Guide to Export Pricing

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Export Bulletin No. 5 – Guide to Export Pricing

INTRODUCTION

The information in this Bulletin is provided to assist the potential KSA Producer/Exporter to develop his pricing policies and strategies for his targeted export markets. It is hoped that it will assist the KSA company to identify and address any major costing/pricing factors that could positively or negatively affect the company’s business prospects/operations, as it expands its sphere of operations into international markets. In this respect, before taking the decision to enter an export market, it is essential that local companies work out their product costing/pricing parameters, as this could affect their future export profitability and viability.

It is hoped that this Bulletin will assist local companies who are looking at export markets as the next stage in their expansion and business development programme. The Bulletin provides basic, practical information on several key aspects of pricing principles, which it is hoped will provide some assistance to the KSA Producer/Exporter to develop and finalise their pricing policies, planning and strategies for their individual and identified export markets.

GENERAL OVERVIEW

Terminology

<p>| Marketing mix | - the set of product, place, promotion, and price variables that a company attempts to control and coordinate. |
| Price elasticity of demand | - the sensitivity of customers to price changes in terms of the products purchased. |
| Price planning | - the systematic decision-making process for establishing pricing objectives, policies, strategies, and tactics. |
| Pricing objectives | - the goals or targets that corporate management tries to reach through pricing policies, structures and strategies. |
| Pricing policies | - the general guidelines, based on an understanding of price objectives and both the internal and external influences on pricing decisions. Intended for use in devising effective price strategies and tactics in specific situations. |
| Pricing strategies | - the framework within which initial price ranges and planned tactical price movements, thorough timeframes, are defined in terms of price objectives and policies. |
| Cost | - is the total of the fixed and variable expenses to manufacturer a product for a customer. |</p>
<table>
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<tr>
<th><strong>Price</strong></th>
<th>is the unit selling price, set by the manufacturer, for a product that a customer pays for purchasing that product.</th>
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<tr>
<td><strong>Profit margin</strong></td>
<td>earnings expressed as a percentage of revenue - that is the percentage of sales the company has left over as profit after paying all its expenses.</td>
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**Marketing Factors**

Any marketing decisions, including pricing, generally fall into the following categories which are the 'marketing mix' and known as the 4-P’s of marketing:-

- Product.
- Price.
- Place (market distribution).
- Promotion.

These 4-P’s are the various parameters that a Producer/Exporter try’s to control, subject to the internal and external constraints of the marketplace. The goal of a company is to take policy decisions that target its customers and create an obvious need for its products and, thereby, generate a positive demand for them.

In this respect, the bottom line of any successful business is profit, which relates to how the product price is established, marketed and promoted in diverse markets. Making a profit simply means producing a product for a lower cost than its selling price. The technique is to know exactly what product quantity has to be manufactured to exceed the cost of what is financially spent on making the product. To maximise profits, accurate pricing is absolutely critical. Prices must be high enough to cover all costs and enable the company to earn a reasonable profit, but low enough to remain attractive to prospective export customers.

Price planning is important in pricing a product for the export markets, as it is one of the most important business decisions that needs to be made on a corporate basis. The product price must be set at a level that the target market is willing to pay for it - and one that produces a profit for the company - otherwise the business will not be viable. There are many approaches to pricing and a framework for taking pricing decisions is provided in the sections below. These take into account the company costs, the effects of competition and the customer's perception of product value.

It can, therefore, be stated that the unit cost of the product sets the lower limit of what the Producer/Exporter might charge for it, and determines the profit margin at higher prices. The total unit cost of a producing a product is made-up of the variable (overhead) costs of producing each additional unit and fixed (direct)
costs that are incurred regardless of the quantity produced. The pricing policy should take into account both types of costs.

It is important for the Producer/Exporter to clearly understand the principals and fundamentals of pricing and plainly identify his 'objectives' and 'strategies' in relation to price, and use this as a basis for developing corporate pricing policies for different export markets. This can then be used as a pricing plan for the future expansion into international markets.

**Product Pricing Considerations for the Producer/Exporter**

Considerable thought and effort needs to be put into determining the pricing levels to be set for export markets - as these can vary from one export market to another and it is, therefore, essential to establish viable pricing policies to meet export market needs. The main criteria needed for the Producer/Exporter to set export pricing, for different markets, is to:-

- **Identifying the KSA exporters objectives in the target markets** - pricing is determined by the objectives to be achieved in the target market and the KSA Producer/Exporter's policy relating to:-
  - The level of penetration sought in each of the export markets.
  - The level of long-term growth planned for the target markets.
  - The commitment to seeking export outlets for surplus local production.
  - The pricing levels needed to enter and meet the particular needs of specific export markets.

- **Ascertaining the market demand for the product** - determining the demand in the selected target market is key to setting prices. It is important to ascertain what the market will bear for a specific product. The per capita income, of the target market, is a good gauge of the market's ability to pay. The KSA exporter should be aware that currency fluctuations could alter the affordability of their products in the export market. Therefore, if possible, final market prices should be padded to also accommodate possible fluctuations in currency.

- **Identifying the competition in the target markets** - few companies are free to set prices without carefully evaluating their competitors' pricing policies (both in the domestic and export markets). In exporting, this is further complicated by the need to evaluate the competition's prices in each target export market that the KSA exporter intends to enter.
Calculating the final pricing levels - adding up all the company’s in-house costs (including the costs related to getting the product into the export market) and adding a profit margin, will enable the calculation of the KSA Producer/Exporter’s export price. This must then be compared with the price in the target market to ascertain whether profits can be made or whether the costing levels are such that a market may need to be set aside until future economies of scale will enable the company to re-look at entering the specific market again. Alternatively, the company may wish to re-evaluate its in-house costs to ascertain whether any savings can be made, which will allow the export price to be reduced to meet existing market levels.

As setting export pricing levels are a critical factor in determining the profitability of the Producer/Exporter, a strategy that could be utilised, amongst others, is:-

- To reduce the Producer/Exporters prices below the local market price to enable easy penetration in the initial stages of accessing the market. Later as market share is developed, the prices can be slowly raised until they are more in line with local competitor prices.
- A possible way to achieving a reduction in export costs (to enable a lower price to be offered in the export markets) is to initially keep all the product overheads on sales in the domestic market.

As in the domestic market, the price at which a product is sold directly determines the company’s revenues. It is, therefore, important that the KSA company undertakes export market research which should include an evaluation of all of the costing variables that may affect the price range for the product to be offered in the targeted countries.

PRICING PARAMETERS

Basic Principles of Pricing

The following are some basic pricing principles to keep in mind when considering the company’s export pricing objectives and strategies:-

- Prices must at least cover costs - If corporate costs are not fully covered (including time), then a loss is likely to be incurred.
- The best way to lower price is to lower costs - As price equals costs plus profit margin, it’s obviously better to reduce the cost element than the profit element if, for any reason, it becomes necessary to reduce prices.
Prices must reflect the environment in which it is operating - Any price (whether the company's or its competitors') reflects the dynamics of cost, demand, market changes, competition, product utilisation, product life-cycle, maintenance and end-usage.

Prices must be within the range of what customers are prepared to pay - It's all very well having the best product in the world but if the price is more than customers are prepared to pay for it, then it will not sell. On the other hand, there is absolutely no reason to charge less than customers are prepared to pay either.

Prices should be set at levels that will ensure products can be sold and not just to beat competitors - It's easy to start delving into all of the sophisticated analysis and research around about optimum pricing levels but, at the end of the day, it must be remembered that prices need to be set as high as possible (to maximise profit) but still ensure that the product can be sold.

The product prices set, should represent a fair return for the company's time, talent, risk and investment - The company's expertise and talent has objective worth and the products produced and sold need to be priced accordingly.

When setting export prices, all operating and legal costs need to be taken into account. Some costing factors relating to exports are sometimes forgotten and not taken into account when 'building-up' (refer to APPENDIX 1 on export price build-up) and setting prices by companies that have not exported before. These cost factors, amongst others, may include some or all of the following:-

- The cost of in-house/in-country warehousing and storage.
- The cost of export formalities (export documentation, etc.).
- The cost of transportation to FOB port.
- The cost of clearance documents at port of disembarkation.
- The cost of duties, tariffs and taxes in destination country.
- The cost of transportation to warehouse and storage in the country of destination.
- The cost of distributor/agent's fees in the specific export market.
- The cost of any additional logistics in destination country.
- The proportional cost of additional business services provided (i.e. accounting, legal services, setting-up a local presence, setting up maintenance/service networks, product return policies, etc.).
- The cost of advertising, etc. in destination country.
In this respect, the company’s accounts, marketing/sales and shipping departments can help to identify all the operating costs related to this aspect of exports. Additionally, the Producer/Exporter’s distributor/agent can also assist in identifying the likely costs to be incurred in relation to the specific export market.

**Relationship Between Prices & Profits**

In essence the basic formula for the relationship between price, cost and profit can be simply stated as being:

\[
\text{PRICE} = \text{Costs} + \text{Profit Margin}
\]

From the above, it follows that before a company can set prices for their products, they must know exactly what are the related costs. In this respect, costs fall into three main areas, namely:

- **Direct (fixed) Costs** - are those that directly related to the production of the product such as raw materials, parts and supplies.
- **Overhead (variable) Costs** - are business costs not directly related to production and include things such as tariffs/duties, taxes, rent, office supplies and equipment, business related travel, logistical costs, insurance, permits, repair of equipment, utilities (e.g. electricity, telephone, etc.), any professional advice (e.g. accountant, lawyer, etc.), and any other such items.
- **Labour** - costs must include ‘time’ as well as all wages/salaries (and any fringe benefits) paid to employees and staff. Once the total costs have been ascertained, then a profit margin can be added.

The easiest way to increase profits is to raise prices. However, export prices cannot just be raised indiscriminately and it will be necessary to look for ways to manipulate niche pricing, where appropriate. This means looking for specific areas of business where there is some latitude to increase prices. The best way to do this is to identify those export market areas where the perceived value of the product on offer is higher than the price currently being charged. This can be done by undertaking a competitive analysis of the business, finding out how the products in question compare with the competitors’ products on the basis of not only price but costs as well. Once the competitive intelligence gathering has been completed, analysing the competitive advantages and disadvantages will enable a pricing decision to be taken accordingly.
Customer Demand & Revenue Estimation

Consumer Demand is a crucial factor in determining pricing levels. Demand is driven by customer tastes, income, and the availability of other similar/competitive products at differing prices. If a competitor company begins to sell its product at a lower price than the KSA Producer/Exporter, then the demand for its KSA product will decrease.

Once customer demand has been established, it should be possible to estimate the total revenues (unit price multiplied by the quantity sold) that can be generated in each of the target export markets. This can indicate the level of profits that can be generated from each market. Markets where 'break-even' cannot be achieved would be better left untouched for the time being. To enter the market in this instance would require the company to ascertain whether it can achieve any cost savings to enable either a 'break-even' situation or enable profits to be generated. The 'break-even' analysis determines the levels of sales needed to cover the total costs and ensures that the company makes no losses or profits (refer to APPENDIX 2 for break-even calculation formulae). Any sales after this point start to build-up profits for the Producer/Exporter.

Price Regulations & Environmental Factors

There are various governmental regulations on pricing in the international markets. It is important and very necessary for the Producer/Exporter to familiarise himself with the laws and regulations operating in his target export markets. From a legal standpoint too, a Producer/Exporter is not always free to price his products at any level he chooses. There may be price controls that prohibit pricing a product too high, while pricing it too low may be considered as 'dumping' by international trade. Offering assorted prices to different customers of the same products, in the same country, may violate laws against price discrimination. While collusion with competitors to fix prices at an agreed level is also illegal in many countries.

Pricing must, therefore, take into account the competitive and legal environment in which the company operates in the export market. From a competitive point of view, the Producer/Exporter must also consider the implications of his pricing on the pricing decisions of his competitors in the target export market. Setting the price too low may risk a price war that may not be in the best interest of either side, while setting the price too high may attract a large number of competitors who want to share in the profits.
PRICING OBJECTIVES

In the first instance, the Producer/Exporter's pricing objectives must be clearly identified in order to ascertain the optimal pricing that can be demanded for the product in a particular export market. Common product pricing objectives should incorporate a combination of the following corporate strategies, which are dependent upon the characteristics and requirements of each of the specific markets being targeted:

- **Profit maximisation** - trying to maximise current profit by taking into account revenue and costs. Current profit maximisation may not always be the best objective if this results in lower long-term profits.

- **Revenue maximisation** - seeking to maximise current revenue with no consideration for generating good profit margins. The underlying objective here is often to maximise long-term profits by increasing market share, through the lowering of costs.

- **Quantity maximisation** - seeking to maximise the number of units sold or the number of customers served in order to decrease long-term costs.

- **Profit margin maximisation** - attempting to maximise the unit profit margin through the lowering of product quality and costs.

- **Quality leadership** - using price to signal high quality in an attempt to position the product as the quality leader in a market.

- **Partial cost recovery** - some companies that have other sources of revenue may seek to only partially recover their product costs - by subsidising the costs from their other sources of product revenue. This could be used for various reasons, including:
  - Using a particular product on a 'loss-leader' basis to enter or sustain a market position on a short-term basis, OR
  - As a mechanism to write-off corporate tax, OR
  - Some other business reason.

- **Survival strategy** - in some serious market situations (such as market decline and/or overcapacity in the market), the goal may need to be to select a price that will only recover the costs and, thereby, enable the company to remain in the market. In such cases, survival may take precedence over profit generation - this objective is only considered to be a very short-term strategy.

- **Status quo situation** - where the company may seek price stabilisation in order to avoid price wars and maintain a moderate but stable level of profit from a particular marketplace.
Finally, the pricing objective depends on many factors including production cost, existence of any 'economies of scale', barriers to market entry, product differentiation, rate of product dispersal in the market, the company's internal resources, and the product's anticipated demand fluctuation over time - in the various targeted export markets.

**PRICING STRATEGY**

Price is one of the four major elements in the marketing mix and it is an important strategic issue, because it is related to product positioning. It also affects other internal marketing mix elements such as product features, distribution and channel outlet mechanisms used, freight costs, and promotion requirements for the products. Further, the level of prices will be determined by external factors such as:

- The levels of competitor pricing in the targeted export markets.
- The levels of local imports and local production.
- The price sophistication of the marketplace.

While there is no single formula to establish and set basic pricing levels (for domestic or export markets), the following list is a sequence of steps that determine the market level at which pricing of a product should be set:

- **Developing marketing strategies for target countries** - performing marketing analysis, segmentation analysis, product targeting, and positioning evaluations.
- **Estimating demand requirements** - understanding how quantity and quality demand varies with price in each marketplace and implementing appropriate policies.
- **Setting pricing objectives** - such as profit maximisation, or revenue maximisation, or price stabilisation (a situation of status quo with other competitors).
- **Determining pricing levels** - using information collected in the above steps to select an appropriate pricing method, develop the pricing structure, and identify any discount policies.
- **Understanding environmental factors** - evaluating likely competitors and their expected actions, understanding legal constraints, trade barriers, logistical constraints, etc. in the target markets.
- **Marketing mix decisions** - defining the product, distribution, and promotional tactics to be utilised in individual markets.
Calculating in-house costs – which include fixed and variable costs associated with the production, marketing, and distribution of the product in a particular export market.

All of these steps are inter-related and are not necessarily performed in the above order, however, the list serves as a starting point for working out the corporate pricing policies and strategies to be followed by the Producer/Exporter.

Since marketing strategy is formulated to include target market selection and product positioning, there is usually a trade-off between product quality and price, hence, price is an important variable in market positioning. Due to the necessity of trade-offs between the various market mix elements, pricing will also depend on other product, distribution, and promotional decisions that need to be made for the target export markets. Addition practical details and formulae are provided in APPENDIX 3.

Methods of Pricing

In order to set the specific price level that achieves their pricing objectives, Producers/Exporters to utilise several pricing methods, which include:-

- **Cost-plus pricing** - setting the price at the production cost plus a certain profit margin.
- **Target return pricing** - setting the price to achieve a required/specific target return-on-investment (ROI).
- **Value-based pricing** - basing the price on the effective value to the customer relative to other competitive products in the export market.
- **Psychological pricing** - basing the price on factors such as levels of product quality, popular price points for the product in question, and what the customer perceives to be fair and just price for the product.
- **Loss-leader pricing** - operates on the basis of losing money on certain very low priced advertised products to secure customer interest, so that they will buy other products at a more profitable level.
- **Flexible-pricing policies** - offer the same product to customers at different negotiated and contracted prices - e.g. cars are typically sold at negotiated prices, while many 'business to business' (B2B) sales are also depend on negotiated contracts.

In addition to setting the product pricing levels, companies also have the opportunity to developing innovative pricing models that better meet the needs of both the Producer/Exporter and his export customers.
**Pricing Tactics**

To penetrate a product into the export market, the pricing objective can often be to either:-(a) maximise profit margin, or (b) maximise quantity sales - to increase market share. To meet these objectives, some demand-orientated tactics can be employed, depending upon circumstance - which can be summarised in the following manner:-

- **Skimming prices** - attempts to 'skim the cream' off the top of the market by setting a high price for the product and selling to only those customers that are less price sensitive. Initially these customers can be charged a high price, then the prices are lowered to 'skim' off the next layer of buyers, etc. Eventually, the price will drop as the product matures and competitors offer lower prices. Skimming is a strategy used to pursue the objective of profit margin maximisation and is most viable:-
  - When demand is expected to be relatively inelastic* - that is when the customers are not highly price sensitive.
  - When large cost savings are not expected at high volumes, or it is difficult to predict the cost savings that would be achieved at high volume.
  - When the company does not have the resources to finance the large capital expenditures necessary for high volume production with initially low profit margins.

NOTE *:- Inelastic demand - the change in quantity demanded is proportionally smaller than the change in price. An increase in price would result in an increase in revenue, an a decrease in price would result in a decrease in revenue.

- **Penetration pricing** - pursues the objective of quantity maximisation by means of a low price. A low initial price is set in order to penetrate the market quickly, while it can also discourages competitors from entering the market. It is an approach that can be used when many segments of the market are price sensitive. It is most appropriate:-
  - When demand is expected to be highly elastic** - that is, customers are price sensitive and the quantity demanded will increase significantly as price declines.
  - When large decreases in cost are expected as cumulative volume increases.
- When the product is one that can gain mass appeal fairly quickly.
- When there is a threat of impending competition.

**NOTE**: Elastic demand - the change in quantity demanded is proportionally larger than the change in price. This means that an increase in price would result in a decrease in revenue, and a decrease in price would result in an increase in revenue.

- **Prestige pricing** - used when cheap products are not taken seriously by some customers unless they are priced at a particular level. In this case the higher price is linked to a perception of better quality product, although this may not be the case always.

- **Odd-even pricing** - takes advantage of human psychology that feels that $199.95 is less than $200. Studies of price points by direct marketers have found that products sell best at certain price points - e.g. as $197, $297, $397, compared to other prices slightly higher or lower.

- **Demand-backward pricing** is sometimes used by producers in certain circumstances. First, the price consumers are willing to pay for a product is determined though research and analysis, then the Producer/Exporter works backward through the standard mark-ups/margins taken by the distribution network to come up with a calculated price that the customer can be charged.

- **Bundle pricing** - is offering two or more products together in a single package price. This can offer savings to both the customer and to the producer, who saves the cost of marketing both products separately. The customer is willing to pay more because he perceives that he is getting a lot more for his money, even though the cost to the producer may not really be that much more.

In estimating the demand requirements, there is a relationship between the price demanded and the quantity of the product required, therefore, it is important to understand the impact of pricing on the sales of the product. Experiments can be performed on product prices by looking at pricing levels above and below the current price in order to determine the elasticity of demand. Inelastic demand indicates that price increases might be feasible for a particular market.

As the product’s lifecycle progresses (from development, introduction, growth, maturity, and decline), there are also likely to be changes in the demand
requirements and costs during the product life-cycle, although this will vary from one export market to another. For this reason the pricing policy should always be re-evaluated regularly over time for each export market.

**Structures for Price Discounts**

The normally quoted price to foreign ‘end-users’ is the *list price*. This price is usually discounted for the Producer/Exporter’s distribution network and some important export end-users. There are several types of discounts that can be offered, which are outlined in the following:-

- **Quantity discount** - offered to customers who purchase in large quantities.
- **Cumulative quantity discount** - a discount that increases as the cumulative quantity increases. Cumulative discounts may be offered to re-sellers who purchase large quantities over time but who do not wish, or are not in a position, to place large individual orders.
- **Seasonal discount** - based on the time that the purchase is made and designed to reduce seasonal variation in sales - e.g. the tourism sector offers lower off-season rates at certain times of year to minimise and stabilise the peaks/troughs in their annual sales.
- **Cash discount** - extended to customers who pay their bill before a specified date - an encouragement to customers to pay early and save some money, which also benefit the cash-flow of the Producer/Exporter.
- **Trade discount** - a functional discount offered to distributors for meeting or exceeding their agreed sales targets.
- **Promotional discount** - a short-term discounted price offered to stimulate sales.

All of the above discount mechanisms act to stimulate sales throughout the year and offer incentives to both distributors and some specific end-users who can achieve discounts on large levels of purchases from the Producer/Exporter.

**LESSONS TO BE LEARNT**

The most important lesson to be learnt is the need to identify very specific pricing objectives and to think through, and then adopt a very deliberate price strategy which is suitable for the specific export market being targeted. To identify the best pricing options for the Producer/Exporter, he needs to address the following questions in terms of whether to:-
Sell the products at a reduced profit, thereby, becoming a low-price leader. OR
Deliberately price the product at a low level in order to penetrate the market quickly and establish an advantage. OR
Price the product at a high level to skim-off a premium profit. OR
Bundle several products together and sell them in order to make a greater profit. OR
Round-off to the nearest dollar, or use an odd price approach.

The best exporters are very deliberate about setting their pricing, do their homework with diligence, and make necessary policy changes quickly when circumstances dictate. Therefore, the company needs to do its best with setting its pricing levels - after all, pricing is the only one of the 4-P's of the marketing mix, which is bringing in revenue, rather than paying it out.

**SUMMARY**

In the context of the information provided in this Bulletin, it is hoped that the exporter has a better understanding of the range of pricing objectives and strategies which need to be considered when developing pricing structures for export markets. Understanding how to utilise the various mechanisms available for product pricing will enable the company to profitably establish and sustain its targeted export market penetration. It must be stressed here that there is considerably more details that an exporter must be aware of when exporting and it is suggested that the Producer/Exporter should spend adequate time to familiarise himself with all the different and varied facets of exporting before fully committing the company and its resources to the export markets. Future Bulletins will endeavour to provide additional information to assist local exporters to become more aware of other aspects of exporting.

On a general basis, the following notes may be of assistance to the KSA Producer/Exporter once export pricing policies and strategies have been identified and the company proceeds to start export marketing:-

To assist with export planning, a booklet has been prepared by the Export Consulting Unit (ECU) of the Saudi Industrial Development Fund (SIDF). This booklet is available from the ECU and has been designed to assist KSA companies who are seeking to develop their export opportunities. It is an aid to exporters and highlights a range of critical subjects that should be addressed by exporters in readiness for finalising their export plan - which forms part of their overall corporate marketing plan.
As export business develops, the KSA producers are encouraged to contact local export insurance and credit institutions in order to utilise the available facilities for export credit and the insurance programmes for high risk countries. Additionally, the Saudi Export Program (SEP), operated by the Saudi Fund for Development (SFD) in Riyadh, is in a position to assist potential KSA exporters to expand their export activities and assist them to increase their sales volumes to more countries while trying to minimise risk factors.
APPENDIX 1

Export Price Build-up

Prices are calculated on the basis of knowing the costs related to the production and marketing of a product, as well as the profit margin that can be made on it, subject to market conditions. In simple terms this can be stated in the following way (refer to pages 5/6):

$$PRICE = Costs + Profit\ Margin$$

In relation to the domestic market, the costs incurred relate to normal variable (overhead) and fixed (direct) costs, however, in the context of exporting there are additional costs that are incurred and need to be incorporated. These include, amongst others, some and/or all of the following:

- **Costs Prior to Exporting:**
  - The costs a product may incur in-house/in-country warehousing and storage costs.
  - The cost incurred in relation to the preparation of export documentation and meeting any other export formalities.
  - The cost of packing products for export.
  - Any costs related to pre-shipment inspection, if required.
  - The cost of transporting the product from the warehouse to the port of departure - i.e. airport, sea port, etc.
  - If selling on a CIF/C&F basis, then the cost of freighting the products to the destination port. If supply on a FOB basis, then the 'landed costs'.

- **Costs at Country of Destination:**
  - The cost of clearance documentation at Customs.
  - The costs related to the payment of any duties, tariffs, and taxes.
  - The cost of meeting any product testing requirements, if any (relates to a product being able to meet local Product Standards).
  - The cost of transportation to warehouse/storage facility.
  - The costs related to the logistical distribution of the product.
Costs related to the Marketing/Selling Structure in Target Country:

- The cost of distributor/agent’s fees.
- The cost of any discounts offered to distributor/agent and/or special end-users.
- The costs related to advertising and any public relations (PR) operations.
- The costs related to setting-up a marketing operation:
  - Costs related to meeting the costs of establishing a presence - i.e. legal, accounts, etc.
  - Setting-up any office facilities.
  - Setting-up any maintenance/service facilities.
  - Setting-up product return systems.
  - Travelling to the market.
  - Costs related to training of distributor/agent.

In relation to the above costs, it is imperative that the Producer/Exporter ensures that they are as accurate as possible to ensure that a stable pricing policy can be established. An additional point to consider here is the need for the company to ascertain whether it should incorporate some level of costs/padding for currency fluctuations.

Incorporating the above additional costs into the pricing formula will enable the Producer/Exporter to build-up his export price, which can be gauged in relation to existing competitor prices in the marketplace. If the company’s end price is lower than the local prices, then there a real possibilities of entering the market - perhaps at possibly a higher profit margin (depending on the company pricing tactics). Conversely, if the price build-up indicates the prices to be higher than the marketplace, then the company needs to take a decision on whether it should enter the market. Alternatively, the company could also review its costs to ascertain whether they can be reduced so that the end price in the market can meet the local pricing levels. At this point in time, decisions need to be made based on corporate policies and strategies - which are likely to be different for each of the export markets being viewed for development.

Most importantly, the pricing levels finally established for the target markets (based on costs and profit margin), should remain stable and be competitively in-line with the company’s competition (local producers as well as other imports). Rapidly changing pricing levels could become a hindrance to sales - from a customer’s perception.
Calculation for Break-even Point

Before deciding on a fair price for a product, it is necessary to determine what it has cost to produce. Once the costs have been identified, then break-even point can be ascertained. This is the point at which a company neither make a loss or a profit in producing a product. Break-even can be calculated by adding up all the fixed costs and determining what the variable costs are at different production volumes. The company must know the cost of its production overhead (fixed costs) as well as the incremental cost-per-unit (variable costs) before it can determine its break-even points. The formula to ascertain break-even revenue is:-

\[
\text{Revenue to break-even} = \frac{\text{Fixed Costs}}{1 - \left(\frac{\text{Variable Cost per unit}}{\text{Selling Price per unit}}\right)}
\]

To determine how many units must be produced and sold to break-even, the following formula can be used:-

\[
\frac{\text{Fixed Costs}}{\text{Unit Contribution Margin}^*} = \text{Break-even unit volume}
\]

NOTE: * Where the unit contribution margin = selling price per unit - (minus) variable cost per unit.

In most business circumstances it is not viable to go below these figures, however, in some very specific cases and for particular reasons it may be necessary to do so but only on a very short-term basis.
Practical Pricing Mechanisms & Formulae

The Producer/Exporter should not compete on the basis of price alone, unless he is a low-cost producer. Normally a company should compete on the basis of product performance, quality, delivery time, or whatever advantage the Producer/Exporter can offer its export customers over its competitors.

In essence, it is the export market that determines the price at which products will sell and sets a maximum 'price ceiling'. The Producer/Exporter's costs and minimum level of profits establish a 'price floor' below which he cannot sell and make a marginal profit – just meeting his costs will only enable the company to achieve 'break-even' point. Establishing good pricing practices requires an understanding of the factors that influence markets, the economy, technology, competition, and internal needs for resources. The Producer/Exporter must, therefore, consider each of these factors in addition to the cost-related factors internal to the company.

Two Basic Rules Relating to Pricing

There is more to pricing than internal costs and there are two important factors to consider in developing export prices, namely:-

- To recognise that it is the market, not the company costs that determine the price at which a products will sell.
- To be aware that the total costs and required minimum profits only establish a price floor below which a product cannot sell and make a profit.

The difference between the price ceiling established by the market and the price floor, determined by costs and the required minimum profits, is the product's 'relevant price range'. Only if a Producer/Exporter can sell at the price the export market determines, can he expect to conduct business profitably.

Price Floor - Costs are a Factor In Establishing Prices

Just as good management depends on good market information, so the same applies for pricing - where having viable costing data is essential. Once basic costing data has been gathered, several alternative methods exist for calculating price floors - based on costs and using cost based methods of pricing. It is important for the company to keep in mind that each of the mark-up on cost methods available to it,
are designed to meet specific pricing objectives. Differing market conditions require different pricing mechanisms to be used, which are identified below:-

- **Full Cost Base** - this method is designed to recover all costs plus a margin. It is computed by adding up all costs and adding to them a mark-up, or some fraction of those costs - as detailed on pages 5/6. The formula for full-costing is:

\[
\text{Price} = \text{All Costs} + \text{Profit Margin}
\]

This method’s main advantage is its simplicity and ease of use. Its biggest disadvantage is that profit may be foregone because of arbitrary overhead allocation. NOTE: In all cost-based pricing approaches careful treatment of overhead is important.

- **Incremental Cost Base** - this method uses direct labour and direct materials cost as its base, and emphasises the incremental cost of producing additional units. Because it is normally a larger mark-up on a smaller base than in the case of full-cost base, it shifts sales emphasis toward products that absorb more overhead. The formula for incremental costing is:

\[
\text{Price} = (\text{Direct Labour} + \text{Direct Materials}) + \text{Mark-up on} (\text{Direct Labour} + \text{Direct Materials})
\]

- **Conversion Cost Base** - this method emphasises the value added or direct labour plus overhead costs in developing the price floor. It shifts sales emphasis toward products with high materials costs and economises on company labour and machines. The formula for conversion cost base is:

\[
\text{Price} = (\text{Direct Labour} + \text{Overheads}) + \text{Mark-up on} (\text{Direct Labour} + \text{Overheads})
\]

It's obvious disadvantage is that overhead allocation must be based on clear rationale because the allocation of overhead will influence the price very heavily.

**Other Cost-Based Approaches**

Other cost-based approaches to pricing include methods designed to determine prices required to accomplish:-

- A desired margin objective, OR
- A desired return on investment.

Generally speaking, the number one target is to secure a good margin on sales, and the number two target is to get a good return on investment (ROI). The methodology used to achieve these aims is identified below:-
Target Margin On Sales - this method can be used when the corporate objective is to establish a price that will return a required margin on sales. The formula for target margin on sales is:

\[
\text{Price} = \frac{\text{Total Manufacturing Cost per Unit}}{100\% - \% \text{ of Sales/Admin Costs} - \% \text{ of Required Margin}}
\]

This method will identify what price must be charged to achieve a required margin on sales. It allows the company to vary the factors and ascertain what price must be charged to accomplish different rates of returns, or what price must be charged, based on various cost figures. NOTE: the target margin on sales method, requires accurate information on sales and administrative costs.

Target Return On Investment - this method can be used to determine what price must be charged to achieve a required return on investment (ROI). The formula for target return on investment is:

\[
\text{Price} = \frac{\text{Desired ROI} \times (\text{Investment $} / \text{Desired Payback Period in Years}) + \text{Fixed Costs} + \text{Variable Costs} \times \text{Quantity Sold}}{\text{Quantity Sold}}
\]

This method is only as accurate as the company’s estimate of the quantity that it will sell. Often, where sales volume is sensitive to price, only a rough estimate of how much will be sold at a given price is possible. Therefore, this method should not be considered an exact method for determining price. After ascertaining the price using this formula, the company should ask itself ‘how much of the particular product can it sell at this price level?’ If anticipated sales at this price level are not at least equal to the unit volumes used in the pricing formula - the Quantity Sold in the formula - the company cannot sell at that price. It must either reduce costs, or accept a lower ROI, in order to reduce the price of the product. If lower costs are possible, or low ROI is acceptable, it will be necessary to rework the formula again to ascertain the new pricing level. Only when the volumes the company can actually sell equals or exceed the quantity (Quantity Sold) used in the price formula, will the desired ROI be achieved.

Price Ceiling - Maximising Profit

The methods so far identified (price floors) are based on cost and only provide information on half of the pricing problem. They identify to the company what price is required to cover costs and earn a minimal return, but they are accurate only if the market will accept the required volume at the resulting price. On the
other hand, the 'price ceiling' decided by a specific export market, is the other side of the pricing scenario. Determining the price ceiling is often difficult to undertake as economics, markets needs, competitiveness, customers requirements, and many other factors can influence it. There are, however, two techniques that can be used to assist in ascertaining the price ceiling of a product, namely they are:- (a) the hit or miss method, and (b) the market research approach.

The hit or miss method requires that the product be produced and put on the market. One principle to be kept in mind when using this approach is to ascertain whether 'It is easier to lower prices that to raise them'. With this approach it is better to put the product on the export market with a little extra margin rather than with not enough. If the market accepts the product at the price with the extra margin included, more rapid recovery of costs will occur. If it will not, the price can be reduced to see if that will stimulate sales. Lowering the price from a high margin is much more likely to be acceptable to the market than introducing the product and then finding that the price was too low, and having to raise the price. On the other hand, the market research approach offers the benefit of not having to risk finding out that the market won't accept the product at the required price before an investment is made in producing that product. This approach requires the use of outside experts to undertake the market research work, and this can be quite costly. The principle to always remember is that products are bought on the basis of perceived value in the minds of the customer and not on the basis of what it costs to produce them. Only if the company can produce at a cost that will allow sales of the product at a price equal to or below the customer's perceived value will the company make the sales in that particular export market.

Points for Consideration

In establishing suitable prices for particular export market there may be a couple of points that may come to light as a result of working out the pricing formulae. These are likely to relate to the following:-

- The market is reluctant to purchase the product - what if the market won't buy the company's product at the established price or if it will not accept the product at a price which will cover costs and the desired margin. In this case four alternative strategies are available to the Producer/Exporter, namely:-
  - Discontinue marketing the product in that particular export market, OR
  - Accept a lower margin in that particular market, OR
  - Reduce overall costs for the product concerned, OR
Find a means to differentiate the product from the other competition - in the minds of customers.

Selecting one of the first three alternatives must be based on the company's profit requirements and whether or not it can reduce costs by a sufficient factor to allow selling at a price that the particular export market will accept. Using several different cost and profit (or margin) figures in the price formulas will help identify which is the best alternatives.

- **Product differentiation** - this is a pricing option that is seldom used to avoid competing on a price basis. It can sometimes be achieved though emphasising particular facets of the product, such as quality, service, product performance, delivery times, financing arrangements, engineering or design support, discounting, and packaging. Producers/Exporters can often find that their sales are not so sensitive to price as they thought if they stress non-pricing factors, when promoting and selling the products in a particular market.

Product differentiation will work best under conditions where price sensitivity is lowest. Several factors influence the customer's sensitivity to prices, which include:-

- The availability of substitute products.
- The frequency with which purchases of the company's product are made by their individual customers.
- The impact of the purchase on the customer's budget.

If competing products are not readily available to the customer, his sensitivity to price will be lower. If his purchase of the company's product is not frequent or does not have a major impact on his budget, then he will be less sensitive to price. If any of the above three conditions exist (few substitutes, low budget impact, or infrequency of purchase), then price may not be as important in selling a company's product as it might be assumed. It may be viable to experiment with increasing prices on a limited basis, but at the same time there will still be a need to emphasise the other attributes of the product as the company promotes and sells its product in the marketplace. If the Producer/Exporter can show the customer that he can provide an advantage in product performance, quality, or services being offered, then the company will find that price may not be as important as it would be if it did not emphasise these advantages.