PROFIT
promoting regional opportunities for investment and trade

Costing & pricing

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Costing & pricing[1]

1. Introduction

You will be aware from running your business in your domestic market that there is a difference between costing and pricing. It is only rarely that businesses can add up all the costs, then add a margin, and call that the price. Normally the two processes are independent: costing is indeed the sum of all the individual costs but pricing is a function of the marketplace and depends on how much customers think they will benefit and thus on how much they are willing to pay.

If you have ever studied marketing (in English) you will be familiar with the 4 Ps: product, price, promotion, place. That should confirm for you that price is a function of the marketplace. Of course, the price has to be higher than the cost. If you set the price too low you will achieve lots of sales — but fail to make a sufficient profit or, worse, make a loss and destroy your business. If you set the price too high, you will fail to make sufficient sales to pay back your initial investment. Pricing policy is clearly a major strategic decision. And once you've set the price and won the orders you then have the thorny question of how you're going to get paid. If you think getting paid in your domestic market is hard work, wait until you try to get foreign customers to pay.

2. Costing

There are many ways in which to cost the products or services that you sell. Identifying the direct costs – the costs of raw materials and direct labour – is usually straightforward. But how do you ensure that you cover all your overhead costs as well. You have probably already been through this exercise and so we will not repeat it here. If you want to learn more about costing, however, you may want to review marginal costing, absorption costing and standard costing. Once you engage in international trade, however, you will quickly find that costing is more complicated than quoting an ex-works figure. This factsheet will help you t think through all the additional costs and quote a price that keeps you profitable.

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[1] This factsheet is based on material originally published in Exporting for the First Time by Graham Smith & Paul Sampson and edited by Colin Weatherspoon & David Irwin, copyright Project North East, 1996, and used with permission.

3. Pricing and pricing policy

The marketing strategies of cost leadership, differentiation and focus will have an impact on your pricing policy. If you pursue a cost leadership strategy, your objective will be to shift maximum volume at least cost. This is normally only appropriate if you are selling commodity products. If you pursue a policy of differentiation, you are likely to offer products or services which are sufficiently different to those of your competitors to enable you to seek a premium price — though your customers will, of course, still expect you to offer good value for money.

In quoting your price you will need to consider whether you will quote for the basic product or service and quote for “add-ons” separately, or whether you will offer an “all-in” price.

Once you have made a first stab at an appropriate pricing level, you will need to have a further look at the marketplace. How do your proposed prices compare with your competitors? What are customers prepared to pay? In particular, will they pay a premium price for your premium quality or unique advantage?

If customers would expect to pay at least a certain amount for a product then it would be foolish to price below that unless you are entirely confident that you will make a high number of sales. Ideally, your price should be the most that customers are prepared to pay, but this is not always possible when seeking to break into a new market. In particular, if you are selling to industry or other ‘trade’ customers, you may have to negotiate prices separately with each buyer, taking into account factors such as volume and terms of their order. It is important to have a clear idea of what you can need to charge, the costs which need to be covered by a quoted price, and especially of where your price fits into your overall marketing plan.

Some study of competitor pricing policies will pay off at this stage. Everything from Chamber of Commerce reports to visiting supermarkets, etc in the selected market can serve to increase your awareness of what is selling and at what price. You should be able to position your product within the existing market structure in terms of quality and benefits and this should give you some idea of the price ‘bracket’ in which it could reasonably be placed. Remember that local competitors will inevitably have lower overheads than an export business and can probably afford to price lower than you can.

You may also want to consider implementing different pricing policies in different markets. This is, for example, a policy used by many of the car manufacturers.

REMEMBER

- Although it is tempting to under-price your goods at the outset to attract custom, this is extremely inadvisable. You need to cover your costs — including the extra initial expense on promotion — and to generate a reasonable profit. It will be much more difficult to raise prices later without losing custom.
- When making product choices, customers will tend to equate quality with price. Thus, in some markets such as luxury goods (gifts, beauty products, foods, etc) or products which are bought infrequently, premium pricing may be an advantage, given the perceived quality of expensive products.
- High pricing will attract competitors into a previously unexploited market, keen to undercut you and capture a share of profits.
- You are not bound by your initial price — once some sales have been made you can be more flexible about offering discounts or price cuts.
- Once again you should make use of advice and information available. In particular, agents, distributors and those with immediate contact with the market can be invaluable sources of data when fixing a price.

As noted above, this factsheet assumes that you already pricing appropriately in your home market and focuses on the likely additional costs that will need to be taken into consideration.

4. Sales quotations

Once you have got serious interest from potential customers it is likely that they will expect you to provide a quotation and explanation of price breakdown before they are willing to place a firm order. This is not quite as simple as it sounds. To where do you deliver the goods? When does your customer take over responsibility for them? Your customers may be able to arrange transport more cheaply than you can, for example. Much of the terminology used in exporting products is covered by what are known as INCOterms.

INCOterms

INCOterms are a vital ingredient of any sales transaction and will have an influence on the price quotation that you submit to the potential customer. Compiled by the International Chamber of Commerce (ICC), INCOterms aim to standardise international terms of delivery and minimise differences in interpretation that may arise between parties. The current edition of the terms is the 2020 version provides for 11 specific terms. If you wish a contract to abide by the 2020 INCOterms a specific clause will need to be included to this effect (See factsheet on *INCOterms*).

INCOterms do not constitute a supply contract. They neither lay down provisions for failure to meet one's obligations, nor cover the duties of the carrier, but they are to be used in conjunction with a specific contract, to clarify the interpretation of the provisions.

It is vital that you use the correct terms as they will affect many aspects of the order. If you are in doubt about how to apply the INCOterms, stick to the traditional business customs of the country and to well established, internationally accepted trading terms. If you intend to use INCOterms you should obtain a copy of the latest edition from the ICC.

Getting paid

The method by which your customers agree to pay, and indeed the risk of whether they will pay, will have an effect on the cost of providing the goods. This is covered in the factsheet on *Getting Paid* but you should read it before you settle on a price to quote to customers.

5. Completing the sales quotation

Once you have agreed your payment method and determined whether you need insurance, you are able to complete your cost calculation and quote a price.

Some countries may require insurance and freight to be contracted to their national firms or import restrictions may be present. You will need to familiarise yourself with these requirements before drafting the final agreements; it will save time, money and effort on both sides if the agreements are correct first time.

An export quotation might look something like this:

> 150 x 50 kilo cartons of (product) at $1 per kilo *Ex Works* Da Nang

In essence, what this means is that the buyer is paying $1 per kilo for the product ($7,500), plus collection/delivery, freight, insurance and customs costs. In contrast, the same product could be quoted as:

> 150 x 50 kilo cartons of (product) at $1.50 per kilo *delivered duty paid* Chennai

What this means for the buyer is that $11,250 will cover all shipment and customs expenses; this will be the total that they have to pay out. The situation for the seller, you, is reversed. Under the second arrangement, you must allow for the unknown quantities and fluctuations of expenses; under the first all you must do is make the goods available and ready for transportation at your premises. As you can see the implications of delivery terms have a significant effect on the price and responsibilities involved in the quotation.

Once quoted the price must remain basically the same and it is important that you maintain some degree of flexibility to account for fluctuations in related expenses. A clause can be inserted in the quotation and sales agreements to cover this or to impose a time limit on the price quoted. Such a clause may be imperative if freight rates are unstable or if the contract spans a lengthy period.

So, when you are ready to make a quotation there are several issues to keep in mind:

- the type of market/customer that you are targeting: for example, a customer from a sophisticated and developed market may prefer to be quoted a complete total, to aid comparison between quotes;
- the economic/political stability of the market and methods of payment open to you;
- the ‘extent and sensitivity’ of profit margins, how they will be affected by fluctuations in costs. This can be ‘considered’ in conjunction with your business history and any likely fluctuation in production costs, problems of supply, etc; and,
- the duration of the contract.

Your buyer is important and their point of view must be considered. This is not to say that you must bend over backwards to accommodate all their needs, you must come to a sensible agreement which benefits the both of you.

A contract of sale entails an ‘offer’, ‘acceptance’, ‘performance’ and ‘consideration’. Ideally the quotation should be considered as an ‘invitation to make an offer’, with the seller free to accept or reject the order/offer. However, it might be expected that your customer will in turn require some commitment from you; if they have to set about organising import licences, etc then it is only fair that you provide some guarantee that the order will be accepted and the goods provided at the quoted price.

A quotation may be general, consisting basically of a price list/catalogue, or be more specific and detailed. In general quotations it is standard that some price flexibility is retained by the seller, but in a more specific document you will need to make special provision for this. If prices are guaranteed for a specific period this will enable the buyer to begin making preliminary preparations, speeding up the whole process, while at the same time protecting you against major cost fluctuations. A specific format may be required by the importing country, eg a pro forma invoice showing a breakdown of all costs.

6. The sales contract

During the export transaction you may be involved, to differing degrees, in up to four types of contract: sales, carriage, finance and insurance. Each contract needs to be explicit in regard to what is paid, to whom and what obligations each party is to fulfil. The INCOterms alone do not constitute a contract of supply and all additions or alterations made to them need to be laid out clearly and explicitly, to be agreed by all parties. Although verbal agreements are binding in theory, in court they will be difficult to uphold.

Each sales contract will differ between markets, countries and even individual customers, but as a guideline it should include the following:

- the purpose of the contract (eg the exchange of specified merchandise)
- the price (and the currency to be used)
- terms of delivery (INCOterms) and payment (ensure this is understood by all involved)

- methods of shipment, packing, etc and insurance terms
- details of the import/export licence and any freight/documentary requirements
- general contract conditions (eg performance/quality of the goods, arbitration, etc)
- signature and details of both parties.

With such a detailed document, it is important that each clause be in writing and is clearly understood by all. This is the end product of all previous efforts and negotiations, so take time and care in its preparation. The sales contract will also have implications for the related contracts, eg terms of carriage, insurance and finance and any problems can be costly in terms of litigation and loss of trade. Your trade association may be able to advise you or may have a demonstration contract to help you. Agree on the language that the contract will use, this will help to narrow down areas of confusion between differing translations.

INCOterms are a vital ingredient of the sales agreement; they should be studied and absorbed carefully. The term that is decided on will determine the respective duties and responsibilities of yourself and your customer, so in effect will determine what actions you go through. Decision should be made in light of needs and 'negotiating power' of buyer, the goods and transport mode involved and the country to which they are being sold. The INCOterm used will determine the structure of the sales quotation and what is included in the total. In the competitive markets of Western Europe and America, Quoting DDP (Delivery Duty Paid) will enable the buyer to make an easier comparison of competing quotes, and will be more convenient for them to have all this organised by the seller. In contrast, developing countries with limited currencies prefer to use arrangements whereby as little currency is paid out to an overseas seller as possible; Ex Works will allow them to give their national shipping lines and insurance companies, business and retain valuable foreign currency.

For DDP or similar term, you, or someone in the company, will need to be familiar with the many varied costs which can be involved in getting the goods from A to B. You will also need to take into account any possible fluctuations in prices which may occur during the time taken to complete the transaction; in this situation inexperienced exporters can end up making a loss! Your carrier or freight forwarder should be able to give you advice on the shipping costs involved and may be able to give you a 'through delivered freight rate' or total cost including, for example, loading and unloading.

Once an order has been received, ensure that you reply with an acknowledgement. This will represent your acceptance of the offer. At this point it is essential that the conditions of sale are as envisaged when the quote was made and are understood by both parties. Check the order thoroughly, it may include 'conditions of purchase'; if there are any problems they must be clarified at this point.

Not only may export sales contracts differ from those within the UK, but you may also be handling various types/terms from customers from the same overseas country. The specific terms of the sales agreement will depend on the type of goods involved, for example, if goods are made to order the transit risk will probably be the buyers, although special packaging will be at the discretion of the manufacturer — in such circumstances the buyer may take the insurance risk but the seller will be in a better position to make the carriage arrangements. ‘Sale or return’ arrangements are rare in exporting for the obvious reason that the goods are subject to much handling and transit costs are high.

As we will see, insurance and payment by the bank may rely on you having evidence that the correct steps and procedures have been followed. This adds to the importance in having all issues clarified and in writing.

Bonds and guarantees

In many cases an order will require you to become involved in a bond or guarantee; either at the request of the buyer or by your bank. This is distinct from credit/goods insurance and applies to your commitment in regard to fulfilling an order. A buyer may need this reassurance in order to proceed in gaining import documents or if any advance or progress payment will be made.

A *tender bid bond* requested by the buyer will indicate your formal intention and ability to abide by an offer made against a tender. A *performance guarantee* may be requested at a later date against any payment made for products /services contracted. Increasingly stand-by letters of credit can be used as a guarantee document, and these have a stated expiry date.

‘*Care as to commitment*’ — this guarantee will be presented by the buyer’s bank, in the local language, covered on your behalf by your bank. Your bank will be able to advise you on what is involved in such procedures and it is important to fully understand the implications of the commitment. Ensure you and your bank are in agreement over the terms of the document, which may be vague.

Should a guarantee be called, it is often the case that the buyer will be in a dominant position and able to obtain his ‘due’ on demand. The first that you might know of this situation is when your account if debited; irrespective of whether you think that the demand was justified. You should regard such commitments as on-going liabilities until your bank advises you that the period has expired. It may be possible to obtain some guarantee commitments on a conditional basis; the buyer will be required to provide proof as to default by the exporter. The ICC produce ‘Uniform Rules for Demand Guarantees’ (no. 458), but professional advice is essential in this vague area and terms must be clarified at the outset.

You can put a time limit on quotation, to cover for large time lags that can occur in processing an order. When evolving strategy for quotation procedure you will need to account for length of time involved between quote and order and number of variable factors involved in price structure.

Although the product itself will need to fulfil local legislative requirements it will be possible for you and your buyer to agree the area of law you will concentrate on in regard to the handling of the goods. Examples of what to choose between include:

- The law of your own country
- The law of the buyer's country
- International Civil Law (UNICTRAL)

You need to be clear which country's law will predominate over any disputes that may arise and legal advice should be sought in regard to this. It will be to your advantage in terms of speed and ease of access/interpretation if your law presides. Legal advice can also be sought when drawing up a binding contract of sale, to ensure that the terms used are standard and any ambiguities are clarified.

7. Checklist of additional costs

- Underlying costs of providing the product to your domestic market
- Higher marketing costs
- Extra costs, for example, for changes to the product to meet local statutory or environmental requirements
- Changes to the product requested by your customers
- Additional quality assurance costs
- Different or additional packaging and export packing
- Transport and freight costs — including transport to a port or delivery point, shipping, air, road or rail freight and delivery to the buyer's premises. It may also involve freight forwarder's fees
- Clearance charges — including any licences, documentation required as well as handling charges, customs, import duty etc
- Extra costs of providing support or service following the sale
- Agent's commission
- Extra bank charges
- Costs of extra credit
- Credit insurance
- Insurance of cargo — essential for overseas transit and must cover goods through every stage of their journey. The responsibility is dictated by the INCO term used.

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