, with the passage of time, these simple machines (e.g., manual typewriters) are now being imported, while US firms export only the sophisticated, electronic versions of such machines. Other products that have gone through a complete international life cycle are synthetic fibers, petrochemicals, leather goods, rubber products, and paper. The electronics sector, a positive contributor to the trade balance of the USA for a long time, turned negative for the first time ever in 1984 with a massive $6.8 billion deficit. A deficit also occurred at the same time for communications equipment, following the trend set by semiconductors in 1982.

Marketing strategies

For those advanced economies' industries in the worldwide imitation stage (e.g., automobiles) or the maturity stage (e.g., computers), things are likely to get worse rather than better. The prospect, though bleak, can be favorably influenced. What is crucial is for firms in the advanced economies to understand the implications of the IPLC so that they can adjust marketing strategies accordingly.

Product policy

The IPLC emphasizes the importance of cost advantage. It would be very difficult for firms in advanced economies to match labor costs in low-wage nations since costs are only 0.5 cent in China. Still, the innovating firm must keep its product cost competitive. One way is to cut labor costs through automation and robotics. IBM converted its Lexington (Kentucky) plant into one of the most automated plants in the world. Japanese VCR manufacturers are counting on automation to help them meet the challenge of South Korea.

Another way to reduce production costs is to eliminate unnecessary options, since such options increase inefficiency and complexity. This strategy may be crucial for simple products or for those at the low end of the price scale. In such cases, it is desirable to offer a standardized product with a standard package of features or options included.

To keep costs rising at a minimum, an initiating firm may use local manufacturing in other countries as an entry strategy. The company can not only minimize transportation costs and entry barriers but also indirectly slow down potential local competition starting up manufacturing facilities. Another benefit is that those countries can eventually become a springboard for the company to market its product throughout that geographic region. In fact, sourcing should allow the innovator to hold down labor costs at home and abroad and retain the original market as well.

Manufacturers should examine the traditional vertical structure in which they make all or most components and parts themselves because in many instances outsourcing may prove to be more cost- effective. **Outsourcing** is the practice of buying parts or whole products from other manufacturers while allowing a buyer to maintain its own brand name. For example, Ford Festiva is made by Kia Motors, Mitsubishi Precis by Hyundai, Pontiac Lemans by Daewoo, and GM Sprint by Suzuki.

A modification of outsourcing involves producing various components or having them produced under contract in different countries. That way, a firm takes advantage of the most abundant factor of production in each country before assembling components into final products for worldwide distribution.

Solectron and Flextronics are examples of contract manufacturers that do manufacturing for many well-known brands. Solectron, a contract electronics maker, makes components and finished products for electronics companies, and its customers include Cisco Systems, HP, and Ericsson. A recent deal involves Solectron making optical networking equipment worth as much as $2 billion for Lucent Technologies for three years. Xerox has a five-year contract that transfers about half of Xerox's manufacturing operations to Flextronics and represents more than $1 billion in annual manufacturing costs. Flextronics, based in Singapore, is a $12 billion global electronics manufacturing services company, manufacturing Xerox office equipment and components at a modest premium over book value. These copiers and printers are used worldwide.

Topic 10. Product strategies: Branding and packaging decisions

Plan

1. Branding decisions
2. Branding levels and alternatives
3. Brand consolidation
4. Brand origin and selection

1. Branding decisions

In many countries, branding may be nothing more than the simple process of putting a manufacturer's name, signature, or picture on a product or its package.

The basic purposes of branding are the same everywhere in the world. In general, the functions of a brand are to: (1) create identification and brand awareness, (2) guarantee a certain level of quality, quantity, and satisfaction, and (3) help with promotion. All of these purposes have the same ultimate goal: to induce repeat sales.

2. Branding levels and alternatives

There are four levels of branding decisions: (1) branding versus no brand, (2) private brand versus Generic (brandless) product manufacturer's brand, (3) single brand versus multiple brands, and (4) local brands versus worldwide brand. Figure 10.1 shows an outline of the decision-making process when branding is considered; Figure 10.2 provides a branding model for decision making;

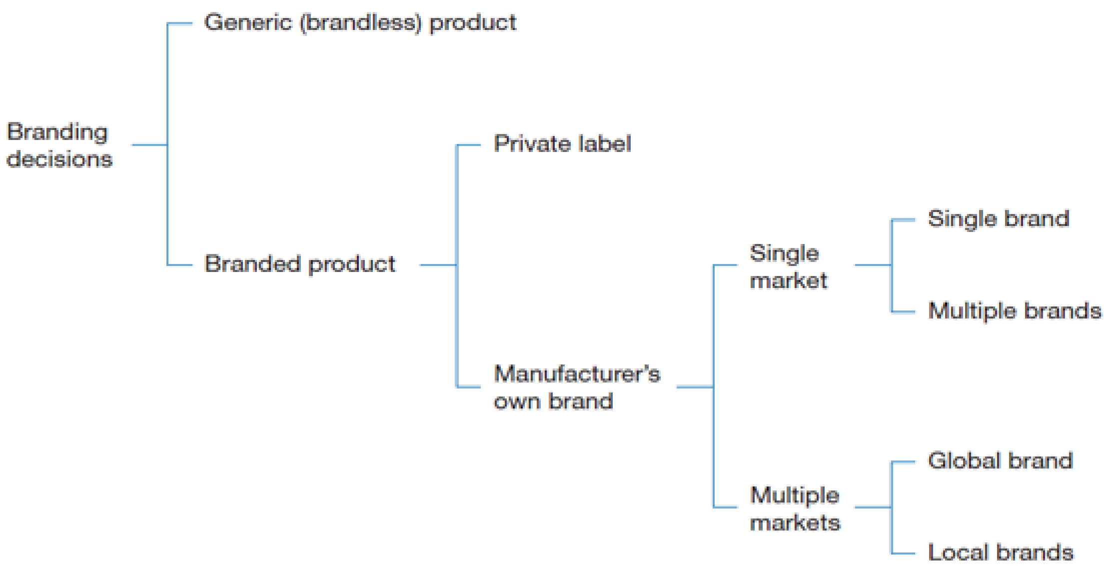

Fig. 10.1. **Branding decisions**

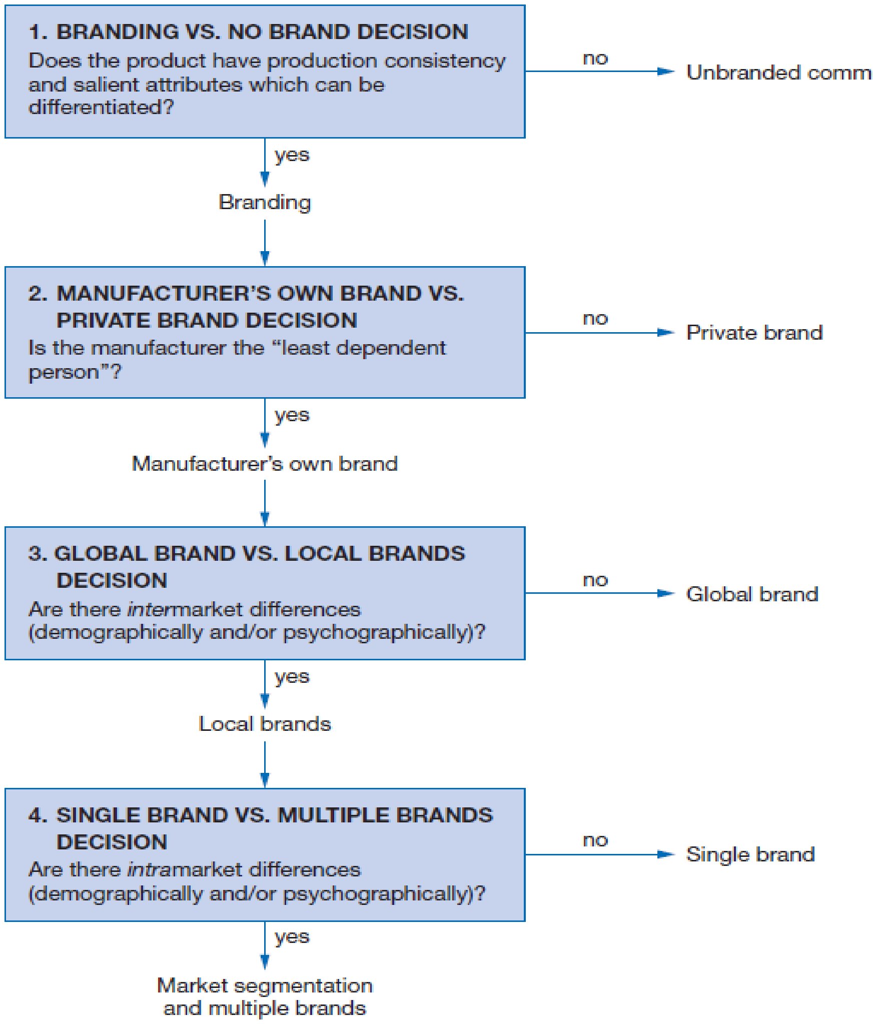

Fig. 10.2. **A branding model for decision making**

Branding vs. no brand

To brand or not to brand, that is the question. Most products are branded, but that does not mean that all products should be. Branding is not a cost-free proposition due to the added costs associated with marking, labeling, packaging, and legal procedures. These costs are especially relevant in the case of commodities (e.g., salt, cement, diamonds, produce, beef, and other agricultural and chemical products). *Commodities* are "unbranded or undifferentiated products which are sold by grade, not by brands". As such, there is no uniqueness, other than grade differential, that may be used to distinguish the offerings of one supplier from those of another. Branding is then probably undesirable because brand promotion is ineffective in a practical sense and adds unnecessary expenses to operations costs. The value of a diamond, for example, is determined by the so-called four Cs — cut, color, clarity, and carat weight – and not by brand. This is why DeBeers promotes the primary demand for diamonds in general rather than the selective demand for specific brands of diamonds.

On the positive scale, a brandless product allows flexibility in quality and quantity control, resulting in lower production costs along with lower marketing and legal costs.

The basic problem with a commodity or unbranded product is that its demand is strictly a function of price. The brandless product is thus vulnerable to any price swing or price cutting. Farmers can well attest to this vulnerability because prices of farm products have been greatly affected by competition from overseas producers. Yet there are ways to remove a company from this kind of cutthroat competition.

Branding, when feasible, transforms a commodity into a product (e.g., Chiquita bananas, Dole pineapples, Sunkist oranges, Morton salt, Holly Farms fryers, and Perdue fryers). A product is a “value-added commodity,” and this bundle of added values includes the brand itself as well as other product attributes, regardless of whether such attributes are physical or psychological and whether they are real or imaginary. The 3M company developed brand identity and packaging for its Scotch videotapes for the specific purpose of preventing them from becoming just another commodity item in the worldwide, price-sensitive market.

Although branding provides the manufacturer with some insulation from price competition, a firm must still find out whether it is worthwhile to brand the product. In general, the following prerequisites should be met:

- Quality and quantity consistency, not necessarily the best quality or the greatest quantity.
- The possibility of product differentiation.
- The degree of importance consumers place on the product attribute to be differentiated.

As an example, Nike’s unique designs (e.g., the waffle sole) allowed the company to differentiate its brand from others and to become the top-rated brand among serious joggers.

Private brand vs. manufacturer’s brand

Branding to promote sales and move products necessitates a further branding decision: whether the manufacturer should use its own brand or a distributor’s brand on its product. Distributors in the world of international business include trading companies, importers, and retailers, among others; their brands are called private brands. Many portable TV sets made in Japan for the US market are under private labels. In rare instances, Japanese marketers put their brands on products made by US companies, as evidenced by Matsushita’s purchases of major appliances from White and D&M for sale in the USA. The Oleg Cassini trademark is put on the shirts actually made by Daewoo. Even though it may seem logical for a distributor to carry the manufacturer’s well-known brand, many distributors often insist on their own private brands for several reasons. First, a distributor may be able to create a unique product by bundling or unbundling product attributes and then adjusting the price to reflect the proper value.

Carrefour, a French retail giant, sells some 3000 in-house products at prices about 15 percent lower than national brands. J. Sainsbury PLC, a British retailer, has a private brand that is able to win 30 percent of the detergent market, moving it ahead of Unilever's Persil and just behind Procter & Gamble's Ariel which is the market leader. It is believed that private-label products now account for one-third of supermarket sales in the United Kingdom and a quarter in France.

Second, a private brand is a defensive strategy which guarantees that a distributor is not bypassed by its supplier. For example, Ponder and Best, after losing the Rolleiflex and Olympus distributorships, came up with its own brand of photographic products, Vivitar.

Third, distributors can convert fixed production costs into variable costs by buying products made by others. Sperry's products are made by more than 200 manufacturers (e.g., Sperry's personal computer is manufactured by Mitsubishi). With this practice, Sperry is able to save cash and research- and-development expenses. Of course, it is important for a distributor with a private brand to have a reliable supplier.

The fourth and perhaps the most important reason for a distributor's insistence on a private brand is due to brand loyalty, bargaining power, and price. In spite of the lower prices paid by the distributor and ultimately by its customers, the distributor is still able to command a higher gross margin than what a manufacturer's brand usually offers. The lower price may also be attributed to the distributor's refusal to pay for the manufacturer's full costs. A distributor may want to pay for the manufacturer's variable costs but not all of the fixed costs. Or a distributor may want to pay for production costs only but not the manufacturer's promotional expenditures, because a distributor gets no benefit from the goodwill of a manufacturer's advertised brand. If a firm has any problem with the supplier (manufacturer), it has the flexibility of switching to another supplier to make the identical product, thus maintaining brand loyalty and bargaining power without any adverse effect on sales. RCA, for example, switched from Matsushita to Hitachi for its portable units of VCRs.

There are a number of reasons why the strategy of private branding is not necessarily bad for the manufacturer. First, the ease in gaining market entry and dealers' acceptance may allow a larger market share overall while contributing to offset fixed costs.

Second, there are no promotional headaches and expenses associated with private branding, thus making the strategy suitable for a manufacturer with an unknown brand.

Third, a manufacturer may judge that the sales of its own product are going to suffer to a greater or lesser degree by various private brands. In that case, the manufacturer may as well be cannibalized by one of those private brands made by the manufacturer.

Single brand vs. multiple brands

When a single brand is marketed by the manufacturer, the brand is assured of receiving full attention for maximum impact. However, a company may choose to market several brands within a single market based on the assumption that the market is heterogeneous and thus must be segmented. Consequently, a specific brand is designed for a specific market segment. In the case of Intel, it spent several hundred million dollars to promote Centrino, a new brand for wireless computing.

Multiple brands are suitable when a company wants to trade either up or down because both moves have a tendency to hurt the firm's main business. If a company has the reputation for quality, trading down without creating a new brand will hurt the prestige of the existing brand. By the same rationale, if a company is known for its low-priced, mass-produced products, trading up without creating a new brand is hampered by the image of the existing products. Casio is perceived as a manufacturer of low-priced watches and calculators, and the name adversely affects its attempt to trade up to personal computers and electronic musical instruments. To overcome this kind of problem, Honda uses the Acura name for its sporty cars so that Acura's image is not affected by the more pedestrian Honda image.

Local brands vs. worldwide brand

When the manufacturer decides to put its own brand name on the product, the problem does not end there if the manufacturer is an international marketer. The possibility of having to modify the trademark cannot be dismissed. The international marketer must then consider whether to use only one brand name worldwide or different brands for different markets or countries. To market brands worldwide and to market worldwide brands are not the same thing.

A single, worldwide brand is also known as an international, universal, or global brand. A Eurobrand is a slight modification of this approach, since it is a single product for a single market (i.e., the European Union and the other Western European countries), with an emphasis on the search for intermarket similarities rather than differences.

For a brand to be global or worldwide, it must, by definition, have a commonly understood set of characteristics and benefits in all of the markets where it is marketed.[11] Coca-Cola is a global brand in the sense that it has been successful in maintaining similar perceptions across countries and cultures. However, most other brands do not enjoy this kind of consistency, thus making it debatable whether a global brand is a practical solution.

A worldwide brand has several advantages. First, it tends to be associated with status and prestige. Second, it achieves maximum market impact overall while reducing advertising costs because only one brand is pushed. Bata Ltd., a Canadian shoe marketer and retailer in ninety-two countries, found out from its research that consumers generally believed Bata to be a local concern, no matter the country surveyed. The company thus decided to become an official sponsor of World Cup soccer in order to enhance Bata's international stature. For Bata and others, it is easier to achieve worldwide exposure for one brand than it is for multiple local brands. Too many brands create confusion and fragmentation.

Third, a worldwide brand provides a convenient identification, and international travelers can easily recognize the product. There would be no sense in creating multiple brands for such international products as *Time* magazine, American Express credit card, Diner's Club credit card, Shell gasoline, and so on.

Finally, a worldwide brand is an appropriate approach when a product has a good reputation or is known for quality. In such cases, a company would be wise to extend the brand name to other products in the product line. This strategy has been used extensively by GE. In another case, 3M perceived commonalities in a consumer demographics and market development worldwide; in response, it devised a “convergence marketing” strategy to develop global identity for its Scotch brand of electronic recording products, whose design displays prominently the Scotch name and a globelike logo.

3. Brand consolidation

Frequently, it is either by accident or lack of coordination that multiple local brands result. Despite the advantages offered by the multiple-brand strategy, it may be desirable to consolidate multiple brands under one brand when the number of labels reaches the point of being cumbersome or confusing. National BankAmericard used to issue cards around the world under twenty-two names before consolidating them all under the Visa umbrella. Unilever markets a vast array of beauty, home-care, and food products under numerous names.

4. Brand origin and selection

Brand names can come from a variety of sources, such as from a firm’s founders (e.g., Francois Michelin, Albert G. Spalding, Pierre Cardin, and Yves St. Laurent), places (e.g., Budweiser), letters and numbers (e.g., IBM), and coined words (e.g., Ikea based on a combination of the initials of the Swedish-born founder, Ingvar Kamprad, with those of the farm, Elmtaryd, and the village, Agunnaryd, where he grew up).

Sometimes, it is easier simply to purchase an existing brand from another company. Hong Kong’s Universal International bought Matchbox, a British toy car maker.W. Haking enterprises, another Hong Kong company, acquired the Ansco name from GAF, and most Americans do not realize that the brand of Haking’s low-priced cameras is actually a Hong Kong brand. North American Philips (NAP) bought the Schick shaver trade name. Underscoring the value of this name, Remington even filed a complaint alleging that the Schick name enabled NAP to avoid spending $25 million needed to launch a new shaver to supplement the Norelco line.

Brand selection is far from being an exact science, as illustrated by the origins of many successful brands. Gabrielle Chanel liked the scent of the fifth sampled bottle in 1921. Feeling that 5 was a pretty number, she named the perfume Chanel No. 5. Denmark’s Lego Group, well known for its interlocking plastic bricks, is the world’s fifth- largest toy maker with annual sales of about $1 billion. The founder, Ole Kirk Kristiansen, named his company Lego which is a combination of the Danish words leg godt, meaning “play well.”

Topic 11. CHANNELS OF DISTRIBUTION

Plan

1. Direct and indirect selling channels
2. Types of intermediaries: direct channel
3. Types of intermediaries: indirect channel

1. Direct and indirect selling channels

A manufacturer can sell directly to end users abroad, but this type of channel is generally not suitable or desirable for most consumer goods. In foreign markets, it is far more common for a product to go through several parties before reaching the final consumer.

Companies use two principal channels of distribution when marketing abroad: (1) indirect selling, and (2) direct selling. **Indirect selling**, also known as the local or domestic channel, is employed when a manufacturer in the United Kingdom, for markets its product through another British firm that acts as the manufacturer's *sales intermediary* (or middleman). As such, the sales intermediary is just another local or domestic channel for the manufacturer because there are no dealings abroad with a foreign firm. By exporting through an independent local middleman, the manufacturer has no need to set up an international department. The middleman, acting as the manufacturer's external export organization, usually assumes responsibility for moving the product overseas. The intermediary may be a **domestic agent** if it does not take title to the goods, or it may be a **domestic merchant** if it does take title to the goods.

There are several advantages to be gained by employing an indirect domestic channel. For example, the channel is simple and inexpensive. The manufacturer incurs no start-up cost for the channel and is relieved of the responsibility of physically moving the goods overseas. Because the intermediary very likely represents several clients who can help share distribution costs, the costs for moving the goods are further reduced.

An indirect channel does, however, have limitations. The manufacturer has been relieved of any immediate marketing costs but, in effect, has given up control over the marketing of its product to another firm. This situation may adversely affect the product's success in the future. If the chosen intermediary is not aggressive the manufacturer may become vulnerable, especially in cases where competitors are careful about their distribution practices. Moreover, the indirect channel may not necessarily be permanent. Being in the business of handling products for profit, the intermediary can easily discontinue handling a manufacturer's product if there is no profit or if a competitive product offers a better profit potential.

Export intermediaries' performance is a function of their possession of valuable, unique, and hard- to-imitate resources. Such resources reduce their client's transaction and agency costs.[1] A related study, focusing on 20,000 French firms, found that export intermediary firms tend to export products with a high commodity content rather than products with a low commodity content, thus confirming the role of product complexity.

Direct selling is employed when a manufacturer develops an overseas channel. This channel requires that the manufacturer deal directly with a foreign party without going through an intermediary in the home country. The manufacturer must set up the overseas channel to take care of the business activities between the countries. Being responsible for shipping the product to foreign markets itself, the manufacturer exports through its own internal export department or organization.

Direct selling is not without its problems. It is a difficult channel to manage if the manufacturer is unfamiliar with the foreign market. Moreover, the channel is time consuming and expensive. Without a large volume of business, the manufacturer may find it too costly to maintain the channel. Hiram Walker, a Canadian distiller, used to have its own marketing operation in New York City to distribute such brands as Ballantine Scotch, Kahlua, and CC Rye. Poor earnings finally forced the company to phase out its costly US selling organization along with its New York City marketing operation.

2. Types of intermediaries: direct channel

There are several types of intermediaries associated with both the direct and indirect channels. Figure 11.1 compares the two channels and lists the various types of domestic and foreign intermediaries.

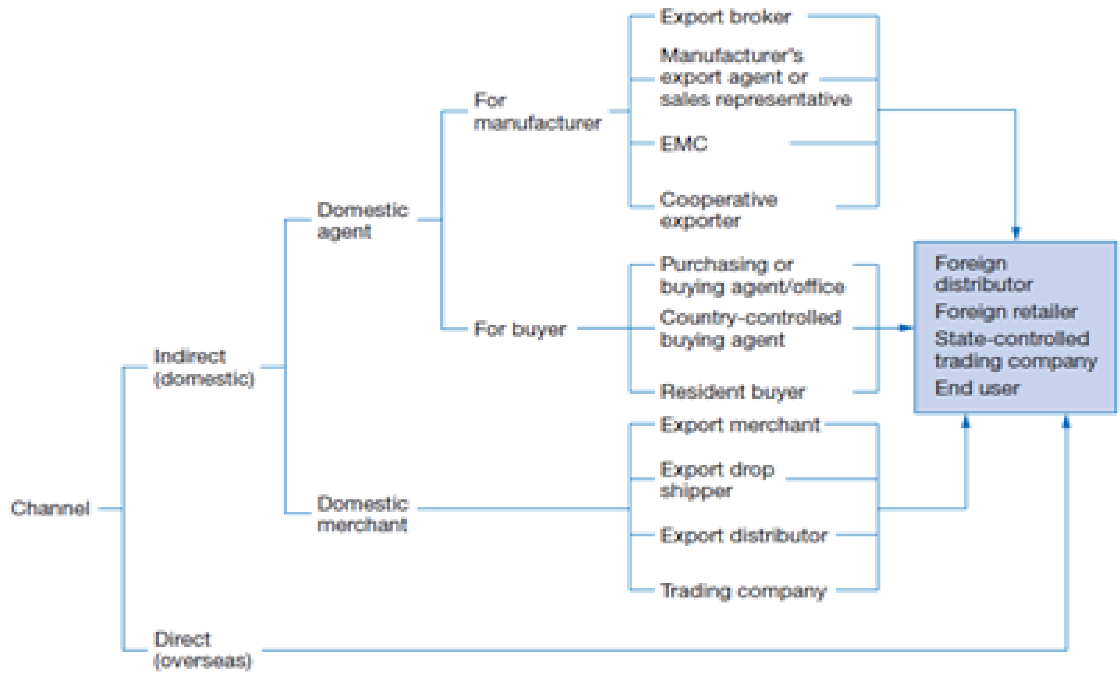

Fig. 11.1 **International channels of distribution**

Foreign distributor

A foreign distributor is a foreign firm that has exclusive rights to carry out distribution for a manufacturer in a foreign country or specific area. For example, when Don Wood returned to Detroit, he still remembered the MG sports car he drove in England during World War II. His letter asking MG's chairman to sell and ship one car to him brought the response that MG's policy was to sell only through authorized distributors, but MG was willing to appoint Wood as its Midwest distributor if he would order two cars instead. Wood agreed to do so and went on to become a successful distributor.

There are a number of benefits in using a foreign distributor. Unlike agents, the distributor is a *merchant* who buys and maintains merchandise in its own name. This arrangement simplifies the credit and payment activities for the manufacturer. To carry out the distribution function, the foreign distributor is often required to warehouse adequate products, parts, and accessories and to make facilities and personnel immediately available to service buyers and users. However, the manufacturer must be careful in selecting a foreign distributor or it may end up with a distributor who is deficient in marketing and servicing the product.

Foreign retailer

If foreign retailers are used, the product in question must be a consumer product rather than an industrial product. There are several means by which a manufacturer may contact foreign retailers and interest them in carrying a product, ranging from a personal visit by the manufacturer's representative to mailings of catalogs, brochures, and other literature to prospective retailers. The use of personal selling or a visit, although expensive due to travel costs and commissions for the manufacturer's representative, provides for a more effective sales presentation as well as for better screening of retailers for the distribution purpose. The use of direct mail, although less expensive, may not sufficiently catch the retailers' attention.

State-controlled trading company

For some products, particularly utility and telecommunications equipment, a manufacturer must contact and sell to state-controlled companies. In addition, many countries, especially those in Eastern Europe, have state-controlled trading companies, which are companies that have a complete monopoly in the buying and selling of goods. Hungary has about a hundred state trading organizations for a variety of products, ranging from poultry to telecommunications equipment and for both imported and exported products.

End user

Sometimes, a manufacturer is able to sell directly to foreign end users with no intermediary involved in the process. This direct channel is a logical and natural choice for costly industrial products. For most consumer products, the approach is only practical for some products and in some countries. A significant problem with consumer purchases can result from duty and clearance problems. A consumer may place an order without understanding his or her country's import regulations. When the merchandise arrives, the consumer may not be able to claim it. As a result, the product may be seized or returned on a freight-collect basis. Continual occurrence of this problem could become expensive for the manufacturer.

3. Types of intermediaries: indirect channel

For a majority of products, a manufacturer may find it impractical to sell directly to the various foreign parties (i.e., foreign distributors, foreign retailers, state-controlled trading companies, and end users). Other intermediaries, more often than not, have to come between these foreign buyers and the manufacturer. This section examines the roles of those middlemen located in the manufacturer’s country.

With an indirect channel, a manufacturer does not have to correspond with foreign parties in foreign countries. Instead, the manufacturer deals with one or more domestic middlemen, who in turn move and/or sell the product to foreign middlemen or final users. Although there are many kinds of local sales intermediaries, all may be grouped under two broad categories: (1) domestic agents, and (2) domestic merchants. The basic difference between the two is ownership (title) rather than just the physical possession of the merchandise. **Domestic agents** never take title to the goods, regardless of whether or not the agents take possession of the goods. **Domestic merchants**, on the other hand, own the merchandise, regardless of whether or not the merchants take possession. An agent represents the manufacturer, whereas a merchant (e.g., a distributor) represents the manufacturer’s product. The merchant has no power to contract on behalf of the manufacturer, but the agent can bind the manufacturer in authorized matters to contracts made on the manufacturer’s behalf.

Agents can be further classified according to the principal whom they represent. Some agent intermediaries represent the buyer; others represent the interest of the manufacturer. Those who work for the manufacturer include export brokers, manufacturer’s export agents or sales representative, export management companies, and cooperative exporters. Agents who look after the interests of the buyer include purchasing (buying) agents/offices and country-controlled buying agents.

Export broker

The function of an export broker is to bring a buyer and a seller together for a fee. The broker may be assigned some or all foreign markets in seeking a potential buyer. It negotiates the best terms for the seller (i.e., manufacturer) but cannot conclude the transaction without the principal’s approval of the arrangement. As representative of the manufacturer, the export broker may operate under its own name or that of the manufacturer. For any action performed, the broker receives a fee or commission. An export broker does not take possession or title to the goods. In effect, it has no financial responsibility other than sometimes making an arrangement for credit. An export broker is less frequently involved in the export (shipping) of goods than in the import (receiving) of goods.

Manufacturer’s export agent or sales representative

Because of the title of this intermediary, one might easily mistake an export agent or sales representative for a manufacturer’s employee when, in fact, this is an independent businessperson who usually retains his or her own identity by not using the manufacturer’s name. Having more freedom than the manufacturer’s own salesperson, a sales representative can select when, where, and how to work within the assigned territory. Working methods include presenting product literature and samples to potential buyers. An export agent pays his or her own expenses and may represent manufacturers of related and noncompeting products. The person may operate on either an exclusive or nonexclusive basis.

Like a broker, the manufacturer's export agent works for commission. Unlike the broker, the relationship with the manufacturer is continuous and more permanent. The contract is for a definite period of time, and the contract is renewable by mutual agreement. The manufacturer, however, retains some control because the contract defines the territory, terms of sale, method of compensation, and so on.

Under certain circumstances, it may not be justifiable for a small manufacturer to set up its own sales force and distribution network. Such circumstances include the following:

- When the manufacturer has a geographically widespread market — the usual case in international marketing.
- When some overseas markets are too thin.
- When the manufacturer's product is new and the demand is uncertain.
- When the manufacturer is inexperienced in international marketing.
- When the manufacturer wants to simplify business activities.

A manufacturer can avoid fixed costs associated with having its own sales and distribution organization when it employs an agent, since the commission is paid only when sales are made. A manufacturer's export agent has extensive knowledge of specific foreign markets and has more incentive to work than the manufacturer's own salesperson. In addition, the agent carries several product lines, and the result is that the expense of doing business is shared by other manufacturers. This arrangement allows the manufacturer to concentrate time, capital, and expertise on the production of goods rather than on having to deal with the marketing aspect. Of course, if the product is successful, the manufacturer can always set up its own sales force.

Export management company (EMC)

An export management company manages, under contract, the entire export program of a manufacturer. An EMC is also known as a **combination export manager (CEM)** because it may function as an export department for several allied but noncompeting manufacturers. In this regard, those export brokers and manufacturer's export agents who represent a combination of clients may also be called EMCs. When compared with export brokers and manufacturer's export agents, the EMC has greater freedom and considerable authority. The EMC provides extensive services, ranging from promotion to shipping arrangement and documentation. Moreover, the EMC handles all, not just a portion, of its principal's products. In short, the EMC is responsible for all of the manufacturer's international activities.

Cooperative exporter

A cooperative exporter is a manufacturer with its own export organization that is retained by other manufacturers to sell in some or all foreign markets. Except for the fact that this intermediary is also a manufacturer, the cooperative exporter functions like any other export agents. The usual arrangement is to operate as an export distributor for other suppliers, sometimes acting as a commission representative or broker. Because the cooperative exporter arranges shipping, it takes possession of goods but not title.

The cooperative exporter's motive in representing other manufacturers primarily involves its own financial interest. Having fixed costs for the marketing of its own products, the cooperative exporter desires to share its expenses and expertise with others who want to sell in the same markets abroad. Because of these activities, a cooperative exporter is often referred to as a *mother hen*, a *piggyback exporter*, or an *export vendor*. Examples of cooperative exporters include such well-known companies as GE, Singer, and Bog-Warner. By representing several clients, the cooperative exporter is regarded as a form of EMC.

Purchasing/buying agent

An export agent represents a seller or manufacturer; a purchasing/buying agent represents a foreign buyer. By residing and conducting business in the exporter's country, the purchasing agent is in a favorable position to seek a product that matches the foreign principal's preferences and requirements. Operating on the overseas customer's behalf, the purchasing agent acts in the interest of the buyer by seeking the best possible price. Therefore, the purchasing agent's client pays a fee or commission for the services rendered. The purchasing agent is also known by such names as commission agent, buyer for export, export commission house, and export buying agent. This agent may also become an export confirming house when confirming payment and paying the seller after receiving invoice and title documents for the client.

Country-controlled buying agent

A variation on the purchasing agent is a country- controlled buying agent. This kind of agent performs exactly the same function as the purchasing/ buying agent, the only distinction being that a country-controlled buying agent is actually a foreign government's agency or quasi-governmental firm. The country-controlled buying agent is empowered to locate and purchase goods for its country. This agent may have a permanent office location in countries that are major suppliers, or the country's representative may make formal visits to supplier countries when the purchasing need arises.

Resident buyer

Another variation of the purchasing agent is the resident buyer. As implied by the name, the resident buyer is an independent agent that is usually located near highly centralized production industries. Although functioning much like a regular purchasing agent, the resident buyer is different because it is retained by the principal on a continuous basis to maintain a search for new products that may be suitable. The long-term relationship makes it possible for the resident buyer to be compensated with a retainer and a commission for business transacted.

The resident buyer provides many useful services for a manufacturer. It can offer a favorable opportunity for a supplier to maintain a steady and continuous business relationship as long as the supplier remains competitive in terms of price, service, style, and quality.

Export merchant

The intermediaries covered so far have certain factors in common: they take neither risks nor title, preferring to receive fees for their services. Unlike these middlemen, domestic merchants are independent businesses that are in business to make a profit rather than to receive a fee. There are several types of domestic merchants. Because they all take title, they are distinguished by other features, such as physical possession of goods and services rendered.

One kind of domestic merchant is the export merchant. An export merchant seeks out needs in foreign markets and makes purchases from manufacturers in its own country to fill those needs. Usually the merchant handles staple goods, undifferentiated products, or those in which brands are unimportant. After having the merchandise packed and marked to specification, the export merchant resells the goods in its own name through contacts in foreign markets. In completing all these arrangements, the merchant assumes all risks associated with ownership.

Export drop shipper

An export drop shipper, also known as a *desk jobber* or *cable merchant*, is a special kind of export merchant. As all these names imply, the mode of operation requires the drop shipper to request a manufacture to "drop ship" a product directly to the overseas customer. It is neither practical nor desirable for the shipper to physically handle or possess the product. Based on this operational method, the shipper's ownership of the goods may last for only a few hours.

Export distributor

Whereas export merchants and drop shippers purchase from a manufacturer whenever they receive orders from overseas, an export distributor deals with the manufacturer on a continuous basis. This distributor is authorized and granted an exclusive right to represent the manufacturer and to sell in some or all foreign markets. It pays for goods in its domestic transaction with the manufacturer and handles all financial risks in foreign trade.

Trading company

Those that want to sell and those that want to buy often have no knowledge of each other or no knowledge of how to contact each other. Trading companies thus fill this void. In international marketing activities for many countries, this type of intermediary may be the most dominant form in volume of business and in influence. Many trading companies are large and have branches wherever they do business. They operate in developing countries, developed countries, and their own home markets. Half of Taiwan's exports are controlled by trading companies. In Japan, general trading houses are known as *sogo shosha*, and the largest traders include such well-known MNCs as Mitsubishi, Mitsui, and C. Itoh. The nine largest trading firms handle about half of Japan's imports and exports. Even large Japanese domestic companies buy through trading companies.

Topic 12. PHYSICAL DISTRIBUTION AND DOCUMENTATION

Plan

1. Modes of transportation
2. Cargo or transportation insurance
3. Packing

1. Modes of transportation

To move a product both between countries and within a country, there are three fundamental modes of transportation: air, water (ocean and inland), and land (rail and truck). Ocean and air shipments are appropriate for transportation between countries, especially when the distance is considerable and the boundaries are not joined. Inland water, rail, and highway are more suitable for inland and domestic transportation. When countries are connected by land (e.g., North America), it is possible to use rail and highway to move merchandise from locations, such as from the USA to Canada. In Europe, rail is an important mode due to the contiguity of land areas and the availability of a modern and efficient rail system.

The appropriate transportation mode depends on (1) market location, (2) speed, and (3) cost. A firm must first consider *market location*. Contiguous markets may be served by either rail or truck, and such is the case when goods are shipped from the USA to Canada or Mexico. To move goods between continents, ocean or air transportation is needed.

Speed is another consideration. When speed is essential, air transport is without question the preferred mode of distribution. Air transport is also necessary when the need is urgent or when delivery must be quickly completed as promised. For perishable items, a direct flight is preferable because a shorter period in transport reduces both spoilage and theft.

Finally, *cost* must be considered as well. Cost is directly related to speed — a quick delivery costs more. But there is a tradeoff between the two in terms of other kinds of savings. Packing costs for air freight are less than for ocean freight because for air freight the merchandise does not have to be in transit for a long period of time, and the hazards are relatively lower. For similar reasons, the air mode reduces the inventory in float (i.e., in the movement process).Thus, there is less investment cost because the overall inventory is minimized and inventory is turned over faster.

A firm must understand that there is no ideal transportation mode. Each mode has its own special kinds of hazards. Hazards related to the ocean/ water mode include wave impact, navigation exposures, water damage, and the various vessel motions (rolling, pitching, heaving, surging, swaying, and yawing). Hazard related to the air mode include ground handling and changes in atmospheric pressure and temperature. Hazards related to the rail and highway modes include acceleration/decelera- tion (braking), coupling impact, swaying on curves, and shock and vibration.

Land

Land transportation is an integral part of any shipment, whether locally or internationally. Some type of land transportation is necessary in moving goods to and from an airport or seaport. The land transportation mode involves rail and truck. When a large quantity of goods needs to be moved over a long distance by land, rail can prove to be quite economical. Europe and Japan have modern rail systems that are capable of moving merchandise efficiently.

On the other hand, trucks are capable of going to more places. In addition, trucks may be needed to take cargo to and from a railway station. When countries have joint boundaries, moving cargo by truck or train is often a practical solution. As a matter of fact, the US trucking industry is quite concerned about a NAFTA agreement which allows Mexican drivers to drive their trucks into the USA. It is debatable whether the real issue is a safety concern or a trade barrier.

Less developed countries generally rely on road transport. In Sub-Saharan Africa, road transport is the dominant form of transport. This form of transport accounts for 80 to 90 percent of the region's passenger and freight movements. Unfortunately, the nearly two million kilometers of roads in Africa have been greatly damaged due to years of neglect. In any case, road transport may be the only access to most rural communities - a situation common in Africa as well as in other developing economies.

Air

Of all the various transportation modes, air accounts for only about 1 percent of total international freight movement; yet it is the fastest- growing mode and is becoming less confined to expensive products. Air transport has the highest absolute rate, but exporters have discovered that there are many advantages associated with this mode. First, air transport speeds up delivery, minimizes the time the goods are in transit, and achieves greater flexibility in delivery schedules. Second, it delivers perishables in prime condition. Harris Ranch uses a 747 jumbo jet to fly live cattle from the USA to Japan. A premium price commanded by high-quality beef in Japan makes it possible to use air freight.

Third, it can respond rapidly to unpredictable and urgent demand. For instance, quick replacement of broken machinery, equipment, or a component part may be made by air. Fourth, it reduces to a minimum damage, packing, and insurance costs. Finally, it can help control costly inventory and other hidden costs, including warehousing, time in transit, inventory carrying cost, inventory losses, and the paperwork necessary to file claims for lost or damaged goods. These costs will increase as the time in transit increases. Furthermore, opportunity costs (e.g., lost sales and customer dissatisfaction) also adversely affect profit, especially in the long term. All of these costs can be minimized with air transport.

Traditionally, the appropriateness of air freight was determined solely by a value-to-weight equation, which dictated that air cargo should be confined to high-value products. One reason for that determination was that transport cost is a small proportion of such products' value. Another reason was that the amount of capital tied up with these products while in transit is high and should be released as soon as possible.

Recently, shippers have begun to shift their attention to the freight rates - density effect, which determines true costs rather than absolute costs of each transportation mode. Air freight rates are usually quoted per unit of weight, and sea freight rates are usually quoted per unit of weight and volume (whichever yields more revenue for the steamship). For example, assume the freight rates are $350/ton by air and $60/ton and/or cubic ft by sea. At first, it would appear that surface (sea) transportation is a great deal cheaper, but for a product that is 1 ton and 7 cubic ft, the cost of sea freight ($420) is actually higher than that of air freight ($350). Therefore, sea freight is very cheap when goods are very dense (i.e., low volume per unit of weight). However, as density declines (i.e., the increase in bulk in relation to constant weight), the charge for sea freight rises rapidly. Consequently, air freight is quite competitive for such low-density goods as ladies' shoes, men's shoes, computers, color TV sets, refrigerators, and towels.

The dominant form of the international transportation of merchandise has always been ocean transport. Its main advantage is its low rate, though the savings achieved for many products are not necessarily greater than other transport modes on an overall basis. This helps explain why, when all the hidden costs related to ocean transportation are considered, air transportation is growing at a very rapid rate.

Half a century ago, virtually all overseas trade went by ship. The use of air freight for high-value, time-sensitive products has jumped since then. The air mode has made it possible to outsource hightechnology products (e.g., computers). A reduction in transit time by one day can reduce a product's price by 0.8 percent. Based on over $800 billion of manufactured imports per year, an extra day can add $7 billion to the costs. Because an ocean shipment, on average, takes twenty days, a shift from a twenty- day ocean shipment to a one-day air shipment can lower the price of a product by about 15 percent.

Water

Bulk shipping is important in international trade because it is one of the most practical and efficient means of transporting petroleum, industrial raw materials, and agricultural commodities over long distances. About 51 percent of the global bulk fleet consist of oil tankers, while dry bulk carriers account for 43 percent. The remainder of the fleet is made up of combination carriers which are capable of carrying either wet (crude oil and refined petroleum products) or dry (coal, iron ore, and gain) bulk cargoes. The bulk shipping industry, being highly fragmented, has no one organization which holds more than 2 percent of the total world fleet.

Quotations for ocean shipping may be obtained from a shipping company or a freight forwarder. Steamship rates are commonly quoted on weight and measurement. Goods are both weighed and measured, and the ship will use the method that yields a higher freight charge. Less-than-container shipments carry a higher rate than full-container shipments.

There are three basic types of shipping company: (1) conference lines, (2) independent lines, and (3) tramp vessels. An ocean freight **conference line** is an association of ocean carriers that have joined together to establish common rules with regard to freight rates and shipping conditions. Consequently, the operators in the group charge identical rates. The steamship conference has also adopted a dual rate system, giving a preferential treatment to contract exporters. A contract exporter agrees to ship all or a large portion of its cargo on a regular basis on vessels of conference member lines — in exchange for a lower rate than that charged for a noncontract shipper. Nevertheless, the contract exporter is allowed to use another vessel, after obtaining the conference's permission, when no conference service is available within a reasonable period of time.

An **independent line**, as the name implies, is a line that operates and quotes freight rates individually and independently without the use of a dualrate contract. Independent lines accept bookings from all shippers.When they compete with conference lines for noncontract shippers, they may lower their rates. In general, independent lines do not offer any special advantage for a contract shipper

because they do not have a significant price advantage. Furthermore, their services are more limited and not as readily available.

Finally, a **tramp vessel** is a ship not operating on a regular route or schedule; that is, tramp steamers do not have the established schedules of the other two types of carriers. Tramp vessels operate on a charter basis whenever and wherever they can get cargo. They operate mainly in carrying bulk cargoes.

In some circumstances, a shipper may not have an option on the vessel to be used. Due to certain laws enacted to protect a country's interests, mandatory use of a particular vessel is not uncommon. Brazil's shipping restrictions require goods imported for use by public or public-supported enterprises to be transported aboard vessels with a Brazilian flag. All exported Japanese automobiles must be shipped on Japanese-owned ships, and the same restriction applies to all tobacco leaf imported to Japan.

2. Cargo or transportation insurance

Inland carriers generally bear the responsibility for any damage to goods while in their possession. The same thing cannot be said for ocean carriers. Their reluctance to accept responsibility is due to the numerous unavoidable perils found at sea. Such perils include severe weather, seawater damage, stranding, fire, collision, and sinking. As a result, ocean carriers refuse to accept any liability for loss or damage unless a shipper can prove that they were purposefully negligent — a difficult task indeed. To protect against loss or damage and to avoid disputes with overseas buyers, exporters should obtain marine insurance.

Marine cargo insurance is an insurance that covers loss or damage at sea, though in practice it also applies to shipments by mail, air, and ship (see Figure 13.4). It is similar to domestic cargo insurance but provides much broader coverage. The purpose of this insurance is to insure export shipments against loss or damage in transit. The insurance may be arranged by either a buyer or seller, depending on the terms of sale.

There are two basic forms of marine insurance: (1) special (one-time) coverage and (2) open (blanket) coverage. A **special policy** is a one-time policy that insures a single specific shipment. Onetime insurance is relatively expensive because the risk cannot be spread over a number of shipments. Nevertheless, it is a practical insurance solution if a seller's export business is infrequent.

An **open policy** is an insurance contract issued to a firm in order to cover all its shipments as described in the policy within named geographic regions.The policy is open in the sense that it is continuous by automatically providing coverage on all cargo moving at the seller's risk. The policy is also open in the sense that the values of the individual shipments cannot be known in advance. Under this policy, no reports of individual shipments are required, although the insured must declare all shipments to the underwriter. The underwriter agrees to insure all shipments at the agreed rates within the terms and conditions of the policy. Open marine cargo policies are written only for a specified time period. A single premium is charged for this time period, based on the insured's estimated total value of goods to be shipped under the policy during the term of the contract.The contract has no predetermined termination date, though it may be cancelled by either party at any time. A firm can also insure profit through a valuation clause in the cargo policy, which insures exports and contains a fixed basis of valuation. The following is an example of a typical valuation clause in a marine policy: "Valued at amount of invoice, plus 10 percent."

3. Packing

Packaging may be viewed as consisting of two distinct types: industrial (exterior) and consumer (interior). Consumer packaging is designed for the purpose of affecting sales acceptance. The aim of industrial packaging is to prepare and protect merchandise for shipment and storage, and this type of packaging accounts for 7 cents of each retail dollar as well as 30 percent of total packaging costs.[10] Packing is even more crucial for overseas shipment than for domestic shipment because of the longer transit time and a greater number of hazards. Consumer packaging is covered extensively in Chapter 11 ; this section concentrates instead on industrial packaging.

Packing problems

There are four common packing problems, some of which are in direct conflict with one another: (1) weight, (2) breakage, (3) moisture and temperature, and (4) pilferage and theft.

Weight

Overpacking not only directly increases packing cost but also increases the weight and size of cargo. Any undue increase in weight or size only serves to raise freight charges. Moreover, import fees or customs duties may also rise when import duties are based on gross weight. Thus overprotection of the cargo can cost more than it is worth.

Breakage

Although overpacking is undesirable, so is underpacking, since the latter allows a product to be susceptible to breakage damage.The breakage problem is present in every step of ocean transport. In addition to normal domestic handling, ocean cargo is loaded aboard a vessel by use of a line (with several items together in a net), conveyor, chute, or other methods, all of which put added stress and strain on the package. Once the cargo is on the vessel, other cargo may be stacked on top of it, or packages may come into violent contact with each other during the course of the voyage. To complicate matters, handling facilities at an overseas port may be unsophisticated. The cargo may be dropped, dragged, pushed, and rolled during unloading, moving in and out of customs, or in transit to the final destination. In China, primitive methods (i.e., carts, sampans, junks, and so on) are used to move a great deal of cargo. Therefore, packing must be prepared to accommodate rough manual handling.

To guard against breakage, it may be desirable to use such package-testing equipment as vibration, drop, compression, incline-impact, and revolving drum. The cargo must not exceed the rated capacity of the box or crate. Attempts should be made to ensure that internal blocking and bracing will distribute the cargo’s weight evenly. Cushioning may be needed to absorb the impact. Cautionary markings, in words and symbols, are necessary to reduce mishandling due to misunderstanding.

One universal packing rule is “Pack for the toughest leg of the journey.” To accommodate this rule, cargo should be unitized or palletized whenever possible. **Palletizing** is the assembly of one or more packages on a pallet base and the securing of the load to the pallet. **Unitizing** is the assembly of one or more items into a compact load, secured together and provided with skids and cleats for ease of handling. These two packing methods force cargo handlers to use mechanical handling equipment to move cargo.

Moisture and temperature

Certain products can easily be damaged by moisture and temperature. Such products are subject to condensation even in the hold of a ship equipped with air-conditioning or dehumidifying equipment. Another problem is that the cargo may be unloaded in the rain. Many foreign ports do not have covered storage facilities, and the cargo may have to be left in the open subject to heat, rain, cold, and other adverse elements. In Morocco, bulk cargo and large items are stored in the open. Mozambique does the same with hazardous, bulk, and heavy items. Cargo thus needs extra strong packing, containerization, or unitization in order to afford some measure of protection under these conditions.

One very effective means of eliminating moisture is **shrink wrapping**, which involves sealing merchandise in a plastic film. Water proofing can also be provided by using waterproof inner lines or moisture-absorbing agents and by coating finished metal parts with a preservative or rust inhibitor. Desiccants (moisture-absorbing materials), moisture-barrier or vapor-barrier paper, or plastic wraps, sheets, and shrouds will also protect cargo from water leakage or condensate damage. Cargo can be kept away from water on the ground if placed on skids, pallets, or dunnage while having drain holes in crates.

There are several steps to ensure the proper way of packing to minimize moisture and breakage problems. These steps are as follows:

- ► Place water-barrier material on interior of sides and roof.
- ► Use vertical sheathing.
- ► Block, brace, and tie down heavy items.
- ► Use new, clear, dry lumber and provide adequate diagonals.
- ► Use multiple similar items.

► Use waterproof tape to seal fiberboard boxes.
► Palletize shipping bags.

Use proper gauge, type, and number of straps.

Containers

An increasingly popular method of shipment is containerization. The growth of the use of containers has been explosive. About 90 percent of the world's cargo now travels via containers.

A container is a large box made of durable material such as steel, aluminum, plywood, and glass reinforced plastics. A container varies in size, materials, and construction. Its dimensions are typically 8 ft high and 8 ft wide, with lengths usually varying in multiples of 10 ft up to a maximum of 40 ft. A container can accommodate most cargo but is most suitable for packages of standard size and shape. Some containers are no more than truck bodies that have been lifted off their wheels and placed on a vessel at the port of export. These containers are then transferred to another set of wheels at the port of import for inland movement. This type of container may be loaded on to a ship, or may become a barcar when placed on a railway flatcar, or may be made into a trailer when provided with a chassis. Containers are ordinarily obtained from either carriers or private parties.

Containers can take care of most of the four main packing problems. Because of a container's construction, a product does not have to have heavy packing. The container by itself provides good protection for the product against breakage, moisture, and temperature. Because breaking into a container is difficult, this method of shipment discourages pilferage and theft as well. In addition, containers have substantially reduced the average transit time of ocean-shipped goods.

It is important to select the right container because containers come in varying sizes and types.

There are two basic types of container: (1) *dry cargo containers*, and (2) *special purpose containers*. Some of the various types of dry cargo containers are end loading, fully closed; side loading, fully enclosed; and open top, ventilated, insulated. Special purpose containers come in different types for refrigerated, liquid bulk, dry bulk, flat rack, auto, livestock, and sea shed.

Topic 13. PROMOTION STRATEGIES: PERSONAL SELLING, PUBLICITY, AND SALES PROMOTION

Plan

1. Promotion and communication
2. Promotion mix
3. Personal selling

1. Promotion and communication

The purpose of promotion is both to communicate with buyers and to influence them. Effective promotion requires an understanding of the process of persuasion and how this process is affected by environmental factors. The potential buyer must not only receive the desired information but should also be able to comprehend that information.

Furthermore, the information must be sufficiently potent to motivate this buyer to react positively.

To communicate effectively with someone means that certain facts and information are shared in common with that person. **Communication** is basically a five-stage process consisting of source, encoding, information, decoding, and destination (see Figure 13.1). Encoding is a step that transforms the idea or information into a form that can be transmitted (e.g., written or spoken words). For a receiver to understand the coded information, that person must be able to decode these words.

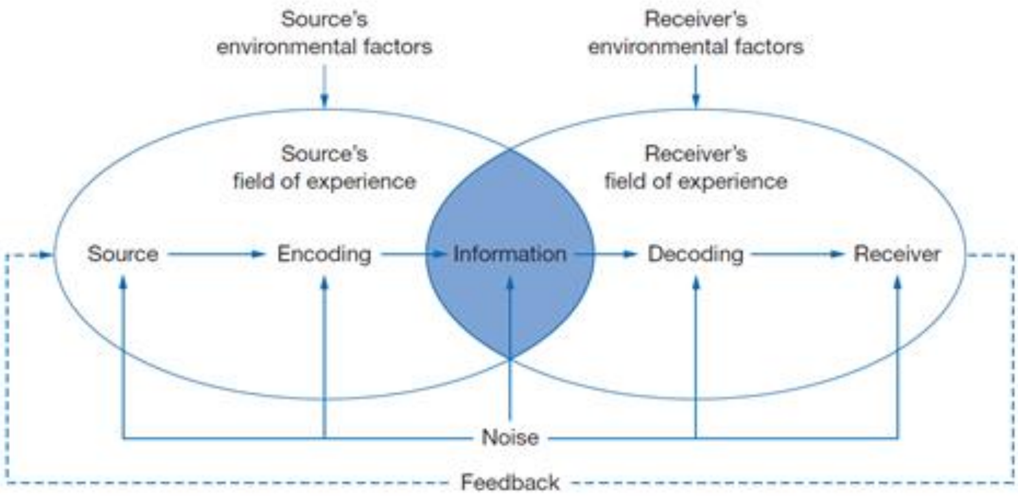

Fig. 13.1 **The process of communication**

The source can encode and the receiver can decode only through the experience each has had. The two large circles in Figure 14.1 represent the **fields of experience** of each party. If the two circles have a large common area, communication is relatively easy because both individuals have similar psychological and social attributes. Communication is more difficult if the overlapping area is smaller. This is often the case with international communication. If the circles do not meet, communication is likely to be impossible; that is, the sender and the receiver have nothing in common, and they therefore have an extremely difficult time understanding each other. Moreover, "**noise**" (interference) can easily affect any one of the five stages, making the effect on the communication difficult to predict. Thus the sender must be receiver oriented. The message must consist of information that the receiver can relate to, and the information must be encoded with relevant images and words common to the receiver's experience and language.

It is not sufficient for the receiver to be informed only by the message; the receiver must also be persuaded to accept the information and to act as suggested. A promotional message thus must be designed in such a way that the purchaser reacts favorably. Effective motivation requires that the principles of mass persuasion be followed.[1]

The first principle is that the message must reach a person's sense organs. This may sound simplistic, yet frequently the message sent is not received by the intended audience. To ensure reception, the message must gain the attention of the receiver. If the right media are not available or if the wrong message channel is used, the message may never get to the intended receiver. Furthermore, if the cue is not appealing, the receiver may never open his or her senses to the message due to a lack of interest. Note that what is interesting in one culture may not be so in another. A message that refers to historical events in a home country (e.g., July 4) may have little meaning in a host country.

The second principle requires that the message should not contradict a person's cultural norms. It is possible, though not probable, that a message that is not consistent with the receiver's beliefs may sometimes be potent enough to make the buyer reevaluate traditional beliefs. In most cases, such a message is likely to be rejected, discarded, or distorted. The effective promotional message is thus one that is accepted as part of the receiver's attitude and belief structure.

The third principle requires that the sender create a message that arouses the receiver's need and that suggests a particular action which will enable the receiver to achieve a desired goal. If the suggested action results in several goals being realized simultaneously, the potency of the message correspondingly increases. An advertiser should thus identify relevant needs and motives. Motives can differ greatly among countries, even when the same product is involved. Consider the automobile. American car buyers usually replace their automobiles every few years, and styling is important to them. A typical British car owner, however, is more likely to view the purchase as a long-term commitment, even though this perspective is also changing. For the Briton, the motive of functions in terms of durability outweighs the emotional appeal of styling.

The last principle suggests that the message must gain control of the receiver's behavior at the right place and time. The message should offer a well- defined path to reach the goal. If the purchaser is placed in a situation requiring action, the chances are increased that the buyer will take the suggested action

2. Promotion mix

To communicate with and influence customers, several promotional tools are available. Advertising is usually the most visible component of promotion, but it is not the only component. The promotion mix also consists of three other distinct but interrelated activities: personal selling, publicity, and sales promotion.

The four promotional components are not mutually exclusive, and it can be difficult at times to determine which one of the four activities a particular promotional tool may be. Consider the common trade fair. Promotion for a trade fair may be viewed as advertising because a fair sponsor, as well as participating companies, generally uses direct mail and newspapers to advertise the event. Since the media receive both advertising orders and news releases, they may be willing to provide free publicity for the fair as well. Furthermore, staffing at a display booth is necessary, and there will be plenty of opportunity for a company's representative to use personal selling to make sales. Finally, it is not uncommon for fair participants to offer free gifts and special prices during the display, and these techniques are classified as sales promotion tools. This chapter concentrates on personal selling, publicity, and sales promotion.

3. Personal selling

According to the American Marketing Association, personal selling is an "oral presentation in a conversation with one or more prospective purchasers for the purpose of making sales." Personal selling, also commonly known as salesmanship, is used at every distribution level. The cost of personal selling is high. One extreme case is German software maker SAP, the world's leader in applications packages for client-server networks. In the USA, SAP America has removed the $140,000 annual limit on sales commissions, making it possible for a salesperson to earn as much as $2 million a year — more than what the company's top German executives make.

In spite of the high cost, personal selling should be emphasized when certain conditions are met.

Industrial buying or large-volume purchases, characterized by a large amount of money being involved, justifies personal attention. Personal selling has also proven to be effective when the market is concentrated or when a salesperson must develop a measure of confidence in the customer for the purchase. The effectiveness of personal selling is also a function of product type. In general, personal selling works well with high-unit value and infrequently purchased products. Such products usually require a demonstration, are custom-made or fitted to an individual's needs, or involve trade-ins.

Note that not all salespersons are directly involved in selling. So-called missionary salespersons, for example, have the task of educating potential buyers about product benefits and promotional campaigns in order to create the goodwill that may result in subsequent sales. When Foremost first introduced milk and ice cream products to the Thai market in 1956, the company sent sales representatives (missionary salespersons) to educate people by giving talks on sanitation and nutrition in schools and by providing free samples to students.

Personal selling vs. advertising

Personal selling is similar to advertising in the sense that both aim to create sales and that both must be understandable, interesting, believable, and persuasive. However, advertising differs from personal selling in several aspects. Advertising relies on a non-personal means of contact and sales

presentation. When compared to advertising, personal selling commands a much larger share of aggregate promotional dollars and accounts for several times more in terms of the number of personnel. This relationship exists in all countries. In fact, the abundant labor supply in developing countries makes it easy and inexpensive to employ sales personnel. Shoplifting problems also necessitate the use of personal selling, making self-selection and self-service relatively rare.

The differences between advertising and personal selling may also be contrasted in terms of the communication process. Advertising is a one-way communication process that has relatively more “noise,” whereas personal selling is a two-way communication process with immediate feedback and relatively less “noise.” Controlling the message is more difficult in personal selling than in advertising because salespersons may react to unforeseen situations in such a way that may differ from the company’s policy. Yet advertising is usually less persuasive because advertisements are prepared in advance by those with minimal contact with customers and because the message must be kept simple to appeal to a large number of people. Personal selling, on the other hand, is more flexible, personal, and powerful. A salesperson can adapt the message to fit the client at the time of presentation, and stimuli can be presented to appeal to all five senses.

Varying quality and style of personal selling

The quality of personal selling varies widely from product to product, from employer to employer, and from one target group to another. In general, salespersons selling for manufacturers are better trained and more qualified than those working for wholesalers and retailers. In terms of the target market, salespersons who sell to industrial users are more likely to be “order getters” and are generally aggressive, well trained, and well informed. Industrial salespeople, receiving high compensation, must be capable of mixing easily with top management.

Those selling to wholesalers, retailers, and consumers have a more routine selling job, and these salespeople are “order takers” and generally less aggressive in securing new business. Expensive products require a higher quality of personal selling than do low-unit value, high-turnover products.

Personal selling is not viewed as a prestigious occupation in most countries. It is often taught in trade schools or vocational schools rather than in colleges, and thus the quality of personal selling outside the USA is far from exemplary. In Brazil, for example, salespeople are not very well trained by US standards.

Selling styles differ significantly. In Japan, employers are agreeable to the practice of having salespeople call on their employees at the workplace. Japanese salespeople sell cars door-to-door. Subaru went one step further. With its image as a vehicle for outdoor types, Subaru equipped its door-to-door salespeople with Sportsman's Guide catalogs. Sportsman's Guide, a US firm selling a proprietary line of sporting goods and accessories, was optimistic about this unique distribution channel.

Intercultural negotiation

Successful negotiations require some understanding of each party's culture and may also require adoption of a negotiation strategy that is consistent with the other party's cultural system. One strategy is to rely on stereotyping. It is possible, for example, to use stereotyped preconceptions to identify the personality traits of negotiators from different ethnic groups or countries. Although stereotyping allows an easy label, it is also risky because generalization may lead one to believe that members of the group must share the same traits. These prejudices, if believed, may affect business negotiations and their outcomes.

International marketers are interested in the effects of cultural adaptation on intercultural communication. Studies should be conducted to identify conditions that make it desirable for businesspeople to adapt their behavior in response to the culture of the other party.

Motivation

Like other employees, salespeople need to be motivated. In many countries, Western firms find it difficult to retain and motivate salespeople. The concept of individual recognition of sales representatives is at odds with Japan's team approach to business and its aversion to a compensation system that pays for performance. In Saudi Arabia, where selling is considered an undesirable occupation, qualified local sales representatives are hard to find due to a labor shortage. Because of India's various languages and social caste system, it is difficult for sales representatives to sell outside their own social level. In Brazil, the determination of sales force compensation and product pricing is affected by rampant inflation and national labor laws. It is thus a problem to pay someone less than the amount paid the previous year.

Based on a representative sample of the labor force in seven countries regarding what individuals seek from working, the two most dominant work goals are "interesting work" and "good pay," and these goals are consistent internationally, across different organizational levels, between the genders and among different age categories. Although wage level has some explanatory value in predicting the compensation ratio, culture is a predominant factor that influences certain compensation patterns.[5] One study found that industrial salespeople's perceptions of organizational fairness varied across the USA, Japan, and Korea.

Telemarketing

Personal selling does not always require a face-to- face conversation. For instance, personal selling may be done over the telephone. Although telephone selling has been in existence for a considerable period of time, the growth of the direct marketing field has pushed this method of selling to the forefront. This marketing practice, now known as **telemarketing**, has become very popular among sellers — but not necessarily with consumers, who feel they are being inundated with such calls. Because of the effective lobbying of telemarketing firms, US lawmakers have been reluctant to pass laws restricting the use of telemarketing. As part of the lobbying effort, the firms pointed out that legislators' own fund-raising efforts would be impede by the proposed restrictions.

Expatriate personnel

One controversial subject for which there is no definite solution is the nationality of the salespeople to be used in a market abroad. Some marketers argue for the use in a foreign market of expatriate salespeople, or those from the home country. Others take the opposite point of view by contending that the best policy is to use local nationals or those salespeople who were born in the host country. According to one study, the higher the interdependence between a branch office and headquarters, the more US nationals are employed in overseas operations to manage the inherent uncertainty.[8] However, though managerial behaviors are related positively to job performance for managers in the USA, they were not related to job performance for American expatriate managers in Hong Kong or job performance for Hong Kong Chinese managers.

Not only must an expatriate cope with new business conditions, but the expatriate's family must also share in the burden of making social adjustments. Life can be difficult both physically and psychologically for those who are unable to make the necessary adjustments for an assignment that requires a lengthy relocation overseas. The expatriate may have second thoughts about accepting such an assignment, fearing that the distance from headquarters may eliminate chances for promotion or that the company may want to keep him or her abroad. Moreover, an overseas assignment may not be easy for American salespeople and their spouses because they may become frustrated with shopping for schooling, and the limited entertainment opportunities. Some may be driven by the boredom and frustration and may initiate an affair or begin to drink excessively. It is thus crucial that the personnel for overseas assignments be selected carefully. In fact, their families should also be interviewed to determine the suitability of their temperament for an overseas assignment.

Topic 14. PROMOTION STRATEGIES: ADVERTISING

Plan

1. The role of advertising
2. Patterns of advertising expenditures
3. Advertising and regulations
4. Advertising media

1. The role of advertising

Developing and socialist/communist countries, emphasizing production and distribution efficiency, usually attack advertising as a wasteful practice whose primary purpose is to create unnecessary wants. Yet advertising serves a very useful purpose - consumers everywhere, irrespective of their countries' political systems and level of economic development, need useful product information.

Many of the largest advertisers in the USA also advertise heavily overseas. Procter & Gamble and General Motors, for example, are among the largest advertising spenders in France and Canada. Local firms in markets outside the USA often view this kind of expenditure as an unfair trade practice. They fear that American firms could easily overwhelm local firms in terms of advertising dollars.

2. Patterns of advertising expenditures

In one study, advertising-to-sales ratios varied across fifteen countries, ranging from 0.95 for Yugoslavia to 7.62 for Australia. These ratios were not related to population size, number of directly competing brands within the firm, or number of directly competing brands outside the firm.

Advertising expenditures vary widely from industry to industry. Mars allocates 5 percent of the company's total sales to advertising. Manufacturers of dolls and stuffed toys maintain an advertising-to-sales ratio of more than 15 percent. On the other hand, manufacturers of certain nonconsumer goods (e.g., industrial machinery and equipment and agricultural chemicals) do not advertise very much, spending perhaps less than 0.5 percent of their total sales.[4]

The relationship between advertising expenditure and sales generated has been well documented. Certain variables determine the size of the advertising budget as well as the size of the overall marketing budget. According to the well-publicized ADVISOR models, the size of an advertising budget is a function of: sales (+), number of users and other participants (+), customer concentration (-), fraction of sales made to order (-), stage in life cycle (-), and product plans (+).The size of a marketing budget is a function of: prospect-customer attitude differences (-), proportion of direct sales (+), and product complexity (-). It should be pointed out that the importance of particular predictor variables is not uniform across countries.

It is important to note variations in the different types of marketing expense - when expressed as a percentage of sales - across countries and product categories. The variations in the marketing expense ratios indicate that executives should be careful when they approach advertising budget decisions in other cultures.

3. Advertising and regulations

Advertising can be affected by local regulations in several ways. The availability of media (or the lack of it) is one example. When and how much media time and space are made available, if at all, is determined by local authorities. Belgium prohibits the use of electricity for advertising purposes between midnight and 8 a.m. German laws regulate TV advertising contents and limit advertising on the national TV channels to twenty minutes a day, forcing advertisers to switch from state-run TV to private channels. Greece and South Korea ban the erection of new signs. Furthermore, nationalism may intrude in the form of a ban on the use of foreign languages and materials in advertising.

The advertising industry may have a local selfregulatory organization which regulates the style and content of promotional activities. As in the case of England, the Committee of Advertising Practice has issued new codes which require all nonbroadcast advertisements to be “legal, decent, honest and truthful.”[5] For instance, no medium may be used to advertise alcoholic drinks if more than 25 percent of the audience is aged under eighteen years. Children should not be encouraged to eat or drink at bedtime or to replace main meals with confectionery or snack foods. Regarding motor vehicles, speed or acceleration should not be the predominant message, and cars on public roads must not be shown to exceed speed limits. Those selling treatment of minor addictions and bad habits must acknowledge the vital role of willpower.

The legitimacy of comparative advertising has not been fully settled in many countries. Certain products are banned altogether from certain media, or from advertising in certain countries.

A number of countries have complete bans on cigarette advertising. Interpreting the law creatively, R.J. Reynolds attempted to circumvent Norway’s ban on cigarette advertising by advertising “Camel boots” instead. The advertisement used the same model, trademark, and lettering in the word Camel as those used in Camel’s cigarette advertisements. After a protest, the advertisement was eventually withdrawn. Advertisements in France are limited to a picture of a cigarette package with no “seductive imagery.” To overcome this restriction, cigarette makers create products such as Marlboro cigarette lighters and Pall Mall matches that are purposefully made to resemble cigarette packages because there is no restriction on how such products may be advertised. In Sudan, Philip Morris advertised by having the Marlboro cowboy hold a Marlboro lighter.

4. Advertising media

International advertising is the practice of advertising in foreign or international media when the advertising campaign is planned, directly or indirectly, by an advertiser from another country. To advertise overseas, a company must determine the availability (or unavailability) of advertising media. Media may not be readily available in all countries or in certain areas within the countries. Furthermore, the techniques used in media overseas can be vastly different from those employed in the USA.

Television

In most countries, television is not available on a nationwide basis due to the lack of TV stations, relay stations, and cable TV. Color television, for the poor, is a rarity. Nevertheless, the viewing habits of people on a lower income should not be underestimated because of the “group viewing” factor. For example, a TV set in a village hall can attract a large number of viewers, resulting in a great deal of interaction among the villagers in terms of conversation about the advertised products.

In many countries, TV stations are state controlled and government operated due to military requirements. As such, the stations are managed with the public welfare rather than a commercial objective in mind. The programming and advertising are thus closely controlled. The programs shown may vary widely and are usually dubbed in the local languages. European governments particularly abhor the US private broadcast model with its degenerate mass programming. More recently, however, European restrictions have been reduced on featuring films with frequent interruptions from advertisements. The reduction is due in part to an attempt by European countries such as France to end the government monopoly on media and to privatize the broadcast business by making available private broadcasting franchises.

Commercial TV time is usually extremely difficult to buy overseas. This is true even in Europe and Japan, where television is widespread. The usual practice in Tokyo is to use TV advertising to bombard the market, but the challenge for the marketer is to get air time. There are several reasons why television advertising time is severely limited. Many countries have only a few TV channels, which may not schedule daytime television or late-night programs. With less broadcast time comes less advertising time. Some countries do not allow program sponsorship other than spot announcements. Belgium, Denmark, Norway, and Sweden ban advertising on television altogether. Some governments permit advertising only during certain hours of operation. In Germany, advertising on television is permitted only between 6.15 and 8 p.m. (except for Sundays and holidays) for a total advertising time available of twenty minutes. That same number of commercial minutes also applies to Switzerland. The problem of getting a fraction of the available television time was so severe for Unilever that the firm had to make adjustments in media strategy by relying more on other media. In most countries, the situation is such that an advertiser is fortunate to get air time at all.

Topic 15. PRICING STRATEGIES: BASIC DECISIONS

Plan

1. The role of price
2. Price standardization
3. Pricing decisions
4. Alternative pricing strategies

1. The role of price

Price is an integral part of a product — a product cannot exist without a price. It is difficult to think or talk about a product without considering its price. Price is important because it affects demand, and an inverse relationship between the two usually prevails. Price also affects the larger economy because inflation is caused by rapid price increases. Yet among the marketing decision variables, price has received the least attention. "The export-pricing literature is characterized by a distinct lack of sound theoretical and empirical works."

Price, however, is no more important than the other three Ps. One should not forget that price should never be isolated from the other parts of the marketing mix. Price should never be treated as an isolated factor.

Price is often misunderstood, especially by many executives. Consumers do not object to price. What they object to is the lack of a relationship between the perceived value of the product and the price being charged. They want a fair price, and a fair price can be either high or low as long as it reflects the perceived value of the product in question. Too high a price causes consumers to resist making a purchase because the value is not there.

Price can be absolutely high from a cost standpoint yet relatively low from a demand standpoint, in relation to its value and other features. Therefore, price must be lower than the perceived value or exactly reflect the perceived value. For example, a markdown may be needed for damaged or obsolete goods, but a "high" price may appear to be quite reasonable when extra value is added to a product. Consumers around the world do not mind a high price if they indeed "get what they pay for." However, this is often not the case.

2. Price standardization

One area of pricing that has received some attention is the issue of pricing standardization. A study of the marketing mix by large US-based industrial firms in their Latin American businesses found that the degree of standardization varied across individual elements, with branding and product being least adapted. Perhaps because of government regulations, price and advertising elements were most adapted. In comparison with the same firms' European and Latin American strategies, price was similarly adapted in both regions.

According to one study, most American multinational firms standardize their prices in most world markets because they are probably cost driven. Due to market variations, one has to wonder why these firms are inflexible and whether they have been successful overseas. Perhaps these firms have been able to be rigid due to the fact that they do not rely on foreign sales very much and that they do business primarily with industrialized countries. In contrast, those companies that are more committed to international business localize their prices and are more successful overseas.

Whether price should be uniform worldwide is a subject of much debate. One school of thought holds that, from the management's viewpoint, there is no reason for an export price to differ from the home price. In addition, economists believe that arbitrage will eliminate any price differential between markets. This is especially the case with the European Union due to the free movement of goods, the elimination of customs barriers, and the harmonization of VAT rates. In addition, the free movement of people will enable them to easily observe prices of the same products in neighboring countries. As a result, internationally recognized consumer goods with wide European distribution are likely to have a more uniform pricing system.

3. Pricing decisions

Pricing is one area of marketing that has been largely overlooked. Of the four Ps of marketing, pricing is probably the one that receives the least attention, especially in an international context.

One problem with an investigation of pricing decisions is that theories are few and vague. Most of the theories that do exist reduce the large number of pricing variables to a discussion of demand and supply. Because the few theories are inadequate, many pricing decisions are based on intuition, trial and error, or routine procedures (e.g., cost-plus or imitative pricing).

When pricing a product, a company must consider a number of factors. The factors of cost and supply are always relevant — domestically and internationally. Other factors such as exchange rate, tariffs, and culture are more applicable in the case of international marketing.

Supply and demand

The law of supply and demand is a sound starting point in explaining companies' price behavior. A common practice is to reduce the large number of pricing factors to two basic variables: demand and supply. In an efficient, market-oriented economy, demand is affected by competitive activity, and consumers are able to make informed decisions. Price, as a measure of product benefit, acts as the equilibrator of supply and demand. On the supply side, suppliers compete for consumers' limited funds by constantly cutting costs and enhancing product value. On the demand side, any increase in demand is followed by a higher price, and the higher price should in turn moderate demand. The higher price, however, usually induces manufacturers to increase the supply, and more supply should lead to a reduction in price which will then stimulate demand once again.

The demand-supply model of pricing seems to work best with commodities under a monopoly situation. OPEC, an oil cartel, once controlled the supply of oil so tightly that the cartel was able to push oil prices up sharply.

However, this pricing model based strictly on demand and supply is oversimplified. The straightforward relationship between supply and price can be affected by several factors. Numerous products have been so differentiated that supply alone as a factor is essentially irrelevant. If a product has a distinct, prestigious image, price may become secondary in importance to image. For such a product, supply can be reduced and price increased without curtailing demand. Waterford Glass became the bestselling fine crystal in the USA by carefully nurturing its “posh image” as well as by controlling the supply. Waterford held down volume while maintaining premium prices. According to the company, there is no advantage in owning a product that anyone can buy.

Because demand-and-supply analysis can only broadly explain companies’ price behavior, it is necessary to consider other relevant factors that affect demand or supply or both, and that ultimately influence pricing decisions.

Cost

In pricing a product, it is inevitable that cost must be taken into account. British Airways at one time blindly matched the competition’s prices without carefully considering its cost structure. By instituting carefully considered restrictions on discount seats, the company was able to increase its yield significantly.

The essential question is not whether cost is considered but rather what kind of cost is considered and to what extent. The typical costs associated with international marketing include: marketing research; credit checks; business travel; international postage, cable, and telephone rates; translation costs; commissions, training charges, and other costs involving foreign representatives; consultants and freight forwarders; product modification; and special packaging.

For one school of thought, the thinking is that export price should be lower than home price because the home market actually gains in its overhead expenses by spreading these costs over an expanded production volume. Furthermore, a low price may be necessary, at least at the beginning, to penetrate a foreign market.

The second school of thought, however, argues that the **cost-plus method** (i.e., **full cost**) should be used in pricing a product for the overseas market. All costs — including domestic marketing costs (e.g., sales and advertising expenses, marketing research costs) and fixed costs (e.g., research, development, and engineering) — must be paid for by all other countries. As such, the company begins with a domestic price and then adds to its various overseas costs (e.g., freight, packing, insurance, customs duties).

A number of international marketers use **marginal-cost pricing**, which is more polycentric and decentralized. This pricing method is oriented more toward incremental costs. An implicit assumption is that some of the product costs, such as administration costs and advertising at home, are irrelevant overseas. In addition, it is likely that research- and-development costs and engineering costs have already been accounted for in the home market and thus should not be factored in again by extending them to other countries.

Elasticity and cross-elasticity of demand

Because of the elasticity and cross-elasticity of demand, a company does not usually have the option of changing or holding its price steady, independent of action taken by its competitors. Ford, thinking that its number-one position in England was insurmountable, moved unilaterally to end price wars by eliminating discounts and incentives. This action proved to be a strategic error because competitors did not follow suit, and Ford's dominant market share dropped from 32 percent to 27 percent. Always remember that it takes only one company to start or continue a price war.

To be competitive does not mean that a company's price must be at or below the market. A superior or unique product can command a higher price. US beef, generally from grain-fed cattle, sells better in Japan than does low-priced Australian and New Zealand beef because cattle in those countries are raised on grass and yield leaner meat. A product with a desirable image can also hold its price above the market. This has always been Sony's strategy, and Sony has stayed away from price wars that may damage its image. But Sony has on occasion been forced to lower prices when, as a result of competitors' price cuts, the price gap between it and other competitors has widened too far.

A company can insulate itself against cutthroat pricing to a certain extent by cultivating a unique and desirable image. A prestigious image allows a firm to act more or less as a monopolist and to gain additional pricing freedom.

Exchange rate

One pricing problem involves the currency to be used for billing purposes. As a rule, a seller should negotiate to bill in a strong currency, and a buyer should try to gain acceptance in a weak currency. European firms can also minimize exchange risk by using euros in place of an individual currency for quotation and billing.

The exchange rate is one factor that generally has no impact in domestic marketing but is quite crucial in international marketing.

The real issue is the relationship between import prices and prices for domestically produced competitive goods. These exchange rate/price relationships are basic in measuring the impact of an exchange rate change on countries' actual trade balances.

Market share

A high market share provides pricing flexibility because the company has the advantage of being above the market if it so chooses. The company can also choose to lower its price because of the better economies of scale derived from lower production and marketing costs. Market share is even more crucial for late entrants because market share acts as an entry barrier. That is, without market share, a company cannot achieve the high volume necessary to improve its efficiency.

Market share can be bought with a very low price at the expense of profit.

Various hypotheses explain the differences in pricing behavior between US and Japanese firms, and they range from the dollar's dominant international role and the substantial market power of US goods to the large size of the US domestic market, which permits insensitivity to exchange rate fluctuations. Another explanation is a model based on differences in planning horizons and hystereses

Tariffs and distribution costs

As a rule, when dumping and subsidies are not involved, a product sold in a host country should cost more than an identical item sold in a manufacturer's home market. This is the case because the overseas price must be increased to cover tariffs and extra distribution costs. In Japan, both tariffs and quotas combine to restrain imports and force the prices of imported goods upward. In addition, the long distribution channel (i.e., many middlemen) common in many countries around the world is responsible for price escalation, often without any corresponding increase in distribution efficiency. Foreigners in Japan may be shocked to find that an order of plain toast (without coffee) can cost a few dollars.

Culture

US manufacturers should keep in mind that neither the one-price policy nor the suggested list price will be effective in a number of countries. In the USA, a common practice is for retailers to charge all buyers the same price under similar buying conditions. In most other countries, a flexible or negotiated price is common practice, and buyers and sellers often spend hours haggling about price. Thus, price haggling is an art, and the buyer with the superior negotiating skills is expected to

4. Alternative pricing strategies

Pricing involves more than simply marking up or down, and a price that can change in terms of an increase or decrease is not the only answer to moving a product. There are several other alternatives available for making price changes that should be considered. These strategies include the timing of the price change, number of price changes, time interval to which price change applies, number of items to change, use of discount and credit, and bundling and unbundling. US car makers have become rather ingenious in employing these strategies. They change the price by small amounts a number of times over the year. By increasing price significantly at the end of the current model year and then doing so again for the new model year one month later, the company can claim that the price increase for the new model is small because the calculation of the increase is based on the last price of the current year's model. Not surprisingly, GM saves the heftiest price increase for the end of the year in order to facilitate high sticker prices on the new models that are shortly introduced.

The effect of price can be masked and greatly moderated by *financing* or *credit terms.* Airbus, a European consortium owned jointly by four companies from France, Germany, the United Kingdom, and Spain, assembles and markets airplanes as an alternative to carriers that prefer not to buy American. In its eagerness to penetrate the US market, the consortium provided export financing that subsidized Eastern Air Lines by more than $100 million. For Boeing, the consortium engaged in predatory export financing just to get sales.

Discounts (cash, quantity, functional, and so on) may be used to adjust prices indirectly. Large buyers are in a position to command a higher discount if it can be granted legally. Although a quantity discount may provide an incentive for dealers to work harder, it often discriminates against smaller middlemen. Ricoh, concluding that it was not a sound practice to compete on price, decided to ignore tiered pricing that rewarded dealers with large orders. Ricoh uses only flat-rate prices, and small dealers pay the same price as large dealers.

Another method used to moderate the price effect is to *bundle* or *unbundle* the product. The price reflects the bundling or unbundling of the product. Bundling adds value and increases prices a little or not at all for added value. This is the strategy used by Japanese car makers, who increase the base price of their cars just enough to cover actual costs. The Japanese also sell cars in the USA with more standard equipment and fewer options. The strategy makes sense because their vehicles must be shipped from overseas factories, and any custom orders would only serve to delay production and shipment. Moreover, the price charged covers a “bundle” of standard equipment and represents good value for buyers.

Topic 16. PRICING STRATEGIES: COUNTERTRADE AND TERMS OF SALE/PAYMENT

Plan

1. Countertrade

Types of countertrade

Problems and opportunities

2. Price quotation

1. Countertrade

Countertrade, one of the oldest forms of trade, is a government mandate to pay for goods and services with something other than cash. It is a practice which requires a seller, as a condition of sale, to commit contractually to reciprocate and undertake certain business initiatives that compensate and benefit the buyer. In short, a goods-for-goods deal is countertrade.

Unlike monetary trade, suppliers are required to take customers' products for their use or for resale. In most cases these are multiple deals that are separate yet related, and a contract links these separable transactions. Countertrade may involve several products, and such products may move at different points in time while involving several countries. Monetary payments may or may not be part of the deal.

There are three primary reasons for countertrade: (1) countertrade provides a trade financing alternative to those countries that have international debt and liquidity problems, (2) countertrade relationships may provide developing countries and MNCs with access to new markets, and (3) countertrade fits well conceptually with the resurgence of bilateral trade agreements between governments. The advantages of countertrade cluster around three subjects: market access, foreign exchange, and pricing. Table 16.1 lists potential motives for countertrade.

Table 16.1. **Potential motives for countertrade**

	Types of countertrade				
	BT[1]	CA/ST[2]	CP[3]	BB[4]	OF[5]
Avoids using foreign exchange	Yes	Yes	No	Rarely	No
Avoids repayment of external debt	Yes	Yes	No	No	No
Hides price discounts	Yes	Yes	No	No	No
Shifts risk	Yes	Yes	Yes	Yes	Sometimes
Substitute for foreign direct investment	No	No	Yes	Yes	Yes
Political factors dominant	No	Yes	No	No	Yes

Notes
1 BT Barter
2 CA/ST Clearing arrangement/switch trading
3 CP Counterpurchase
4 BB Buyback
5 OF Offset

Countertrade offers several advantages. It moves inventory for both a buyer and a seller. The seller gains other benefits, too. Other than the tax advantage, the seller is able to sell the product at full price and can convert the inventory to an account receivable. The cash-tight buyer that lacks hard currency is able to use any cash received for other operating purposes.

Countertrade constitutes an estimated 5 to 30 percent of total world trade. Perhaps the single most important contributing factor is LDCs' decreasing ability to finance their import needs through bank loans.

Noncash transactions, by substituting for trade and bank credit, help firms to survive in a credit- constrained environment. In the case of time-lagged nonmonetary deals, an enterprise essentially enjoys a credit from its partner because a payment does not have to be made until later. Even in the case of a spot barter, a seller is forced to accept either goods now or money later, being mindful of the fact that "later" may turn out to be "never." This artificial demand allows goods to be produced by the old style, inefficient enterprises that should have gone out of business.

Because of the nontransparent nature of countertrade, there are implicit subsidies from the state in the form of tax offsets which amount to tax discounts. Because barter prices are arbitrary, tax evasion is facilitated. In addition, by allowing inefficient enterprises to remain, countertrade acts as an entry barrier for new firms. There is a vicious cycle: barter makes it harder to screen firms and monitor their performance. As their access to bank credit is further reduced, they have to barter even more.

Types of countertrade

There are several types of countertrade, including barter, counterpurchase, compensation trade, switch trading, offsets, and clearing agreements. Figure 16.1 provides a classification of countertrade.

Barter

Barter, possibly the simplest of the many types of countertrade, is a one-time direct and simultaneous exchange of products of equal value (i.e., one product for another). By removing money as a medium of exchange, barter makes it possible for cash-tight countries to buy and sell. Although price must be considered in any countertrade, price is only implicit at best in the case of barter. For example, Chinese coal was exchanged for the construction of a seaport by the Dutch, and Polish coal was exchanged for concerts given by a Swedish band in Poland. In these cases, the agreement dealt with how many tons of coal were to be given by China and Poland rather than the actual monetary value of the construction project or concerts. It is estimated that about half of US corporations engage in some form of barter, primarily within the local markets of the USA.

Counterpurchase (parallel barter)

Counter purchase occurs when there are two contracts or a set of parallel cash sales agreements, each paid in cash. Unlike barter, which is a single transaction with an exchange price only implied, a counter purchase involves two separate transactions — each with its own cash value. A supplier sells a facility or product at a set price and orders unrelated on non-resultant products to offset the cost to the initial buyer. Thus the buyer pays with hard currency, whereas the supplier agrees to buy certain products within a specified period.

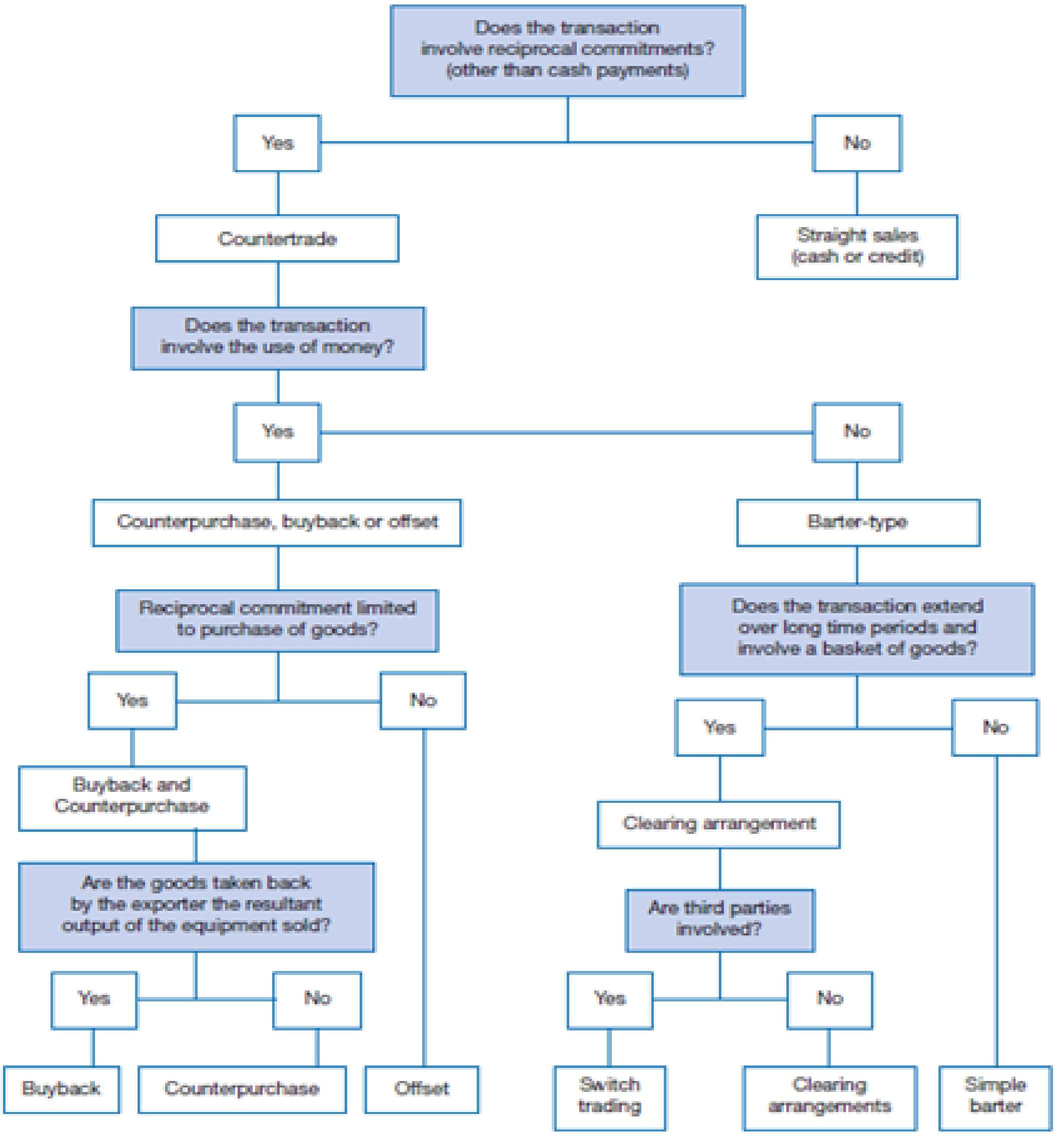

Fig. 16.1 **Classification of forms of countertrade**

Compensation trade (buyback)

A compensation trade requires a company to provide machinery, factories, or technology and to buy products made from this machinery over an agreed period. Unlike counter purchase, which involves two unrelated products, the two contracts in a compensation trade are highly related. Under a separate agreement to the sale of plant or equipment, a supplier agrees to buy part of the plant's output for a number of years. For example, a Japanese company sold sewing machines to China and received payment in the form of 300,000 pairs of pajamas. Russia welcomes buyback.

Switch trading

Switch trading involves a triangular rather than bilateral trade agreement. When goods, all or part, from the buying country are not easily usable or saleable, it may be necessary to bring in a third party to dispose of the merchandise. The third party pays hard currency for the unwanted merchandise at a considerable discount. A hypothetical example could involve Italy having a credit of $4 million for Austria's hams, which Italy cannot use. A third-party company may decide to sell Italy some desired merchandise worth $3 million for a claim on the Austrian hams. The price differential or margin is accepted as being necessary to cover the costs of doing business this way. The company can then sell the acquired hams to Switzerland for Swiss francs, which are freely convertible to dollars.

Offset

In an offset, a foreign supplier is required to manufacture/assemble the product locally and/or purchase local components as an exchange for the right to sell its products locally. In effect, the supplier has to manufacture at a location that may not be optimal from an economic standpoint. Offsets are often found in purchases of aircraft and military equipment. One study found that more than half of the companies countertrading with the Middle East were in the defense industry and that the most common type of countertrade was offset. These companies felt that countertrade was a required element in order to enter these markets.

Clearing agreement

A clearing agreement is clearing account barter with no currency transaction required. With a line of credit being established in the central banks of the two countries, the trade in this case is continuous, and the exchange of products between two governments is designed to achieve an agreed value or volume of trade tabulated or calculated in nonconvertible "clearing account units." For example, the former Soviet Union's rationing of hard currency limited imports and payment of copiers. Rank Xerox decided to circumvent the problem by making copiers in India for sale to the Soviets under the country's "clearing" agreement with India. The contract set forth goods, ratio of exchange, and time length for completion. Any imbalances after the end of the year were settled by credit into the next year, acceptance of unwanted goods, payment of penalty, or hard currency payment. Although nonconvertible in theory, clearing units in practice may be sold at a discount to trading specialists who use them to buy saleable products.

Although countertrade is a common and growing practice, it has been criticized on several fronts. First, countertrade is considered by some to be a form of protectionism that poses a new threat to world trade. Such countries as Sweden, Australia, Spain, Brazil, Indonesia, and much of Eastern Europe demand reciprocity in order to impose a discipline on their balance of payments. In other words, imports must be offset by exports. Indonesia links government import requirements in contracts worth more than Rp. 500 million to the export of Indonesia products, other than oil and natural gas, in an equivalent amount to the foreign-exchange value of the contract.

Second, countertrade is alleged to be nothing but "covert dumping." To compensate any supplying partners for the nuisance of taking another product as payment, a countertrading country frequently trades its products away at a discount. If the countertrading country discounts directly by selling its goods itself in another market instead of through a foreign firm, dumping would clearly occur, but, according to an International Trade Commission study, the practice does not seem to be harmful to the USA. Countertrade activity actually results in US exports always greatly exceeding the value of imports. Thus it would appear that many products which US firms agree to take from their customers for overseas marketing are not dumped back on the US market.

Third, countertrade is alleged to increase overhead costs and ultimately the price of a product. Countertrade involves time, personnel, and expense in selling a customer’s product — often at a discount. If another middleman is used to dispose of the product, a commission must also be paid. Because of these expenses, a selling company has to raise the price of the original order to compensate for such expenses as well as for the risk of taking another product in return as payment. The fact that the goods are saleable - either for other goods or, in the end, for cash somewhere else - means that additional and probably unnecessary costs will be incurred. As explained by Fitzgerald, “Countertrade requirements, like any trade restrictions, increase the cost of doing business. These costs cannot be passed into the international market but must be borne within the country imposing the requirements.”

2. Price quotation

A quotation describes a specific product, states the price for that product as well as a specified delivery location, sets the time of shipment, and specifies payment terms. When a company receives an inquiry from abroad, the quotation must be very detailed in terms of weight, volume, and so on because of the customer’s unfamiliarity with foreign products, places, and terms. Since the time of shipment is crucial, the prepared quotation should specify whether the time mentioned is from the factory or the port of export and whether it includes the estimated inland transit time. Furthermore, price quotations should state explicitly that they are subject to change without notice. It is a good idea to specify the precise period during which a specific price or offer remains valid.

Because it is often requested by a buyer, a **pro forma invoice** may have to be prepared and supplied with or instead of the quotation. Even when it is not requested, it is still good business practice to include it with any international quotation. This type of invoice is not for payment purposes; it is essentially a quotation in an invoice format. The buyer uses it to apply for an import license or to arrange for funds. A pro forma invoice should be conspicuously marked “pro forma invoice,” and it should include a statement certifying that the pro forma invoice is true and correct as well as a statement describing the country of origin of the products.

Topic 17. SOURCES OF FINANCING AND INTERNATIONAL MONEY MARKETS

Plan

1. Nonfinancial institutions
Self-financing and debt financing
Equity financing
2. Financial institutions
3. Government agencies

1. Nonfinancial institutions

Self-financing and debt financing

There are several nonfinancial institutions that can provide financing. First, there is self-financing because a business can use its own *capital* or can withhold *dividends* so that profits can be plowed back into the organization for further business expansion. Second, retailers and manufacturers alike may be able to seek *trade credit* and financial assistance from certain middlemen, such as export merchants and trading companies. Third, when joint ventures are *formed, foreign partners* can also lend a helping hand. Fourth, subsidiaries of MNCs may borrow from *affiliated firms* as well as from the *employee retirement* *fund*.

Finally, the business may decide to raise equity capital by selling *stocks*, or it may depend on debt financing by selling *commercial paper* or *bonds.* Bond buyers or holders are the firm's creditors rather than its owners. US firms may sell bonds in either the USA or foreign countries, with Eurobonds as a prime example. Treasurers of US firms must decide whether their bonds to be sold abroad are to be denominated in the dollar or in foreign currencies. In any case, it should be noted that debt financing requires the services of investment banks. Virtually every multinational bank or multinational brokerage house has a division that acts as an investment bank.

Another source of financing is **venture capital**. Venture capitalists invest funds in a firm in exchange for a share of ownership. Although known for their investments in high-technology firms, venture capitalists have diversified their portfolios. There are about 600 venture capital firms in the USA. Private investors, however, fund most ventures. Venture Capital Network in Durham, New Hampshire, is a nonprofit service affiliated with the University of New Hampshire. Attempting to match entrepreneurs with investors, the Network charges investors $200 a year and those seeking capital $500 annually for registration.

When self-financing is used, a company should take advantage of a tax shelter for its export profit.

Because the EU's exports are exempt from value- added taxes, the US Congress gave a tax break to American firms by creating a **foreign sales corporation** (FSC, pronounced "fisk"). A FSC is a special kind of corporation, making its possible for it to gain a corporate tax exemption from 15 to 32 percent of the earnings generated by the sale or lease of exported goods (i.e., extraterritorial income derived from goods for sale or use abroad).

Equity financing

With regard to the other means of self-financing, it is a common practice for MNCs to use both equity and debt financing. As an example, Munich Re, the world's largest reinsurer, announced in 2003 that it would sell new shares worth $4.4 billion to shore up its capital base.

A company can raise equity capital by selling stock, both in its own country and in foreign markets. American stocks are traded in London, and European stocks are traded in New York. Israel has sixty-two companies quoted on US exchanges, second only to Canada.

Although many firms limit the listing of their securities to their domestic exchanges, the growing internationalization of capital markets suggests that more and more firms perceive that the benefits of listing their stocks on foreign exchanges outweigh the related costs. A study of 459 internationally traded MNCs, with at least one foreign listing on one of nine major stock exchanges, found strong evidence that financial disclosure levels and the level of exports to a given foreign country significantly influenced foreign listing locations.

Another investigation of the motives for listing abroad analyzed data on 481 multinationals. There is a significant correlation between the likelihood of listing abroad and a firm's relative size in its domestic capital market as well as its ratio of foreign to total sales. In general, the absolute size of firms (and their relative size), their main line of business, and their nationality affect the decision to list on foreign stock exchanges. Firms that are larger within their domestic capital markets appear more likely to list abroad. Regarding the extent of a firm's dependence on foreign consumer and product markets, firms that generate a greater portion of their revenues abroad are more likely to list on a foreign stock exchange. Firms are willing to list on stock exchanges located in capital markets that are smaller than their own because of the positive relationship between foreign sales and listing abroad. Furthermore, listing abroad increases visibility in that country and provides free advertising.

Equity markets appear to have a life cycle consisting of four distinct stages. As an equity market becomes more developed and has some degree of credibility, market liquidity increases. In the final (mature) stage, the most active stocks are just as liquid as those listed on industrial country exchanges. There is strong evidence that greater stock market liquidity supports (or precedes) economic growth.

Emerging stock markets vary greatly in terms of the number of firms listed, the number of new listings per year, market capitalization, and so on. Naturally, such markets carry significant risk, but emerging stock markets are likely to play an increasingly important role in financing companies' growth. The share of total world capitalization represented by the emerging markets has soared. It goes without saying that the emerging stock markets can be very volatile. Take the case of Turkey.

2. Financial institutions

International companies have several options in financial institutions that have the capability of dealing in international. The most common alternative are banks (and nonbank banks), both domestic and overseas. In addition to the well-known giant banks that operate globally, there are many medium-sized banks that have international banking departments. The multinational banks can make arrangements to satisfy all kinds of financing needs.

Other than making loans, banks are also involved in financing indirectly by discounting (i.e., factoring) letters of credit and time drafts. Some **factoring houses** buy accounts receivable with or without recourse at face value and then provide loans at competitive rates on 90 percent of the factors' acquired but not yet collected receivables. In general, factors help clients eliminate several internal credit costs by providing credit guarantee of receivables, by managing and collecting accounts receivable, and by performing related bookkeeping functions. The industry average factoring commission for these services is 1 percent. Factoring is a substantial part of business for a company such as Heller International.

An exporter usually initiates a factoring arrangement by contacting a factor offering export services. This factor then requests a credit undertaking on the importer from an affiliate (import) factor, through an international correspondent factor network. After local approval of credit, the exporter ships the goods on open account and submits the invoice to the export factor. The export factor then sends it to the import factor for credit risk assumption and administration and collection of the receivables. Typically, the exporter does not deal with the import factor. In any case, factoring export receivables allows small and medium-sized exporters to be competitive as it is a hassle-free method of financing export sales and collecting payment from buyers.

Another familiar financing tool for European exporters but rather an unknown tool for American firms is forfaiting which finances about 2 percent of all world trade. **Forfaiting** originates from the French term "a forfait" which means to surrender or relinquish rights to something. When used, an exporter surrenders possession of export receivables by selling them at a discount. The cost depends on country risk. For sales to Japan and France the discount rate may be 6.75 percent, and terms may reach five years, whereas sales to Pakistan may boost the discount rate to 7.75 percent with a one-year term limit. Generally, an exporter consults with a forfaiter before incorporating the discount rate into the final selling price.

Export factoring and forfaiting are similar since both involve selling export receivables to a third party at a discount. There are a few differences, however, between the two parties. First, factors like a large percentage of an exporter's business, but forfait houses do not mind working on a one-off basis. Second, while factors specialize in short-term receivables (up to 180 days), forfaiters tend to work with medium-term receivables. Finally, forfeiters are more willing to deal with high-risk countries.To protect themselves, forfait houses require a guarantee from a reputable commercial bank in the importer's country. The guarantee is in the form of an **aval** (bank guarantee).An endorsement with the words "PER AVAL" or "GUARANTEED PER AVAL" is stamped directly on to the notes or bills by the guarantor bank.[16]

Banks may provide **equipment leasing** as another alternative form of financing. The most attractive benefit of leasing is its low cost while allowing an exporter to conserve capital and improve cash flow. Leasing may involve 100 percent financing with no down payment. It may be used in conjunction with conventional lending sources.

3. Government agencies

It is not unusual for governments to provide **concessionary financing**. Such public loans, as a rule, carry lower than market interest rates, and their terms are more favorable than those of private financial institutions. Governments' role in financing can also be indirect but significant. Japan, for example, uses qualification for public loans as an inducement for private banks to cofinance. The qualification carries this significance by implying that any investment would be in the national interest and that the firm in question is financially sound.

To win a project in a developing nation, an exporting country may provide **tied aid** which is concessionary financing terms conditioned on the purchase of the equipment and services from the donor country. Trade-motivated tied aid may thus persuade a buyer to lean in the direction of the donor — not necessarily on the merit of product quality and true price. Ellicott Machine Corp. International, a small US company, lost market share in Indonesia where the Indonesian government has been the company's largest single customer for dredging equipment for over 100 years. The market share loss was due to European competitors' use of tied aid soft loans.

To win back market share, a team of trade promotion agencies — Export-Import Bank, the Department of Commerce, the Department of Transportation, the US Embassy, and TDA — joined forces. Export-Import Bank approved a $22 million direct loan to Ellicott. The Secretary of the Department of Transportation wrote a letter to the Indonesian Minister of Communications. Furthermore, TDA hosted a reverse trade mission which allowed Indonesian officials to visit the USA to learn about American-made equipment. As a result, Ellicott was able to sell five split barges, one tug boat, and spare parts to P.T. Runkindo, Indonesia's state-owned dredging company.

European governments have been offering **mixed** or **blended credit**. This type of financing package combines an official, conventional loan with either outright grants or foreign aid grants at below market rates, in effect reducing the actual interest rate based on the condition that donor countries' products are bought. France, the heaviest user of this technique, won Malaysia's contract for a $200 million turnkey power plant by disguising its thirty- year loan at a 4.5 percent rate as an aid grant, which made up almost half of the financing package. Mixed credit is particularly important in the sale of hightechnology capital goods, and the indiscriminate use of this technique in foreign aid/export financing packages has fostered a built-in expectation for it on the part of buyers.

Topic 18. CURRENCIES AND FOREIGN EXCHANGE

Plan

1. Money
2. Foreign exchange
3. Foreign exchange market
4. Foreign exchange rate

1. Money

Money is so simple that most users take it for granted. Actually, it is one of the great innovations in history. Being so simple, useful, and common, money facilitates the exchange of goods and services. In the USA, numerous currencies circulated during the late 1700s and throughout most of the 1800s. It took nearly 140 years after becoming one nation for the USA to have a successful central bank in 1914.

A **hard currency** is hard because of the solid trust that people have in the currency and not because of its gold backing. Businesspeople must have faith that the country issuing the currency will fulfill its obligations. For money to function as a store of value, there must exist something of value to store.

An international currency fulfills three basic functions in the global monetary system: it serves as a medium of exchange, a unit of account, and a store of value. As a *medium of exchange,* private parties use an international currency in international trade and international capital transactions, whereas official agents use it for balance-of-payments financing and to intervene in foreign exchange markets. As a *unit of account*, private parties use an international currency for invoicing merchandise trade and for denominating financial transactions, whereas official agents use it to define exchange rate parities. As a *store of value*, international currencies are held by private agents as financial assets (e.g., in the form of bonds held by nonresidents) and by official agents (such as central banks) as reserve assets.

For a currency to be used internationally, two sets of factors are essential. First, there must be confidence in the value of the currency and in the political stability of the issuing country. Second, a country should possess financial markets that are substantially free of controls. These markets should be broad (i.e., contain a large assortment of financial instruments) and deep (i.e., have well-developed secondary markets). The country should also possess financial institutions that are sophisticated and competitive in overseas financial centers.

2. Foreign exchange

Foreign exchange transactions involve the purchase or sale of one national currency against another. The easiest way to understand this type of transaction is to view money as just another product that customers are willing to buy and sell. Like other products, money can be branded, and the US dollar, Swiss franc, Japanese yen, and so on are simply some of the brand names for a money “product.” Some of these brand names carry more prestige and are more desirable than others, much like brand names of consumer products.

People often wonder why it is necessary to have so many different currencies. Obviously, it would be preferable to have only one worldwide currency that could be used anywhere on Earth, similar to the US dollar's being used and accepted in all fifty states. But a global currency is currently impossible due to two uncontrollable factors — national sovereignty and inflation.

3. Foreign exchange market

Firms needing to make payment for foreign business transactions never seem to have enough currency on hand, and it is cumbersome for them to seek out those with adequate amounts to sell. There is thus a need for a foreign exchange market to suit all individuals and institutions in order that they may contact one another for this purpose. The foreign exchange market as it exists has no central trading floor where buyers and sellers meet. Most trades are completed by banks and foreign exchange dealers using telephones, cables, and mail. As a worldwide market, the foreign exchange market operates twenty-four hours a day.

The foreign exchange market facilitates financial transactions in three different ways. First, it provides *credit* or *financing* for firms engaged in international business. This can be achieved through a variety of means, such as letter of credit, time draft, forward contract, and so on. Second, it performs a *clearing* function similar to a domestic bank's clearing process for checking-account customers. Clearing is a process by which a financial transaction between two parties involving intermediation between banks is "settled." In the case of international clearing, the funds are transferred on paper from a commercial customer to its local bank, from there to a New York bank, and finally to a foreign bank abroad. The process allows payments to be made for foreign goods without a physical transfer or movement of money across countries.

Third, the market furnishes facilities for *hedging* so that businesses can cover or reduce their foreign exchange risks. **Hedging** is an activity that is used as a temporary substitute purchase or sale for the actual currency. This temporary transaction allows users to protect the price they secure from fluctuations because it establishes equal and opposite positions in the market.

The rationale for hedging lies in the exchange rate fluctuation, which can move significantly and erratically, even within a short time. For example, due to inflation and instability, the Russian ruble lost 27 percent of its value against the US dollar in a single day in 1994. The panic started when the central bank stopped supporting the declining ruble. The ruble tumbled from 3081 to the dollar to 3926, and it was a record fall. In just three months, the ruble lost half its value. Consumers, to hedge against price increases, bought merchandise as much as they could, while merchants sharply marked up prices.

The foreign exchange market provides a hedging mechanism needed to protect corporate profits against undesirable changes in the exchange rate that may occur in the future. For this purpose, the market has two submarkets — spot and forward. The two differ with respect to the time of currency delivery. The **spot market** is a *cash* market where foreign exchange is available for immediate delivery. In practice, delivery of major currencies occurs within one or two business days of the transaction, whereas other currencies may take slightly longer. A US firm holding foreign currency can go to its bank for immediate conversion into dollars based on the spot rate for that day.

Exporters should also consider doing some hedging well before the arrival of foreign funds, and this is where the **forward market** becomes significant. Companies can protect themselves by selling their expected foreign exchange forward. A forward contract is a commitment to buy or sell currencies at some specified time in the future at a specified rate. By signing a forward contract of, say, forty-five days, a company has locked in a certain rate of exchange and knows precisely how many dollars, after conversion, it will get — even though payment, conversion, and delivery will not be made until later (i.e., forty-five days after).

It should be understood that the exchange rate specified in the forty-five-day forward contract is not necessarily the same rate as the forward rate of the next day or the spot rate of forty-five days later. Both rates change constantly, fluctuating from day to day and even from minute to minute. The only rate that will stay unchanged is the one agreed on by the bank and the hedger as stipulated in the signed forward contract, even though subsequent forward and spot rates may move drastically the day after the signing of that contract.

An exporter should realize that, in most cases, the spot rate is irrelevant for the preparation of

price quotations and the determination of operational costs, since foreign currency as payment is not received until a later date. Since there is no immediate conversion, the forward rate is the more appropriate one. The expectation in terms of interest rate inflation has already been factored into the agreed-on forward rate.

It is not uncommon for companies to limit their exposure to foreign currency fluctuations by requiring payments in US dollars or other currencies corresponding to the currency in which costs are incurred. They may use forward exchange contracts to hedge foreign currency transactions. These contracts allow the companies to exchange, say, US dollars for foreign currencies at maturity at rates agreed to at inception of the contracts.

4. Foreign exchange rate

The foreign exchange rate is simply a *price* — the price of one national currency as expressed by the value of another. This exchange price, once established, allows currencies to be exchanged one for another. The exchange rate, however, is more than just a price of a currency. It affects the cost of imported goods and exported goods; the country's rate of inflation; and a firm's profit, output, and employment.

Much like the price of any other product, the price of a currency is determined by the demand and supply of that currency. When the currency is in demand, its price increases, but if a currency's supply increases without any corresponding increase in demand, its value declines.

With excess imports comes an excess supply of money because a large volume of money must be generated to pay for all the imports. With excess money in circulation, the business community, as well as the general population, begins having doubts about its value, making the currency appear overvalued. In contrast, excess export results in too much demand for the exporting nation's currency, since foreign buyers require large amounts to pay for goods. The currency then becomes expensive due to its scarcity, and its real value increases.

The demand of a currency is determined by several factors. Some of these include the following:

- Domestic and foreign prices of goods and services.
- Trading opportunities within a country.
- International capital movement as affected by the country's stability, inflation, money supply, and interest, as well as by speculators' perceptions and anticipations of such conditions.
- The country's export and import performance.

Currency equilibrium

A nation's currency is in equilibrium when its rate creates no net change in the country's reserve of international means of payment. The equilibrium rate operates to keep the nation's balance of payments in proper perspective over an interval of time by making imports equal to exports. When in equilibrium, the foreign exchange rate is stable, perhaps fluctuating slightly before returning to its parity position.

Despite most nations' desire to maintain currency equilibrium, currency has a tendency to get out of balance. The equilibrium is affected by the intensity of such fundamental problems as inflation and excess import. Both inflation and excess import are negatively related to the subsequent price of the currency. In theory, neither persistent trade surpluses nor deficits are desirable. Persistent trade surpluses are unwelcome because they make the surplus nation's currency too cheap and imported products too expensive, resulting in a loss of local consumers' buying power.

Effect of devaluation

Devaluation is a reduction in the price of one currency in terms of other currencies. As in the case of Russia before its economic crisis in August 1999, it gave up 6.7 rubles for each dollar. Then the crisis hit, and the exchange rate jumped to about 23 rubles per dollar by the end of the year. Turkey did not fare any better. In early 2001, the country's currency lost 28 percent of its value in a single day. Turkey was forced to let its currency float freely to prevent capital flight and stabilize its stock market.

If the economy is successful in expanding exports and reducing imports as intended, devaluation should increase the national income, which in turn will stimulate the volume of imports once again. Thus the initial effect of devaluation can be reversed in the long run. Moreover, any deliberate devaluation carried on will result in a beggar-my-neighbor policy, which will export domestic unemployment to other countries. The deliberate practice of devaluation can easily provoke other trading partners to retaliate by lowering their own money value. Because of these consequences, the net gain from devaluation in the longer run is not going to be as large as its initial gain.

GLOSSARY

International marketing is the multinational process of planning and executing the conception, pricing, promotion, and distribution of ideas, goods, and services to create exchanges that satisfy individual and organizational objectives.

Domestic marketing is concerned with the marketing practices within a researcher's or marketer's home country.

Comparative marketing its purpose is to contrast two or more marketing systems rather than examine a particular country's marketing system for its own sake.

Balance of payments The system of accounts that records a nation's international financial transactions.

Balance of trade The difference in value over a period of time between a country's imports and exports

Global marketing The performance of business activities designed to plan, price, promote, and direct the flow of a company's goods and services to consumers or users in more than one nation for a profit. The most profound difference between global and domestic marketing involves the orientation of the company toward markets and planning activities around the world.

Quality The essential character of something, such as a good or service; defined in two dimensions: market-perceived quality and performance quality. Consumer perception of a product's quality often has more to do with market-perceived quality than performance quality.

Quotas Specific unit or dollar limits applied to a particular type of good by the country into which the good is imported.

Distribution channels The various routes through which marketers must negotiate their goods to deliver them to the consumer. Distribution channel structures range from those with little developed marketing infrastructure, as found in many emerging markets, to those with a highly complex, multilayered systems, as found in Japan. Consideration for channel structure involves "the six Cs": cost, capital, control, coverage, character, and continuity.

Direct exporting The type of exporting in which a company sells to a customer in another country

Dumping An export practice, generally prohibited by laws and subject to penalties and fines, defined by some as the selling of products in foreign markets below the cost of production and by others as the selling of products at below the prices of the same goods in the home market

Export regulations Restrictions placed by countries on the selling of goods abroad; among reasons they may be imposed are to conserve scarce goods for home consumption and to control the flow of strategic goods actual or potential enemies.

Foreign-trade zones (ftzs) Regions or ports that act as holding areas for goods before quotas or customs duties are applied. In the United States, more than 150 ftzs allow companies to land imported goods for storage or various processing such as cleaning or packaging before the goods are officially brought into the United States or reexported to another country

Global brand The worldwide use of a name, term, sign, symbol (visual or auditory), design, or a combination thereof to identify goods or services of a seller and to differentiate them from those of competitors.

Global marketing The performance of business activities designed to plan, price, promote, and direct the flow of a company's goods and services to consumers or users in more than one nation for a profit. The most profound difference between global and domestic marketing involves the orientation of the company toward markets and planning activities around the world.

Marketing research The systematic gathering, recording, and analyzing of data to provide information useful in marketing decision making.

Import regulations Restrictions placed by countries on the sale of goods from outside markets; among the reasons they are imposed are to protect health, conserve foreign exchange, serve as economic reprisals, protect home industry, and provide revenue from tariffs. Exporters to markets under such regulations may have to go through various steps to comply with them.

International marketing research The form of marketing research involving two additional considerations: (1) the need to communicate information across national boundaries, and (2) the challenge of applying established marketing techniques in the different environments of foreign markets, some of which may be strange or vexing milieus for the marketer.

Direct selling is employed when a manufacturer develops an overseas channel.

Innovation An idea perceived as new by a group of people; when applied to a product, an innovation may be something completely new or something that is perceived as new in a given country or culture.

Licensing A contractual means by which a company grants patent rights, trademark rights, and the rights to use technology to another company, often in a foreign market; a favored strategy of small and medium-sized companies seeking a foothold in foreign markets without making large capital outlays.

Secondary data Data collected by an agency or individual other than the one conducting research; often useful in market research

Primary data Data collected, as in market research, specifically for a particular research project

Protectionism The use by nations of legal barriers, exchange barriers, and psychological barriers to restrain entry of goods from other countries.

Tariff A fee or tax that countries impose on imported goods, often to protect a country's markets from intrusion from foreign countries

Joint venture A partnership of two or more participating companies that join forces to create a separate legal entity.

International trade is the exchange of capital, goods, and services across international borders or territories. It is the exchange of goods and services among nations of the world. In most countries, such trade represents a significant share of gross domestic product (GDP). While international trade has existed throughout history (for example Uttarapatha, Silk Road, Amber Road, salt roads), it's economic, social, and political importance has been on the rise in recent centuries.

Culture The human-made part of human environment - the sum total of knowledge, beliefs, arts, morals, laws, customs, and any other capabilities and habits acquired by humans as members of society.

Personality traits are relatively stable qualities, but they do vary in degree from person to person.

Exporting is a strategy in which a company, without any marketing or production organization overseas, exports a product from its home base.

A **brand** (or **marque** for car model) is a name, term, design, symbol, or other feature that distinguishes one seller's product from those of others

Branding is a set of marketing and communication methods that help to distinguish a company from competitors and create a lasting impression in the minds of customers.

Price is an integral part of a product - a product cannot exist without a price

Advertising is an audio or visual form of marketing communication that employs an openly sponsored, nonpersonal message to promote or sell a product, service or idea.

Communication is basically a five-stage process consisting of source, encoding, information, decoding, and destination

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